Medical Equipment Stocks for Risk-Takers

By Bob Kohut | 07.09.2015

It has been 25 years since Australia has seen a recession but the financial press is abuzz with talk that the remarkable string may soon be broken. Add to our local worries the concerns about a Chinese led slowdown in global growth and you have a recipe for a bumpy road ahead.

Investors who lose sleep over daily, weekly, or monthly swings in stocks should stick with fixed income investments. Investors with an appetite for risk cautiously approach the current investing climate as a possible buying opportunity. Should the doomsday scenarios prove true, are there any safe sectors in which to look for investments?

People need to stay healthy regardless of global economic conditions. You don't forego needed medical treatment because of the potential of a recession. In addition to the defensive nature of the demand for healthcare there are the substantial tailwinds for healthcare stocks from an ageing population and the growth of the middle class in emerging markets.

This is not to say there is no risk with investing in healthcare stocks. Even long-standing and successful healthcare companies are at risk from changing government regulations, new competition, loss of patents, and failure to get regulatory approval of new treatments. The risk is heightened in start-up companies in early stages of development and testing.

According to Shane Storey, head of research at Wilson HTM Investment Group here in Australia, medical equipment stocks are less risky because "devices can find their way into the market faster than drugs, and investors get rapid and authentic feedback as to whether the technology is any good."

Canaccord Genuity analysis crunched the numbers to compare the share price performance of the ASX XJO against ASX medical device companies and ASX drug developers. Here is the chart covering Calendar Year 2013 through early 2015.

Two of the hottest medical device stocks on the ASX in 2015 have slumped by over 10% since the current market declines began in earnest on 19 August.

Nanosonics Limited (NAN) makes a disinfection product called Trophon® EPR to combat HAI's (healthcare associated infections). It is used on ultra sound probes, which cannot be disinfected via heat. Think of the number of ultra-sounds performed in hospitals around the world and you get an idea of the potential of this product.

Impedimed Limited (IPD) has a diagnostic system that can detect an after-effect of cancer treatments called lymphedema, a swelling of arms and/or legs. Both stocks have been on a steady upward trend until the recent market drop. Here is a one year chart comparing the two companies.

These two stocks are not the only medical device manufacturers with potential. The following table includes one stock that bucked the downtrend with a surprising increase, and three others with percentage drops.

Company (CODE)	Market Cap	Closing Share Price 19 August	Closing Share Price 3 September	% Change	Year over Year % Change
Nanosonics (NAN)	$366.5m	$1.70	$1.30	-23.5%	+27%
Impedimed (IPD)	$302.1m	$1.16	$1.03	-11.2%	+133%
Reva Medical (RVA)	$242.7m	$0.57	$0.72	+26%	+397%
Somnomed (SOM)	$126.1m	$2.79	$2.47	-11.4%	+24.4%
Compumedics (CMP)	$45m	$0.31	$0.27	-12.9%	+157%
AtCor Medical (ACGI	$37.8m	$0.24	$0.19	-20%	+102%

Buying on the dip can be a sound strategy if the dip is not due to a fundamental change in the company. For start-ups like these there are few hard numbers to look at, so we are talking about things like regulatory changes, approval delays, or impending competition. Let's look at each of these device manufacturers to see if there is anything afoot that might have contributed to the price drop. Note that all the stocks have seen healthy share price increases year over year; and one, **Reva Medical (RVA)** – a manufacturer of a device to treat coronary artery disease – not only showed the highest yearly increase, but also went up despite the global headwinds of late.
Nanosonics has distribution arrangements in place with Miele in Europe and General Electric in the United States. The company reported its first profit back in February but its 31 July release of quarterly results showed a slowdown in sales, which was expected as the company is establishing direct sales operations in North America. HAI's are an increasing problem likely to lead to stricter guidelines and regulations. This would be yet another tailwind for this company. Nanosonics has been on the radar screen of investors for several years. The company's total shareholder return over three years is 38.2%.

Impedimed's share price took a leap northward back in November when its flagship L-Dex procedure got its CPT1 code – an approval mechanism deeming a procedure medically necessary -- from the American Medical Association for reimbursements at a rate of US$116 per assessment versus the US$30 many analysts had expected. The company reported its Full Year 2015 earnings on 27 August with a 38% revenue increase but a continued loss, increasing from a loss of $3.5 million a year ago to $4.9 million. Investors liked the revenue increase enough to bump the stock price from $1.06 to $1.09.

Reva Medical (RVA) may have seen the most share price appreciation year over year but it also may be the riskiest stock in the table. Coronary artery disease represents a massive potential market for Reva's device, called a "scaffold." Basically it is a non-metallic stent made of a polymer substance that is "bioresorbable," meaning the scaffold disappears as it is absorbed by the surrounding artery. While this sounds revolutionary the company has a single clinical evaluation of 112 patients in Australia, Brazil, Europe and New Zealand that began in December of 2014. The trial is expected to last five years with data released at nine and 12 month intervals

SomnoMed (SOM) has a device called SomnoDent for treating sleep apnea disorders. What is unique about this product is that resembles a simple mouth guard that keeps the mouth slightly open during sleep to allow breathing. Sleep apnea disorders are commonly treated by CPAP (continuous positive airway pressure) devices that are essentially machines that pump air to keep breathing passages open. There is a significant market for people who cannot tolerate a CPAP device. In addition, the cost of the device is far less than a CPAP machine.

The company scored a major breakthrough on 22 June when it announced the US FDA had approved the use of a micro recorder in SomnoDent devices, allowing physicians to monitor and track patient progress. This is the only product with recording capability on the market.

SomnoMed sells its product direct in the Asia Pacific region, Europe, and North America. Full Year 2015 results showed a 13.8% revenue increase along with NPAT (net profit after tax) increase of 47.1%. The revenue rise broke sales records in all three of the company's geographic markets.

Compumedics (CMP) provides computer based diagnostic systems targeting three clinical areas – sleep, neurology, and cardiology. Compumedics systems are sold to hospitals, medical centres, and home care providers.

Full Year Results release on 26 August were positive and resulted in a slight rise in stock price from $0.28 to $0.30 which has since dropped to $0.27, as of 3 September. The company saw sales growth in all its geographic markets – 16% in the US; 110% in Asia; 19% in Europe; and 6% in Australia. Revenues increased 9% and NPAT more than doubled, rising from $0.9 million to $2 million.

Compumedics is expanding in the US, China, and Germany and is planning to commercialise a cloud-based sleep diagnostics platform.

AtCor Medical (ACG) has developed the SphygmoCor system for diagnostic and management purposes in the cardiovascular space. The company operates in the America, Europe, and the Asia Pacific Region. The system is non-invasive giving it a competitive advantage over surgical diagnostic methods. On 11 March the stock price got a big boost when the company announced that the American Medical Association (AMA) was recommending a Category-1 code for AtCor's SphygmoCor blood pressure device. This goes into effect in January of 2016 and AtCor went through a two capital raises in July to raise funds for additional sales and service personnel needed for the January launch. The Category 1 Code has caused some analysts to hype the stock as the "next Impedimed."

Although one can never be 100% certain about anything in share market investing, it does appear that the price drops in all of these stocks was a result of global headwinds, not internal issues.

http://www.thebull.com.au/premium/a/55538-medical-equipment-stocks-for-risk-takers.html