

EMIS Group

Trading update

Internal review uncovers support issue

In an otherwise in-line trading statement, EMIS announced an issue within its customer and product support processes for EMIS Web where it has not been fully meeting the service level and reporting requirements set by NHS Digital in England. This will result in an exceptional charge (our estimate £9m) and potentially higher ongoing costs in the Primary Care business. A 5% reduction in EPS in FY18e and FY19e is more than discounted in the current share price. Further clarity that the scale and cost of this issue are contained should provide support to the share price.

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	15.7	3.0
12/17e	165.0	37.0	45.7	46.8	25.8	17.0	3.3
12/18e	173.7	38.3	47.1	48.7	26.8	16.4	3.5
12/19e	183.5	43.0	53.0	54.6	27.8	14.6	3.6

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.

Reviewing issues with customer & product support

During a review of customer and product support processes, EMIS discovered that some errors in its EMIS Web GP software were a) not being resolved within required timeframes; and b) were not being reported to NHS Digital as required. Management is confident that the errors do not affect patient safety or data, and is working with NHS Digital to ascertain the scale of the issue. While the costs relating to this issue are yet to be finalised, EMIS expects an exceptional charge in the high single-digit millions. On an ongoing basis, we expect that EMIS will need to deploy additional development resource to this area to resolve the error backlog and to deal with new errors in a timely fashion. Management is confident that this will not affect the ongoing EMIS Web procurement in Scotland although, in our view, it may need to provide additional comfort to existing and potential customers that it has adequate internal controls and resources in place to provide good customer support and meet compliance requirements.

Trading update confirms remaining business in line

Aside from the issue above, the company traded in line with expectations in FY17. We have revised our forecasts to reflect a one-off exceptional charge of £9m in FY17 and higher operating costs for the Primary Care business in FY18 and FY19. This reduces our EMIS-adjusted EPS forecasts by 5.0% in FY18 and 4.6% in FY19. We note that net cash at end FY17 of £14.0m was ahead of our £7.2m forecast, providing some element of cushion for the exceptional costs.

Valuation: Reflects uncertainty

The stock is down 20% on the news. On our revised forecasts, this equates to a P/E multiple of 16.4x FY18e and 14.6x FY19e normalised EPS, compared to 19.4x and 17.3x respectively prior to today's news. On EMIS-adjusted forecasts, the stock is trading at 15.9x FY18e and 14.2x FY19e, which is at a discount to international healthcare software peers and UK software companies.

Software & comp services

18 January 2018

Price 775p

Market cap £491m

Net cash (£m) at end FY17	14.0
Shares in issue	63.3m
Free float	98%
Code	EMIS
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(2.6)	0.8	1.8
Rel (local)	(5.6)	(2.0)	(6.0)
52-week high/low	1,017p	833.5p	

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 events

FY17 results	14 March 2018
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Review of customer and product support processes

The company has announced that during a review of customer and product support processes, instigated as part of a wider review of the business by the new CEO, it was discovered that the Primary Care business had not been meeting all of its service level requirements and reporting requirements to NHS Digital in respect of EMIS Web. EMIS Web is available for use by English GP practices under the GP Systems of Choice (GPSoC) framework agreement. As part of being selected to be on the GPSoC framework, software suppliers commit to providing certain levels of functionality, certain service level agreements (SLAs) and regular reporting to NHS Digital. This includes regularly reporting software errors/bugs to NHS Digital, classified by order of severity.

Management discovered during the review process that some lower-level errors had not been resolved within the relevant timeframe (ie had not met SLAs) and also had not been reported to NHS Digital. The company is confident that none of these errors relates to patient safety or data (if they were, they would have been classified as a higher-level error) but are mainly linked to the usability of the software. It has been working with NHS Digital to ascertain the full extent of the issue.

Initial estimates are for an exceptional charge in the upper single-digit millions of pounds; the company expects to update the market when it has a more concrete estimate. We expect that this charge would include any penalties payable to NHS Digital for missing SLAs and for not adhering to reporting requirements. In addition, it would include the cost of ascertaining the extent of the problem. We would expect an ongoing cost to the business of fixing the existing backlog of errors as well as fixing newly discovered errors within the SLA time limits. EMIS could deal with this either by redeploying existing developers from other project work, or could hire extra staff to undertake the work. We have taken a prudent approach and assumed a higher ongoing level of operating costs for the Primary, Community & Acute Care division in FY18 and FY19.

FY17 trading update

The company also announced that trading for FY17 was in line with expectations, with revenues slightly above the level in FY16. The internal reorganisation is now complete. On a divisional basis:

- **Primary, Community & Acute Care:** Primary care has maintained its market share. The implementation of EMIS Web in Northern Ireland is progressing well and the procurement process for EMIS Web in Scotland is ongoing. In Wales, the company expects an update on the re-procurement process soon. Community grew market share through further contract wins. Acute Care grew in H2, although hospital demand remained subdued.
- **Community Pharmacy:** market share has been maintained and the roll-out of ProScript Connect continues on track.
- **Specialist & Care:** the division saw revenue growth and a return to profitability in H217 (our forecast was for a small loss).
- **Patient:** the Patient.info and Patient Access websites and mobile apps have been refreshed.

Net cash at year-end stood at £14.0m, well ahead of our £7.2m forecast. This should provide some element of cushion in funding the exceptional costs.

Changes to forecasts

We have revised our forecasts to incorporate a one-off charge of £9m in FY17 and higher operating costs of £2m per annum for Primary Care in FY18 (+2.3%) and FY19 (+2.2%). This reduces EMIS-adjusted EPS by 5.0% in FY18 and 4.6% in FY19. We have not updated our net cash forecast for

end FY17, in the absence of detail on working capital and profitability. Therefore, we believe our revised net cash forecasts as at the end of FY18 and FY19 are very conservative. We expect more detail on the precise one-off charge and ongoing costs to the business when the company reports FY17 results on 14 March.

Exhibit 1: Changes to forecasts

£000s	FY17e				FY18e				FY19e			
	Old	New	Change	y-o-y	Old	New	Change	y-o-y	Old	New	Change	y-o-y
Revenues	164,955	164,955	0.0%	3.9%	173,684	173,684	0.0%	5.3%	183,534	183,534	0.0%	5.7%
Normalised operating profit	36,562	36,562	0.0%	-6.0%	39,809	37,790	-5.1%	3.4%	44,451	42,366	-4.7%	12.1%
Reported operating profit	23,844	14,844	-37.7%	-36.9%	32,091	30,072	-6.3%	102.6%	36,733	34,648	-5.7%	15.2%
EMIS adjusted operating profit	37,275	37,275	0.0%	-3.8%	40,814	38,795	-4.9%	4.1%	45,463	43,377	-4.6%	11.8%
Normalised EPS (p)	45.7	45.7	0.0%	-7.6%	49.7	47.1	-5.2%	3.2%	55.6	53.0	-4.8%	12.4%
Reported EPS (p)	29.6	18.2	-38.7%	-40.2%	40.0	37.5	-6.4%	106.1%	46.0	43.3	-5.8%	15.6%
EMIS adjusted EPS (p)	46.8	46.8	0.0%	-4.9%	51.3	48.7	-5.0%	4.1%	57.2	54.6	-4.6%	12.0%
Net cash/(debt)	7,162	7,162	0.0%	N/A	23,929	13,314	-44.4%	85.9%	43,970	31,686	-27.9%	138.0%

Source: Edison Investment Research. Note: EMIS adjusted forecasts – cash accounts for development costs and excludes exceptional items and amortisation of acquired intangibles.

Exhibit 2: 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	52,003	56,679
Operating Profit (before amort. of acq. intang, SBP and except.)		34,787	37,123	38,897	36,562	37,790	42,366
EMIS adjusted operating profit		32,639	36,553	38,753	37,275	38,795	43,377
Amortisation of acquired intangibles		(6,269)	(6,509)	(6,639)	(6,718)	(6,718)	(6,718)
Exceptionals		873	(18,500)	(6,714)	(14,000)	0	0
Share-based payments		(270)	(684)	(473)	(1,000)	(1,000)	(1,000)
Operating Profit		29,121	11,430	25,071	14,844	30,072	34,648
Net Interest		(543)	(449)	(237)	(150)	(50)	0
Profit Before Tax (norm)		34,206	36,625	39,159	37,012	38,340	42,966
Profit Before Tax (FRS 3)		28,540	10,932	25,333	15,294	30,622	35,248
Tax		(5,719)	(5,558)	(5,208)	(3,059)	(6,124)	(7,050)
Profit After Tax (norm)		27,617	29,801	32,175	29,610	30,672	34,373
Profit After Tax (FRS3)		22,821	5,374	20,125	12,235	24,498	28,198
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	47.1	53.0
EPS - EMIS adjusted & diluted (p)		39.4	45.1	49.2	46.8	48.7	54.6
EPS - FRS 3 (p)		35.3	7.2	30.4	18.2	37.5	43.3
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%	29.9%	30.9%
Operating Margin (before GW and except.) (%)		25.3%	23.8%	24.5%	22.2%	21.8%	23.1%
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	58,431	79,259
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	13,314	31,686
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	112,763	122,134
CASH FLOW							
Operating Cash Flow		44,856	42,711	43,657	43,619	43,421	57,149
Net Interest		(445)	(422)	(324)	(50)	50	100
Tax		(5,247)	(6,896)	(7,655)	(7,402)	(7,668)	(8,593)
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	6,152	18,372
Opening net debt/(cash)		13,491	11,817	9,109	430	(7,162)	(13,314)
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)	(13,314)	(31,686)

Source: EMIS, Edison Investment Research

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