

CEO on Update

Open Briefing interview with CEO Sam Hupert



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In this Open Briefing®, Sam discusses:

- Recent US contract win
- Contract implementation and expected revenue flow
- Continuing earnings momentum
- Post RSNA Update

Record of interview:

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Pro Medicus Limited (ASX: PME) recently announced that it had won a seven year, US\$7 million (A\$8 million) contract with WellSpan Health, a regional healthcare network based in Pennsylvania, in the US. Under the contract, Pro Medicus will supply its Visage 7 enterprise imaging platform to WellSpan on a fee-per-transaction basis. When will you start booking revenue from the contract, how will it impact current year earnings, and what is the likely profile of earnings over the life of the contract?

CEO Sam Hupert

Implementation will start in the third quarter of the current financial year. The phase-in period should be relatively short, so we should see some revenue from the contract toward the end of the year. After that, revenue should at least reflect the contracted minimum transaction volume, with the potential for upside if WellSpan grows organically, as it has in the past few years, or if it makes any acquisitions of hospitals or other facilities that include a radiology unit.

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This is the second deal Pro Medicus has signed in the US in recent months with a large health network, comprising hospitals as well as outpatient and other facilities. What were the key terms of the competitive tender for the WellSpan contract and what were the factors that lead to your winning?

CEO Sam Hupert

We competed against many of the majors, who typically sell fully integrated enterprise systems. In the past, in the large health system space, customers have usually gone with a large company single vendor solution. However, we're seeing a paradigm shift in the market, where users are increasingly favouring a "deconstructed" solution comprising best of breed modules from different providers. Our technology fits well with this model.

That set the framework for the decision but I think the key deciding factor was the technology itself; Visage 7 has a number of very significant benefits compared with existing PACS (picture archiving and communication system) solutions. It is better able to handle the huge data files generated by the latest radiology equipment. Our thin-client streaming technology provides virtually instant image access, versus the lengthy download times for traditional technology. Visage 7 also provides the most functionality in a single desktop, so radiologists

can visualise anything from a 2D chest X-ray through to the most sophisticated 3D datasets. They never need to switch applications or move to another workstation to do their work as they would with other solutions. This together with the scalability of the system, were important factors in the WellSpan decision.

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What are the implications of the deal for Pro Medicus in terms of winning more work in the US market? What is the size of the addressable market and what has been your progress in expanding your US marketing team to respond to the opportunities?

CEO Sam Hupert

Every deal we win, especially against well known competitors, raises our profile in the market and helps to prove the technology. Certainly, these two sizeable wins will increase our sales momentum in the US. We have already seen flow-on effects from the first sale and expect more as we win more contracts.

The US PACS market is estimated at US\$1.5 billion to US\$1.7 billion annually. That includes maintenance and service, not just sales of new systems. Most PACS customers bought new systems when they made the shift to digital technology from analogue in the early to mid 2000s. Many of these systems would normally have been refreshed or replaced five or six years ago, but were not, mainly because the major PACS providers failed to offer any really compelling product innovation. So there is certainly pent-up demand and we're finding that many of the large health networks are ready to reinvest in a differentiated offering.

In terms of responding to opportunities, we're acutely aware of the importance of being able to service our growing client base and maximise the opportunities in the market. Winning these large contracts has helped us attract good staff. We've added a number of new staff to our US team in the current year and we'll continue to pro-actively ramp up our implementation and training capability as we go forward.

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At your recent AGM, you highlighted the fact that post the WellSpan win, Pro Medicus had contracted sales of \$35 million-plus over the next six years. This implies contracted revenue of \$5.8 million per year over the next six years, which is significant compared with 2014 revenue of \$14.27 million. Given the contracted sales are based on minimum transaction numbers, what is the potential upside?

CEO Sam Hupert

Roughly speaking that is true but the revenue from each deal is not split equally across the term of the contract. In every deal there is a phase-in period when we're implementing the technology and training the client's staff and during which they are steadily building their transaction volume. The length of that period varies depending on the size of the client but can be anywhere from two months to a year in the case of our larger clients. The minimums then kick in after the phase in period.

It's also worth noting that the minimum volumes are based on a percentage of the client's overall examination volume and that we charge for any transactions above these minimums. The beauty of this is that we have a guaranteed floor on our revenues under each contract, but not a ceiling. So there is inherent upside in every deal even if the client does only its usual volumes, not to mention the upside if the client grows organically or makes an acquisition.

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Last financial year saw a turnaround in your Australian business, which booked EBIT of \$1.18 million, versus an EBIT loss of \$0.74 million in previous year. What has been the trend in Australian earnings in the current financial year to date? What are the nearer term opportunities in this market?

CEO Sam Hupert

As we foreshadowed in our 2014 annual report and at the AGM, we expect our Australian business to continue to improve this year. The continuing roll-out of Visage RIS, our new RIS platform, has stopped customer erosion and we're seeing increasing sales to new clients of both Visage RIS and Visage PACS, which is encouraging. Full transition of our existing client base to the new RIS will happen over the next 12 months, creating a good cross-sell opportunity. We're hopeful that over time a growing number of our Australian clients who are using Visage RIS will also adopt Visage PACS especially once they see the advantages of the integrated package.

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Last year's group-wide EBIT was \$2.27 million, up from a loss of \$0.52 million, with much of the growth occurring in the US, in the second half of the year. At the AGM you indicated that results for the year to date were above budget. Is the growth sustainable over the remainder of the year?

CEO Sam Hupert

Certainly we've maintained the momentum of last year's second half. Two of our large US contracts started to contribute in that period, and have continued to build in the first half of this year and will continue to do so in the second half and into FY2016. Now we've won WellSpan, it will begin contributing in the second half of the year, adding to the existing contracts and forming a growing base as we go forward.

We have more certainty and visibility of future revenue with the increase in transaction-based contracts, and as I said earlier, we believe there is potential upside in the contracts we've already won. We're also confident that the new sales momentum will continue.

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You have just come back from the Radiology Society of North America (RSNA), the large radiology conference held every year in Chicago where Visage was an exhibitor. How was Visage received at the show?

CEO Sam Hupert

The RSNA is essentially the world conference of radiology. It's a huge event attracting over 55,000 registrants from all over the globe making it easily the most significant event on our calendar. This year we had an even bigger presence than previous years, our stand being 60 percent larger, enabling us to have more demonstration space. We were flat out – by any measure this was our busiest and most successful RSNA to date.

In terms of industry trends, there is no question that the move to a best in breed or "deconstructed PACS" model is getting a large amount of traction. Virtually all prospective clients who came to our stand are looking to go down this path which is good for us.

I also think our technology showed extremely well. People were amazed at the speed and functionality of the system especially when we are able to show them how quickly we could visualise even the largest and most complex datasets such as a digital breast tomo synthesis (DBT) which can be up to 6 GB per study. We certainly feel that the industry as a whole is starting to recognise the uniqueness of our technology and the advantages it can bring to their business.

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What impact has the RSNA had on your current pipeline of sales opportunities in the US?

CEO Sam Hupert

We had a healthy and growing pipeline of opportunities leading into the RSNA however there is little doubt that it has increased as a result of the conference. Those groups that were already speaking to us took the opportunity to come and see us, often multiple times. We

also met with a number of new prospects who were either referred to us or who had heard about our recent North American wins and some of these will progress into solid opportunities going forward.

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At the AGM you announced that Pro Medicus is implementing a global management structure. What is the strategy behind this decision?

CEO Sam Hupert

Pro Medicus is already a global company. We have staff in Australia, Berlin and throughout the US.

The roles we've announced will give people already in the business a global mandate in addition to their regional roles. This is designed to leverage the significant technical expertise we have in all three regions as well as underpin the next phase of our growth by having a more global view of our sales opportunities. While the US is our key focus at present and we're seeing many great opportunities there, growth beyond that market is definitely on our radar.

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Thank you Sam.

For more information about Pro Medicus, visit www.promedicus.com or call Sam Hupert on (+61 3) 9429 8800.

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