



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 (Chess depository interests or CDIs)

Share price: \$33.84

Market cap: \$49.5 billion

CDI equivalents on issue: 1,462,342,440 (10 CDIs are equal to one NYSE share)

Financials (six months to December 31, 2021): revenue \$US1,798.9 million (up 16%), income (earnings) from operations \$US548.4 million (up 12%), net income \$US438.3 million (up 12%), quarterly dividend per share 42 US cents (up 7.7%), cash \$US194.46 million (down 33%), debt \$US680 million (up 4%)

Chief executive officer: Michael Farrell

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

Identifiable major shareholders (US stock): Vanguard 10.25%, WCM Investment Management 6.2%, Black Rock Inc 5.56%, SSGA Funds Management 4.3%, Fidelity Management 2.8%.

Rather like the top men's tennis players given a leg-up after Novak Djokovic was ejected from the country, the sleep and respiratory giant has been conferred a huge advantage because of a rival's woes.

In June last year, sleep apnoea device maker Philips recalled three to four million of its Dream Station devices because of faulty sound muffling, with the directive later extended to 5.2 million devices.

Philips initially costed the recall at EUR250 million (\$A395 million); now it's EUR720 million.

Resmed, of course, doesn't wish its rival ill-will, but it's been quick to capitalize on what chief executive Mick Farrell dubs the "almost infinite" potential to gain market share while Philips sorts out the problem.

On the negative side, Resmed is suffering the component supply problems - especially for semi-conductors - that have beset so many other manufacturers. So, the infinite gains may remain - well - infinite.

That said, Resmed reports \$US125 million to \$US145 million (\$A176 million to \$A200 million) of additional revenue from the Philips recall in the December half year.

By the time the year to June 30 is done, the number is expected to be \$US300 million to \$US350 million - roughly nine percent of total revenue.

"The bottom line is we have at least 12 months more of incredible demand for our Resmed products," Mr Farrell says.

Released in mid-January, Resmed's December quarter (and first half) numbers were a picture of defiance against the pandemic-related disruptions to both supply and patient flows.

About Resmed

Resmed is a leader in obstructive sleep apnoea (snoring) and other sleep-related respiratory disorders. Along the way, Resmed has expanded into diagnostic products, ventilation and dental devices, portable oxygen concentrators and internet cloud-based services.

Resmed sells in 140 countries - either directly or via distributors - but the US by far is its most important market.

Blame Krispy Kreme donuts.

Resmed's technology is based on the continuous positive airways pressure (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.

Until then, a tracheotomy was the standard treatment for chronic snoring and despite the dangerous knife work involved, many patients were willing to be signed up ... by their spouses.

Intriguingly, the CPAP machines evolved from the quixotic efforts of Sydney sleep expert Dr Colin Sullivan, who converted a vacuum cleaner to deal with the deafening snores emitted by dogs with pushed-in faces such as pugs, bulldogs and boxers.

Further dogged work ensued at the Asthma Foundation (in relation to the then rampant sudden infant death syndrome) and the University of Toronto.

Resmed was incorporated as a US company and admitted to the Nasdaq in June 1995. The company then changed its domicile to the New York Stock Exchange and listed its Chess depository instruments on the ASX in November 1999.

Michael Farrell took over from his father Peter as CEO in 2013. Dad remains chair.

Getting acquisitive

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 is used for product development and proving the devices actually work.

The digital push is reflected in a string of acquisitions, kicking off with the \$US800 million purchase of Brightree in April 2016. Brightree is not a Christmas ornament, but a software as a service provider for out-of-hospital care.

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 aged care and other home-based providers.

In December 2018, it was 'chocks away, chaps' as Resmed bought Propeller Health, a Wisconsin-based asthma and pulmonary health specialist, for \$US225 million. Propeller markets sensors that attach to an asthma inhaler or a chronic obstructive pulmonary disease (COPD) drug delivery device and pairs with a mobile application to track medication use.

With its acquisitive appetite yet to be sated, in January 2020, Resmed bought Snapworx, a private software company supporting the re-ordering of medical supplies. In the latest - but no doubt not the last - foray, in October last year, Resmed bought Ectosense, purveyors of the Nightowl cloud-connected home sleep test. The acquisition price was not material and thus not disclosed.

'We never sleep so our patients can'

With seven percent of revenue devoted to research and development, Resmed has developed a constant flow of new products, both in its traditional devices'n'masks domain and the brave new digital world.

The "new" traditional products tend to involve tweaks such as the Airfit N30i mask. With this one, the air tube protrudes from the top of the mask, allowing the person to sleep in any position.

In the digital space, Resmed has 'cloud' based products for patients (Myair), physicians (Airview) and the Brightree range for home medical equipment providers.

In Europe, the company launched Airview for high-risk ventilation patients. Apart from monitoring existing patients, the tool also enables early intervention at the first sign of problems.

Michael Farrell hopes Airview will become the standard-of-care for ventilation "in the same way as our core apnoea platform has".

For non-fans of CPAP, Resmed sells a \$279 device called the Bongorx, a set of soft silicon seals one bungs up one's nose. The Bongos create back pressure (expiratory positive airway pressure) when a patient breathes out.

You will comply!

A well-known shortcoming of CPAP masks is that while they work well, they don't work at all if they're not used and compliance rates are low. Quasi rival Somnomed (mouthguard type devices) cites research that shows 70 percent of patients discard the requisite pumps and masks within months because they're uncomfortable.

Thanks to the digital 'cloud' devices, management notes that the company is now privy to more than 10 million nights of (de-identified) patient data. This in turn will inform the company's research and development push.

The company cites an 85,000 patient, peer review study showing that patients availing of Myair increased compliance by more than 87 percent.

Carried out in conjunction with the French Government medical system, an Alaskan study of 176,000 patients showed a 39 percent decline in mortality when CPAP usage was maintained.

The Covid bit

Resmed was both a winner and loser from the pandemic. On the negative side, sleep clinic traffic dwindled as patients prioritized avoiding the bug over a decent night's kip.

Depending on the geography, patient traffic has bounced back to 85 percent to 100 percent of pre-Covid levels.

Of course, we might not be done with the cheeky virus yet. But Mr Farrell says that with the emergence of remote screening and monitoring, "we expect the impact of new variants to diminish each time".

On the positive side, Resmed benefited from converting CPAP machines to ventilators for use in Covid wards.

This side-line generated \$US160 million of additional revenue in the year to June 30, 2020 and a further \$US70 million in 2020-'21, but is now immaterial.

More broadly, Mr Farrell says, the pandemic has highlighted the importance of “respiratory hygiene” and digital monitoring and telehealth.

Finances and performances

Resmed’s December quarter revenues rose 12 percent to \$US895 million, with net profit gaining by a similar increment, to \$US202 million. The half-year receipts from customers were up 15.9 percent to another record: \$US1,798,900,000 (\$A2,555,500,000).

Global device revenues surged a record 16 percent, while mask revenues climbed eight percent. Overall, Resmed gleaned 52 percent of its revenue from devices, 37 percent from masks and 11 percent from the digital out-of-hospital category.

The company derived 66 percent of revenue from the Americas, with 11 percent hailing from the software-as-a-service business. These ‘cloud’ revenues rose eight percent year-on-year.

The remaining 35 percent of revenue came from Europe and Asia, which just about covers the rest of the world.

The company is sitting on cash of \$US194 million, which might come in handy for another bolt-on acquisition or two.

Resmed shares hit a record \$40 a share in early September 2021, having traded as low as \$23.38 in mid-March of that year.

After listing on the ASX in 1999 the shares traded at 88 cents, so long-term holders can sleep easily.

Eyes on supplies

The Philips fillip aside, Mr Farrell says the 16 percent surge in device revenue was none too shabby given the component supply crunch.

To ameliorate this, management implored component makers to prioritize healthcare clients over mobile 'phone and electronic vehicle manufacturers (and the like). Apparently, this appeal to the (corporate) heart was quite successful. Resmed, in turn, shared the love and prioritized its “highest acuity” patients.

The company has also honed its supply chain to enable new suppliers to be verified more quickly. But with the supply problems unlikely to abate for the next few months, the company has bunged a \$US12 per device supply chain “levy” - a.k.a. a price rise - effective from January 1, 2022.

Dr Boreham's diagnosis:

Despite Resmed's three decades evolution from sleep apnoea pioneer to market gorilla, Mr Farrell describes the sleep and respiratory markets as "chronically underserved".

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.

Furthermore, there are 380 million chronic obstructive pulmonary disease (COPD) sufferers worldwide and a further 330 million asthma patients.

In the shorter term, the company plans to treat 250 million patients by 2025, compared with 133 million treated over the last 12 months.

"We expect to see pent-up demand as Covid-19 eases," Mr Farrell says. "We expect the [software as a service] business to accelerate in the high single digits by the end of 2022."

While the core of the Resmed business remains the somewhat clunky CPAP machines and disposable masks, the company has consistently grown thanks to seemingly endless product tweaks and - most importantly - the expansion into the 'cloud'.

As for the Philips recall, don't underestimate the effort required by this stricken rival to regain market share.

Unless Resmed management falls asleep at the wheel, this growth trajectory should not abate.

Disclosure: Dr Boreham is not a qualified medical practitioner and can only have uninterrupted dreams of possessing a doctorate of any sort.