



# Biotech Daily

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*Daily news on ASX-listed biotechnology companies*

## Dr Boreham's Crucible: Resmed

**By Tim BOREHAM**

**ASX code:** RMD (Chess depository interests or CDIs)

**New York Stock Exchange code:** RMD

**Share price:** \$25.37

**Market cap:** \$36.5 billion

**Shares on issue\*:** 1,437,692,440 (CDI equivalents)

**Financials (December 2019 first half):** revenue \$US1.4billion (\$A2.1 billion; up 14%), non-GAAP net profit after tax \$US311.7 million (up 20%), earnings per share \$US2.14 (up 18%), cash \$US204.1 million

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

**Chief executive officer:** Michael Farrell

**Board:** Dr Peter Farrell (founder and chairman), Michael Farrell, Carol Burt, Jan De Witte, Richard Sulpizio, Ron Taylor, John Wareham, Karen Drexler, Harjit Gill

**Identifiable major shareholders (US stock):** Vanguard 10.3%, Black Rock Inc 8.74%, Fidelity Management 4.96%

The venerable sleep disorders house is starting to sound like a car maker that has exhausted the possible names for its variant models and is now relying on letters, dashes, errant capital letters and numbers.

A case in point is Resmed's latest iteration of its continuous positive airways pressure (CPAP) device, the "AirFit N30i".

Unlike many of Resmed's past models, the air tube on this one protrudes from the top of the patient's head rather than directly from the mask, allowing the person to sleep in any position.

Don't confuse the AirFit N30i with the Hyundai i30 or the Mazda MX-5, let alone the previous AirFit P30i or the AirFit N20.

The products are part of what Resmed CEO Farrell describes as a "steady rhythm" of new launches, intended to keep the home-grown, San Diego-based company competitive.

Unlike its customers Resmed hasn't been caught napping, with its recent quarterly results suggesting the company has successfully expanded the market for its old markets and is forging new ones.

Not that everything is going right for the company, as we will discuss ...

### **Giving the Sandman a helping hand**

Resmed is a leader in obstructive sleep apnoea (snoring) and other respiratory disorders that occur during sleep.

Along the way, Resmed has expanded into diagnostic products, ventilation and dental devices, portable oxygen concentrators and internet cloud-based services.

Resmed sells in 120 countries - either directly or via distributors - but the US is by far its most important market. Increasingly, the company is emphasizing the out-of-hospital (home care) market.

CPAPs deliver pressurized air through a nasal mask to prevent the collapse of the upper airway - and thus snoring - during sleep.

To increase "therapy adherence", the company has heavily invested in the product tweaks such as the "tube up" variants and more comfortable masks.

The company estimates the global sleep apnoea market at more than 900 million patients, male and female. Yep - they're not all fat, middle-aged men.

### **Noisy hounds spur the Resmed story**

We can thank the noisy nocturnal emissions of canines for the first CPAP machine, invented in 1980 by Sydney sleep expert Dr Colin Sullivan.

Doc Sullivan chanced on the idea of using a vacuum cleaner to ameliorate the deafening snores emitted by dogs with pushed-in faces such as pugs, bulldogs and boxers.

The RSPCA's stance on this novel notion of animal testing is not on record.

Anyway, the experiment led to doc Sullivan rigging up a mask and tube for human use, powered by a vacuum cleaner motor.

Further work ensued at the Asthma Foundation (in relation to the then rampant Sudden Infant Death Syndrome) and the University of Toronto.

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

Believe it or not, before then a tracheotomy was the standard treatment for dangerous snoring - and we're not talking about impromptu procedures performed by a sleep-deprived spouse with a butter knife.

Resmed was incorporated as a US company and admitted to the Nasdaq in June 1995. But in September, the upwardly mobile Resmed changed its home domicile to the New York Stock Exchange.

In a nod to its homeland, the company then listed its chess depository instruments on the ASX in November 1999.

Espousing the 'keep it in the family' philosophy, Michael Farrell took over from his father Peter as CEO in 2013. Dad remains chairman and we're sure he still tells his son to turn out the lights and clean up the mess in the executive bathroom.

## **From CPAP to SAAS**

The CPAP device variants aside, Resmed's growth increasingly is coming from the "connected care" or "software as a service" (SAAS) part of the business.

By that we mean out-of-hospital software that enables the patient to use the devices at home, with data streamed to the clinician. The accrued data itself is also a handy asset in terms of aiding product development.

A string of recent acquisitions has extended Resmed's reach to internet-based monitoring of sleep devices, as well as broadening its presence in chronic obstructive pulmonary disease (COPD) - an ever-expanding market as the wheezing populace ages.

Resmed kicked off by acquiring software-as-a-service business Brightree in April 2016 for \$US800 million.

The company then gobbled up Healthcarefirst and Matrixcare in late 2018, for \$US126 million and \$US750 million respectively.

Healthcarefirst provides services to home health and hospice agencies, while the Minnesota-based Matrixcare provides software to more than 15,000 providers such as nursing organizations, retirement homes and home-based care providers.

Last year, Resmed went out on a wing and bought the Wisconsin-based Propeller Health Solutions for \$US225 million. Propeller markets sensors that attach to an asthma inhaler or COPD drug delivery device, pairing with a mobile application to track medication usage.

Propeller also provides “connected health” services for COPD and asthma sufferers.

With its acquisitive appetite yet to be sated, in January, Resmed bought Snapworx, a private software company supporting the re-ordering of medical supplies.

## **Financials and performance**

In late January, Resmed reported second (December) quarter non-GAAP earnings of \$US176.3 million, up 22 percent on revenue of \$US736.2 million (up 13 percent).

Mr Farrell (Mick) highlighted the “superb” performance of the mask division, especially in the US where the company has been increasing market share. “Customers are voting with their wallets and they are voting for Resmed,” he said.

Globally, devices accounted for close to half of Resmed’s sales with a further 38 percent derived from “masks and others”. But reflecting the growing importance of the connected care division, SAAS sales now account for 12 percent of total revenue, compared with 9.6 percent in the December 2019 quarter.

The US, Canada and Latin America remain Resmed’s most important market, accounting for 67 percent of sales compared with 65 percent previously.

Investors liked the January 31 results, sending the stock up 74 cents or three percent, in a coronavirus-infected market.

Broker EL&C Baillieu dubbed the result as “robust”, but said the SAAS growth was a tad soft. “Resmed continues to benefit from having the broadest portfolio, having launched five new masks in the past 18 months,” the firm says.

To keep ahead of pesky rivals, Resmed this year is devoting 6.8 percent of its revenue to research and development.

The company can’t rest easily: rival Fisher & Paykel Healthcare has just launched the Evora, a minimalist nasal mask to compete with the Hyundai i30 ... sorry ... AirFit N30i.

## **Alleged kickbacks result in \$US39.5 million blowback**

Resmed may be in a purple patch but not everything is going its way.

In mid-January the company agreed to settle a civil case with the US Department of Justice for \$US39.5 million, with another \$US2 million payable to various US states.

The payout stemmed from allegations including that Resmed provided products to sleep clinics free or below cost, to induce patient referrals.

Such behavior breaches the Anti-Kickback Statute which relates to services reimbursable by Medicare or Medicaid.

The settlement did not involve the company admitting liability.

Resmed's line is that settling the matter was more efficient than satisfying the government's request for screeds of documents.

But the company did enter a so-called Corporate Integrity Agreement, requiring it to implement additional controls around product pricing and sales, with internal and external monitoring of referral sources.

The regulator's key concern was outlined in a statement by the US Attorney for the Eastern District of New York, Richard Donoghue.

"When companies give free equipment to doctors for the sole purpose of generating business and increasing their bottom lines, federal health insurance programs should not foot the bills," he intoned. "This case rights that alleged wrong by Resmed."

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

One might think that Resmed is a mature play in a mature category, but management believes there's plenty of CPAP growth to be achieved.

Resmed cites a global market of 936 million people with mild to severe sleep apnoea - 54 million in the US - with about 80 percent of them undiagnosed and untreated.

(Mrs Crucible included, just quietly).

The company also says it has "helped" 100 million out-of-hospital patients to date and wants this coverage to rise to 250 million patients by 2025.

Management also estimates a global COPD market of 400 million sufferers. "We don't believe these people are well served by the global healthcare system today," Mr Farrell says.

"Many are frequent visitors to emergency wards."

Research house Markets and Markets estimates the global value of respiratory care at \$US20.6 billion in 2019 and forecasts the sector to grow to \$US31.8 billion by 2024 (a compound annual growth rate of nine percent).

These days, have-a-go Aussie hero Resmed is worth an eye watering \$35 billion – a healthcare sector feat surpassed only by the \$143 billion market cap CSL.

The aforementioned legal hitch aside, it's business as usual as Resmed continues to roll out the medical device equivalent of turbo-charged models with sports trim, sun roofs and heated leather seats.

***Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. Hopefully he is not boosting Resmed's customer base by boring his readers to snores.***