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Dr Boreham's Crucible: Compumedics

By TIM BOREHAM

ASX Code: CMP

Share price: 45.5 cents; **Market cap:** \$80.6 million; **Shares on issue:** 177.2 million

Executive chairman: Dr David Burton

Board: Dr David Burton, Dr Alan Anderson, and David Lawson

Financials (December half): revenue \$16.2 million (down 7%) earnings before interest taxation depreciation and amortisation (ebitda) \$1.2 million (down 50%), net profit \$200,000 (down 88%), cash \$5.72 million (up 86%)

*2016-17 revised guidance: revenue of \$33 million (down 12%), ebitda of \$2.1 million to \$3.6 million (down 24% to 58%).

Major shareholders: David Burton (and associated entities) 59.7 percent, Teijin Pharma 4.9 percent, Beijing Bestmed 2.9 percent, Medigas Italia 2.57 percent.

Investors in the sleep and neurological disorders house don't need a hairnet with multiple sensors to work out why they toss and turn at night: the answer lies with the company's erratic share performance.

On June 20, Compumedics shares soared almost 50 percent after the company won a big US contract for its magneto-encephalography (MEG) scanning technology (see below).

But the biotech gods are fickle indeed and on July 7 the stock tumbled as much as 19 percent after a hefty sales and earnings downgrade for 2016-'17.

The revision - prompted by a \$5 million sales shortfall in the US - highlights a paradox of Compumedics: it's a global leader in its specialist sectors, but is still a miniscule entity as far as global device and diagnostics plays go.

Perchance to dream

Most of us spend about one-third of our life in slumber and the brain's activity during this time remains a mystery.

In his quest to crack the enigma, David Burton founded Compumedics in 1987 and in that year installed Australia's first fully computerized sleep clinic at Melbourne's Epworth Hospital.

Dr Burton (who had a background in electronics for sound recording studios) gained his inspiration after visiting a doctor for a sore throat. Apart from prescribing antibiotics, the physician asked him if it was possible to invent a sleep monitoring device and the idea was thus spawned.

The moral of the story: don't put off that visit to the quack.

Awake to global opportunities

Compumedics now has 20,000 systems installed globally and, unusually for a Western Devil, has a strong position in China as the biggest supplier of sleep and neurological equipment - with orders in 2015-'16 for \$US8.2 million.

The company owns the US-based Neuroscan and Germany's DWL Elektronische.

Geographically, Compumedics can lay claim to being truly diversified, with 29 percent of sales from the US, 41 percent from Asia and 15 percent from both Europe and Australia.

Compumedics claims a six percent share of the sleep diagnostics market, globally worth \$US250 million a year. In Australia and China it has number one market position and is third biggest in the competitive US market.

Compumedics also has a sub one percent share of the \$US1.3 billion neuro diagnostics clinic market, with similar market positioning in these geographies.

The neuro diagnostics (research) and brain blood flow diagnostics markets are worth \$US20 million and \$US15 million, respectively, and the company has a 30 to 35 percent share of these.

Like most device plays, Compumedics is moving from a capital equipment model (that is, selling the gizmos) to cloud-based service models that produce ongoing service revenues.

For example, four sites in the US to date have signed up for Nexus360, a cloud-based sleep diagnostics platform.

Currying favour with MEG

In brain imaging, the company's Curry brain analysis software is the leader in the magneto-encephalography market (MEG), which is a small sector but growing at about 10 percent a year.

MEG is considered to be superior to magnetic resonance imaging (MRI) for Alzheimer's disease and similar ailments. MEG maps brain activity using magnetic fields and we are assured it is not skewed for patients with magnetic personalities.

At the heart of the company's Orion Lifespan Curry MEG is a "patented double relaxation oscillator super conducting quantum interference device", or Dros Squid for short, sensor system. Once again, we're assured this surfeit of adjectives has nothing to do with sub-standard calamari.

The potential for using MEG brain imaging is huge, given the prevalence of not just Parkinson's disease but Alzheimer's and other dementia conditions, autism and epilepsy.

On June 20, Compumedics announced a MEG contract with Arizona's Barrow Neurological Institute, the world's biggest neurological disease institution and home to the Muhammad Ali Parkinson Centre.

The circa \$5 million deal, which relates to the Orion Lifespan device, is the biggest system contract in the company's history.

The company cites cloud-based sleep diagnosis and, in the neuro-diagnostics sector, long-term epilepsy. Traumatic brain injury applications are also an area of interest.

Another initiative is a cloud-based services platform called Ehealthmedics, which captures or transfers "medical grade sleep parameters from any web-enabled device".

The company reports forward orders of more than \$10 million over the next three years for its electronic-health tool, Nexus 360.

Behind the numbers

Compumedics reported \$200,000 of net profit and \$1.2 million of ebitda for the first (December) half, on revenue of \$16.2 million.

Management also guided to a 2016-'17 net profit of \$4 million to \$6 million and ebitda of \$4.5 million to \$7.5 million, on sales of \$41 million to \$43 million.

On July 7, the company said revenues would be about \$33 million (compared with \$37.5 million in 2015-'16) and ebitda would be \$2.1 million to \$3.6 million (and that's before \$1.6 million of one-off restructuring costs).

Management blamed the timing of US sales and associated restructuring of its core business for the revenue tweak. In the first half, Compumedics also referred to a \$2 million shortfall of US sales with this soothing reassurance: "the business has not been lost, just not received in the time frame anticipated".

Burton dubs the revised result as "not entirely as we expected", but insists management is not asleep at the wheel and its growth strategies remain intact.

Dr Boreham's diagnosis:

Compumedics listed in 2000 at 50 cents apiece, but up until late 2014 they did their best Rip Van Winkle impression. A stirring rally saw the stock peak at 93 cents in November last year, before slipping as low as 33 cents in June, then more than doubling to 73 cents, only to sink below the issue price again.

A former Exporter of the Year, Compumedics has much to be proud of in terms of its global presence and reputation. And hats (or hairnets) off to management for not packing it in and pursuing medical pot or graphite exploration instead.

We suspect the stock presents a buying opportunity at these levels, but as usual investors should sleep on it.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. Because he doesn't own any Compumedics shares he sleeps soundly at night.