



Biotech Daily

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Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Resmed

By **TIM BOREHAM**

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

Share price: \$26.70; **Market cap:** \$38.85 billion

Shares on issue: 1,455,079,340 (CDI equivalents)

Financials (December 2020 first half):** revenue \$US1,552 million (up 9.5%), net income \$US391.8m (up 26%), earnings per share \$US2.68 (up 25%), cash of \$US256 million, debt of \$US826 million, net debt \$US570m

* Ten CDIs are the equivalent of one NYSE ordinary share

** Non-GAAP (generally agreed accounting principles) measure is used, which adjusts for items such as amortization of acquired intangible assets and restructuring expenses.

Chief executive officer: Michael Farrell

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

Identifiable major shareholders (US stock): Vanguard 10.3%, Black Rock Inc 6%, WCM Investment Management 6%, SSgA Funds Management Inc 4.5%, Capital Research and Management 3.6%, Fidelity Management 3%.

When it came to the revenue opportunities presented by the coronavirus, the sleep disorders house wasn't caught napping during the "once in a century respiratory medical pandemic".

Used to power its continuous positive airway pressure (CPAP) therapy units, Resmed's ventilators were ideal for Covid-19 sufferers with mild to severe breathing difficulties.

So, the business shift was not so much a full-on pivot for the company, as a gentle sideways shuffle.

History shows that Resmed enjoyed a bumper March and June quarter last year, as coronavirus related ventilator sales more than compensated for a decline in new patients seeking sleep therapy.

"Clearly 2020 was an unprecedented year for companies across every industry and there was much suffering around the world," says Resmed chief Mick Farrell (son of founder Peter).

"But we see some blessings: we were able to be there during the emergency and provide 150,000 of them where they were needed."

Hearteningly, Resmed's December quarter (and December half) results released last week show the company is managing a return to more stable conditions, with half year revenue and income increasing 10 percent and 27 percent respectively.

Yes - the virus still rages in the US and Europe. But the company reports that ventilator demand from hospitals has now "largely been met".

As we will discuss, Covid-19 impacted Resmed in multiple unexpected ways - some positive and some negative.

Resmed: a tireless growth story

Resmed evolved from the first CPAP machine invented in 1980 by Sydney sleep expert Dr Colin Sullivan.

Believe it or not, the crude device was based on a converted vacuum cleaner and was intended to quash the deafening snores of certain dogs.

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

These days, management's narrative is about digital health: home-based care, based on internet monitoring of sleep behavior.

Resmed sells in 140 countries - either directly or via distributors - and employs 7,500 "Resmedians" (that's "staff" to you and me).

Still, the restless US market accounts for just over half of revenue.

The company is also super keen on emerging Asian markets and geographies such as Germany, where reimbursement trends are favorable.

Covid sales become a non e-vent

In the early stages of the pandemic, Resmed pledged to triple its ventilator ('vent') output and ended up producing 150,000 in the June half, a 350 percent increase.

(The company notes that it's not so much about ramping-up production as having the distribution networks that ensure the devices are getting to the right places).

In the June quarter, Resmed chalked up a revenue benefit of \$US35 million (\$A45 million), peaking at \$US124 million in the June quarter and then abating to \$US42 million in the September stanza.

In this context, investors were heartened that Resmed managed to increase its overall device sales by five percent, while demand for masks and other peripherals rose nine percent.

Mr Farrell says Resmed's overall sales have been restored to 70 to 90 percent of pre pandemic levels in the US and 80 to 90 percent in Germany (reflecting broader European patterns).

In China - where the sharpest declines were seen – patronage has returned to 70 to 75 percent of pre pestilence levels.

The virtues of The Virus

The plague has also produced some unexpected benefits for Resmed, in terms of increasing awareness of "respiratory hygiene".

This resulted in improved adherence (clients actually using the CPAP contraptions) and increased re-ordering of masks, tubing and humidifiers.

"It's a complex equation and we are working through the variables," Mr Farrell says.

He says in the early stages of the pandemic, some patients feared using CPAP machines would pump more viruses into the room.

Unlike the one about Covid being engineered by Bill Gates - with possible help from the whole Jewish diaspora and space lasers - this one was quashed as fake news.

Mr Farrell says the crisis also boosted the awareness and adoption of remote patient screening diagnosis as well as remote patient monitoring and management.

In other words: digital health.

"We have seen this crisis deliver the importance of healthcare outside the hospital," Mr Farrell says. "And that's where Resmed competes for more than 90 percent of its business and where we add value for customers and where we win."

The rise and rise of ‘connected care’

Software-as-a-service, or ‘connected care’ is an emerging - but increasingly material - business for Resmed.

By that, we mean out-of-hospital software that enables the patient to use the devices at home, with data streamed to the clinician.

In the December quarter, software-as-a-service revenue rose six percent to \$92 million and now accounts for 11 percent of total revenue.

Recent acquisitions have extended Resmed’s reach to internet-based monitoring of sleep devices, as well as broadening its presence in chronic obstructive pulmonary disease.

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 Matrixcare provides software to nursing and retirement homes and home-based care providers.

In 2019, Resmed paid \$US225 million for the Wisconsin-based Propeller Health Solutions, which makes sensors to track asthma or chronic obstructive pulmonary disease (COPD) medication usage.

Mr Farrell says there’s a more permanent shift to digital healthcare beyond Covid.

“We have also seen national governments including Japan, France and the US adopting models and taking action to accelerate digital health adoption,” he says.

“It provides better availability of healthcare, excellent quality care and significantly lower costs for healthcare systems.”

Finances and performance

Last October, management guided to a “sequential” increase in demand following the Covid disruptions (such as folk not keeping sleep clinic appointments).

Indeed, a U-shaped - rather than a more violent V-shaped - recovery has transpired.

Resmed’s June half revenue surged 10 percent to \$US1,552 million with profit (‘net income’ to our American friends) soaring 27 percent to \$US367 million. More reflecting the post-Covid landscape, December quarter revenue gained nine percent to \$US800 million, while profit rose 12 percent to \$US179.5 million.

Management flags “solid high single-digit” revenue growth for the rest of the year, with double-digit profit growth. This is despite lower patient activity “and little or no incremental benefit from ventilator sales”.

Meanwhile, Resmed has been reducing its sizeable debt, the result of the aforementioned acquisitive binge. The company's current net debt of \$US570 million and \$US1.5 billion of untapped facilities means it's well placed for bolt-on purchases.

Alternatively, management hints that the company might resume a shelved share buy-back program.

Resmed's ASX-listed shares have traded between \$18.10 and \$30.08 over the last 12 months.

Taking a breather in former growth market

About five years ago, Resmed made some to-do about entering the portable oxygen concentrator (POC) sector: those mobile tanks and masks wheeled around by folk with COPD and other serious respiratory issues.

During the quarter the company quietly closed this fledgling business.

Mr Farrell says the POC market is not as attractive as it used to be, for reimbursement and other reasons.

"We entered the POC market as way to engage with stage two and stage three COPD patients," he says.

"Since then, we acquired Propeller which gave us access to early-stage patients. Of course, we have core non-invasive ventilation and life support ventilation for more severe COPD patients."

The POC closure cost \$13.9 million in "restructuring expenses", but no more imposts are expected and the closure is expected to be immaterial to future revenue and earnings.

Dr Boreham's diagnosis:

If only because Resmed has been around for so long, it's easy to assume the company's growth prospects have peaked.

Until the digital health push, the gains seemed to be eked out by tweaking the mask and pump range, rather like a car-maker dollying up an ageing vehicle model with more cup holders.

The raw stats are that 936 million people globally suffer from sleep apnoea, with a further 380 million afflicted with COPD (the number two killer and third biggest reason for hospitalizations.) A further 340 million suffer asthma.

So that's an addressable market of 1.6 billion, compared with Resmed's customer base of 118 million and a target of servicing 250 million out-of-hospital users by 2025.

Further growth will come from improving adherence among existing patients and deriving revenue from cloud subscriptions - and the eight billion nights of patient data amassed, so far.

We long ago conceded that Resmed was the gift that keeps giving, despite the low compliance rate with CPAP masks and the advent of more sophisticated oral mouthguard-like appliances (a viable alternative for some sleep sufferers and snorers).

If anything, Covid-19 underlined the resilience of its business model, although the still-rampaging virus means business conditions are “dynamic and unpredictable”.

On Morgan Stanley’s reckoning, Resmed is trading on a current year earnings multiple of 40 times, assuming subdued current year earnings growth.

It’s a moot point whether this is excessive, fellow biotech big boys Cochlear and CSL have traded on similar or higher ratios and have always delivered the bacon.

“We get a good night’s sleep,” Mr Farrell says.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. Sweet dreams!