Nanosonics LTD

Strong demand

12 June 2009

$0.51

BUY

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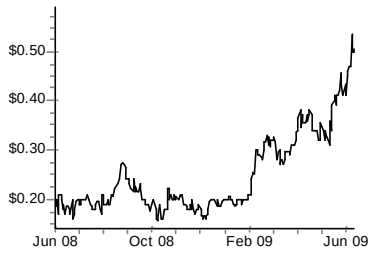
Price Performance



Security/Capital Details

ASX Code	NAN
Market Cap	$102 M
Issued Shares	201.6 M
Avg Mth T'over	3.01 M
12 Mth High – Low	$0.54 - $0.16

Key Data/Ratios – FY 2009

Cash	$15M
Cash burn	$8.3M
EV	$85M
Interest Cover	na
ROE	-35.7%
EPS Growth	-0.8%
PEG Ratio	na
NTA / Share	$ 0.08
DCF	$ 0.49
12 Mth Price Target	$ 0.57

Recommendation

We are increasing our valuation for the company after taking into account better than expected demand and higher pricing. The company's assembly facility which has come a long way since our last site visit. It's clear that the company has successfully put in place all the systems required to supply the Trophon on the global market. The company's marketing application to the FDA was submitted in May, so the earliest one could expect approval is Aug. 09, but we would not be surprised if the review takes longer than expected. Our DCF valuation increases to 49 cps, and our 12 month target to 57 cps, with significant upside risk.

Key Points

We are increasing our valuation for the company after taking into account the following factors:

- Orders into France are above our expectations, as it appears French authorities are pushing for clinicians to move from aldehyde based disinfection systems to safer (i.e. non toxic) and more effective systems in hospitals.
- Sales into the German market are also ahead of our expectations in terms of timing, with sales beginning in the current quarter as opposed to Q1FY10.
- We recently visited the company's assembly facility. This facility has come a long way since our last site visit, and it is clear that the company has successfully put in place all the systems required to supply the Trophon on the global market. Current assembly capacity is 35 units per week, but this is only for a single shift.
- By doubling the number of shifts per week and outsourcing capabilities being exploited, the company will have the ability to increase supplies to the market from 1,800 p.a. to 12,000 p.a. on short notice.
- It appears we underestimated the price NAN would be able to charge for the Trophon so we have increased this in our model by around 5% from $4,750 per unit to $5,000 per unit.
- The company's 510K marketing application to the FDA was submitted in May, so theoretically the earliest one could expect approval is August 2009. However we would not be surprised if the review takes longer than expected as approval is also a function of work load, and requests for additional information. It appears though everything is on track for an October 2009 launch in the US at a major trade fair. As the company will rely on third party distributors, we await with eager anticipation an announcement of a marketing and distribution agreement for the US market.
- Our DCF valuation increases from 33 cps to 49 cps, and our 12 month target from 39 cps to 57 cps. We still use a discount rate in our DCF of 17%, but emphasise that this rate will decrease once the company receives FDA approval and agreement is reached to market the Trophon in the US, so there is upside risk to this valuation.

BUY: Total return +10% or more over a 12 month period HOLD: Total return expected to be between +10% to -10% over a 12-month period
SELL: Total return expected to be -10% or more over a 12 month period TOTAL RETURN OR TSR = capital growth in share price + expected dividend yield in that period

Year to June	NPAT (Rep) $M	EPS (Norm) c	EPS Growth %	PER x	P/CF x	EV/EBITDA x	DPS c	Div Yld %	Franking %
2008a	-7.1	-3.7	-21.9	-13.8	-13.8	-8.4	0.0	0.0	0
2009e	-7.3	-3.7	-0.8	-13.7	-12.0	-10.5	0.0	0.0	0
2010e	-2.9	-1.4	61.1	-35.1	-25.9	-29.6	0.0	0.0	0
2011e	5.1	2.5	274.3	20.1	68.2	14.3	0.0	0.0	0

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Strong Demand for Trophon

We are increasing our valuation for the company after taking into account the following factors:

- Orders into France are above our expectations, as it appears French authorities are pushing for clinicians to move from aldehyde based disinfection systems to safer (i.e. non toxic) and more effective systems in hospitals.
- Sales into the German market are also ahead of our expectations in terms of timing, with sales beginning in the current quarter as opposed to Q1FY10.
- We recently visited the company's assembly facility. This facility has come a long way since our last site visit, and it is clear that the company has successfully put in place all the systems required to supply the Trophon on the global market. Current assembly capacity is 35 units per week, but this is only for a single shift.
- By doubling the number of shifts per week and outsourcing capabilities being exploited, the company will have the ability to increase supplies to the market from 1,800 p.a. to 12,000 p.a. on short notice.
- It appears we underestimated the price NAN would be able to charge for the Trophon so we have increased this in our model by around 5% from $4,750 per unit to $5,000 per unit.

Regulatory Approvals and Distribution Agreements

While the company plans to submit a marketing approval application to the Japanese Ministry of Health by March 2010, we have not yet included the Japanese market in our valuation, as approval can take up to 12 months from date of filing. However, we understand that management is seeking partners to enter the Japanese and Asian markets.

The company's 510K marketing application to the FDA was submitted in May, so theoretically the earliest one could expect approval is August 2009. However we would not be surprised if the review takes longer than expected as approval is also a function of work load, and requests for additional information. It appears though everything is on track for an October 2009 launch in the US at a major trade fair. As the company will rely on third party distributors, we await with eager anticipation an announcement of a marketing and distribution agreement for the US market.

Changes to Forecasts

As sales into Europe are proceeding better than we had expected we are increasing our forecasts and valuation for the company. These changes are shown in Table 1.

Table 1: Changes to Forecasts

Previous ($M)	**FY09**	**FY10**	**FY11**
Revenue	0.5	8.4	20
EBITDA	-9.8	-5	2.6
NPAT	-8.8	-4.8	1.8
New ($M)			
Revenue	0.6	9.0	23.0
EBITDA	-8.3	-3.1	6.4
NPAT	-7.3	-2.9	5.1

Source: WHTM

Our DCF valuation increases from 33 cps to 49 cps, and our 12 month target from 39 cps to 57 cps. We still use a discount rate in our DCF of 17%, but emphasise that this rate will decrease once the company receives FDA approval and agreement is reached to market the Trophon in the US, so there is upside risk to this valuation.

Nanosonics LTD (NAN : $0.51)

INVESTMENT FUNDAMENTALS

Yr Ending June	2007A	2008A	2009E	2010E	2011E
EPS Reported (c)	-3.0	-3.7	-3.7	-1.4	2.5
EPS Normalised (c)	**-3.0**	**-3.7**	**-3.7**	**-1.4**	**2.5**
EPS Growth (%)	N/A	-21.9%	-0.8%	61.1%	274.3%
PER Normalised (x)	**-16.8**	**-13.8**	**-13.7**	**-35.1**	**20.1**
DPS (c)	0.0	0.0	0.0	0.0	0.0
Payout (%)	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**0.0%**
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Franking (%)	0%	0%	0%	0%	0%

VALUATION DATA

Yr Ending June	2007A	2008A	2009E	2010E	2011E
EV / EBITA (x)	-10.5	-8.2	-10.2	-26.3	15.5
EV / EBITDA (x)	-10.7	-8.4	-10.5	-29.6	14.3
CFPS (c)	-2.4	-3.7	-4.2	-2.0	0.7
Price / CF	**-20.9**	**-13.8**	**-12.0**	**-25.9**	**68.2**
Book Value / Share ($)	0.2	0.1	0.1	0.1	0.1
Price / Book (x)	**3.1**	**4.0**	**6.0**	**7.3**	**5.3**

PROFIT & LOSS ($m)

Yr Ending June	2007A	2008A	2009E	2010E	2011E
Sales Revenue	0.0	0.0	0.6	9.0	23.0
EBITDA	-6.2	-8.8	-8.3	-3.1	6.4
Depreciation	0.2	0.2	0.3	0.4	0.5
EBITA	**-6.3**	**-9.1**	**-8.6**	**-3.5**	**5.9**
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	**-6.3**	**-9.1**	**-8.6**	**-3.5**	**5.9**
Net Interest Expense	-0.6	-1.9	-1.2	-0.6	-0.5
Pre-tax Profit	**-5.7**	**-7.1**	**-7.3**	**-2.9**	**6.4**
Tax	0.0	0.0	0.0	0.0	1.4
Tax rate (%)	0.0%	0.0%	0.0%	0.0%	21.1%
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
Net Profit	**-5.7**	**-7.1**	**-7.3**	**-2.9**	**5.1**
Abn's / Extraord's	0.0	0.0	0.0	0.0	0.0
Reported Net Profit	-5.7	-7.1	-7.3	-2.9	5.1
Revenue Growth (%)	N/A	N/A	N/A	1,401.3	156.2%
EBIT Growth (%)	N/A	-43.5%	5.7%	59.2%	269.2%
NPAT Growth (%)	N/A	-25.3%	-2.6%	60.4%	274.1%

PROFITABILITY RATIOS

Yr Ending June	2007A	2008A	2009E	2010E	2011E
EBIT / Sales (%)			**-**	**-38.9%**	**25.7%**
ROA (%)	N/A	-625.2%	-333.4%	-54.0%	46.3%
ROE (%)	**N/A**	**-25.5%**	**-35.7%**	**-19.2%**	**31.3%**
ROFE (%)	N/A	6,973.2	-779.1%	-123.7%	97.4%

INTERIMS ($m)

Half Yr	Dec 07	Jun 08	Dec 08	Jun 09	Dec 09
Yr Ending June	**1H A**	**2H A**	**1H A**	**2H E**	**1H E**
Sales Revenue	0.0	0.0	0.0	0.6	2.3
EBIT	-4.0	-5.1	-5.1	-3.4	-2.8
Net Profit	**-3.1**	**-4.1**	**-4.3**	**-3.0**	**-2.5**
EBIT / Sales (%)				-572.2%	-124.4%

BALANCE SHEET ($m)

Yr Ending June	2007A	2008A	2009E	2010E	2011E
Cash	31.9	24.2	14.6	9.8	10.3
Receivables	0.2	0.1	0.0	0.4	0.7
Inventories	0.0	0.0	0.0	0.4	0.7
Other	0.4	0.2	0.0	0.0	0.0
Current Assets	**32.4**	**24.6**	**14.7**	**10.6**	**11.7**
Net PPE	1.0	1.1	2.1	2.6	3.1
Investments	0.0	0.0	0.0	0.0	0.0
Intangibles	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	1.6	5.8	11.8
Non-current Assets	**1.0**	**1.1**	**3.7**	**8.4**	**14.9**
Total Assets	**33.4**	**25.6**	**18.4**	**19.0**	**26.6**
Current Payables	1.9	0.8	1.1	4.8	8.0
Current Debt	0.0	0.0	0.0	0.0	0.0
Non-Current Debt	0.0	0.0	0.0	0.0	0.0
Provisions	0.1	0.3	0.7	0.6	0.0
Other	0.0	0.0	0.0	0.0	0.0
Total Liabilities	**2.1**	**1.1**	**1.9**	**5.4**	**8.0**
Equity	41.5	41.2	41.2	41.2	41.2
Reserves	0.0	0.7	0.0	0.0	0.0
Retained Profits	-10.2	-17.3	-24.6	-27.5	-22.5
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	**31.3**	**24.6**	**16.5**	**13.6**	**18.7**
Total Funds Employed	**-0.6**	**0.3**	**1.9**	**3.8**	**8.4**

LIQUIDITY & LEVERAGE RATIOS

Yr Ending June	2007A	2008A	2009E	2010E	2011E
Net Debt (Cash) ($m)	-31.9	-24.2	-14.7	-9.8	-10.3
Net Debt / Equity (%)	**-101.9%**	**-98.6%**	**-88.7%**	**-72.1%**	**-55.3%**
Interest Cover (x)	10.1	4.7	6.9	5.9	-12.2
Debt / CashFlow (x)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

CASHFLOW ($m)

Yr Ending June	2007A	2008A	2009E	2010E	2011E
EBIT	-6.3	-9.1	-8.6	-3.5	5.9
Dep'n and Amort'n	0.2	0.2	0.3	0.4	0.5
Net Int Rec'd (Paid)	0.6	1.9	1.2	0.6	0.5
Tax Paid	0.0	0.0	0.0	0.0	0.0
Dec / (Inc) W'kg Cap	0.0	-0.3	-0.3	-2.7	-3.0
Other	1.0	0.1	-1.0	1.3	-2.4
Operating Cash Flow	**-4.6**	**-7.1**	**-8.3**	**-3.9**	**1.5**
Capital Expenditure	-0.7	-0.4	-1.3	-0.9	-1.0
Asset Sales	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Other Inv. Flows	0.0	0.0	0.0	0.0	0.0
Investing Cash Flow	**-0.7**	**-0.4**	**-1.3**	**-0.9**	**-1.0**
Equity Raised	30.6	0.3	0.0	0.0	0.0
Inc / (Dec) in Loans	0.0	0.0	0.0	0.0	0.0
Dividends Paid	0.0	0.0	0.0	0.0	0.0
Other Fin. Flows	-1.8	-0.7	0.0	0.0	0.0
Financing Cash Flow	**28.8**	**-0.4**	**0.0**	**0.0**	**0.0**
Net Cash Flow	**23.5**	**-7.9**	**-9.6**	**-4.8**	**0.5**

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