



Biotech Daily

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Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Pro Medicus

By TIM BOREHAM

ASX code: PME

Share price: \$19.95

Market cap: \$2.07 billion

Shares on issue: 103,616,518

Chief executive officer and founder: Dr Sam Hupert

Board: Peter Kempen (chairman), Dr Hupert, Anthony Hall, Anthony Glenning, Dr Leigh Farrell

Financials (December half): revenue \$25.4 million (up 60%), net profit \$9.1 million (up 184%), adjusted profit* \$9.2 million (up 80%), earnings per share 8.7 cents (up 184%) interim dividend per share** 3.5 cents fully franked (up 40%), cash of \$24.7 million (down 2%)

* Adjusts for net currency gain and the impact of revenue recognition accounting rule

** The company also paid a fully franked 2.5 cents special dividend as an advance on this year's expected final dividend

Identifiable major shareholders: Dr Sam Hupert 29.33%, Anthony Hall 29.29%, Bram and Maaïke Vander Jagt 0.82%, Grain Exporters Australia Pty Ltd 0.66%, Peter and Elaine Kempen 0.66%.

Now with a \$2 billion market capitalization, the home-grown radiology digital imaging outfit has crept up on investors having been valued at less than \$100 million five years ago.

Not that Pro Medicus has been an overnight success: Melbourne general practitioner Dr Sam Hupert and technologist and fellow wine buff Anthony Hall formed the company in 1983, when mullets and perms rather than digital imaging were all the rage.

Having evolved its technology and products - but not its intrinsic nature - over that time, Pro Medicus is now a recognized leader in the US and Europe with its proprietary internet cloud-based software for large medical enterprises and individual practices.

In the US, Pro Medicus has signed up five of the top 20 hospitals and won 14 of the last 17 requests for proposals (tenders for new work).

“Truth be known we have gone further far more quickly than most people anticipated,” Dr Hupert says.

About Pro Medicus

Pro Medicus provides diagnostic imaging, practice management and image archiving software to radiology practices. The company is mainly involved in the ‘viewing’ part of the chain: enabling clinicians to call up the images quickly and make better use of them.

The company’s key products are Visage RIS (as in radiology information system) and Visage 7 (enabling users to consolidate information requiring multiple views into a customized single platform).

Pro Medicus has surfed the burgeoning data requirements for modern imaging techniques such as high density multi slice CT (computed tomography) scans, high density breast tomo-synthesis, opto-acoustic breast ultrasounds and total body scans.

With breast imaging, a mammography used to require about 300 megabytes of capacity; now breast tomo-synthesis creates files of four to six gigabytes.

“Now there’s a new high-definition version requiring eight to 10 gigabytes per study,” Dr Hupert says.

Pro Medicus also stands to benefit from new rules in the US mandating electronic health records in all hospitals, with 90 percent of this data related to imaging.

The Pro Medicus ‘Alan Bond’ moment

At the height of the global financial crisis 10 years ago, Pro Medicus acquired the California based Visage Imaging for a knock-down \$5 million.

Then a leader in digital imaging, Visage Imaging otherwise was an unwanted life sciences offshoot of the Nasdaq-listed Mercury Computer Systems.

The purchase price was quickly validated, because Pro Medicus shed Visage Imaging’s unwanted research arm shortly after for \$15 million.

“We were in the right place at the right time,” Dr Hupert says. “It was a company-changing acquisition.”

As the Visage product moniker implies, the acquisition was the foundation of the current business.

The purchase delivered Visage Imaging’s Berlin-based intellectual property as well as its key people, 90 percent of whom are still with the company.

Who’s who of clients

Pro Medicus has managed to attract a book of big-name hospitals, including two of the top four in the US.

Locally, the company provides Visage RIS to the two biggest radiology providers, Healius (formerly Primary Healthcare) and I-Med.

US clients include the esteemed Mayo Clinic and Yale New Haven Health (the state of Connecticut’s second-biggest employer).

In its biggest contract, Pro Medicus last year signed Massachusetts’ largest health system Partners Healthcare for a \$27 million, seven-year deal.

Initially the deal covers the Massachusetts General Hospital (part of Harvard Medical School) and the Brigham and Women’s Hospital.

(Memo to anyone: why do US hospitals have such odd names?)

In late April, North Carolina’s biggest health system Duke Health signed a \$14 million deal over seven years to roll out Visage 7 across all of its radiology departments. Revenues are also transaction based, but with a guaranteed minimum.

In Germany, the company extended a three-year contract with a big government hospital network.

Britain is a notable exclusion to the company’s coverage, because the National Health System (much loved as it is) involves too much bureaucracy.

The size of the prize

Dr Hupert says about 410 million radiology tests are undertaken in the US each year and the sector is growing at about three to four percent each year.

“We think we have around four to five percent of the market but we are never going to address the full 100 percent because some sectors are not economic to service,” he says.

“We are a premium product and we hope to be the best product.”

Currently most radiology is not in the internet 'cloud' because of fears about patient privacy and data breaches.

"But the pendulum is swinging because some cloud providers have better security," Dr Hupert says.

Pro Medicus currently services large multi-facility providers who don't want to run their own infrastructure, but smaller providers without the wherewithal to do so are also a target.

The company competes with equipment makers such as Philips and Siemens, as well as the old film (imaging) houses such as Fuji and Clearstream (formerly Kodak). It also competes with other independent software houses.

The ASX-listed Mach7 also makes for an interesting comparison.

Based in Burlington Virginia, Mach7 provides cloud-based enterprise software for hospitals and clinics that aggregates an individual's medical records so that they are readily available for healthcare professionals.

In reality, Mach7 plays more in the archiving than the 'viewing', so Pro Medicus doesn't bump into them too often.

But given Mach7 has former Pro Medicus (and Visage Imaging) CEO David Chambers on the board, Dr Hupert certainly knows who they are.

Finances and performance

In the six months to December 31, Pro Medicus posted a net profit of \$9.2 million, up 80 percent on revenue of \$25.3 million (up 60 percent).

"The result was particularly pleasing in that we saw growth in all three major jurisdictions," Dr Hupert says.

In the first half, Pro Medicus gleaned half of its revenue from examination licences (\$12.1 million, up 31 percent), one quarter derived from support and baseline fees and one quarter from capital payments and professional services.

Pro Medicus derives 64 percent of turnover from North America and 18 percent each in Europe and Australia. While the US is obviously the key market, the North American reliance has reduced from 70 percent in the previous half, reflecting stellar European growth.

Pro Medicus's profit margins have expanded to 51 percent in the first half, compared with 49 percent in 2017-'18 and 45 percent in 2016-'17.

Unusually, Pro Medicus is both debt free and dividend paying. On top of the interim payout of 3.5 cents a share, the company advanced a 2.5 cents full year divvie to beat Labor's proposed abolition of cash franking credits.

The company has shareholder approval to carry out a share buyback. But apart from an early foray when the stock traded at 20 cents, it is yet to repurchase stock in earnest.

On the flipside, the company has never done a capital raising beyond the initial public offer, but would consider doing so if a compelling add-on opportunity came along.

Pro Medicus's share base of a tad over 103 million shares is not much more than its 100 million shares when it listed in September 2000 (at \$1.15 a share).

Pro Medicus shares have traded in a 12-month range of \$20.52 (late April) and \$6.85 (late June 2018).

Dr Boreham's diagnosis:

Dr Hupert says the company has had a record number of requests for proposals in the current half, while other opportunities abound in other 'ologies' such as cardiology and ophthalmology.

At a pinch, the company might consider expanding into non-health sectors.

Pro Medicus is also poised for the much-vaunted advent of artificial intelligence, by engineering its platform to allow algorithms developed by third parties.

"We see it becoming mainstream but we don't know when," Dr Hupert says. "Currently there's no reimbursement and using a new algorithm requires separate regulatory approval."

With Pro Medicus stock trading on an earnings multiple of 110 times, the valuation looks stretched. But Dr Hupert notes the contracts in place are generating annuity revenue, with \$160 million of examination revenues locked in over the next five years.

Revenue and earnings then compound with every additional deal.

Dr Hupert says Pro Medicus is a technology company that happens to be in healthcare and is thus classed in the healthcare/biotech space by investors.

Never mind about the classification: we herald Pro Medicus for becoming the fourth-biggest listed 'biotech' behind CSL, Resmed and Cochlear – a feat that catapulted Dr Hupert and Mr Hall on to this year's Rich List with a combined worth of \$860 million.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He is yet to feature on the Rich List and feels he may have left his run too late.