



## SDI Ltd (SDI.ASX)

### *Punching Above Its Weight in the Global Dentistry Market*

#### Event:

- We initiate coverage on SDI (SDI), with a BUY recommendation and a price target of \$1.36/share.

#### Investment Highlights:

- SDI is a developer, manufacturer and distributor of dental restorative products, whitening systems and small dental equipment.** SDI was founded in 1971 and listed in 1985. Over 90% of SDI's sales exported to +100 countries via +500 distributors. The founder/management own c.45% of SDI.
- SDI's core focus has been to develop products in growing market segments that have few players, which in turn generate higher profit margins.** SDI's three key drivers of growth are its aesthetics products: 1) glass ionomers (c.25% y-o-y), 2) composites (c.20%) and 3) teeth whitening (c.+10%). These are highly technical products compared to SDI's mature amalgam solution (silver).
- SDI develops and manufactures its product at a company owned facility in Bayswater, Victoria.** SDI have distribution facilities in German and the USA, whilst it also has packaging facilities in Brazil. Outside of Australia, SDI's customers are distributors, who on-sell to dealers, with the end customer being the dentist. The distributors are generally exclusive to SDI, whereas the dealers also sell competing products. In Australia, SDI sells directly to dentists & dealers.
- Regulation is a barrier to entry:** SDI's products are classified as Class 2 medical devices, meaning registration is required in +100 countries either directly or via consultants or distributors.
- SDI operates in dental restoratives market which is expected to be worth US\$3.5bn by 2019 and growing c.3.0-3.5%**, with certain sub segments like glass ionomers anticipated to grow at a faster rate. Market growth is being driven by the ageing population. Increasing middle class wealth is also driving growth in markets throughout Latin America and Asia, where the greatest rate of growth in dental restoratives is expected to occur.
- In its recent trading update, SDI indicated that constant currency growth is c.10% in the non-amalgam part of the business, with amalgam soft.** Profitability has significantly declined over pcp, principally due to depreciation of GBP against the AUD. Eliminating FX noise and taking a 5-year view, we believe SDI will innovate and grow its high margin non-amalgam business. With the increasing momentum in non-amalgam products, we would not be surprised to see growth of c.+10% per annum (excluding any FX impact). No doubt it will be a bumpy ride.

#### Recommendation:

- We initiate on SDI with a BUY recommendation and a valuation of \$1.36/share.** Our valuation is based on FCF supported by peer comparative analysis.
- Catalysts include:** 1) continued investment in research and development of new products contributing to constant currency sales growth above market growth rates, 2) positive momentum and moving to profitability in the Brazilian market (along with expansion throughout South America), 3) a possible acquisition or organic expansion of a product (CAD/CAM solution) or distributor in a new market. We would not be surprised to see SDI acquired by a larger player down-the-track or merged with a similar sized vendor, such as Coltene.

<b>Rating</b>	<b>BUY</b>
Previous	n/a
<b>Price Target (\$)</b>	<b>\$1.36</b>
Previous	n/a
<b>Share Price (\$)</b>	<b>\$0.76</b>
52 week low - high (\$)	\$0.44-1.16
Valuation (\$/share)	\$1.36
Risk	High

<b>Capital Structure</b>	
Shares on issue (m)	118.9
Market Cap (\$m)	89.7
<b>Net cash/(debt) (A\$m)</b>	<b>0.3</b>
EV (A\$m)	90.0
Av 12mth daily volume ('000)	217

<b>Y/e Jun</b>	<b>FY16A</b>	<b>FY17E</b>	<b>FY18E</b>	<b>FY19E</b>
Sales \$M	74.1	76.3	83.9	94.4
EBITDA \$M	15.2	14.5	16.4	18.9
NPAT Adj. \$M	7.6	7.0	8.3	9.9
EPS adj c	6.4	5.9	7.0	8.4
PER (x)	11.8	12.7	10.8	9.0

<b>Board</b>	
Jeffery James Cheetham	Executive Chairman
Samantha Jane Cheetham	Managing Director
John Joseph Slaviero	Executive Director, COO and CFO
Dr Geoffrey MacDonald Knight	Non-Executive Director
Gerald Allan Bullon	Non-Executive Director
Cameron Neil Allen	Non-Executive Director
Gerard Desmond Kennedy	Non-Executive Director

<b>Substantial Shareholders</b>	
Currango Pastrol Company Pty Ltd	45.8%

#### Share Price Graph



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 The analyst does not hold SDI securities