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IBA Health Group Limited
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Record of interview:

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IBA Health Group Limited on Tuesday reported net profit of $10.3 million for the first half ended December 2008, compared with a loss of $1.1 million in the previous corresponding period. Underlying EBITDA was $67.5 million, up from $33.7 million on revenue of $275.4 million, up from $102.8 million. Your guidance for the full year ending June 2009 – revenue of $540 million to $560 million and EBITDA of $120 million to $130 million – implies revenue of $265 million to $285 million and EBITDA of $52 million $62 million in the second half. Why is the second-half EBITDA contribution expected to be lower than the first half and what's your level of confidence in the full-year guidance?

Executive Chairman & CEO Gary Cohen
I think there's a general misunderstanding regarding this matter. We're pleased with our performance year to date. The first-half result puts our EBITDA margin ahead of our full-year guidance, and our revenues on track. We're not saying that the second half is going to be weaker than the first half. In fact, traditionally the second half is generally our strongest half. However, we issued our guidance six months ago and we all felt that we did not need to change our full-year guidance at this point of time.

Although there's a lot of economic uncertainty we're not seeing any immediate impact on our business from the global financial crisis, given our public sector focus. Also, as flagged at the beginning of the year, we're increasing expenditure targeted at ensuring the long-term health of the business, and that will impact our margin to some extent in the second half.

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In a slower growth environment, IT is characterised as an area where spending is largely discretionary and where entities will look first to cut costs. Have you seen any evidence of health IT budgets being cut in the current downturn?

Executive Chairman & CEO Gary Cohen
Excluding some of our smaller markets, overall we haven't seen any material effects on our customers or their commitments. On the contrary, our industry is in a relatively strong position in this global downturn. We're seeing many governments commit to health IT spending, including the recent commitment by US President Barak Obama to a $30 billion initiative to introduce computerised health records. And of course the National Programme for IT (NPfIT) initiated by the UK National Health Service (NHS), in which we're a major partner, is the world's largest civilian public sector IT project.

Gartner research forecasts that between 2007 and 2012 global health IT spending will grow at an annual compound rate of 5 percent to US$100 billion. That's the fastest expected growth among all major global industries and more than four times the growth in IT generally.

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IBA won $78.2 million of new or extended contracts in the first half. Can you comment on your current contract success rate and the level of competition you're seeing for new work? How do these compare historically?

Executive Chairman & CEO Gary Cohen
Year on year (at constant currency) we've grown our sales by just under 20 percent. This reflects the renewed confidence our customers have in us and that we're winning more business than we have previously. Whilst it's often difficult to generalise across all our territories, it seems our customers see us now as a far more credible and long-term partner than many of our competitors.

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IBA booked net operating cash outflow of $12.9 million in the first half versus inflow of $25.1 million in the June half. This reflected a substantial increase in working capital, particularly in receivables and accrued revenue. Do you have any concerns regarding creditor quality? How do you expect EBITDA cash conversion to trend going forward?

Executive Chairman & CEO Gary Cohen
In our business the first-half cash flow is always affected by seasonality issues. Most of our customers pay for their support contracts in advance in the second half – so the cash relating to the revenue we booked on these contracts in the first half was received in the last half of last year. Furthermore there are some significant payments we receive from our UK project in the second half – even though much of the work is done in the first half. Finally, because we're growing our sales there's a working capital effect due to the timing of the invoicing. This year there was also a one-off settlement payment of $11.3 million that related to the closure of the ESA (contract financing) arrangement we inherited with the iSOFT acquisition.

Looking forward, we're confident we can achieve operating cash flow levels equivalent to 80 percent of EBITDA.

With regards to your question on debtor quality, the overwhelming majority of our business is with the public sector, so we don't have concerns there.

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You've indicated that in the first half currency movements had a minimal impact on revenue and EBITDA. How are you seeking to mitigate currency risk going forward?

Executive Chairman & CEO Gary Cohen
At exchange rates prevailing at the beginning of the period, first-half reported EBITDA would have been about $3 million (or just over 4 percent) lower. Revenue growth at constant currency would have been about 5 percent less. These differences come from translation effects as some 77 percent of our business is naturally hedged. However, we have some exposure to the Indian rupee given our product development centre in that country, so in November last year we put in place some hedging for the rupee against the British pound .

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IBA's first-half EBITDA margin was 25.3 percent, down from 27.7 percent in the second half of 2008, the first six-month period in which the iSOFT acquisition made a full contribution. Nevertheless, the margin was higher than implied by your guidance, which assumed an increase in expenses targeted at longer-term growth. How is this spending tracking and when do you expect to see earnings benefits from the program?

Executive Chairman & CEO Gary Cohen
Due to the timing of events, our marketing spending will be higher in the second half. But overall, spending is on track, with increased investment in product management and development, marketing and sales activities, and our ICT network and hardware.

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In the first half, capitalised R&D spending was $6 million, compared with $8.7 million for the full June 2008 year. What were the major objects of the first-half R&D spending and is the level of spending indicative of that going forward?

Executive Chairman & CEO Gary Cohen
The spending primarily reflected the LORENZO Clinicals development, and we expect this level of spend to continue into fiscal 2010.

We're in a unique position as an IT company in that much of our R&D for LORENZO is expensed as part of our work for the UK NPfIT. We retain the LORENZO IP, which means we keep the benefits of the new technology while being paid to develop it.

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On a rolling 12-month basis, finance costs were $46.2 million and underlying EBITDA to interest cover was 3.0 times, well below your targeted interest cover ratio of around 5.9 times. What's your level of comfort with interest

cover at this level and what's the expected time line for realising the targeted ratio?

Executive Chairman & CEO Gary Cohen
The target of 5.9 times is based on the interest cover calculation used for our debt covenants, not on a straight EBITDA to finance cost ratio. Under the covenant calculation, we meet the target which gives both us and our bankers a lot of comfort about the financial strength of the business going forward.

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Net debt was $321.9 million as at the end of December, up from $279.1 million six months earlier. Net debt to equity was 44.8 percent, down from 47.6 percent. What's your level of comfort with gearing at this level given the cash flow performance of the business in the first half?

Executive Chairman & CEO Gary Cohen
Given the timing of the cash flow, which I mentioned earlier, we're comfortable our gearing level will improve in the second half as we've indicated in our guidance. We're working comfortably within our covenants now and as projected we're paying down contract funding in the current second half and expect this to be about $30 million lower by June 30.

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You've indicated you'll seek to retire your $60 million in subordinated secured borrowings from AEP. Will paying down this debt require a capital raising?

Executive Chairman & CEO Gary Cohen
It's important to understand that this debt is subordinated to the senior facility so this means we have more flexibility to deal with it should repayment take longer than it's technical due date. This is because AEP cannot call a default. Having said that the AEP facility is our most expensive debt so we believe it's in our shareholders' interest to retire that debt if we can do so in a non-dilutive way. We have a number of options here, including restructuring the facility.

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You've indicated that you're looking to launch LORENZO Studio in the US market in the current half and that you're considering potential acquisitions in that market. What are your aspirations in the US market and how would you seek to fund any expansion there?

Executive Chairman & CEO Gary Cohen
We're not planning to take on the major players in the US market. As we announced recently we're planning to release LORENZO Studio, our development toolkit, as a solution to work with partners, including other IT vendors, in that market. The US is where more than 50 percent of the world healthcare IT spend is and it's now committing to spend even more. We believe LORENZO is extremely timely for this market as it enables sharing of health records between healthcare organisations. Today in the US this is generally not possible.

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IBA has indicated that it will seek shareholder approval to change the name of the company to iSOFT. What's the rationale for the name change and what is the anticipated timing?

Executive Chairman & CEO Gary Cohen
We have since the acquisition re-branded all our trading operations with the iSOFT name. Today our 13,000 customers all know and associate us with this name. Accordingly we felt that it would make sense to have a unitary branding strategy to ensure that the goodwill we're generating with the iSOFT brand would reflect through to our shareholders.

We expect the name change to take effect by the end of April.

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In light of the global financial crisis and slowing economic growth in most of your markets, what level of earnings visibility do you have beyond the current year?

Executive Chairman & CEO Gary Cohen
Ninety four percent of our projected revenue for the current year is recurring, contracted or expected revenue. Beyond the current year, 60 percent of projected revenue is recurring or contracted under existing agreements, providing a solid base for future growth. The pipeline continues to grow so we have a reasonable degree of visibility to our next year revenues. Given most of our business is with the public sector, our revenues have a relatively high level of security, especially in an economic downturn.

We believe we're well positioned in a sector that's resilient to short-term economic movements. So in spite of the gloomy economic outlook, we have a relatively high degree of earnings visibility and we remain very optimistic about our future.

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Thank you Gary.

For more information about IBA Health, visit www.ibahealth.com or call Gary Cohen or Director Corporate Affairs Stuart Kelly on (+61 2) 8251 6769

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