

EMIS Group

Unveiling EMIS-X

At its recent capital markets day, EMIS outlined its plans to reinvigorate revenue growth and unveiled its new platform, EMIS-X, onto which it plans to move all of its software. With new applications just launched and under development, the company expects to expand its addressable market. In the medium term, it is targeting an acceleration of annual revenue growth to mid to high single-digits and an expansion in operating margins from the current 21% towards 30%.

Year end	Revenue (£m)	PBT* (£m)	Dil EPS* (p)	EMIS adj. dil. EPS** (p)	DPS (p)	P/E (x)
12/17	160.4	35.2	43.1	47.0	25.8	21.6
12/18e	170.4	36.9	45.4	47.0	28.4	20.5
12/19e	176.8	39.3	49.8	49.5	29.8	18.7
12/20e	184.1	42.5	54.5	54.6	31.4	17.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **EMIS adjusted EPS – cash accounts for development costs, and excludes exceptional items and amortisation of acquired intangibles.

Plan to unify all solutions on EMIS-X platform

EMIS is developing a new platform, EMIS-X, onto which it will ultimately move all of its software products. It is upgrading EMIS Web to meet the requirements of IT Futures and will shift users over to EMIS-X on a modular basis. To meet NHS requirements for interoperability, the platform is designed to give clinicians the ability to access a comprehensive view of a patient using data from EMIS and third-party software systems. At the same time, EMIS is planning to shift all 40m records hosted in its datacentres to Amazon Web Services (AWS).

Capitalising on strong market positions

EMIS plans to evolve its existing software products across primary care, acute, community pharmacy and Patient, using innovative technology to improve operational efficiency and provide a more joined up service within the NHS. It will also open up the platform to third-party software providers and seek to grow its private sector business to reduce its reliance on NHS funding.

Financials and valuation: Accelerating growth supports upside to share price

The company believes development and support costs can be reduced by running one core code base rather than the multiple products supported by EMIS. Combined with an increase in the addressable market from the new technology being developed and the shift to the cloud, the company is targeting mid to high single-digit revenue growth with operating margins approaching 30% in the medium term. From our DCF analysis assuming revenue growth scenarios of 5–9% pa from FY21, we estimate that successful execution of the growth strategy could provide upside to the current share price of 8–38%.

Capital markets day

Software & comp services

4 December 2018

Price 931p
Market cap £589m

Net cash (£m) at end H118	32.3
Shares in issue	63.3m
Free float	98%
Code	EMIS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.8	(5.3)	(0.6)
Rel (local)	2.8	1.5	3.4
52-week high/low		1050p	705p

Business description

EMIS is a clinical software supplier to the primary, community and acute care markets in the UK, and provides software to the community pharmacy and specialist ophthalmology markets. Its Patient business provides medical and wellbeing information as well as transactional services to patients.

Next events

FY18 trading update	January 2019
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Drivers of new growth strategy

EMIS has historically generated good organic growth from the development and roll-out of EMIS Web and the extension of its software beyond primary care. This has supported a high level of recurring revenues and strong operating margins and cash generation. Its track record from acquisitions has been more varied. Some, such as Rx Systems, have been successfully integrated and have contributed to revenue growth and profitability. Others, such as Ascribe, have struggled as NHS IT budgets have shrunk. Overall, in the last two years, growth has slowed and margins have trended down (see Exhibit 1).

Exhibit 1: Historic financial performance								
£m	2010	2011	2012	2013	2014	2015	2016	2017
Organic revenues	56.9	59.6	86.3	96.5	108.0	142.2	157.5	159.5
Acquisitions CY	5.0	0.0	0	9.0	1.6	0.7	0	0
Acquisitions PY	0.0	13.6	0	0.0	28.0	13.0	1.2	0.9
Total revenues	61.9	73.2	86.3	105.5	137.6	155.9	158.7	160.4
Revenue growth		18.3%	17.9%	22.2%	30.4%	13.3%	1.8%	1.0%
Organic revenue growth		4.8%	17.9%	11.8%	11.9%	4.5%	1.5%	0.5%
Recurring revenues	82%	83%	80%	77%	75%	79%	81%	83%
Normalised operating margin	35.6%	33.4%	32.0%	28.9%	25.3%	23.8%	24.5%	21.8%
Source: EMIS								

Recognising that the business in its current form would struggle to generate growth at the historic higher levels, management has devised a growth strategy to combine its existing strong market position with innovative technology to widen its addressable market and improve operating efficiency. At the same time, it continues to develop its core software to meet the requirements of NHS Digital, in particular to ensure its GP software is selected for the new IT Futures framework.

Source of future growth opportunities

The company outlined the areas from which it believes it can generate growth. This broadly falls into two areas: providing integrated care solutions to improve the operating efficiency of the NHS and EMIS, and the private sector. The table below summarises areas in which EMIS has or expects to develop technology, the current estimated size of the market and the company's estimate of the market size in the medium term.

Exhibit 2: Growth strategy				
Goal	Improve operating efficiency for NHS and EMIS	2018 addressable market	2022 addressable market	Funding sources
Area	NHS integrated care			
	-Primary care	£335m	£672m	NHS global digital exemplars, local integrated care record exemplars, hospital medicines management, health systems support framework, IT Futures
	-Child health			
	-Mental health			
	-Community			
	-Unscheduled care			
	-Social care			
Goal	Double-digit growth	Current addressable market	Future addressable market	
Area	Private sector			
	-Medicine management	£145m	£325m	Eg, Patients, advertising, other tech companies, pharmacies
	-Patient-facing services	£20m	£100m	
	-Partner eco-system	£20m	£100m	
	-UK healthcare blockchain			
	-New markets	tbc	tbc	
Source: EMIS				

Introducing EMIS-X

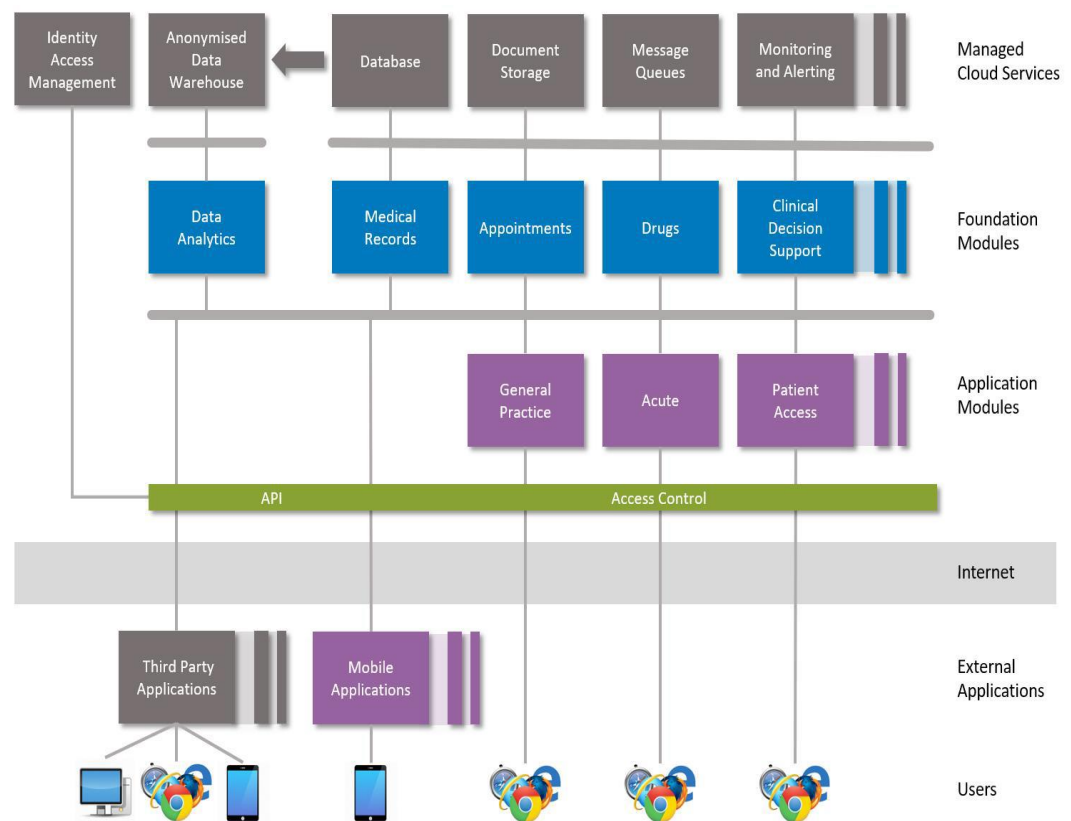
The company announced the development of a new platform, EMIS-X, on which it will ultimately build all of its software solutions. This will bring together an upgraded EMIS Web with the solutions it offers in community pharmacy, acute and Patient. The aim is develop the UK's first integrated clinical platform serving all types of care. This will address the issue of a lack of interoperability between existing IT systems within the NHS and the fact that each citizen tends to have multiple records held by different care providers. This results in a high level of duplication, manual processing, potential clinical errors and inconvenience for both patients and clinicians.

The platform will have the following features:

- Cloud based, hosted exclusively in AWS datacentres
- Multi-tenant with controlled data sharing
- Foundation modules providing common services via application programming interface (API)
- Application modules providing user apps via a user interface
- Supports third-party applications and full interoperability
- Leverages blockchain technology
- Aligned with the NHS England and NHS Digital roadmap and the requirements for GP IT Futures

Exhibit 3 shows conceptually how the platform will work.

Exhibit 3: EMIS-X concept



Source: EMIS

The platform is designed to allow federated working for patient records and appointment booking. For example, a clinician will be able to access a patient's record, which in turn will pull in all relevant information held in different care settings, for example, GP, A&E and mental health records. The information could be held across a variety of different software systems from different vendors, but

will be accessible in one place, giving a full view of the patient's medical history. It will be possible to select specific types of information from records, such as medication, providing more comfort to the patient that the clinician is only accessing the data necessary for that particular consultation. The patient ultimately has control over the sharing of this data and can say no to allowing access to all or particular records.

Half of developers to work on EMIS-X

Over the last 12 months, EMIS has added 150 developers, and now has 450 across the UK and India. Over the next six months, the company expects to move half of its developers to the EMIS-X project. We understand that many of these developers are involved in clearing the backlog of software bugs uncovered in the recent service level issue, but this is close to completion and hence they can be redirected to new projects.

Modular development and cloud migration

The platform is being developed on a modular basis. As new functionality is developed, it will be accessible via an embedded browser within EMIS Web. Functionality will be added progressively until it reaches equivalence with EMIS Web; at that point, the system will move over to EMIS-X.

At the same time, the company will replicate all data to AWS, using a mirroring model to update the cloud-based data every time a change is made to the EMIS Web data that is currently hosted in EMIS's datacentres. The company has not yet received formal permission from NHS Digital to shift to AWS, so has been shifting dummy data to the cloud to test the process. Once permission is received, the company will start replicating data on the cloud. Once the switch has been made to EMIS-X, the company will no longer need to use its own datacentres.

Evolution of existing products and services

GP IT Futures: Represents risk and opportunity

Within Primary Care, by far the largest customer is NHS Digital with EMIS Web used by 4,197 English GP practices (82% of the total number of practices it supports in the UK). The software is available to practices via the GP System of Choice framework, which is centrally funded by the NHS. The framework has been extended until the end of 2019 while the new framework, IT Futures, is developed. The procurement process has started and EMIS expects the formal bid process to start in Q119.

Clearly it is crucial that EMIS is selected as a vendor on the IT Futures framework agreement. The company communicates regularly with NHS Digital to discuss the technical requirements for the new framework. This includes increased flexibility, interoperability and modularity, to support the many emerging care pathways. The move to keep patients out of hospital as far as possible while reducing the pressure on primary care is likely to mean greater use of community care (eg district nurses, specialist clinics, pharmacists) and self-care.

The core capabilities to support GPs are largely already available in EMIS Web. Additional capabilities such as patient services (prescription ordering, telehealth, appointments), document management and data extraction and analysis represent opportunities for new EMIS products.

Introducing new solutions for the GP market

The company demonstrated several new services, some of which are not yet commercially available.

- **Online triage:** via the Patient Access app or on a practice's website, a patient can enter their symptoms and find out more information about possible causes and options for self-care. It can also be used to highlight when a patient needs urgent help, guiding them to call 999 or to see a doctor within 48 hours if the condition is potentially serious. This should reduce the burden on GPs from patients with minor conditions who would not benefit from an appointment, such as coughs, colds, minor injuries, while getting help to patients who need urgent treatment. It should also free up time for receptionists. This was launched in September; Stratford Village Surgery in Newham is an early adopter and has already seen a reduction in unnecessary appointments and a reduction in appointment waiting times.
- **Video consultations:** this is to enable GPs to offer consultations via the Patient Access app. This is one of the main services offered by medtech start-ups such as GP at Hand and Push Doctor.
- **AI-based assistant:** this uses AWS's speech recognition software to provide a live transcript of a consultation (if permitted by the patient) and to bring up relevant information held within the patient's record for faster access by the GP. It can also be used to populate data fields, giving the GP more time to talk to a patient rather than spending the consultation typing into a PC. This is not yet available.

Medicines management: End-to-end solution

EMIS already has a strong position in the overall medicines management market, with the largest market share in community pharmacy (c 37%), the largest share of primary care prescribing (via its 56% market share of the UK GP market), and the number two position in hospital pharmacy (c 32%). Via Patient Access, it is the leader in online repeat prescription requests. Medicines accounted for £17bn of NHS spend in 2016/17 and represent an area for efficiency savings. At the same time, clinical safety needs to be improved to reduce prescribing errors.

The company sees the opportunity to provide an end-to-end medicines management service to serve several and sometimes competing aims: to improve patient outcomes, minimise the cost to the payer and maximise margins for wholesalers and pharmacies. It aims to join up:

- prescribing – via GP or hospital
- sourcing and supply
- dispensing – in hospital or community pharmacy
- the patient taking the medicine – at home or in hospital

This is likely to include supply chain optimisation and centralised fulfilment models, support for patients for medicine adherence/optimisation, new pharmacy services for Patient Group Directions,¹ and data analytics including monitoring and utilisation analysis and intelligence-driven prescribing and supply.

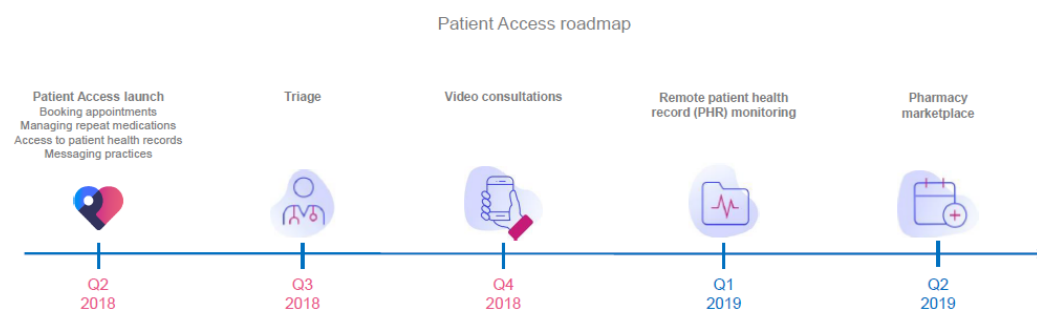
Patient: The patient-facing gateway to health services

The current version of the Patient Access app enables patients to view their GP records (if the GP practice gives permission), read clinical content, book appointments at their GP practice and order repeat prescriptions. The company has highlighted that it wants to increase the services available to patients via the app, to include those developed by EMIS as well as those offered by third parties. The video consultation and online triage services described above are examples of EMIS-developed services that are being added to the app. Other possible services include referrals to other NHS care professionals such as physiotherapists or information on private healthcare providers.

¹ Patient Group Directions allow healthcare professionals to supply and administer specified medicines to pre-defined groups of patients, without a prescription.

Patient generates revenues from three sources: software licensing, advertising and transaction fees when patients use the app to book appointments or order repeat prescriptions. It is targeting additional revenues from appointment booking revenue shares (for private sector services), listing fees and partner API licensing. The chart below shows the near-term launch roadmap for Patient.

Exhibit 4: Patient roadmap Q218-Q219



Source: EMIS

Financial implications of growth strategy

The company believes the development of EMIS-X and Patient should support a step-up in revenue growth from the recent level of c 1% (FY16 and FY17) to mid to high single-digit percentage growth in the medium term. As the move to a single platform will result in consolidation around a single code base, it should ultimately reduce the ongoing costs of development and support, supporting a shift in operating margins from the current 21–22% level towards 30%.

Part of the step-up in revenue growth is expected to come from an expansion in sales to private sector customers, where EMIS sees double-digit revenue growth potential. The table below shows the split of revenues between NHS and related bodies and private sector customers from 2010–2017. In the medium term, the company is targeting a 50/50 split between NHS and private sector customers, from the current 70/30 split. Management noted it is considering acquisitions as part of this growth process.

Exhibit 5: Revenues and revenue growth by source

	2010	2011	2012	2013	2014	2015	2016	2017
Revenues from NHS and related bodies (%)	84.3%	72.9%	69.7%	71.9%	71.9%	72.3%	70.8%	71.5%
Private sector revenues (%)	15.7%	27.1%	30.3%	28.1%	28.1%	27.7%	29.2%	28.5%
Revenues from NHS and related bodies £m	52.2	53.4	60.2	75.9	99.0	112.7	112.4	114.7
Private sector revenues £m	9.7	19.8	26.2	29.7	38.7	43.2	46.3	45.7
Growth in NHS revenues		2.3%	12.7%	26.1%	30.4%	13.9%	-0.3%	2.0%
Growth in private sector revenues		104.2%	31.8%	13.4%	30.4%	11.7%	7.3%	-1.4%

Source: EMIS, Edison Investment Research

The increased investment in development over the next two to three years will be self-funded. The company expects to be able to make productivity gains over this period and expects an element of customer funding. We forecast that EMIS will grow its net cash balance from £4.2m at the end of FY18e to £23.5m by the end of FY20e, providing funds to support additional development costs over and above the level already included in our forecasts. The company also has access to a credit facility if needed but does not expect a significant increase in leverage and does not foresee any impact on its dividend policy.

Successful execution should have positive impact on valuation

We have performed a DCF analysis, based on our current forecasts for FY18–20e followed by growth at three different rates for FY21–27e, each achieving a different level of profitability. We use a WACC of 8.5% and a long-term growth rate of 2%. We assume capex/sales falls to 6% of sales from FY21e, as we assume the shift to the cloud more than offsets any increase in capitalised development costs. We have also factored in lease payments from FY19e, as the introduction of IFRS16 from FY19e removes operating lease costs from operating costs and spreads the cost across depreciation and interest charges.

Exhibit 6 below shows the upside possible if the company is able to achieve growth and operating margins in the targeted range.

Exhibit 6: DCF scenario analysis			
	Low case	Base case	High case
Revenue growth FY21–27e	5.0%	7.0%	9.0%
Operating margin - ave FY21–27e	26.6%	28.0%	28.9%
Terminal operating margin	27.8%	30.0%	30.7%
DCF valuation per share (p)	1002.8	1155.3	1286.7
Upside/(downside) to current share price	7.7%	24.1%	38.2%
Source: Edison Investment Research			

Exhibit 7 below shows the sensitivity of the base case scenario to changes in the WACC or long-term growth rate.

Exhibit 7: Sensitivity of valuation to WACC and terminal growth rate (p)						
		Terminal growth rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
WACC	1155.3					
	7.0%	1360.3	1549.3	1832.8	2305.3	3250.3
	7.5%	1241.5	1393.6	1613.3	1958.5	2579.9
	8.0%	1140.2	1264.3	1438.1	1698.9	2133.4
	8.5%	1052.7	1155.3	1295.2	1497.3	1814.9
	9.0%	976.4	1062.2	1176.4	1336.4	1576.4
	9.5%	909.5	981.7	1076.2	1205.1	1391.1
	10.0%	850.2	911.6	990.6	1095.8	1243.2
	10.5%	797.5	850.0	916.6	1003.7	1122.4
	11.0%	750.2	795.5	852.1	924.8	1021.9
	11.5%	707.6	746.9	795.3	856.7	937.0
Source: Edison Investment Research						

Exhibit 8: Financial summary

	£'000s	2014	2015	2016	2017	2018e	2019e	2020e
Year end 31 December								
PROFIT & LOSS								
Revenue		137,639	155,898	158,712	160,354	170,420	176,780	184,144
Cost of Sales		(12,782)	(12,955)	(14,151)	(14,674)	(15,934)	(16,847)	(17,807)
Gross Profit		124,857	142,943	144,561	145,680	154,486	159,933	166,337
EBITDA		47,645	51,964	52,288	49,222	50,722	53,751	57,268
Operating Profit (before amort. of acq. intang. SBP and except.)		34,787	37,123	38,897	34,895	36,360	38,999	42,180
EMIS adjusted operating profit		32,639	36,553	38,753	37,406	37,336	38,797	42,207
Amortisation of acquired intangibles		(6,269)	(6,509)	(6,639)	(6,717)	(6,718)	(6,718)	(6,479)
Exceptionals		873	(18,500)	(6,714)	(16,988)	0	0	0
Share-based payments		(270)	(684)	(473)	(550)	(1,000)	(1,000)	(1,000)
Operating Profit		29,121	11,430	25,071	10,640	28,642	31,281	34,701
Net Interest		(543)	(449)	(237)	(299)	(50)	(300)	(300)
Profit Before Tax (norm)		34,206	36,625	39,159	35,192	36,946	39,335	42,516
Profit Before Tax (FRS 3)		28,540	10,932	25,333	10,937	29,228	31,617	35,037
Tax		(5,719)	(5,558)	(5,208)	(2,074)	(5,583)	(6,323)	(6,657)
Profit After Tax (norm)		27,617	29,801	32,175	27,989	29,557	31,468	34,438
Profit After Tax (FRS3)		22,821	5,374	20,125	8,863	23,645	25,294	28,380
Average Number of Shares Outstanding (m)		62.8	62.7	62.8	62.9	63.0	63.0	63.0
EPS - normalised & diluted (p)		42.8	46.0	49.4	43.1	45.4	49.8	54.5
EPS - EMIS adjusted & diluted (p)		39.4	45.1	49.2	47.0	47.0	49.5	54.6
EPS - FRS 3 (p)		35.3	7.2	30.4	12.8	36.2	40.2	45.1
Dividend (p)		18.4	21.2	23.4	25.8	28.4	29.8	31.4
Gross Margin (%)		90.7%	91.7%	91.1%	90.8%	90.7%	90.5%	90.3%
EBITDA Margin (%)		34.6%	33.3%	32.9%	30.7%	29.8%	30.4%	31.1%
Operating Margin (before GW and except.) (%)		25.3%	23.8%	24.5%	21.8%	21.3%	22.1%	22.9%
BALANCE SHEET								
Fixed Assets		166,415	143,546	133,292	122,979	118,035	117,201	109,270
Intangible Assets		139,397	121,383	110,953	100,844	94,264	86,344	78,427
Tangible Assets		24,313	22,032	22,187	22,037	23,037	29,487	28,837
Other fixed assets		2,705	131	152	98	734	1,370	2,006
Current Assets		37,221	39,800	46,088	56,900	48,317	64,393	78,997
Stocks		1,550	1,206	1,815	1,633	1,633	1,633	1,633
Debtors		28,732	33,893	39,970	40,148	42,488	44,074	45,910
Cash		6,939	4,701	4,303	13,991	4,196	18,686	29,454
Current Liabilities		(67,665)	(63,819)	(56,158)	(65,131)	(58,329)	(62,506)	(65,026)
Creditors		(54,763)	(51,960)	(51,425)	(65,131)	(58,329)	(60,506)	(63,026)
Short term borrowings		(12,902)	(11,859)	(4,733)	0	0	(2,000)	(2,000)
Long Term Liabilities		(21,063)	(12,481)	(9,080)	(6,734)	(5,020)	(9,716)	(4,361)
Long term borrowings		(5,854)	(1,951)	0	0	0	(6,000)	(4,000)
Other long term liabilities		(15,209)	(10,530)	(9,080)	(6,734)	(5,020)	(3,716)	(361)
Net Assets		114,908	107,046	114,142	108,014	103,002	109,372	118,879
CASH FLOW								
Operating Cash Flow		44,856	42,711	43,657	48,834	40,580	54,342	57,952
Net Interest		(445)	(422)	(324)	(356)	27	(223)	(300)
Tax		(5,247)	(6,896)	(7,655)	(8,139)	(6,168)	(7,628)	(12,012)
Capex		(15,161)	(14,058)	(12,084)	(11,342)	(13,000)	(13,000)	(13,000)
Acquisitions/disposals		(9,959)	(4,587)	(1,790)	329	(9,500)	0	0
Financing		(1,578)	492	881	571	(577)	(577)	(500)
Dividends		(10,792)	(14,532)	(14,006)	(15,476)	(21,157)	(18,424)	(19,373)
Net Cash Flow		1,674	2,708	8,679	14,421	(9,795)	14,491	12,768
Opening net debt/(cash)		13,491	11,817	9,109	430	(13,991)	(4,196)	(10,686)
HP finance leases initiated		0	0	0	0	0	(8,000)	0
Other		0	0	0	0	0	0	0
Closing net debt/(cash)		11,817	9,109	430	(13,991)	(4,196)	(10,686)	(23,454)
Source: EMIS, Edison Investment Research								

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