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Dr Boreham's Crucible: Compumedics

By TIM BOREHAM

ASX code: CMP

Share price: 47 cents

Market cap: \$83.3 million

Shares on issue: 177,162,948

Executive chairman: Dr David Burton

Board*: Dr David Burton, David Lawson, Tucson Dunn

* Dr Alan Anderson stepped down in October last year

Financials (December half): revenue of \$18.7 million (up 16%), net profit \$811,000 (up 26.5%), earnings per share 0.5 cents (up 25%), net tangible assets 10.8 cents (up 13.7%), cash of \$4.3 million (up 13%)

Identifiable major shareholders: D and DJ Burton Holdings (David Burton) 55.3%, Teijin Pharma 4.7%, Beijing Bestmed Tech 2.8%, Medigas Italia 2.45%

Perseverance is the byword at the Melbourne based Compumedics, which has become a global market leader in sleep and brain diagnostics.

Not that Compumedics has been an overnight success: executive chairman David Burton founded the company way back in 1987 - just before the stock market caved in for the paper shuffling entrepreneurs of that era.

In that year, Dr Burton installed Australia's first computerized sleep clinic, at Melbourne's Epworth Hospital.

Listed since 2000, Compumedics has not changed its spots - which is more than one can say for most of its tech boom-era contemporaries.

Come to think of it, not many of them still exist.

"The company has continued to generate cash and grow profitably," Dr Burton says.

About Compumedics

Compumedics products range across sleep diagnosis, clinical electro-encephalogram (EEG) scans, brain monitoring and ultra-sonic blood-flow systems.

Products include Grael and Siesta for sleep, Neuvo LTM for neurology and Neuroscan, Synamps RT and Curry for brain research.

In brain imaging, Compumedics is a leader in magneto-encephalography, or MEG, regarded as the most reliable form of brain imaging.

One of the company's flagship products is the Orion Lifespan Curry MEG, a "patented double relaxation oscillator super conducting quantum interference device." Of course.

MEG is considered a high-growth sector given the prevalence of Alzheimer's disease and other dementia conditions, not to mention the enormous research dollars.

A global pygmy

In size terms Compumedics is a mere flea in the global pantheon of health diagnostic companies, but it has a true global presence nonetheless across an installed base of 25,000 units.

Last year, 40 percent of the company's revenues came from the US, 30 percent from Asia (notably China) and a further 30 percent from Asia and 12 percent from here.

Compumedics owns the US-based Neuroscan and Germany's DWL Elektronische (which delivered the company's Doppler transcranial scan capacity: that is, ultrasounds to detect vascular systems within the brain).

Locally, Compumedics claims to be the number one provider of sleep and neurological diagnostics and is number one for sleep in that land of work-obsessed insomniacs, Japan.

Half of Australian hospitals use Compumedics neuro-diagnostics and EEG products, while the company has also tied up the majority of sleep clinics.

Compumedics is targeting a sleep diagnostics market worth \$US250 million and a neuro-diagnostics market valued at \$US1.3 billion.

But its dominant market share is in the smaller markets for brain research (worth \$US20 million) and brain blood flow diagnostics (\$US15 million).

MEG is the word

Compumedics' MEG business promises to be a transformative one for the company, which in mid-2017 won its first (and to date only) customer for its new, improved machine: the Barrow Neurological Institute in Phoenix, Arizona.

Home to the Muhammad Ali Parkinson Centre, Barrow is considered number one in the US for both neurology training and neurological vascular surgery.

Compumedics won the deal after a nine-month tussle with rival Electa, which was widely expected to be the victor as it already provided cancer scanning equipment.

"That was a big statement for us to win the order, especially as Electa already had an installation with Barrow," Dr Burton says.

Dr Burton helpfully describes the MEG units as a "Marge Simpson type hairdryer" that sits on top of the head.

It works with magnetic sensors operating at very high temperatures. With two modes for adults and children, it can detect early markers of autism, dementia and epilepsy.

Compumedics claims several advantages over the existing MEG devices: it is 50 percent more effective and can re-use all of the helium (a coolant) which otherwise cannot be fully recycled.

Unlike its rivals, the units can operate around the clock.

Dr Burton describes MEG as "MRI of the brain" and hopes it will take off in the same way that MRI (magnetic resonance imaging) devices did after widespread reimbursement.

"There were 100 to 200 MRI units in the early 1980s," Dr Burton says.

"Now there are 34,000 MRIs globally. What happens is the medicine follows the money."

Compumedics licensed the MEG hardware from the Korean Research Institute of Standards and Science (KRISS), that country's equivalent of the CSIRO.

Financials and performance

Compumedics generated revenue of \$18.7 million in the half-year to December 31, up 16 percent, and grew net profit by 26.5 percent to \$811,000. Earnings before interest, taxation, depreciation and amortization (ebitda) grew 55 percent to \$1.3 million.

Asian and US revenues grew 37 percent and 19 percent respectively.

Chief financial officer David Lawson says underlying earnings (ebitda) was not up as strongly as hoped, but that was the result of investing in additional activities, including building the sales and marketing capabilities.

Compumedics has provided guidance of \$40 million to \$42 million in revenue for the full 2018-'19 year (up eight to 13 percent), ebitda of \$5.5 million to \$6.5 million (up 31 to 54 percent) and a net profit of \$4 million to \$5 million (up 43 to 78 percent).

This implies a very robust second half, but the company has the advantage of \$7 million of forward orders and its first Japanese sales.

"It may look like a step up but it's a logical step up when you break down where the growth might come from," Mr Lawson says.

In the longer term, the MEG business could take the company's financial performance to a new level: While the Curry software sells for around \$30,000, the MEG sells for \$3 million to \$5 million a pop.

Sleep beds and basic neurology systems - from which most of Compumedics revenue currently is generated - sell for \$15,000 to \$25,000 and \$20,000 to \$45,000 respectively.

The company has an initial target list of 40 potential MEG buyers, mainly research institutions.

"Selling two or three systems a year obviously changes the financial performance of the business," Mr Lawson says.

Compumedics last raised equity in a \$4.5 million placement in September 2016, so can't be accused of going to the well for more funds every five seconds.

Other catalysts

MEG aside, Compumedics is close to rolling out Somfit, an internet "cloud", home-use sleep diagnostics tool based on a single-use disposable monitor.

In effect, Dr Burton says, Somfit migrates 30 years of the company's sleep development into the internet cloud.

The company expects Somfit to be available for less than \$200, or by monthly subscription.

Dr Burton notes that 30 percent of adults suffer sleep disorders, including insomnia and "disordered breathing".

In all, there are 85 recognized sleep ailments. Apart from intense grumpiness, inadequate sleep is also recognized as a factor in diabetes, given insulin is produced at night.

This month Compumedics attained 'preferred vendor' status with Adventist Health Systems of the US, which has 48 hospital campuses in the south and southwest US.

In an initial order, a Tampa, Florida hospital has ordered 19 epilepsy monitoring systems. It's now competing with the Nasdaq-listed Natus for the business of a much bigger hospital in Orlando.

"The US neurology business has been small to date," Dr Burton says. "But having won Tampa and with a good shop at Orlando, between them that's a \$US5 million neurology business."

Compumedics presence in China - where it is in seven of the top hospitals - also should not be sneezed at.

Dr Boreham's diagnosis:

With a board contingent of a mere three souls and with Dr Burton controlling 55 percent of the register, Compumedics is one of the tightest biotech stocks we've come across.

As a result, there is little liquidity and the stock is prone to volatile daily movements when it does trade.

Despite the company's progress, Compumedics has been trading water valuation-wise over the last two years. When we last covered them in July 2017, the stock traded at 45 cents.

The stock listed at the turn of the century at 50 cents apiece. While the MEG business has the potential to take the company to the next level, another event to watch out for is a possible deal to spin off the Somfit business in some way.

As management concedes, the consumer market is not its forte.

Despite its indifferent share performance Compumedics still ranks as a dinky-di Aussie national champion, albeit a tad smaller than the Resmeds and Cochlears of the world.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. Without a good night's sleep, he is prone to intense grumpiness.