



SDI Ltd (SDI.ASX)

Working Towards A White Amalgam

Event:

- **1H17A results were at the lower-end of guidance.** Aesthetics provided a positive contribution, while the disappointment occurred in SDI's commoditised amalgam filling product, coupled with FX impacts.

Investment Highlights:

- **SDI revised its FY17E outlook for sales growth of 2%, with non-amalgam sales increasing 10% (prev. +10%) & amalgam sales declining 13% (prev. flat).** FX impacts occurred from GBP/EUR turning 4.6% growth to a decline of 5% in AUD. Eliminating FX noise and taking a 5-year view, we believe SDI will innovate and grow its high margin non-amalgam business. No doubt it will be a bumpy ride.
- **Key metrics in 1H17A results are:** Sales \$34.4m -0.9% yoy, GP \$20.7m -4% yoy, EBITDA \$4.9m -20% yoy, NPAT \$2.0m, EPS 1.7 cents, interim dividend 1.0 cent & net debt \$1.7m. GP was impacted by stronger sales in lower margin markets & FX. Inventory increased +\$2.1m due to stocking Brazil & lower amalgam sales.
- **Aesthetics are the key growth drivers & new products released soon:** Aesthetics sales +13.4% (36% of sales), whitening sales +3.7% (26% of sales), equipment sales flat (9%) & amalgam sales declined 15.1% (30% of sales). New product releases at the Cologne Dental Show are Riva Cem (ionomer cement) & Radii Xpert (equipment) that are likely to contribute to profitability in the near-to-medium term.
- **US operations disappointing, anticipating improvement in 2H17E:** SDI's North American operations were impacted following a sales force restructure, slowdown in the overall dental market (c.40% of US sales are amalgam) & differences between distributor purchasers & sell-through. As SDI is not selling to the end-user directly forecasting can be more challenging. Brazil operations are scaling up & SDI plans to package & distribute its products to SA from this location. Brazil is the only market that has been supportive from FX this half.
- **SDI is a developer, manufacturer and distributor of dental restorative products, whitening systems and small dental equipment:** SDI's core focus has been to develop products in growing market segments that have few players, which in turn generate higher profit margins. Over 90% of SDI's sales exported to +100 countries via +500 distributors.

Earnings, Valuation & Recommendation:

- **We have downgraded our FY17E & FY18E NPAT to \$6.1m (vs \$7.0m) & \$6.5m (vs \$8.3m) due to FX and stronger sales in lower margin markets.** Our revised FCF valuation is \$0.84 (\$1.35), the primary driver being c.5% on-going top-line growth. Further global comparatives are trading on c.20x PER 2018E, whilst Australian emerging industrials are trading on 14.5x (SDI 10.9x). On conservative assumptions this provides around 30% upside to the current share price.
- **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) in the medium-term, a possible acquisition or organic expansion of a product or distributor in a new market. We would not be surprised to see SDI acquired by a larger player down-track or merged with a similar sized vendor, such as Coltene.

Rating	BUY
Previous	BUY
Price Target (\$)	\$0.84
Previous	\$1.36
Share Price (\$)	\$0.62
52 week low - high (\$)	\$0.44-1.16
Valuation (\$/share)	\$0.84
Risk	High

Capital Structure	
Shares on issue (m)	118.9
Market Cap (\$m)	73.7
Net cash/(debt) (A\$m)	-1.7
EV (A\$m)	72.0
Av 12mth daily volume ('000)	229

Y/e Jun	FY16A	FY17E	FY18E	FY19E
Sales \$M	74.1	75.5	79.3	83.3
EBITDA \$M	15.2	13.2	13.9	14.6
NPAT Adj. \$M	7.6	6.1	6.5	6.9
EPS adj c	6.4	5.2	5.5	5.8
PER (x)	9.7	12.0	11.3	10.6

Board	
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

Substantial Shareholders	
Currango Pastrol Company Pty Ltd	45.8%



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 The analyst does not hold SDI securities