



# Biotech Daily

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*Daily news on ASX-listed biotechnology companies*

## Dr Boreham's Crucible: Resmed

By **TIM BOREHAM**

**ASX:** RMD (Chess depository interests); **New York Stock Exchange:** RMD

**Share price:** \$12.34; **Market cap:** \$17.6 billion

**Shares on issue:** 142,891,971 US shares; 1,428,919,708 CDIs\*

**Financials (December half):** revenue \$US1,125 billion (\$A1,409 billion) (up 13%), operating income \$US258.5 million (up 35%), net income \$US95,651,000 (\$A119,792,200) (down 37%).

**(December quarter):** revenue \$US601.3 million (up 13%), operating income \$US146 million (up 51%), net income \$US9.5 million (down 88%\*\*), cash \$US858 million (up 9%), dividend per share 35 US cents (up 6%).

**Chief executive officer:** Michael Farrell

**Board:** Dr Peter Farrell (founder and chairman), Carol Burt, Dr Gary Pace, Richard Sulpizio, Ron Taylor, John Wareham, Karen Drexler. (Long serving Resmed director and former Cochlear chief Dr Chris Roberts retired at the last AGM)

**Identifiable shareholders:** Fidelity Management 6.03%

\* Ten CDIs are the equivalent of one NYSE ordinary shares

\*\* Reflects \$US119.8 million "transitional impact" of US tax cuts and \$US6.7 million deferred tax impact.

The sleep disorders house has been listed since 1999 and has been around since 1989, so is well-known as our second-biggest biotech stock (behind CSL and ahead of Cochlear).

A prominent Australian global medical success story, Resmed's reach covers four million patients in 120 countries.

But for the Rip van Winkles among us who have missed it all, here's a quick primer:

Resmed makes devices and cloud-based software to diagnose and treat sleep apnoea (snoring), chronic obstructive pulmonary disease (COPD) and other chronic respiratory ailments.

Obstructive sleep apnoea - bad snoring - is not only hazardous to marriages, but it can be life threatening.

Given the condition is linked to overweight middle-aged men, Resmed gleans about half of its revenue from the US, land of the fat and the free.

Believe it or not, a tracheotomy was the standard treatment for dangerous snoring before continuous pressure air pumps (CPAPs) and masks came along.

Resmed now has access to 1.5 billion nights of respiratory care data - akin to watching the Chinese and Japanese populace combined snoozing for one night - and that makes for a valuable resource for developing new products and arguing for reimbursement.

Awareness of sleep disorders is also growing, while the recovering US economy means more sufferers have the means to do so and not suffer in silence (so to speak).

It wasn't too many sleeps ago that Resmed was feeling the effects of enhanced competition and poor patient compliance, mainly because its sleep masks were uncomfortable and made the user look like Hannibal Lecter on an especially homicidal day.

Judging from the San Diego-based Resmed's December (second) quarter results, the Australian-grown overseas success story has regained its groove, on the back of both new and re-imagined products.

Despite some challenging numbers in the previous corresponding quarter, Resmed globally recorded a nine percent rise in device sales (the air pumps) and a 13 percent increase in mask sales.

Resmed is also tapping the internet cloud software phenomenon, which means clinicians can monitor patients in the comfort of their own beds (the patients' own beds, just to clarify).

"Our masks have performed well around the world, device sales are solid and our cloud based software continues to grow rapidly," chirps CEO Mick Farrell.

Resmed is also winning market share from its key rivals: Philips Respironics, Fisher & Paykel Health, DeVilbiss Healthcare, Apex Medical and BMC Medical.

The companies revel in constant patent disputes, with Resmed duking it out with Fisher & Paykel in several tit-for-tat legal actions, globally.

While selling prices remain under pressure - we don't know by what quantum because the company no longer discloses them - Resmed was able to maintain gross margins by increasing "operating leverage".

In layman's terms, that means cutting costs.

Mick Farrell, by the way, took over from old man Peter - the company's founder - in 2013. We have no problem with such nepotism, relatively speaking

### **Song remains the same (but different)**

With apologies to Led Zeppelin, the song remains the same at Resmed, which still gleans most of its revenue from the sleep apnoea market.

But the songbook has tweaked in three ways: improved iterations of old products, a move into the expansive chronic obstructive pulmonary disease (COPD) sector and an expansion into the cloud-connected market.

In early 2016 Resmed acquired Brightree - a software-as-a-service business - for \$US800 million.

Resmed's focus on remote cloud-based monitoring recently won the imprimatur of French authorities, who said 'oui' to reimbursement for telemonitoring of sleep apnoea patients. Not surprisingly, the company is in active conversation with governments and payers (insurers) elsewhere.

"We will get the message through to them that telemonitoring ... improves outcomes and improves lives and we think other countries will follow suit," Mr Farrell says.

Resmed's product suite would do an Apple store proud: new products include Airfit and Airtouch (facial and nasal masks), Airmini (the smallest continuous pressure air pump on market), and Myair (a patient engagement app).

In particular, management calls out the success of the Airfit F20 facial mask as a driver of market share gains. The difference? The mask is made of foam, not plastic and feels more like a comfy pillow.

This quarter Resmed plans to assault the COPD market with its first-own branded portable oxygen compressor unit, the Mobi. The company acquired the Texas-based Inova Labs two years ago.

To date, Resmed has sold Inova's Activox range of compressors.

The COPD market is seen as lucrative because there are 65 million sufferers globally and it's now the third-biggest cause of death, with high rehospitalisation rates.

## **Let's talk about tax**

Much of the second quarter results briefing was devoted to tax reform on both sides of the Pacific. In the US, Trump's famous corporate tax cuts are a reality, while the Bunyip Parliament is expected to pass tougher multinational tax laws any tick of the clock.

While the Trump tax changes are positive overall for Resmed, the measures will play havoc with the company's short term reported numbers.

The quarterly numbers recognised an extra tax bill of \$126.6 million, reflecting a transitional tax on unremitted foreign income and the diminished value of residual tax assets.

This resulted in Resmed's 'official' 88 percent plunge in reported earnings. Excluding the one-offs, the effective tax rate for the quarter was six percent, but is expected to rise to 15-16 percent in the second half and then settle at 21-23 percent in the 2018-'19 year.

But Resmed believes the overall US package will be positive, providing more flexibility to repatriate funds to the US and undertake capital management or acquisitions.

## **... and the dollar**

Currency is an eternal issue and the Aussie dollar chugging above 80 US cents is an unwanted headwind. Resmed, however, reports in greenbacks, so the key translation effect is converting the US dividend to the local lingo.

Philosophical chief financial officer Brett Sandercock says the company has lived with the Aussie being as low as 47 US cents and as high as \$US1.03.

"We just have to live with currencies moving around and have initiatives in place to counteract that," he says.

For example, manufacturing is now done in Singapore as well as Australia and the company deploys the usual currency hedging instruments.

## **Dr Boreham's diagnosis:**

While expansive, the sleep disorders market is heavily competed, not just by the pump-and-mask brigade but the likes of Somnomed, which makes a bespoke mouthguard for sleep apnoea at a fraction of the price.

And who can forget Rhinomed's Mute plastic nose clips to keep the nostrils open: \$24.99 for three at all good pharmacies (for a while, Resmed was selling the Mutes on its online store).

Given the alternatives, Resmed management thus deserves credit for maintaining sales revenue off a \$US2.2 billion a year global sales base.

Over the last year, Resmed shares have meandered between \$9 and the post-results record \$12.66.

While the results were well-received, not everyone's a fan given the company trades on a meaty earnings multiple of around 28 times.

This year, Resmed will spend \$40.6 million on R&D - almost seven percent of revenue.

Given that chunky spend, a steady flow of new devices (and tweaked old ones) should ensure sweet dreams for investors and patients alike.

***Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He also does not snore, but admittedly has not stayed awake to check.***