



SDI Ltd (SDI.ASX)

Working Towards a White Amalgam

Event:

- FY17e trading update, below expectations.** Aesthetics provided a positive contribution, while the disappointment primarily occurred in SDI's commoditised amalgam filling product, coupled with FX impacts. Results will be released 25th August.

Investment Highlights:

- SDI released a FY17e trading update that has constant FX sales growth of 2%, with flat sales in AUD (FSBe forecast 2%).** Non-amalgam sales increased 4.4% & amalgam sales declined 9%. NPAT is expected to be A\$5.6m (FSBe forecast A\$6.1m) which compares with \$7.6m in FY16a. Eliminating FX noise and taking a 5-year view, it is quite likely SDI will innovate and grow its high margin non-amalgam business. No doubt it will be a bumpy ride.
- Aesthetics are SDI's key growth drivers:** In local currency aesthetics sales +12% (35% of sales), whitening sales +7% (26% of sales), equipment sales declined 4% & amalgam sales declined 7% (30% of sales). Whilst amalgam sales decline improved in 2H17e, we remain cautious heading into FY18e.
- US operations were disappointing with a 6% decline in FY17e and continue to be impacted following a sales force restructure, along with structural changes in the dental market, as the USA market becomes increasingly corporatized** (c.40% of US sales are amalgam). We remain cautious of SDI's USA operations, until we start to see significant improvement in financial results. As SDI is not selling to the end-user directly forecasting can be more challenging.
- 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 changed our recommendation to Neutral (from Buy) and have downgraded our FY17e & FY18e NPAT to \$5.6m (vs \$6.1m) & \$5.9m (vs \$6.5m) due to weak amalgam/USA sales and FX impacts.** Our revised FCF valuation is \$0.60 (\$0.84), following more conservative assumptions. We would prefer to see material improvement in SDI's USA operations before we would buy the stock.
- Catalysts include:** 1) improvements of the financial metrics of SDI's USA operations, 2) continued investment in research and development of new products contributing to constant currency sales growth above market growth rates, 3) positive momentum and moving to profitability in the Brazilian market (along with expansion throughout South America), 4) 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 be acquired by a larger player down-the-track or merged with a similar sized vendor, such as Coltene.

Rating	Neutral
Previous	BUY
Price Target (\$)	\$0.60
Previous	\$0.84
Share Price (\$)	\$0.56
52 week low - high (\$)	\$0.52-1.16
Valuation (\$/share)	\$0.60
Risk	Very High

Capital Structure	
Shares on issue (m)	118.9
Market Cap (\$m)	66.6
Net cash/(debt) (A\$m)	-1.0
EV (A\$m)	65.6
Av 12mth daily volume ('000)	206

Y/e Jun	FY16A	FY17E	FY18E	FY19E
Sales \$M	74.1	74.1	75.6	77.8
EBITDA \$M	15.2	12.4	12.9	13.8
NPAT Adj. \$M	7.6	5.6	5.9	6.4
EPS adj c	6.4	4.7	4.9	5.4
PER (x)	8.8	12.0	11.3	10.4

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	
Currago Pastrol Company Pty Ltd	45.8%

Share Price Graph



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 The analyst does not hold SDI securities