

# ifa systems

Forecast revisions

Enhanced products strategy = enhanced profits

ifa systems is enhancing its product strategy to better exploit its leading technology and premium market position in ophthalmology software and clinical decision support systems. The changes are designed to both widen the application of ifa's technology and provide even more predictable revenues. As a result, we are significantly increasing our revenues and profits forecasts for the coming years. Another encouraging development is the ADR listing, which we see as a clear indication of the management's wider ambitions and a potential catalyst of a re-rating of the shares. ifa's shares trade at material discounts to European and US peers and these forecast increases make the discounts even more evident.

| Year end | Revenue (€m) | PBT* (€m) | EPS* (c) | DPS (c) | P/E (x) | Yield (%) |
|----------|--------------|-----------|----------|---------|---------|-----------|
| 12/12    | 7.4          | 0.9       | 23.7     | 3.0     | 31.6    | 0.4       |
| 12/13    | 7.8          | 1.5       | 41.7     | 9.0     | 18.0    | 1.2       |
| 12/14e   | 8.4          | 2.2       | 60.9     | 12.0    | 12.3    | 1.6       |
| 12/15e   | 9.6          | 3.1       | 86.4     | 15.0    | 8.7     | 2.0       |

Note: \*PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

## Widening the addressable market

ifa is enhancing its product strategy to address more geographies and user types. The key part of this is the offering of medium- to long-term finance options for fixed-term subscriptions, making ifa's high-end products more palatable for smaller customers than its traditional upfront licence model. There is also a software rental model, taking ifa's reach further into the smaller ophthalmology clinics market, and even plans for a fee-per-use model too. We do not believe that the changes will stop there. We believe management is looking to find alternative direct and indirect routes to markets for its technologies.

## Forecasts raised

We have added €0.5m (FY15e) and €1.0m (FY16e) in new revenues that, combined with some adjustments to reflect lower costs in FY14, lead to a significant increase in earnings estimates for FY14, FY15 and FY16 EPS up 27%, 46% and 57% respectively (see Exhibit 1 overleaf). It is, of course, very early days for the revised product strategy and, given the nature of the industry, the impact could well be significantly more or less than these first estimates, but for now we regard our upward revisions as conservative.

## Valuation: Forecast increases mean discounts widen

Our valuation work shows ifa's shares to be trading at revenue and earnings multiple discounts to both its US and European peer groups – discounts that we regard as unjustified. Our reverse DCF work shows the current share price can be seen as reflecting 3% revenue growth in the medium term, with ongoing operating margins at 21.5% – levels well below those suggested by ifa's opportunities in the US, Latin America, the Middle East and China.

Software and comp services

3 December 2014

Price **€7.5**

Market cap **€19m**

Net debt (€m) as at end June 2014 0.5m

Shares in issue 2.5m

Free float 48.4%

Code IS8

Primary exchange Frankfurt

Secondary exchange OTC Pink

### Share price performance



% 1m 3m 12m

Abs 22.4 33.0 90.1

Rel (local) 14.0 27.3 79.9

52-week high/low €8.02 €4.05

### Business description

ifa systems provides software and clinical decision support systems for ophthalmology in clinics and hospital departments. Its principal products deal with the collection, management and use of electronic medical records (EMR), but it also has key technologies relating to device integration, clinical decision support and telemedicine.

### Next event

Q4 release February 2015

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## Enhanced product strategy equals enhanced profits

### Widening addressable marketplace

In German-speaking markets ifa addresses the requirements of all but the smallest ophthalmology departments and clinics, but in international markets its attention has been focused on the larger A-list customers – the teaching hospitals and larger clinics. Management believes this was the correct model to follow. However, the developments in technology, the fact that ifa finds itself at times constrained in its ability to implement against demand, and the increasing demand for sophisticated ophthalmology software internationally from smaller clinics have changed the situation.

Management has decided to address the wider ophthalmology market through an enhanced product strategy. For more detail on the products that ifa systems offers and how it has historically addressed its markets, see our [initiation note](#) *The opportunity is clear*, 16 June 2014.

The first and most significant part is the medium- to long-term financed product offer – fixed-term subscriptions with the customer paying an additional amount overall to reflect the additional finance costs that this offer effectively imposes on ifa. Management believes this is a more palatable option for smaller customers than the traditional upfront licence and implementation cost model. Management has suggested this could account for up to 20% of ifa's new business in the medium term.

Extending the flexible payment approach, ifa can now also offer a software rental model that management suggests could account for 10% of new business in the medium term, which serves to actually increase the addressable market for ifa into small clinics. Finally, ifa plans to provide a fee-per-use software offer as a test proposition. Management does not anticipate significant revenues or EBIT from this.

We believe that there will be further and continuing changes to the way in which ophthalmologists can access ifa's technologies. We believe management is actively considering and exploring direct and indirect alternative routes to market for the products, in particular, through international partner(s) that could offer much of ifa's technology and experience, but in a lower-cost and less extensive form.

### Forecast revisions

Following the adoption of the enhanced product strategy, we have added €0.5m for FY15e and €1.0m for FY16e in new revenues that, combined with some adjustments to reflect lower costs in FY14 (lower staff costs and amortisation of development, and higher levels of capitalisation of development expenditure), lead to the changes to forecasts set out in Exhibit 1 below. The operational gearing effect sees a significant proportion of the increase in revenues translate into profits and so the impact on earnings estimates is marked. It is, of course, very early days for the revised product strategy and, given the nature of the industry, the impact could well be significantly more or less than these first estimates, but for now we regard our upward revisions as conservative. We understand that ifa has already won business under the enhanced product strategy in Mexico, Cameroon, Egypt and Norway.

**Exhibit 1: Forecast revisions**

|        | Revenues<br>new (€000s) | Revenues<br>old (€000s) | EBITDA<br>new (€000s) | EBITDA<br>old (€000s) | PBT<br>new (€000s) | PBT<br>old (€000s) | EPS<br>new (c) | EPS<br>old (c) |
|--------|-------------------------|-------------------------|-----------------------|-----------------------|--------------------|--------------------|----------------|----------------|
| 12/14e | 8,379                   | 8,379                   | 3,042                 | 2,775                 | 2,175              | 1,708              | 60.9           | 47.8           |
| 12/15e | 9,641                   | 9,141                   | 4,052                 | 3,177                 | 3,085              | 2,110              | 86.4           | 59.1           |
| 12/16e | 10,894                  | 9,894                   | 4,999                 | 3,569                 | 3,932              | 2,502              | 110.1          | 70.0           |

Source: Edison Investment Research

Management has stated that they see potential operating margins in the high 30s in percentage terms, helped by the increase in levels of high-margin run-time licences, the enhanced product

offering and the fading significance of the €700k or so of low-margin pass-through hardware sales that the company makes in Germany. Following the revisions to estimates, our forecasts now reflect this ambition, with forecast EBIT margins in 2015 and 2016 of 33% and 37% respectively. These are considerable increases on the 21% EBIT margin seen in 2013 and the 27% that we forecast for 2014, reflecting the anticipated transition of the business and, to a lesser extent, its markets.

Our forecasts now show a revised estimate of dividends following the announcement in Q2 results that the management is to propose an FY14 dividend of 12c vs our previous estimate of 10c. We have increased our estimate accordingly from 10c to 12c for FY14e, 12c to 15c for FY15e and 14c to 19c for FY16e.

## Discount on multiples undeserved

There is a significant base of US-listed healthcare IT companies, but these are generally far larger operations with more general products and typically with a focus more toward the revenue cycle than toward clinical decision support. The table below shows that the selected US comparators mostly trade at revenues and earnings multiples above those of ifa systems. The new ADR listing should make investment in ifa's shares more accessible for US-based investors (both institutional and private) and this could make the US comparator valuations more relevant in considering the valuation of ifa systems' shares.

In Europe there is a handful of listed healthcare software companies, which are smaller in scale than the US majors. Once again, as can be seen in the table below, ifa systems trades at revenues and earnings multiples discounts to most of these comparators, the exception being niche imaging specialist MeVis. Although some of these entities have some exposure to potential growth in US healthcare IT spend, they typically lack the direct exposure to the high-growth international markets that ifa systems provides. We believe that the level of discount to the European peers is too great, even after considering ifa's limited free float (48%), liquidity and relatively small size.

| Exhibit 2: ifa systems vs listed comparators |             |                            |            |                   |                 |     |     |               |      |      |         |      |      |
|--|-------------|----------------------------|------------|-------------------|-----------------|-----|-----|---------------|------|------|---------|------|------|
| Company                                      | Share price | EV (m)<br>(Local currency) | Year 1 end | EBITDA Margin Yr2 | EV/Revenues (x) |     |     | EV/EBITDA (x) |      |      | P/E (x) |      |      |
|  |             |                            |            |                   | Yr1             | Yr2 | Yr3 | Yr1           | Yr2  | Yr3  | Yr1     | Yr2  | Yr3  |
| IFA Systems                                  | 7.5         | 19.3                       | Dec-14     | 42.0%             | 2.3             | 2.0 | 1.8 | 6.3           | 4.8  | 3.9  | 12.3    | 8.7  | 6.8  |
| US Comparators                               |             |                            |            |                   |                 |     |     |               |      |      |         |      |      |
| Cerner                                       | 64.3        | 21625                      | Dec-14     | 34.9%             | 6.4             | 5.7 | 4.9 | 18.8          | 16.2 | 14.1 | 38.7    | 33.0 | 28.3 |
| Allscripts                                   | 12.5        | 2624.5                     | Dec-14     | 16.2%             | 1.9             | 1.8 | 1.6 | 13.0          | 10.9 | 9.1  | 38.9    | 26.5 | 20.4 |
| Quality systems                              | 14.9        | 947.8                      | Mar-15     | 17.7%             | 2.0             | 1.8 | 1.7 | 12.5          | 10.4 | 8.8  | 26.1    | 20.4 | 19.4 |
| Merge Healthcare                             | 3.2         | 519.0                      | Dec-14     | 21.8%             | 2.4             | 2.3 | 2.1 | 10.6          | 10.6 | 9.0  | 18.0    | 16.2 | 13.0 |
| AthenaHealth                                 | 116.8       | 4582.5                     | Dec-14     | 18.1%             | 6.1             | 5.0 | 4.0 | 33.6          | 27.4 | 20.9 | 106.2   | 92.0 | 72.1 |
| European comparators                         |             |                            |            |                   |                 |     |     |               |      |      |         |      |      |
| CompuGroup                                   | 20.5        | 1392.5                     | Dec-14     | 23.1%             | 2.7             | 2.6 | 2.5 | 13.1          | 11.1 | 10.4 | 15.8    | 13.0 | 12.1 |
| Craneware                                    | 4.9         | 119.8                      | Jun-15     | 29.7%             | 2.5             | 2.3 | 2.0 | 8.4           | 7.6  | 6.7  | 13.2    | 12.2 | 11.1 |
| MeVis  | 16.8        | 44.2                       | Dec-14     | 38.2%             | 3.6             | 3.6 | 3.7 | 9.2           | 9.4  | 10.0 | 10.3    | 10.7 | 11.7 |
| Emis   | 8.1         | 511.6                      | Dec-14     | 31.1%             | 3.8             | 3.5 | 3.3 | 12.4          | 11.4 | 11.0 | 20.2    | 18.8 | 17.3 |
| Nexus  | 13.1        | 170.5                      | Dec-14     | 22.0%             | 2.1             | 1.9 | 1.8 | 10.3          | 8.8  | 8.2  | 21.8    | 16.8 | 15.2 |
| All (ex IFA)                                 |             |                            |            |                   | 3.3             | 3.0 | 2.8 | 14.2          | 12.4 | 10.8 | 30.9    | 26.0 | 22.1 |
| N America (ex AthenaHealth)                  |             |                            |            |                   | 3.2             | 2.9 | 2.6 | 13.7          | 12.0 | 10.2 | 30.4    | 24.0 | 20.3 |
| Europe (ex MeVis)                            |             |                            |            |                   | 2.8             | 2.6 | 2.4 | 11.0          | 9.8  | 9.1  | 17.7    | 15.2 | 13.9 |

Source: Thomson, Edison Investment Research. Note: Prices as at 2 December 2014.

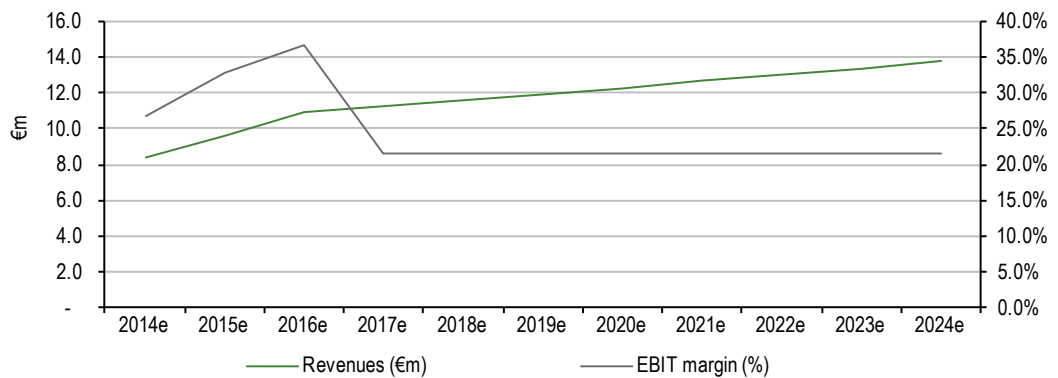
Placing the shares on a prospective FY15 P/E of 18.0x, a 25% discount to the US comparator group (to reflect the smaller size and free float/liquidity issues) ex-AthenaHealth (an outlier and SaaS-type story) yields a value per share of €15.6, 107% ahead of the current price.

Placing the shares on a prospective FY15 P/E of 12.9x, a 15% discount to the European comparator group (to reflect the smaller size and free float/liquidity issues and the same discount as applied in our [initiation note](#) *The opportunity is clear*, 16 June 2014) ex-Mevis (a negative earnings growth story) yields a value per share of €11.2 49% ahead of the current price.

### Reverse DCF suggests the market may expect no growth

We also consider the valuation of ifa systems with a reverse DCF to find a scenario that would reflect the current €7.5 share price based on a cost of capital of 10%. Working forward from our revised published figures (2014-16e), we find that a scenario that includes zero revenue growth in the period 2017-24e, along with an operating margin of 21.5% (ie below current year estimated levels) over that period yields the current share price. We would regard such revenue growth and operating margin outcome as highly disappointing given the opportunities facing the company in the US, Latin America, the Middle East and China.

**Exhibit 3: Reverse DCF for €7.5 share price**



Source: Edison Investment Research

**Exhibit 4: Financial summary**

| Year ending December                         | €000s | 2012    | 2013    | 2014e   | 2015e   | 2016e   |
|--|-------|---------|---------|---------|---------|---------|
|  |       | IFRS    | IFRS    | IFRS    | IFRS    | IFRS    |
| <b>PROFIT &amp; LOSS</b>                     |       |         |         |         |         |         |
| Revenue                                      |       | 7,402   | 7,771   | 8,379   | 9,641   | 10,894  |
| Cost of Sales                                |       | (689)   | (698)   | (838)   | (1,005) | (1,126) |
| Gross Profit                                 |       | 6,713   | 7,073   | 7,541   | 8,636   | 9,768   |
| EBITDA                                       |       | 1,489   | 2,648   | 3,042   | 4,052   | 4,999   |
| Operating Profit (before amort. and except.) |       | 958     | 1,601   | 2,242   | 3,152   | 3,999   |
| Intangible Amortisation                      |       | 0       | 0       | 0       | 0       | 0       |
| Exceptionals                                 |       | 0       | 0       | 0       | 0       | 0       |
| Other  |       | 0       | 0       | 0       | 0       | 0       |
| Operating Profit                             |       | 958     | 1,601   | 2,242   | 3,152   | 3,999   |
| Net Interest                                 |       | (67)    | (60)    | (67)    | (67)    | (67)    |
| Profit Before Tax (norm)                     |       | 891     | 1,541   | 2,175   | 3,085   | 3,932   |
| Profit Before Tax (FRS 3)                    |       | 891     | 1,541   | 2,175   | 3,085   | 3,932   |
| Tax  |       | (318)   | (498)   | (653)   | (926)   | (1,180) |
| Profit After Tax (norm)                      |       | 573     | 1,043   | 1,523   | 2,160   | 2,752   |
| Profit After Tax (FRS 3)                     |       | 573     | 1,043   | 1,523   | 2,160   | 2,752   |
| Average Number of Shares Outstanding (m)     |       | 2.4     | 2.5     | 2.5     | 2.5     | 2.5     |
| EPS - normalised (c)                         |       | 23.7    | 41.7    | 60.9    | 86.4    | 110.1   |
| EPS - normalised and fully diluted (c)       |       | 23.7    | 41.7    | 60.9    | 86.4    | 110.1   |
| EPS - (IFRS) (c)                             |       | 23.7    | 41.7    | 60.9    | 86.4    | 110.1   |
| Dividend per share (c)                       |       | 3.0     | 9.0     | 12.0    | 15.0    | 19.0    |
| Gross Margin (%)                             |       | 90.7    | 91.0    | 90.0    | 89.6    | 89.7    |
| EBITDA Margin (%)                            |       | 20.1    | 34.1    | 36.3    | 42.0    | 45.9    |
| Operating Margin (before GW and except.) (%) |       | 12.9    | 20.6    | 26.8    | 32.7    | 36.7    |
| <b>BALANCE SHEET</b>                         |       |         |         |         |         |         |
| Fixed Assets                                 |       | 15,361  | 16,480  | 17,680  | 18,930  | 20,230  |
| Intangible Assets                            |       | 12,211  | 13,896  | 15,096  | 16,346  | 17,646  |
| Tangible Assets                              |       | 651     | 279     | 279     | 279     | 279     |
| Investments                                  |       | 2,499   | 2,305   | 2,305   | 2,305   | 2,305   |
| Current Assets                               |       | 2,174   | 2,294   | 2,392   | 3,001   | 4,078   |
| Stocks                                       |       | 117     | 75      | 75      | 75      | 75      |
| Debtors                                      |       | 1,364   | 1,341   | 1,513   | 1,703   | 1,892   |
| Cash   |       | 693     | 878     | 804     | 1,223   | 2,112   |
| Other  |       | 0       | 0       | 0       | 0       | 0       |
| Current Liabilities                          |       | (1,094) | (1,387) | (1,263) | (1,263) | (1,263) |
| Creditors                                    |       | (884)   | (1,158) | (1,034) | (1,034) | (1,034) |
| Short term borrowings                        |       | (210)   | (229)   | (229)   | (229)   | (229)   |
| Long Term Liabilities                        |       | (3,023) | (3,249) | (3,249) | (3,249) | (3,249) |
| Long term borrowings                         |       | (647)   | (458)   | (458)   | (458)   | (458)   |
| Other long term liabilities                  |       | (2,376) | (2,791) | (2,791) | (2,791) | (2,791) |
| Net Assets                                   |       | 13,418  | 14,138  | 15,560  | 17,419  | 19,796  |
| <b>CASH FLOW</b>                             |       |         |         |         |         |         |
| Operating Cash Flow                          |       | 2,968   | 3,825   | 2,921   | 3,912   | 4,860   |
| Net Interest                                 |       | (67)    | (60)    | (67)    | (67)    | (67)    |
| Tax  |       | (318)   | (498)   | (653)   | (926)   | (1,180) |
| Capex  |       | (3,587) | (2,588) | (2,050) | (2,200) | (2,350) |
| Acquisitions/disposals                       |       | 0       | 0       | 0       | 0       | 0       |
| Financing                                    |       | 1,515   | 0       | 0       | 0       | 0       |
| Dividends                                    |       | (250)   | (75)    | (225)   | (300)   | (375)   |
| Net Cash Flow                                |       | 261     | 604     | (74)    | 419     | 889     |
| Opening net debt/(cash)                      |       | 474     | 164     | (191)   | (117)   | (536)   |
| HP finance leases initiated                  |       | 0       | 0       | 0       | 0       | 0       |
| Other  |       | 49      | (249)   | 0       | 0       | 0       |
| Closing net debt/(cash)                      |       | 164     | (191)   | (117)   | (536)   | (1,425) |

Source: Edison Investment Research, company accounts

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