

ResMed, Inc.

NYSE:RMD

Analyst: Alexandre Thiam

Sector: Healthcare

BUY

Price Target: \$78.55

Key Statistics as of 12/2/2016

Market Price:	\$59.61
Industry:	Medical Appliances/Equipment
Market Cap:	\$8.66b
52-Week Range:	\$50.77 – \$70.90
Beta:	1.06

Catalysts:

- **Short-term:** Clinical trial for CAT-HF
- **Medium-term:** Rising cost of Hospital care
- **Long-Term:** partnerships/acquisition strategy

Company Description:

ResMed was founded in 1989 in Australia by the current Chairman Peter C. Farrell, with the mission to provide a device to treat obstructive sleep apnea. The current CEO is Mick Farrell and was appointed in 2013. The company's headquarters are located in San Diego as the company relocated in 1990 (1 year after its creation). The company is in the Healthcare sector and operates within the Medical Appliances and Equipment industry. ResMed is now a global manufacturer of CPAP masks (Continuous Positive Airways Pressure) and other device assisting people with sleep disorder breathing. The company employs roughly 5,000 people, operates in 100 countries going from Europe to Asia and have revenues of \$1.9 billion for a global Market Capitalization of \$7.5 billion. The company had its IPO on June 2, 1995 and started to be traded on the NASDAQ at \$0.75 per shares (currently traded in the \$60 range). The company recorded 4 splits over the course of its trading days and all of them were 2 for 1 splits.



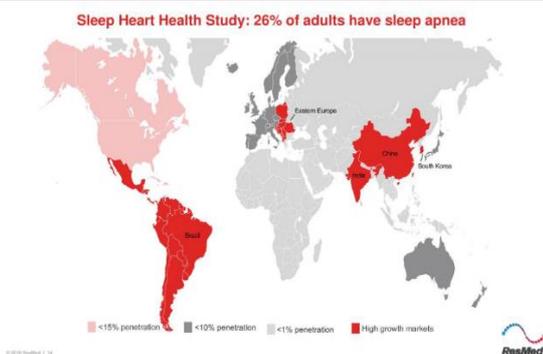
Thesis

- ResMed is showing signs of undervaluation and regarding the low level of volume (214,358 with an avg. at 962,623) that indicates that the stock is not highly followed by analysts.
- The current financials and relative valuation is showing that ResMed is doing considerably better than its peers.
- The current management of the firm is showing efficiencies namely with the growth and expansion strategy.

Macro Outlook

Oxygen therapy is the largest non-drug delivery medical device segment for the treatment of COPD. COPD Chronic Obstructive Pulmonary Disease is a major cause of mortality and obesity. More than 200 million people are diagnosed with COPD throughout the world. 3 million people die each year due to this condition. Lot of undiagnosed people are actually in those growing markets as shown in the map below. Those markets are the primary sources targeted by ResMed and could represent a majority of the company's revenue within the next few years. In India and China, the poor air quality highly contributes to the death of individuals having COPD. According to the World Health Organization (WHO) 11% of the deaths attributed to ambient air pollution were people with COPD. In the U.S. chronic obstructive pulmonary disease are the third leading cause of death, and CEO Mick Farrell said that this handicapping condition was on its way to "achieve the same ranking globally unfortunately".

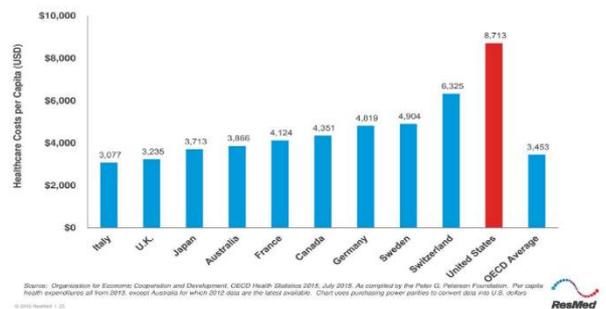
➤ Sleep apnea is a huge, underpenetrated market



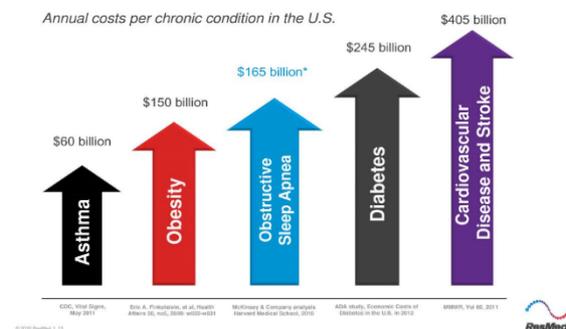
Business Model

Ultimately, the goal of ResMed is to shift care from hospitals to home. The company's clients are mostly individuals as they are not designing devices for hospital use. ResMed wants to broaden its market by making its products cheaper than usual care given in hospitals. In essence, the company wants to reduce costs, and improve outcomes in other words cheap price and decent qualities. The graph below is showing the average healthcare costs per capita in some of the biggest markets.

➤ Significant opportunity to shift care from hospital to home



➤ We can reduce costs of key chronic diseases



Unsurprisingly, the United States which accounts for the majority of ResMed revenues have the highest healthcare care costs. ResMed also has a well-defined growth strategy composed of three steps the CEO Mick Farrell calls "Horizons of growth". The first horizon is "Sleep Disorder Breathing" and represent ResMed core market. This market is still growing (6-7% yearly) but ResMed has actually outperform the growth with a 10% + growth gaining revenues as well as market shares. This market is less than 10% to 15% penetrated which means that there are far more people to be reached in the coming years. For the second horizon called "Respiratory Cares" ResMed is using the cash flow from the first horizon to finance it. It is

composed by COPD masks, NMD (Neuro Muscular Disease) and ALS and is said to be a huge multi hundreds million dollar niche for the company. Last but not least the third horizon called “Cardiology and Monitoring”. It is oriented towards the customers and chronic disease. All in all, the company uses data collected to enhance its technology. Furthermore, the company is collecting data from the first two horizons to launch the third phase. The last phase is supposed become effective by 2019 (2 years to collect the data). The final goal is to operate a change in healthcare client’s behavior to shift from hospital care to in-home treatment.

Products and Innovation

AIR VIEW is a cloud-based system that manages patients with sleep-disordered breathing and respiratory insufficiency. With AirView, physicians, clinicians and care providers can work along efficiently by storing patient's diagnostic, prescription and information in a single, and safe location. The service had over 3 million clients and 2 million + connected at home, 200,000+ diagnostic test up in the cloud 1000+ sign up for ‘My Air’.

My Air is an “online support program and app that is included with any ResMed Air10™ device and automatically sends your CPAP machine data to your computer or smartphone.” It reduces unreach clients by 87% and increase new patient setup by 55%, it also saves labor cost. The service already counts 128,000 clients (2015) and compliance with other medical devices improved by 24%. Company also has other service as I said Air View Diagnostic, Air view, U-Sleep, GoScripts, ReSupply. Overall, the company has over 2 million cloud connected devices liberating data every day.

Concerning innovation, ResMed is considered as the leader worldwide. The company has really strong R&D expenses with “centers of excellence” across Europe, North America and Australia. The company increased its R&D expenses during the last two quarters of 2016 going from spending an average of \$28 million to \$34.5 million. It translate the ambitions of the firm on to confirming its leadership its industry. ResMed has more than 5,000 patents in their IP portfolio which gives them a global leadership in innovation as well as market share in the sleep disorder devices market.

Acquisition and Expansion

In 2016, the ambitions of the company’s ambition took a 360 turn and this could easily be observed through its aggressive acquisition strategy.

Inova Labs: Long-term oxygen therapy with best in class portability and mobility for COPD patients. The company offers laptop sized ventilators. ResMed acquired Inova Labs earlier this year on January 11 2016 but the terms of the deal were not disclosed. CEO of the firm Mick Farrell stated Inova Labs could generate an additional \$500 million in annual sales “We are excited to expand our offerings and solutions for the global COPD epidemic and to progress even more swiftly toward our ResMed goal of improving 20 million lives by 2020. With the acquisition of Inova Labs, ResMed is delivering on its commitment to find further ways to improve the quality of life for tens of millions of people as they deal with COPD, this chronic, progressive disease that literally takes patients’ breath away when untreated.”

Curative: On October 7, 2015 ResMed acquired Curative China’s leader in Respiratory Care. Again, the financials terms of the transaction were not disclosed but the firm is supposed to considerably boost growth in that country as well as local partnerships. ResMed acquired Curative in order to **preserve** its positions in China as they were already the two market leaders. Secondly, the company wanted to **strengthen** its position by enhancing local R&D. Thirdly, ResMed wanted to **grow** by investing in growing markets and increase market shares. ResMed believes that Curative will retain product manufacturing, sales and Research and Development in China.

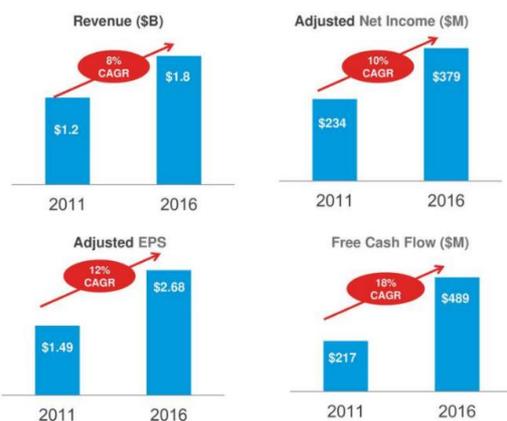
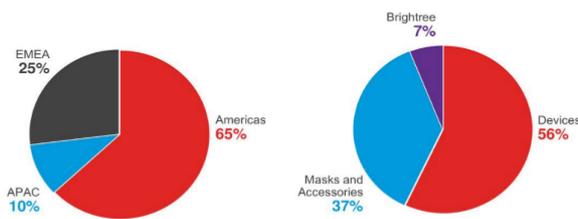
Brightree: In February of 2016 ResMed acquired the leading company in the connected healthcare solutions for approximatively \$800 million. ResMed will primarily fund this acquisition with debt, but Brightree’s financial are showing promising future results with net sales over \$100 and EBITDA of about \$43 million. The transaction included \$300 million from an anticipated future tax benefit that would impact positively ResMed cash flow in the next 15 years. With the present value of the expected tax benefit, the \$800 million invested represent a valuation multiple of 13.5 time 2015 EBITDA. Brightree is expected to increase software growth

opportunities as well as enhance efficiencies for customers, providers and payers. Brightree helps customers improve both clinical and business performances of sleep disorders devices. "This acquisition furthers ResMed's position as the leading tech-driven medical device company and gives our customers new tools to help them increase operational efficiency and improve cash-flow while delivering best-in-class patient care," said Mick Farrell, CEO of ResMed.

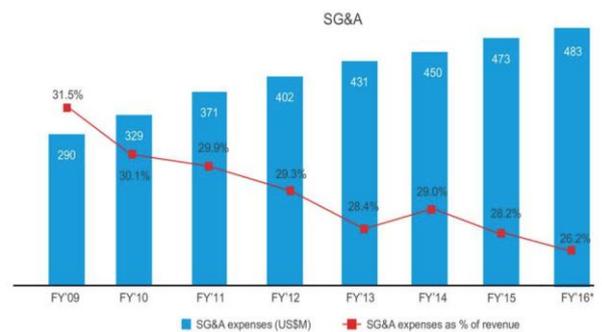
Financials

To get to understand the company a little bit better, it is vital to know where the firm makes most of its money as well as the geographical opportunities tied to different markets. Revenues by geography are showing that ResMed is making most of its money in the United States with 65% of total revenue, the remainder are generated in the rest of the world (35%) with 8.9% in Germany and 7.4% in France. The company only has one single segment that is Sleep Disorder Products. As I shown on the map above, a consequent portion of the population affected by sleep and pulmonary disorders are outside of the U.S. which means that there is still room for the company in improve in those area and generate more sales.

➤ Diversified revenue sources by region & product



On paper, ResMed already resemble like a winning company but when looking at the margins and relative valuation, the firm further distinguish itself from the crowd. The company's P/E ratio is at 24.39 which is considerably lower than industry average at 44.98. In regards to the firm's commitment and discipline, this can only show signs of undervaluation. ResMed is a mature company in a market that could continue to grow. The company has 10.66% sales growth slightly lower than average at 16.14% nonetheless the company remains the only blue-chip among its peers with sales growth higher than 10%. EBITDA margin is at 28.05% above the industry average at 21.57%. The operating margin is at 22.97% which roughly shows the proportion of SG&A of ResMed (Data expressed on the graph below).



Summary

Overall, we have seen that ResMed is doing substantially better than its peer and is set to achieve greater results in a near future. The current shape of the market for sleep disorder devices is promising knowing that 10 to 15% is fully penetrated. In other words, 85 to 90 % of opportunities are in front of ResMed said CEO Mick Farrell. Furthermore, the firm is showing signs of undervaluation. Regarding the low level of volume (214,358 with an avg. at 962,623) that indicates that the stock is not highly followed by analysts and I believe that this under the radar giant will soon be under the spotlights.

ResMed Inc. (RMD)

CENTER FOR GLOBAL FINANCIAL STUDIES

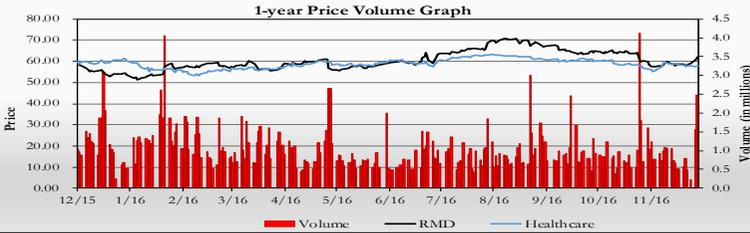
BULLISH

Analysis by Alexandre Thiam
12/2/2016

Current Price: **\$59.54**
Divident Yield: **2.2%**

Intrinsic Value: **\$72.36**
Target Price: **\$78.55**

Target 1 year Return: **34.12%**
Probability of Price Increase: **100%**



Description	
ResMed Inc. designs, develops, manufactures, and markets medical devices and cloud-based software applications that diagnose, treat, and manage respiratory disorders.	
General Information	
Sector	Healthcare
Industry	Healthcare Equipment and Supplies
Last Guidance	November 3, 2015
Next earnings date	January 24, 2017
Estimated Country Risk Premium	3.84%
Effective Tax rate	25%
Effective Operating Tax rate	26%

Market Data	
Market Capitalization	\$8,395.91
Daily volume (mil)	0.42
Shares outstanding (mil)	140.97
Diluted shares outstanding (mil)	141.62
% shares held by institutions	74%
% shares held by investments Managers	61%
% shares held by hedge funds	3%
% shares held by insiders	1.24%
Short interest	11.68%
Days to cover short interest	17.10
52 week high	\$70.90
52-week low	\$50.77
Levered Beta	0.68
Volatility	25.04%

Past Earning Surprises	
Quarter ending	Revenue
9/30/2015	-0.81%
12/31/2015	-3.08%
3/31/2016	-3.31%
6/30/2016	-2.04%
9/30/2016	<u>-3.97%</u>
Mean	-2.64%
Standard error	0.6%

EBITDA	
9/30/2015	-5.42%
12/31/2015	5.15%
3/31/2016	-7.33%
6/30/2016	-0.42%
9/30/2016	<u>-10.45%</u>
Mean	-3.69%
Standard error	2.7%



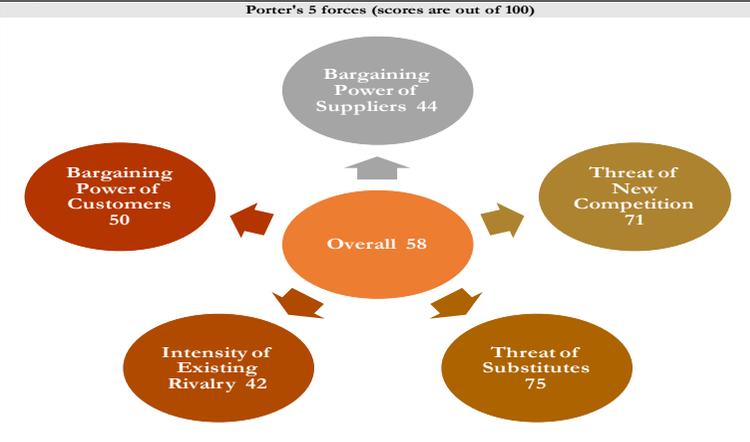
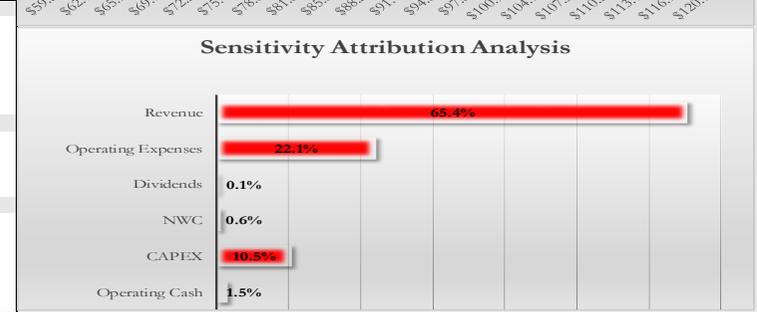
Management	
Farrell, Michael	Chief Executive Officer and President and Chief Operatin
Douglas, Robert	Chief Financial Officer and Chief Administrative Officer
Sandercrook, Brett	President of Americas
Pendarvis, David	Chief Information Officer
Hollingshead, James	
Lacagnina, Frank	

Total compensations growth	
10.18% per annum over 4y	
15.33% per annum over 6y	
1.28% per annum over 6y	
1% per annum over 6y	
-0.31% per annum over 4y	
N/M	

Peers	
Teleflex Incorporated	
Intuitive Surgical, Inc.	
Edwards Lifesciences Corporation	
IDEXX Laboratories, Inc.	
C. R. Bard, Inc.	
Integra LifeSciences Holdings Corporation	
CONMED Corporation	
Inogen, Inc.	

Profitability	
ROIC	18.3%
NOPAT Margin	23%
Revenue/Invested Capital	0.80
ROE	42.0%
Adjusted net margin	22%
Revenue/Adjusted Book Value	1.91
Invested Funds	
Total Cash/Total Capital	20.4%
Estimated Operating Cash/Total Capital	20.4%
Non-cash working Capital/Total Capital	9.7%
Invested Capital/Total Capital	66.9%
Capital Structure	
Total Debt/Common Equity (LTM)	0.14
Cost of Existing Debt	1.77%
Estimated Cost of new Borrowing	4.45%
CGFS Risk Rating	CCC
Unlevered Beta (LTM)	0.62
WACC	6.01%

RMD (LTM)	
20.28%	
26.35%	
0.77	
23.61%	
25.84%	
0.91	
RMD (5 years historical average)	
20.28%	
26.35%	
0.77	
23.61%	
25.84%	
0.91	
Industry (LTM)	
9.72%	
18.4%	
0.53	
11.12%	
16.6%	
0.67	



Revenue growth	
Base Year	10.7%
9/30/2017	8.7%
9/30/2018	6.1%
9/30/2019	7.8%
9/30/2020	7.3%
9/30/2021	6.9%
9/30/2022	6.4%
9/30/2023	5.9%
9/30/2024	5.5%
9/30/2025	5.0%
9/30/2026	4.5%
Continuing Period	4.1%

Valuation	
NOPAT margin	
22.8%	3.04
23.7%	2.55
23.7%	2.36
24.6%	2.50
24.0%	2.48
23.4%	2.45
23.1%	2.46
22.8%	2.46
22.5%	2.45
22.1%	2.44
21.7%	2.43
21.3%	2.41

Invested Capital	
Base Year	\$1,796.17
9/30/2017	\$2,007.78
9/30/2018	\$2,261.42
9/30/2019	\$2,305.01
9/30/2020	\$2,362.55
9/30/2021	\$2,566.81
9/30/2022	\$2,944.75
9/30/2023	\$3,102.71
9/30/2024	\$3,287.18
9/30/2025	\$3,466.71
9/30/2026	\$3,633.38
Continuing Period	

Net Claims	
\$1,419.57	\$72.38
\$1,367.68	\$78.11
\$1,083.91	\$84.11
\$845.62	\$89.85
\$606.25	\$95.66
\$423.28	\$101.11
\$234.15	\$106.65
\$21.91	\$112.42
-\$231.38	\$118.53
-\$550.36	\$125.14
-\$947.15	\$132.43