

EMIS Group

Maintaining profitability

H117 results

EMIS reported a solid H117 despite pressure on revenues and profitability in several business areas. With management expectations maintained, our adjusted operating profit forecasts are substantially unchanged. Over the medium term, we expect the new CEO to make investment/divestment decisions to ensure the group is able to maintain growth and profitability despite the challenging NHS funding backdrop.

Year end	Revenue (£m)	PBT* (£m)	Dil EPS* (p)	EMIS adj. dil. EPS** (p)	DPS (p)	P/E (x)	Yield (%)
12/16	158.7	39.2	49.4	49.2	23.4	18.4	2.6
12/17e	165.0	37.0	45.7	46.8	25.8	20.0	2.8
12/18e	173.7	40.4	49.7	51.3	26.8	18.3	2.9
12/19e	183.5	45.1	55.6	57.2	27.8	16.4	3.0

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.

Adjusting the cost base to reflect market pressures

EMIS generated flat H117 revenues year-on-year on an organic basis and a small decline in adjusted operating profit. Cost reductions arising from the reorganisation programme partially offset the additional investment made in the Patient business. Budgetary pressures within the NHS continued to hold back revenues in the Acute business and depressed growth in Primary Care. Market share improved in Primary and Community Care and is set to increase in Community Pharmacy.

New CEO takes opportunity to review strategy

The recently appointed CEO is taking the opportunity to review the structure of the group to assess which businesses are core to the group's future. Over time, we expect decisions to be made regarding the future of the Specialist & Care and Acute businesses. Options include additional investment to drive organic growth, acquisitions to strengthen market positions in focus areas or divestment of businesses that are unlikely to reach sustainable profitability. Budgetary pressures and organisational change are constant factors within the NHS and in our view, it is crucial that the group is able to operate profitably in this environment.

Forecasts and valuation: Earnings growth is key

Our forecasts are substantially unchanged for FY17, bar an additional £1m in restructuring costs. We have reduced our FY18 revenue forecast by 1% although operating profit is essentially flat. With a slightly lower tax rate, adjusted FY18 EPS increases by 0.4%. We introduce FY19 forecasts for 5.7% revenue growth, 11.4% adjusted operating profit growth and adjusted EPS growth of 11.6%. We increase our dividend forecasts to reflect the higher interim dividend. EMIS is trading on 20x FY17e EPS, at a c 20% discount to its peer group median. Although EMIS is more profitable than its peers, the forecast decline in earnings in FY17 is weighing on the valuation. Evidence of a resumption in earnings growth will be key to share price upside – in the short term, this could include improvement in Acute and Specialist & Care, and in the longer term, evidence that the investment in Patient is paying off. Strong cash generation underpins the nearly 3% dividend yield.

Software & comp services

5 September 2017

Price 914p
Market cap £579m

Net cash (£m) at end H117	10.5
Shares in issue	63.3m
Free float	98%
Code	EMIS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(3.8)	(2.8)	(10.0)
Rel (local)	(2.5)	(1.1)	(16.7)
52-week high/low	1019.0p	807.0p	

Business description

EMIS is a clinical software supplier to the primary care market in the UK (supplying over 50% of UK GP practices), a software supplier to UK pharmacies, and through several acquisitions also supplies specialist and acute care software.

Next event

Trading update	January 2018
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Review of H117 results

Exhibit 1: Half-yearly results highlights			
£m	H116	H117	YoY
Revenues	78.7	79.2	0.7%
Gross margin	91.2%	90.1%	(1.1%)
EBITDA	24.8	23.5	(5.3%)
EBITDA margin	31.6%	29.7%	(1.9%)
Normalised operating profit	17.9	16.7	(6.6%)
EMIS adjusted operating profit*	17.7	17.5	(1.0%)
Reported operating profit	12.1	10.5	(13.8%)
Normalised operating profit margin	22.8%	21.1%	(1.6%)
EMIS adjusted operating profit margin	22.5%	22.1%	(0.4%)
Reported operating profit margin	15.4%	13.2%	(2.2%)
Net interest income	(0.2)	(0.2)	(35.1%)
Normalised PBT	18.0	16.9	(5.7%)
Reported PBT	12.2	10.7	(12.4%)
Tax	(2.4)	(2.1)	(14.0%)
Normalised net income	14.1	13.2	(6.9%)
EMIS adjusted net income	13.9	13.9	0.2%
Reported net income	9.4	8.2	(11.9%)
Normalised dil. EPS (p)	22.4	20.9	(6.9%)
EMIS adjusted dil. EPS (p)	22.1	22.1	0.0%
Reported basic EPS (p)	14.9	13.1	(12.0%)
Net cash	0.7	10.5	1397%
Source: EMIS, Edison Investment Research. *Note: EMIS adjusted operating profit, EMIS adjusted EPS – cash accounts for development costs and excludes exceptional items and amortisation of acquired intangibles.			

EMIS reported 0.7% year-on-year revenue growth in H117. Excluding the £0.5m contributed by the acquisition of Intrelate (December 2016), revenues were flat year-on-year. Recurring revenues grew 4% to make up 84% of revenues. Adjusted operating profit was marginally lower y-o-y due to increased investment in the Patient business. Excluding the additional investment, adjusted operating profit was 4% higher y-o-y. The tax rate of 19.2% was close to the statutory rate for the period. Overall, this resulted in flat adjusted net income y-o-y. Normalised operating profit and net income reduced year-on-year, reflecting the increase in amortisation of capitalised development costs (H116 £3.0m, H117 £3.3m) at the same time as a decrease in capitalised development costs (H116 £2.9m, H117 £2.1m). The company had previously flagged its reorganisation programme – this incurred exceptional costs of £2.5m in H117.

The company closed the period with cash of £10.5m and no debt. The company also secured a new revolving credit facility with Barclays and Lloyds at a reduced cost. The initial facility is for £30m over three years with an accordion arrangement to increase it to £60m with options to extend to a maximum of five years.

An interim dividend of 12.9p (+10% y-o-y) was announced, higher than our forecast of 12.2p. The company expects to match this for the final dividend, making a full year dividend of 25.8p compared to our previous forecast of 24.4p.

Divisional performance: Cost control maintains profitability

EMIS reported divisional results according to the new company structure for the first time (Exhibit 2). The Primary, Community & Acute Care (PCA) division reported a 3% revenue decline, as the Acute business continued to suffer from NHS funding pressures. In addition, discretionary spending in Primary Care came under pressure and hosting revenues declined. Despite this, the company managed to improve profitability, with PCA adjusted operating profit 5% higher and the adjusted operating margin expanding from 25.4% to 27.5%.

Community Pharmacy achieved a solid performance, with 5% revenue growth resulting in 16% growth in adjusted operating profit.

Specialist & Care saw 19% revenue growth as several screening contracts won in 2016 were implemented. This brought with it additional costs, resulting in a small adjusted operating loss.

The Patient division has been split out for the first time. The increase in revenues was more than offset by the increase in investment to build the business, resulting in a loss of £0.33m on revenues of £1.45m.

Exhibit 2: Divisional performance (£m)			
Revenues	H116	H117	y-o-y
Primary, Community & Acute Care	60.26	58.48	(2.9%)
Community Pharmacy	10.35	10.85	4.9%
Specialist & Care	7.05	8.41	19.4%
Patient	1.02	1.45	41.7%
Total	78.67	79.19	0.7%
Adjusted operating profit			
Primary, Community & Acute Care	15.30	16.11	5.3%
Community Pharmacy	2.21	2.58	16.5%
Specialist & Care	0.37	(0.06)	(114.9%)
Patient	0.55	(0.33)	(159.8%)
Central costs	(0.74)	(0.79)	7.9%
Total adjusted operating profit	17.69	17.51	(1.0%)
Reported operating profit			
Primary, Community & Acute Care	9.73	9.76	0.4%
Community Pharmacy	2.71	2.21	(18.6%)
Specialist & Care	(0.11)	(0.39)	243.8%
Patient	0.55	(0.33)	(159.8%)
Central costs	(0.74)	(0.79)	7.9%
Total reported operating profit	12.14	10.47	(13.8%)
Adjusted operating margin			
Primary, Community & Acute Care	25.4%	27.5%	2.2%
Community Pharmacy	21.4%	23.8%	2.4%
Specialist & Care	5.2%	(0.7%)	(5.9%)
Patient	53.6%	(22.6%)	(76.3%)
Total adjusted operating margin	22.5%	22.1%	(0.4%)
Source: EMIS			

Business update

Primary, Community & Acute Care – mixed performance

The business has been restructured to bring the Acute business under the same leadership as Primary Care and Child, Community & Mental Health (CCMH). The majority of the reorganisation was completed in H117; in H2 the company will focus on putting in place the right processes to improve accountability.

In **Primary Care**, the company achieved a small increase in market share from 55% to 56%. The roll-out of EMIS Web in Northern Ireland is underway, with 23 practices live at the end of H1. More than a quarter of CCGs use EMIS Web exclusively in all GP practices in their area (from 51 to 57 CCGs over the course of H1). The company noted that discretionary spending available under the GP System of Choice framework (GPSoc) was tightened up from 1 January 2017, which had a negative effect on revenues in H1.

With two new contracts won in H1, **CCMH** increased market share from 16% to 18% and is on the way to meeting its 20% target for the end of FY17.

The **Acute** business continued to feel the pressure from NHS budget constraints. Revenues declined 14% y-o-y, mainly due to a lower level of non-recurring implementation work. The business

won several smaller contracts for hospital pharmacy systems, bed management and emergency care. The division continues to work with the University Hospital Southampton on its global digital exemplar project.

Community Pharmacy – solid H1

Community Pharmacy maintained its market share of 37%, with a small increase in the total estate from 5,091 to 5,120. The roll-out of ProScript Connect to Celesio's independent estate is about to start, to be followed by roll-out to the Lloyds Pharmacies' estate, which should take the company's market share to c 50% once complete (target FY19). 284 existing customers had been upgraded to ProScript Connect by the end of H117.

Pharmacies have not been immune from the budgetary pressures affecting the NHS – the government has reduced by 7% the fees earned by pharmacies for issuing prescriptions. EMIS believes its software can help pharmacies to offer additional services (eg flu jab, monitoring services) to patients to generate alternative revenue streams.

Specialist & Care – gaining share, but not yet profitable

The Care eye-screening business took its market share from 18% to 26% over the period as it implemented five contracts it won in 2016. These contracts incurred start-up costs in the form of additional staff and extra equipment to support the service. The company expects that profitability should improve over the life of the contracts. The company had previously announced that it had given 12 months' notice on a loss-making contract. This should have a positive impact on profitability from H218.

The company had previously noted that the Specialist software business was bidding for Public Health England's national screening platform; it has just announced that it was not selected. As the new contract is implemented, this is likely to reduce EMIS' market share. However, management does not expect the new national screening platform to be live soon, as it understands that the winning bidder does not yet have working software.

Patient – development well underway

A management team is now in place and the new website was launched in August. Further development is underway to enable fully responsive, multi-device functionality for Patient.info and Patient Access by the end of 2017. During 2018, the focus will be on completing the e-commerce platform. The company expects to be able to deliver the development work more cheaply than originally planned, as it expects to be able to use its in-house development team in Chennai rather than third-party providers for more of the work than originally expected. Rather than reducing the absolute amount invested in Patient, it is likely to result in faster delivery of projects.

New CEO outlines strategy

Andy Thorburn, the recently appointed CEO, outlined his views on the strategic direction of the company. He believes that EMIS should aim to have a number one or strong number two position in each business area in which it operates. Some parts of the company (CCMH, Acute, EMIS Care) are not currently in this position, and the challenge now is to decide whether to focus investment on these areas to grow share organically or via acquisition, to enter into partnerships, or whether to exit from certain business areas.

Outlook and changes to forecasts

The company has guided to FY17 revenues of c £165m with adjusted operating profit in the region of £37m. We have revised our forecasts to reflect the new divisional reporting structure as well as H1 results. We have increased exceptional costs by £1m in FY17 to £5m (the company guided to a total cost of £4-6m for the reorganisation programme). Despite slightly lower revenue forecasts in FY17 and FY18, we assume that the reorganisation programme will enable the company to maintain profitability.

Exhibit 3: Changes to forecasts

£000s	FY17e	FY17e	Change	y-o-y	FY18e	FY18e	Change	y-o-y	FY19e	y-o-y
	Old	New			Old	New			New	
Revenues	166,168	164,955	-0.7%	3.9%	175,354	173,684	-1.0%	5.3%	183,534	5.7%
Normalised operating profit	36,960	36,562	-1.1%	-6.0%	39,794	39,809	0.0%	8.9%	44,451	11.7%
Reported operating profit	25,263	23,844	-5.6%	1.3%	32,097	32,091	0.0%	34.6%	36,733	14.5%
Adjusted R&D operating profit	37,496	37,275	-0.6%	-3.8%	40,854	40,814	-0.1%	9.5%	45,463	11.4%
Normalised EPS (p)	46.0	45.7	-0.7%	-7.6%	49.4	49.7	0.6%	8.8%	55.6	11.9%
Reported EPS (p)	31.3	29.6	-5.4%	-2.6%	39.8	40.0	0.5%	35.1%	46.0	14.8%
Adjusted R&D EPS (p)	46.8	46.8	0.0%	-4.9%	51.1	51.3	0.4%	9.6%	57.2	11.6%
Net cash	8,300	7,162	-13.7%	N/A	26,237	23,929	-8.8%	234.1%	43,970	83.8%

Source: Edison Investment Research

Valuation

On earnings multiples, EMIS trades at a discount to both the mean and median of its peer group, despite forecasts for it to achieve margins at the top end of the peer group. We believe this is due to the combination of lower than average revenue growth leading to lower earnings growth. With recurring revenues at 84% and a strong balance sheet, we expect the company to be able to maintain its above average dividend yield.

Exhibit 4: Valuation multiples

	y/e	EV/sales (x)			P/E (x)			EV/EBIT (x)			EV/EBITDA (x)		
		2016	2017e	2018e	2016	2017e	2018e	2016	2017e	2018e	2016	2017e	2018e
EMIS	31-Dec	3.7	3.6	3.4	18.4	20.0	18.3	15.1	16.1	14.8	11.3	11.7	10.9
EMIS (cash R&D)		3.7	3.6	3.4	18.5	19.5	17.8	15.2	15.8	14.4			
AllScripts	31-Dec	2.6	2.2	1.9	24.0	21.4	17.8	18.3	16.0	13.6	13.2	11.3	9.8
athenahealth	31-Dec	5.4	4.8	4.2	74.3	76.0	58.8	44.2	43.4	34.2	23.0	22.8	18.7
Cegedim	31-Dec	1.5	1.4	1.3	N/A	19.6	13.3	24.6	20.8	15.6	10.2	9.5	8.1
Cerner	31-Dec	4.7	4.3	4.0	29.7	27.3	24.7	19.9	18.4	16.4	14.6	13.2	12.1
Craneware	30-Jun	6.9	6.1	5.3	35.4	31.1	26.7	25.0	21.7	18.7	22.0	19.2	16.5
CompuGroup	31-Dec	5.2	4.6	3.6	51.2	25.6	17.5	35.8	26.7	17.5	23.1	19.9	14.2
Nexus	31-Dec	3.4	3.1	2.9	46.8	34.2	27.5	33.5	25.7	20.1	18.7	15.0	12.8
Quality Systems	31-Mar	2.0	1.9	1.9	19.2	23.5	20.7	13.3	15.9		10.8	12.4	11.6
Servelec	31-Dec	3.2	2.8	2.6	18.0	14.7	13.6	13.5	11.2	10.1	12.5	10.5	9.7
Average		3.9	3.5	3.1	37.3	30.4	24.5	25.4	22.2	18.3	16.5	14.9	12.6
Median		3.4	3.1	2.9	32.6	25.6	20.7	24.6	20.8	17.0	14.6	13.2	12.1

Source: Edison Investment Research, Bloomberg (as at 4 September).

Exhibit 5: Performance metrics

	EBIT margin			EBITDA margin			Rev growth			Div yield			EPS growth		
	2016	2017e	2018e	2016	2017e	2018e	2016	2017e	2018e	2016	2017e	2018e	2016	2017e	2018e
EMIS	24.5%	22.2%	22.9%	32.9%	30.5%	31.1%	1.8%	3.9%	5.3%	2.6%	2.8%	2.9%	7.4%	-7.6%	8.8%
EMIS (cash R&D)	24.4%	22.6%	23.5%											-4.9%	9.6%
AllScripts	14.1%	14.1%	14.2%	19.6%	20.0%	19.7%	11.8%	14.9%	16.5%	0.0%	0.0%	0.0%	17.0%	12.4%	20.2%
athenahealth	12.2%	11.0%	12.3%	23.5%	20.9%	22.5%	17.1%	13.2%	13.6%	0.0%	0.0%	0.0%	40.7%	-2.2%	29.2%
Cegedim	6.1%	6.8%	8.6%	14.8%	14.9%	16.5%	3.4%	6.4%	6.2%	0.0%	0.7%	1.5%	-156%	-278%	47.0%
Cerner	23.6%	23.5%	24.4%	32.2%	32.8%	33.0%	8.4%	8.5%	8.3%	0.0%	0.0%	0.0%	9.0%	8.7%	10.5%
Craneware	27.8%	27.9%	28.3%	31.5%	31.5%	31.9%	16.7%	14.4%	14.7%	1.5%	1.6%	1.7%	10.4%	14.1%	16.3%
CompuGroup	14.6%	17.4%	20.4%	22.7%	23.4%	25.2%	3.1%	12.7%	30.1%	0.7%	0.8%	1.0%	18.8%	100.4%	46.2%
Nexus	10.3%	12.1%	14.3%	18.4%	20.8%	22.6%	10.0%	10.9%	7.9%	0.6%	0.7%	0.7%	9.6%	36.9%	24.6%
Quality Systems	15.0%	12.2%	N/A	18.5%	15.7%	16.2%	3.5%	2.9%	3.8%	3.3%	0.0%	0.0%	13.9%	-18.2%	13.6%
Servelec	23.9%	25.5%	26.2%	25.8%	27.2%	27.3%	-3.3%	13.6%	7.6%	1.9%	2.0%	2.2%	-11.0%	22.4%	8.6%
Average	16.4%	16.7%	18.6%	23.0%	23.0%	23.9%	7.9%	10.8%	12.1%	0.9%	0.6%	0.8%	13.5%*	21.8%*	21.1%*
Median	14.6%	14.1%	17.4%	22.7%	20.9%	22.6%	8.4%	12.7%	8.3%	0.6%	0.7%	0.7%	10.4%	12.4%	20.2%

Source: Edison Investment Research, Bloomberg (as at 4 September). Note: *excludes Cegedim.

Exhibit 6: Financial summary

	£000s	2014	2015	2016	2017e	2018e	2019e
Year end 31 December							
PROFIT & LOSS							
Revenue		137,639	155,898	158,712	164,955	173,684	183,534
Cost of Sales		(12,782)	(12,955)	(14,151)	(15,440)	(17,229)	(18,665)
Gross Profit		124,857	142,943	144,561	149,515	156,455	164,868
EBITDA		47,645	51,964	52,288	50,275	54,022	58,764
Operating Profit (before amort. of acq. intang, SBP and except.)		34,787	37,123	38,897	36,562	39,809	44,451
EMIS adjusted operating profit		32,639	36,553	38,753	37,275	40,814	45,463
Amortisation of acquired intangibles		(6,269)	(6,509)	(6,639)	(6,718)	(6,718)	(6,718)
Exceptionals		873	(18,500)	(6,714)	(5,000)	0	0
Share-based payments		(270)	(684)	(473)	(1,000)	(1,000)	(1,000)
Operating Profit		29,121	11,430	25,071	23,844	32,091	36,733
Net Interest		(543)	(449)	(237)	(150)	(50)	0
Profit Before Tax (norm)		34,206	36,625	39,159	37,012	40,359	45,051
Profit Before Tax (FRS 3)		28,540	10,932	25,333	24,294	32,641	37,333
Tax		(5,719)	(5,558)	(5,208)	(4,859)	(6,528)	(7,467)
Profit After Tax (norm)		27,617	29,801	32,175	29,610	32,287	36,041
Profit After Tax (FRS3)		22,821	5,374	20,125	19,435	26,113	29,867
Average Number of Shares Outstanding (m)		62.8	62.7	62.8	62.9	62.9	62.9
EPS - normalised & diluted (p)		42.8	46.0	49.4	45.7	49.7	55.6
EPS - EMIS adjusted & diluted (p)		39.4	45.1	49.2	46.8	51.3	57.2
EPS - FRS 3 (p)		35.3	7.2	30.4	29.6	40.0	46.0
Dividend (p)		18.4	21.2	23.4	25.8	26.8	27.8
Gross Margin (%)		90.7%	91.7%	91.1%	90.6%	90.1%	89.8%
EBITDA Margin (%)		34.6%	33.3%	32.9%	30.5%	31.1%	32.0%
Operating Margin (before GW and except.) (%)		25.3%	23.8%	24.5%	22.2%	22.9%	24.2%
BALANCE SHEET							
Fixed Assets		166,415	143,546	133,292	125,361	116,930	108,399
Intangible Assets		139,397	121,383	110,953	102,122	92,991	83,860
Tangible Assets		24,313	22,032	22,187	23,087	23,787	24,387
Other fixed assets		2,705	131	152	152	152	152
Current Assets		37,221	39,800	46,088	50,103	69,046	91,542
Stocks		1,550	1,206	1,815	1,815	1,815	1,815
Debtors		28,732	33,893	39,970	41,126	43,302	45,758
Cash		6,939	4,701	4,303	7,162	23,929	43,970
Current Liabilities		(67,665)	(63,819)	(56,158)	(50,925)	(53,518)	(56,445)
Creditors		(54,763)	(51,960)	(51,425)	(50,925)	(53,518)	(56,445)
Short term borrowings		(12,902)	(11,859)	(4,733)	0	0	0
Long Term Liabilities		(21,063)	(12,481)	(9,080)	(9,080)	(9,080)	(9,080)
Long term borrowings		(5,854)	(1,951)	0	0	0	0
Other long term liabilities		(15,209)	(10,530)	(9,080)	(9,080)	(9,080)	(9,080)
Net Assets		114,908	107,046	114,142	115,459	123,378	134,417
CASH FLOW							
Operating Cash Flow		44,856	42,711	43,657	43,619	54,439	59,235
Net Interest		(445)	(422)	(324)	(50)	50	100
Tax		(5,247)	(6,896)	(7,655)	(7,402)	(8,072)	(9,010)
Capex		(15,161)	(14,058)	(12,084)	(12,500)	(12,500)	(12,500)
Acquisitions/disposals		(9,959)	(4,587)	(1,790)	0	0	0
Financing		(1,578)	492	881	(500)	(500)	(500)
Dividends		(10,792)	(14,532)	(14,006)	(15,575)	(16,651)	(17,284)
Net Cash Flow		1,674	2,708	8,679	7,592	16,767	20,041
Opening net debt/(cash)		13,491	11,817	9,109	430	(7,162)	(23,929)
HP finance leases initiated		0	0	0	0	0	0
Other		0	0	0	0	0	0
Closing net debt/(cash)		11,817	9,109	430	(7,162)	(23,929)	(43,970)

Source: EMIS, Edison Investment Research.

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