



Biotech Daily

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Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Resmed

By **TIM BOREHAM**

ASX and New York Stock Exchange Code: RMD

Share price: \$13.11

Market cap: \$18.7 billion

Shares on issue: 142,494,116 (NYSE), 1,424,941,161 (ASX)
(Ten Chess depository instruments are the equivalent of one NYSE ordinary share)

Financials (December quarter): \$US651 million (up 8%), net income \$US144.5 million (up 0.4%)**, earnings per share \$US1 (steady), dividend per share 37 US cents (steady).

(December half): revenue \$US1,239 million (up 10%), net income \$US260.7 million (up 10%)**, earnings per share \$US1.81 (up 9%), cash balance \$US149 million (down 82%)

** net income is a non-GAAP (US accounting standards) measure excluding amortization on acquired intangibles, acquisition-related items and the impact of US tax reforms.

Chief executive officer: Michael Farrell

Board: Dr Peter Farrell (founder, chairman), Michael Farrell (Peter's son), Carol Burt, Dr Gary Pace, Richard Sulpizio, Ron Taylor, John Wareham, Karen Drexler.

Identifiable major shareholders (US stock): Vanguard 10%, Capital World Investors 8.54%, Black Rock Inc 8.51%, Fidelity Management 6.03%

Company chieftains love to wax lyrical about a "transformational year" in their glossy material, if only for want of something more positive and concrete to say. But in the case of our third-biggest home grown but globalized healthcare outfit, there's more than a kernel of truth about the 2018 year being, well, transformational.

While the San Diego-based Resmed has always been a keen acquirer, in the last nine months it has shelled out \$US1.1 billion for three businesses in the US that stray beyond the company's previous remit of tackling sleep and respiratory disorders.

The acquired operations are all in the broader game of digital health: that is, gathering and analyzing patient data to improve the standard and efficacy of clinical support. They also broaden Resmed's presence in chronic obstructive pulmonary disease (COPD), which is an ever-expanding market as the wheezing populace ages.

While an extension of Resmed's increasing emphasis on cloud-based monitoring of its sleep devices, the purchases also diversify the company when cheaper and more convenient alternatives are emerging to Resmed's continuous positive air pressure (CPAP) masks and pumps.

"The acquisitions are driven by our strategy to be the world leader in digital health for sleep apnoea and COPD and out-of-home software," CEO Mick Farrell says.

CPAPs deliver pressurized air through a nasal mask to prevent obstruction of the upper airway - and thus snoring - during sleep. But many users find them uncomfortable and compliance rates in the past have been low, which hasn't stopped the company from selling in 120 countries with coverage of six million cloud-connected devices.

While Resmed is no spring chicken it's still only lightly penetrating the global market: according to Mr Farrell, 836 million people "suffocate" with sleep apnoea every night.

Despite the perception that snoring is largely the claim of fat. Middle-aged men, 40 percent of patients are women.

A sleeper awakes

Resmed's technology is based on the CPAP intellectual property developed by the Baxter Centre for Medical Research and acquired by Resmed founding father Dr Peter Farrell in 1989. Baxter sold the masks in Australia from 1988.

Up until then, a tracheotomy was the standard treatment for dangerous snoring, which supports the adage that the cure can be worse than the disease.

Incorporated in Delaware (where else?), Resmed was formed as a holding company and admitted to the Nasdaq in June 1995. But in September, Resmed changed its home exchange to the New York Stock Exchange.

Along the way, Resmed has acquired businesses in ventilation devices and diagnostics, dental devices, portable oxygen generators and cloud-based software informatics.

Mick Farrell took over from old man Peter as CEO in 2013, but Dad remains chairman.

Resmed turns Pacman

With Resmed gobbling up so many targets, the investor relations department's mergers and acquisitions announcement template is fast wearing out.

In December, Resmed unveiled the purchase of Propeller Health, a Wisconsin-based asthma and pulmonary health specialist, for \$US225 million.

Propeller markets sensors that attach to an asthma inhaler or COPD drug delivery devices and pairs with a mobile application to track medication use (successfully achieving what Adherium had hoped).

In mid-November last year, Resmed completed the \$US750 million purchase of Minnesota's Matrix Care, "a leader in software solutions for more than 15,000 providers across skilled nursing, life plan communities, senior living [retirement homes] and private duty [home based care]".

Matrix Care provides to 13,000 facilities run by 2,500 home and hospital operators.

Early in the September quarter, Resmed closed the \$US126 million acquisition of Healthcarefirst, which provides services to home health and hospice agencies.

A new joint venture with Verily combines Resmed's expertise in sleep apnoea with Verily's advanced health data analytics, to study the financial and health aspects of undiagnosed untreated sleep apnea.

Resmed's big-ticket splurge started with the \$US800 million purchase of software-as-a-service business Brightree in April 2016.

In early 2016, Resmed entered the COPD market with its first own-branded portable oxygen compressor unit, the Mobi (two years previously Resmed acquired the Texas-based Inova Labs and sold Inova's Activox range of compressors).

Despite the digital penetration - so to speak - Resmed hasn't exactly been ignoring its core products, having unleashed several iterations of the existing masks.

For instance, the Airfit F30 minimal contact full face CPAP mask is suited to customers who need to wear glasses to bed and the Airfit N20 nasal mask that sits lower on the face and leaves fewer facial marks.

Financials and performance

Investors last week accorded Resmed's December quarter (and first half) results the all-round raspberry, sending the shares down 12 percent on the day (from \$16.45 to \$14.47) and then a subsequent nine percent over the ensuing week.

Using Resmed's internally deployed non-GAAP accounting measure, earnings were steady at \$US144.5 million, while revenue increased eight percent to \$US651 million.

As usual, there were a variety of gripes including slow non-US device sales - up three percent on a constant currency basis - with sales in France and Japan especially sluggish because the company has lost an earlier revenue boost from device upgrades.

Some commentators bemoaned the cessation of share buy-backs, which should not be surprising given the acquisition spree. Resmed last year bought back 200,000 shares, at a cost of \$US22.8 million

Overall, mask sales grew 10 percent and device sales crept up three percent. With the exception of France and Japan, the company reports “excellent” growth in masks and devices in the Asia Pacific and Western Europe.

The Matrixcare purchase is expected to generate \$US122 million of proforma revenue and earnings before interest, taxation, depreciation and amortization (Ebitda) of \$US30 million in 2018 (that is, assuming the business was owned for the full year).

Despite last week’s slump, Resmed shares have performed okay, given the general global market meltdown of late 2018, with the ASX-listed shares gaining 17 percent over the last 12 months.

Longer term performance has been solid rather than spectacular: a \$US100 parcel of shares acquired in June 2013 was worth \$US253 as of June 2018, exceeding the performance of the S&P500 healthcare index (\$US175).

This performance is consistent with the Dow Jones US medical device index (\$US264) and outperforms the S&P500 healthcare index (\$US175)

To keep ahead of pesky sleep device rivals such as Respironics (Philips) and Fisher & Paykel Healthcare, Resmed spent \$US155 million on research and development in 2018 and plans to spend close to \$US200 million this year.

Dr Boreham’s diagnosis:

Despite the acquisitive splurge into non-sleep apnoea activity, Resmed remains focused on the “globally underpenetrated” sleep and respiratory markets.

While management hasn’t ruled out further purchases, we get the impression that the company will focus on its existing assets, in terms of increasing operating leverage and interoperability between the businesses.

The quarterly results show the growing importance of the digital side of the business, with software-as-a-service revenues gaining 63 percent to \$63.2 million.

Resmed’s overall revenue for the quarter increased eight percent to \$US651 million, which means the software-as-a-service side now accounts for just under 10 percent of turnover compared with six percent a year earlier.

“We are now moving to the point where software-as-a-service has become a big enough segment to talk about,” Mr Farrell says.

Resmed cites a global market of 936 million people with mild to severe sleep apnoea, fewer than 20 percent of whom have been diagnosed and treated.

On a geographic note, 62 percent of Resmed’s revenue derived from the US in 2018 and the company expects this to remain similar “in the foreseeable future”.

From local sleeper to global health leader, Resmed’s growth over the years has been extraordinary. Given the shares are trading on a price-earnings multiple of around 33 times - well above the industrial average - investors expect more growth to continue.

Management’s challenge is not to fall asleep at the wheel as it squeezes as much as it can from the acquisitions.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He admits to the occasional day-dream but so far has never been caught asleep on the job.