

# Snoozing no longer: Compumedics

Alan Kohler June 7, 2018 *CEO Interviews*



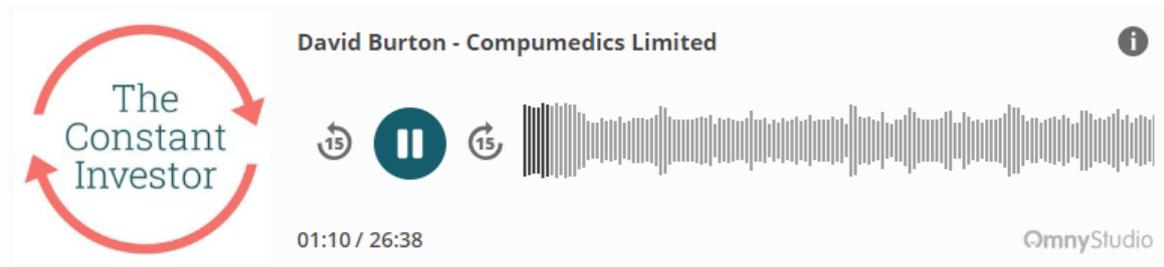
David Burton is the CEO of Compumedics. David Burton started it in 1987 so it's been around for 31 years and it's had its ups and downs. It listed in 2000 at \$0.50, promptly fell to below 10 cents and it had a good sort of six years of difficulty. But just this month, in the last couple of weeks in fact, the share price has popped up from 40 cents to 72 cents and then back down to 60 cents, so it sits at 60 cents. That's because of a big deal that David has signed in China to sell sleep devices.

Basically, the big Chinese company called Health 100, has committed to buy 1 million of their sleep devices at \$100 each on average and suddenly Compumedics has made it. After 31 years it's really on the map now and I think David Burton has finally pulled it off, it would seem. Obviously, the share price hasn't quite settled near a dollar yet but if he continues to perform these deals in China then it could well do that, so I thought we better catch up with him.

David's in Shanghai still talking to Health 100 and bedding the deal down which was announced with the Victorian Premier, Daniel Andrews, last week.

ASX code:	CMP
Share price:	\$0.575
Market cap:	\$101.869 million
PE ratio:	47.92

Here's David Burton, the CEO of Compumedics from Shanghai.



**David, obviously we're here to mainly talk about the new announcement in China which is very exciting and you're in Shanghai dealing with that now. I wonder if we could just go back a bit into the history.**

**You started the company in 1987 when you installed some equipment in Epworth, which is 31 years ago so it's been around a long time and you listed the business, 2000, I think at \$0.50 and the share price promptly collapsed over the following five or six years down to below 10 cents. I just wonder what happened in those years, what went wrong in those years between 2000 and 2006?**

Thanks for that question, Alan, I always appreciate you opening the conversation on such a bright note!

**[Laughs] No, you're in a good place now, I think that's fantastic and I just wanted to find out...**

I'll answer the question. I did say I enjoy your exciting calls. In the early days, Alan, we developed the first computerised sleep centre of its kind for the Asia-Pacific region and that was right at the beginning of really an industry, being the sleep management which includes diagnostics and treatment. We were focused on the diagnostic phase. Back then I developed, at that stage for my GP as it turned out who had an interest in sleep and we installed it at Epworth Hospital and it opened and soon after that we were then developing the next generation which are the portable

systems and that gave us some opportunity with two NASA contracts which gave us quite a bit of exposure.

That led to the world's largest study which was the Sleep Heart Health Study with the National Institute of Health in America and that ended up with 14,000 or more subjects in their home with ambulatory. That was really the second generation of sleep and of course all that excitement, Alan, led to a fairly strong surge in the Compumedics outlook and we grew the company on that and actually listed in 2000, and acquired the world leader in cognitive neuroscience, which was Neuroscan, and also Transcranial Doppler, which is why our core business is currently sleep diagnostics focused and neurology. A lot of these sciences, Alan, to answer your question, they're fairly substantial. There'll be things coming up just like the other areas in Transcranial Doppler, but they're quite in-depth, they require a lot of research and that's what we've been doing over these years.

Lastly, Alan, you would have seen the announcement with the world first MEG machine, which is akin to the MRI of the brain. Neurofunctional disorders are certainly one of the major disease burdens of the modern age. Now, Compumedics is making \$2-5 million dollar machines that are for the brain. Our first installation, similar to the winning of the early sleep systems that you mentioned, Alan, the first MEG is for BNI (Barrow Neurological Institute), which is the number one surgical centre in the world. It has more neurosurgical vascular operations than any other centre and it's also a leading education and training centre.

That's the market for our neurology and of course, this is using super-conductive quantum interference device technology combined with our neural analytics. So yes, to answer your question specifically, some of these things do take a little time, Alan.

**I think the thing is, David, you're a real survivor. I mean, you've been around a long time and you've been growing this company or at least holding it together for a long time. Did you have to change in those middle years, 2006 – around the time of the GFC and so on, did you have to change what the company was doing?**

Well, I like to think that we're more than just survivors, Alan. I mean, I think we're all, including yourself, survivors. Our focus has been on

technology and then vertically expanding on that. Of course, when the tough markets hit we globalised the company more so and we really changed our focus, if you like, to a more balanced scientific business focus in around about 2012-13. That's why you're seeing that fairly recent surge and continued growth in that period. Prior to that we were probably more weighted towards the scientific and technical to be quite honest.

I think the wake-up call for a lot of businesses, including many that I know, realised that in that 2008 era we had to have much more robust financials, we had to have much more in the reserve, so we really changed to a more commercially orientated and globalisation. That was probably the big changing point, Alan, but along the lines you mentioned there was an incredible transition. Now what you're seeing in the space of the five years is that we looked at our core business strategically and we looked closely, realising that our competence was in the sleep and in the neuro-diagnostics. Back then, had a good look at what are the areas that we could have breakout growth and global innovation but also commercial leadership.

They turned out to be transitioning more towards on our brain imaging. The analytics now are in the imaging domain, which was a multi-billion-dollar business and thus, the MEG focus, Alan, to put our analytics with a scanning machine. In the first part of the company we were selling our software packages for \$20-30,000 dollars, but very limited number of sales. Now we're selling machines at \$2-5 million and we have a machine, the MEG Orion which is 50% more sensitive or greater resolution than the market leader.

That's one example and then the sleep, which brings us to the introduction with our deal in China that we just announced which is AUD\$130 million dollars for 1 million Sleep Somfit Systems. We realised that opportunity was in home, but real sleep monitoring. We migrated our analytics in the cloud some time ago, we implemented that across the professional hospitals with our sleep diagnostics. Then we developed in parallel a small disk device that can be worn in the home that gives for the first time everyone in their home access to the same level of analytics in the home for true sleep.

The reason this deal has come off, there's a lot of claims and there's a plethora of so-called devices that are able to monitor home sleep. Non-

contact, breathing linked, rings, all sorts of things, Alan, but there's only one scientific standard in terms of principles of the human sleep monitoring and that requires monitoring real brain, real muscle and real eye movements. These are the signals – in fact, there's more than 11 signals that we've incorporated in this small disk device, but we haven't taken the short-cuts, if you like, to by-pass the real science. Suddenly you're getting medical grade accuracy in the home on a daily basis instead of a once or twice in a year or a lifetime at the Sleep Lab.

**Could you describe the device for us? When you say it's a disk, what does it look like, how do you wear it?**

Well, it's about a 25 millimetre – similar to a coin. It's probably 4 or 5 millimetres thick, very light. It's only 25 grams. It simply attaches to a band-aid type device on the forehead and the band-aid type device is a sensor which once again a quality medical grade sensor. That can be thrown away so you have that ease and also reduction of cross infection and the like. The little sensor can be re-used. It's battery, blue-tooth, it links to the mobile phone and it utilises the power of the cloud computing to produce a full analysis report for your study during the night.

You may wonder, why bother with all of that? Well, sleep is clearly the third pillar of health along with nutrition and exercise, but it's never been available to us, Alan, in our home. It's always been an exercise where we have to go to a specialist centre or a hospital university. That's why so many gadgets have popped up, but what's important about sleep is there's actually – we all have three or four cycles. These cycles go through wake, stage 1, 2, 3 and dream sleep. Now, if we don't get enough of that deep sleep, which is like stage 3 sleep – which can only be measured, by the way, and dream sleep, only be measured with real brain waves, real electromyography or muscle activity and real eye movements, electroencephalography and electrooculography.

These measures are what our device does, but obviously transparent to the user without any wires, just a little disk popped on the forehead and our analytics that we've developed over 30 years. That's an example of transitioning, if you like, our focus on science to a real commercialisation app and that's what's powered this deal. It puts us well ahead of the field for obvious reasons, real point of care sleep in the home. You may ask why is everyone interested in that? Well, the majority of mental disorders

such as depression and anxiety also relates to sleep disruption, as are physiological disorders, even diabetes – our insulin generation. It has an enormous impact on our health, Alan, and that's why it's important and that's how it's linked to commerce and the transition of Compumedics' business.

### **Could you describe the deal that you've done in China with Health 100?**

Absolutely. First of all, Health 100, it's the leading health provider for health checks in China. In 2017, Alan, it undertook 20 million health checks ranging from a few hundred dollars to thousands of dollars for each employee. Every employee in China today has a regulatory requirement to have their employees checked. Each year there's a check and this company has the vast market share of the market and now we're in a joint venture with them and part of that joint venture is our Somfit systems and the agreement to order 1 million of those systems at at least USD\$100. You would have read the \$130 million Somfit deal which I believe is the largest deal of its kind certainly in the world.

In the first two years we'll be installing those and 1 million systems, you may think that's a big number but when you consider they're doing 20 million in 2017 and scheduled for 30 million studies, that's health checks in this current year... They currently have 400 health centres which are like virtual mini to major hospitals each, all with brain scanners and top monitoring equipment and will be now the sleep arm of each of those centres. In 2020 they're slated for 1,000 centres. It's a major group – they'll use those just within their daily checks straight away and that's only the kick-off order in the first two years.

**Can you just tell us what exactly you signed last week? Because from what I read, the framework agreement will be signed, I think, within 90 days, then following that the joint venture will be agreed. So you haven't actually signed the joint venture at this point, right? What exactly is the deal that you've done now?**

Sorry, Alan, I don't know where you read that, but it's wrong.

**This is the press release, I'm just looking from the press release.**

It says we signed a framework agreement and there's elements of that that are binding and within 90 days we'll sign the joint venture agreement. It's not an agreement to an agreement to an agreement. The binding clauses include those orders and the essential elements. The JV is more about the logistics, Alan, and such as the details one puts together when they build a new enterprise like this. Not so much aspects such as the binding elements of the deal.

**So you've actually sold a million Somfit devices at \$100 bucks each, that's what you've done now effectively?**

Yes.

**That's fantastic. What's the potential for an increase on that? I mean, is that just, in your view, the beginning of the deal?**

Well, let's put it in context. A study was conducted in China that over 30% of the Chinese population are having sleep disorders of one kind or the other. This group are the number one health check centre in China and they have, as I said, 30 million health checks slated each year. That's not up to date, that's each year. They've grown 40% per annum, this is Health 100. They're listed at about \$15 billion dollars equivalent Australian in the Shenzhen Stock Exchange and they only listed about five years ago, Alan.

They're right in the start of their growth and now we're a major joint venture with them to service their sleep across the group. Yes, I think this is really just a start/kick-off as was mentioned.

**It says in the press release it's an initial 1 million devices.**

Well, that means a kick-off or start-off, Alan.

**It says, 'Health 100 commits to purchasing an initial...' – so they'll buy the devices, so how does the joint venture work? The joint venture is 49% you and 51% Health 100?**

Health 100 is one client of course in China, but the joint venture is going to address the broader market and this really is just an order only for the Health 100, so it's a good strategic venture with the most powerful

healthcare player in China and clearly arguably the world, given China is the collective strongest in terms of growth and baseline these days. Not necessarily 5-10 years ago but times have changed, Alan. This deal is focused on servicing our strategic partner but the joint venture is designed for the more complete market which includes mobile companies, consumer market and what's currently today seen as the bigger market.

It has the benefit of giving us a secure strategic partner who can utilise these units in an ongoing and growing basis, by the way, as well as by setting up the joint venture clearly, we have access to benefits in China such as expediting the regulatory aspects, understanding the China business and getting access to that upper tier of the consumer market and other areas of the market, hospital networks and the like that otherwise with the Somfit in particular we wouldn't have had access to.

**Just to be clear though, you're selling 1 million devices to Health 100, they've committed to that and then your joint venture with them will sell those Somfit products to the rest of the Chinese market, is that the idea?**

That's right. The joint venture will be setup to provide the service, the ongoing support, the Chinese focused development and the broader distribution of Somfit and related platform products across the greater China. It's specific to the Greater China. The 1 million units doesn't include the whole world. We still have full rights on that. It's just for the China market and Somfit focus primarily.

**Are you selling the Somfit devices elsewhere in the world already or is that still to come?**

No, naturally on the back of this deal we're now looking at entertaining those approaches at a more serious level. We've seeded the market with earlier conversations but clearly we're looking for good corporate partners in regions like USA, Europe and the rest of the world who obviously have a similar demand for enabling the third pillar of health which is sleep monitoring in the home for everyone. By the way, at a typical device price of \$2-400, Alan. To be able to monitor your sleep every night with a system that's actually based on medical grade technology and the principles of science, that's probably a lot better than what we see today,

which is gadgets costing similar but only offering surrogate measures or indirect measures of the true sleep measures.

### **What's your margin on those devices?**

Well, on those sort of scales, clearly we see much more handsome margins. When you're talking about setting up production of units in a million they're naturally in terms of automation and the processes far better now. We haven't exactly released our margins yet, Alan, but they're quite attractive based on the volumes and the repetitive scale, and particularly the fact that we've now got access to some of the best manufacturing availability in the world which of course is China.

**I'm just trying to get a sense of the profit, the sort of operating leverage that you can achieve out of this. I'm looking at your presentation for the first half, you reported sales of \$16.1 million and a gross margin on that of 58%, but the net profit, the profit after tax, was \$700,000. Obviously, there's quite a lot of fixed costs in there, fixed expenses, \$8.6 million. The sense would be, presumably, as your sales line grows, the fixed costs will enable a fair bit of operating leverage, is that reasonable?**

That's correct. As you'll be aware about, clearly with a company like Compumedics we'd be more of a scientific and instrumentation, where there's few sales at large costs but the actual scientific expertise and the cost base is quite large to cover the universities and hospitals as they're clearly very demanding and complex installations. Whereas, when we move into a scale function, whether it's a consumable device – Somfit has a sensor which is a consumable and the device itself, these are all mass produced and therefore, wide scale usage and they're a repetitive manufacturing function versus each system being customised for a specific hospital.

The cost base is significantly lower. The EBITDA is obviously significantly higher and it's more of a commercialisation of our scientific business of the past, Alan, and that's that change I mentioned towards the 2008 GFC and beyond. We produced the strategy which looked at just the commercialisation aspects and this is a typical way for us to commercialise the sleep strength of our business, with more of a mass scale, higher EBITDA, more coordinated manufacturing.

**It's quite a transformation of your business in a way, isn't it?**

You could say that, Alan. It's certainly the biggest transformation to date for the reasons we said. 1 million units – typically we sell hundreds of units per year and we invest enormous resources, now we're dealing with a company, Health 100... Health 100, Alan, just to give you an idea – people might say they're going to get indigestion, they're going to choke, they can't handle this... Well, Health 100 employ 40,000 people just for China. That's 15,000 people or more to be mobilised with the Somfit in terms of the sales and the ongoing support and they're our major strategic partner in the joint venture, so there's a vested interest in them getting it right and supporting us. Clearly that's a totally different outlook for Compumedics, as you well noted, in terms of the type of market model, the EBITDAs, the scale of the profitability.

**Just to get the pricing right, you said that the price for the device to Health 100 is \$100, but you seem to be saying that for elsewhere in the world it's going to be \$2-400 dollars, is that right?**

Well, if you consider Health 100, that's US Dollars, Alan. When you're talking China, we talk US. When you consider the number ordered, I think that's reasonable for both.

**Yes – no, no, I'm not criticising it, I'm just wondering if I heard you right? That was right?**

Well, I don't know what you heard but I think you heard me right.  
[Laughs]

**[Laughs] Okay. Is the price in China always going to be \$100 per device?**

No, I didn't say that. What the article says, the average price will be at least USD\$100. There'll be a full spectrum of products going up to the more professional usage which will incorporate more complex monitoring and analysis and viewing capabilities and there'll be then the lower cost prices for the entry point in the market. That's why I sort of tried to give you a bit of a spectrum of pricing, Alan.

**I'm just looking at your forecast for this year for the second half and total sales forecast for financial year '18 is \$40 million. Is that now kind of been superseded by what's likely to occur in China?**

Well, for this year we've just announced, as you'd be aware the deal was announced a few days ago on the 31<sup>st</sup> of May. June-end is our financial year, probably a bit much to get the factories and the units shipped out this month, Alan.

**Of course.**

But we will be working hard, don't you worry! It will definitely have an impact on next financial year and in terms of the actual modelling, we've got people like – I think [25:39] Partners have got reports and things either out or on their way out, that gives a bit more of the detail. We're trying to be sensible about it at the same time and avoid too many peaks and troughs on the spiking of the shares. But it's a step by step process and it started with our MEG, which is the neurology domain commercialising, and now we're moving to sleep and I think this is a strong step in the right direction. As you said, we've been around for 30 years, been through the process, we're fairly sensible about this and we're going to take the step and build the organisation to be a major global player. This is just one more step in that direction.

**We'll leave it there. It's great to talk to you, David, and congratulations again on your deal, it's fantastic.**

Thanks, Alan, appreciate the time.

**That was David Burton, the CEO of Compumedics.**

<https://theconstantinvestor.com/snoozing-no-longer-compumedics/?loggedinmember>