



# Biotech Daily

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*Daily news on ASX-listed biotechnology companies*

## Dr Boreham's Crucible: Nanosonics

**By TIM BOREHAM**

**ASX code:** NAN

**Share price:** \$7.23

**Market cap:** \$2,173.4 million

**Shares on issue:** 300,603,570

**Chief executive officer:** Michael Kavanagh

**Board:** Maurie Stang (chair), Mr Kavanagh, Marie McDonald, Dr David Fisher, Steven Sargent, Geoff Wilson, Dr Lisa McIntyre.

**Financials (December half 2019):** revenue \$48.5 million (up 19%), pre-tax profit \$6.7 million (down 39%), net profit after tax \$5.7 million (down 20%), earnings per share 1.88 cents (down 20%), cash of \$82 million (up 13.5%)

**Identifiable major shareholders:** FMR LLC (Fidelity) 9.26%, Selector Funds Management 5%, Maurie Stang 6.32%, Bernard Stang 5.82%, Steve Kritzler 2.84%

Let's stress from the outset that Nanosonics is one of the few device plays that has resisted drawing a Covid-19 'save the world' angle into its narrative.

But given Nanosonics is at the front line of germ warfare with its medical probe sterilizing devices, the company has more reason to do so than most of its peers.

Well before the crown of spikes virus wrought havoc on the world, Nanosonics' Trophon device had become well-established as the high-level disinfectant standard of care.

Replacing more cumbersome and less effective bug-busting techniques, the Trophons are sold in 21 countries - notably the US - either directly or via distribution partners.

A key figure in Nanosonics' evolution, chairman Maurie Stang says any new medical technology has to be both cost effective and produce clear measurable benefits.

"While physicians and hospitals want the latest and the best, boards and financial directors are playing a greater role," he says. "One of the great strengths is that infection control organizations work hand-in-glove with Nanosonics."

A spin off from the private Novopharm Research, Nanosonics listed on the ASX in May 2007, having raised \$27 million at 50 cents apiece.

With the Trophons well established, the burning question now is what product the company will roll out next?

### **A new weapon in germ warfare**

The Trophons are not monsters from Dr Who but wall-mounted units that treat the probes with biocidal micro droplets, derived from a canister containing hydrogen peroxide.

Only water and oxygen are produced as byproducts and they're as wholesome as daisies and buttercups.

"Most disinfectants are used over again," Mr Stang says. "With Nanosonics, every patient gets a fresh dose. The process is automated and takes seven minutes, which is the time it takes to change a [surgical] gown."

While the capital cost of a unit is about \$10,000, Nanosonics also derives considerable revenue from selling the associated consumables, such as the hydrogen peroxide canisters, probe covers, printers and printer rolls.

Launched in 2018, the Trophon 2 is a bells-and-whistles version with enhanced functionality, such as the ability to create and store digital records for audit purposes.

"Every day approximately 60,000 patients are protected from the risk of cross contamination because their probe has been Trophoned," the company says.

Trophoned? You know you've really made it when your brand name becomes a commonly used verb - not that the company is quite at that juncture yet.

Trophon sales have been spurred by new rules on high-level disinfectant requirements in Britain, the US and Germany. In April, the French Ministry of Health followed suit, requiring high-level disinfection of endo-cavity ultrasound probes even if a sheath is used.

## **Distribution hits and misses**

Initially, the company signed up GE Healthcare as its sole distributor in North America. But after it became clear that GE was focused on its own customers, Nanosonics built its own sales force and also cut a better deal with the healthcare giant.

GE remains an important distributor, with a tie-up recently expanded to cover Denmark, Finland, Spain and Portugal. The devices are sold by a range of distributors elsewhere - such as Toshiba, Philips and Siemens - and via a direct sales force in Britain.

Customers can either acquire the equipment outright or rent it, or enter a hybrid managed equipment service arrangement.

The distributors can buy the machines, consumables and spare parts and on-sell them, or just the capital equipment

## **Finances and performance**

Given its profitable status Nanosonics doesn't need to 'do' quarterly reports, but in early April reported that third (March) quarter sales were well up on the previous corresponding period.

Covid-19 has restricted access to hospitals, thus tempering Trophon unit sales for the remainder of the financial year to June 30, 2019. But consumables sales are in line with pre-virus expectations.

In the first (December) half the company increased revenue by 19 percent to \$48.5 million. But reported net profit declined by 20 percent to \$5.7 million, the result of increased investment in the aforementioned opportunities.

The research and development budget also ramped up to \$6.8 million - from \$5.5 million previously.

During the half year, the company sold 22,500 Trophon units, up 17 percent year on year and eight percent on the half year. Of these, 19,930 (88 percent) were sold in North America (mainly the US, in other words).

The numbers also show that Nanosonics gleaned 70 percent of its revenue from service and consumables, with the remainder from the Trophon unit sales.

Nanosonics has a very hygienic cash balance of \$82 million, up \$9.5 million on the half, with only nominal debt of \$302,000.

Nanosonics shares peaked at \$7.60 on February 14 and slumped to a low of \$4.37 on March 23, before staging an almost perfect V shaped recovery.

## **From Nanosonics to Megasonics**

Nanosonics greater fortunes rest with a new product based on the Trophon platform.

“The technology is designed to address a major unmet need in infection prevention and would involve both capital equipment and consumables,” Mr Kavanagh told the company’s annual general meeting.

The product also presents a “similar financial opportunity” to the Trophons.

Hinting at the nature of the new product, Nanosonics cites extension opportunities in compliance and traceability, instrument cleaning, environmental decontamination and both high-level and low-level disinfection.

With the Trophons, Nanosonics cites a global “base opportunity” of 120,000 units, which means it’s captured less than 20 percent of the worldwide market.

But this penetration varies markedly: the Trophons account for half of the North American market, but only two percent of the European and Middle Eastern market and four percent of the Asia Pacific.

The company enjoys 75 percent penetration of its home market of Australia and New Zealand.

## **Sparking joy in Japan**

Having recently obtained regulatory approval there, Japan looms large on Nanosonics’ list of new geographies to conquer.

That’s because dirty doings are afoot in ascetic and germ-obsessed Japan, the nation that brought minimalist maven Marie Kondo to the world.

Disconcertingly, a study of sterilization methods for transvaginal ultrasound probes found that 90 percent were still infected after being treated in the standard way - a quick going-over with an alcohol or ammonia wipe.

Half of the tainted devices contained the antibiotic-resistant bacteria *Staphylococcus aureus*, which is unlikely to spark joy in anyone. Naturally, Nanosonics will play-up any adverse findings but we reckon just one dirty device is one too many.

## **Dr Boreham’s diagnosis:**

While Nanosonics shares are still slightly off their peak levels, the stock is still valued at a heady \$2 billion and the term ‘the next Resmed’ is tricking from the mouths of salivating investors.

One never knows.

A measure of Nanosonics' potential from here is the degree to which it can further penetrate its target markets and encourage upgrades to the Trophon 2 (the oldest Trophons are now more than five years old and are starting to be replaced).

Then there's the Mystery Product, due for release sometime by July 2021.

Eventually, the Trophons are expected to account for less than 40 percent of sales, so there's much rising on the enigmatic instrument and, indeed, further product iterations.

Mr Stang notes the \$10 billion a year anti-infection market is bigger than Resmed's sleep apnoea space or Cochlear's hearing market.

On broker Morgans' numbers, Nanosonics shares are trading on a heady earnings multiple of 166 times, assuming current-year earnings of \$12.2 million.

This valuation drops to a mere 98 times in the year to June 30, 2021, based on forecast earnings of \$20.7 million.

The firm notes that given the restricted access to hospitals, there's some doubt about volumes in the June and September quarters.

"Nanosonics success is not an accident," Mr Stang says. "When 3M and GE invested, we were an encouraging start up, now we are in the ASX200 and our road map is becoming clearer by the day."

Your columnist doesn't question Mr Stang's assertion that Nanosonics is at the early stages of growth but reckons the stock is one to buy on weakness - such as when they almost halved during the March selloff.

Dang! Why doesn't anyone ever ring the bell on such occasions?

***Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He likes to think he asks probing questions, but keeps it clean at the same time.***