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**iSOFT****First Half in Perspective**

Open Briefing interview with **Executive Chairman & CEO, Gary Cohen**

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**In this Open Briefing®, Executive Chairman & CEO Gary Cohen explains the various impacts on the first half result**

- Margins impacted by increased costs related to growing the business, revised NPfIT contract
- Signs of recovery in demand post GFC, which impacted healthcare spending in many markets
- ISF well positioned to benefit from long-term growth in healthcare market, particularly in US

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**Record of interview:**

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iSOFT Group Limited (“ISF”) recently announced underlying NPAT of \$18.0 million for the first half ended December 2009, down 28 percent from the previous corresponding period, on revenue of \$237.3 million, down 14 percent. On a constant currency basis, i.e. translating the previous first half result at the exchange rates applying in the December 2009 half, underlying NPAT was down 9 percent and revenue was down 1 percent. Your latest guidance is for full-year revenue of \$500 million to \$520 million, representing growth of 6 to 10 percent in constant currency terms. Why aren’t we seeing the revenue growth of over 10 percent incorporated in your original guidance?

**Executive Chairman & CEO, Gary Cohen**

We are in a far stronger position than our reported numbers suggest, even though we had some frustrations where tenders had been delayed or didn’t happen. Excluding the UK National Program for IT (NPfIT), our backlog – that is, the contracts we’ve signed where we expect to make revenue in the future – has grown by about 50 percent compared with last year. This shows we’re building the business and positioning it for revenue growth longer term. The total backlog, including the NPfIT, was \$634 million at the end of December, up from \$614 million a year earlier.

In the shorter term, we’re encouraged that some of the more sluggish markets are showing signs of picking up following the immediate effects of the global financial crisis on government spending. We’re also seeing our pipeline in the Middle East come back quite strongly. The UK market has grown 11 percent year on year, and we’re confident more opportunities will emerge, particularly once the UK election is behind us.

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Some of this growth may not translate into revenues as soon as the second half, which is why we have tempered our expectations for the full year. We still believe the overall dynamics of global health IT are intact and healthy, and we are investing now for the significant opportunities that will continue to emerge.

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The reported profit results were negatively impacted on translation into a materially stronger Australian dollar. The currency had a \$12 million negative impact on first half EBITDA, which was \$40.8 million, down from \$67.5 million. But, the currency impact doesn't fully explain the drop in EBITDA. What else caused the decline in the first half?

**Executive Chairman & CEO, Gary Cohen**

When you strip out the currency translation effect on the first half result, the majority of our core business in the UK and Europe performed in line with or better than our expectations. Only our Australia and New Zealand, and Asia, Middle East and Africa units, which together make up 17 percent of Group revenue, were below our internal targets. Significantly, in the first half of fiscal 2009 we were also able to recognise contingent milestones under the NPfIT that boosted revenue and EBITDA by \$11.5 million compared with the first half of fiscal 2010.

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You have renegotiated your agreement with CSC, which you have said will impact margins in the second half. What are the benefits of the new agreement and when do you expect them to come through?

**Executive Chairman & CEO, Gary Cohen**

We renegotiated our UK NPfIT agreement with CSC in December. In return for lower short-term margins, the new agreement provides us with far greater upside potential in the long run.

This renegotiation of the rates for our services as well as other costs and new sharing elements provides us with greater visibility for the next 18 months in terms of the services we're providing. However, the revenue and the margins will be lower than last year, and lower than our original forecast. The new CSC contract will provide around \$90 million per annum compared with just under \$106 million under the old contract in constant currency terms. As we retain the same number of people and the same overall costs, the lower revenue has a direct margin impact.

We agreed to these changes because, first, we felt that it was important to have an agreement in place with CSC that allowed us to enter the NHS contract negotiations together as a team. Secondly, we were not willing to give up our rights in relation to the retention of our intellectual property in our Lorenzo solution in exchange for limited short-term revenue. Although we gave up the opportunity to earn some additional revenue in the short term, the new contract provides increased flexibility, and gives us the ability to win business in our own right.

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Your previous guidance for 2010 was EBITDA of about \$130 million, which implied a full-year EBITDA margin of 24 percent, whereas the latest guidance is a full-year margin of 21 to 23 percent. This implies a significant increase in your second-half margins to between 23 to 28 percent from the 17 percent you recorded in the first half. What will be the drivers of second half margin improvement?

**Executive Chairman & CEO, Gary Cohen**

Internally we were expecting a lower margin in the first half. We have a relatively fixed cost base, and our revenue is typically higher in the second half than in the first half. That translates to a higher margin in the second half. We expect our second half revenue to be \$20 million to \$40 million higher, with costs remaining relatively flat. That means the incremental revenue should flow directly into EBITDA in the second half.

Our current guidance indicates an EBIITDA split of 33:66 between the first half and second half. It's worth noting that last year the profit split was 50:50 because the recognition of the \$11.5 million contingent milestones from the UK NPfIT contract in the first half of last year distorted the weighting between the halves.

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With the currency volatility impacting your reported earnings, have you considered using currency hedges?

**Executive Chairman & CEO, Gary Cohen**

We hedge where we have a mismatch between our revenues and costs, such as in India. But in the majority of our businesses we are naturally hedged – that is, our revenues in British pounds or euros are largely offset by our costs in those currencies. The issue is that our reporting currency, which is Australian dollars, represents less than 10 percent of total revenue. Leaving aside the cost of hedging, if we were to hedge back to Australian dollars to get a more stable reported result, we would be punting our assets. We're not in the business of taking gambling risks.

The accounting rules are such that we have to translate our revenue and expenses every month into Australian dollars. This doesn't mean that profits, revenues and expenses are leaving the countries of origin each month. But it does mean that reported profit is subject to volatilities that are outside our control.

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Group expenses were \$198.5 million in the first half, down 5 percent in actual dollars, but up 7 percent on a constant currency basis. This increase accounted for a large part of the profit drop. What is your ability to contain Group costs across relatively fragmented markets?

**Executive Chairman & CEO, Gary Cohen**

The media has picked up on our travel costs. But for a company with 4,500 people doing business in 40 countries around the world, we don't believe our travel bill of around \$9 million in the half is out of control. These costs, which include air travel, accommodation and reimbursement of travel expenses, were down 10 percent from the previous corresponding period and represented around 5 percent of total costs in the half. We've just invested in our

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own travel management system to ensure we can take another \$2 million to \$3 million out of travel costs annually.

The more significant increase in expenses was mainly for building our business for future growth. We've had increased spend on marketing, distribution and innovation and we've set up a central product management group. Those are all costs that relate to helping to build the backlog, and those initiatives are meeting with success as we discussed earlier.

We're incurring costs and investing to deliver growth over the next 12 months to two years. However, now we've made those significant investments for growth we need to look at what initiatives can be deferred over the next six to 12 months to shift the balance so that the costs are a little less upfront.

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Given the pressures on revenues and costs during the first half, why did you spend money on sponsoring events such as Ideaworks?

**Executive Chairman & CEO, Gary Cohen**

Ideaworks was a strategic marketing initiative to emphasise our focus on investment and innovation. We've had another Ideaworks event in the Netherlands, and we're looking to hold similar events in Asia and Australia. These additional events can be completed at very little marginal cost, using the original templates.

Ideaworks has helped reinforce our credibility as a serious provider of clinical innovation. Gartner research tells us we're now regarded as a major innovative company; 12 months ago that wasn't the case. This is a very important driver of our sales and growth.

Further, the work we did for Ideaworks has already led to new products, for example Vantage Point, which is an innovative human-machine interface. We expect Ideaworks to lead to more new business over the next 12 to 18 months.

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Your spending on marketing and other growth initiatives increased across the board, not just in the UK. Where specifically do see growth being generated?

**Executive Chairman & CEO, Gary Cohen**

We're growing in Europe, we're doing well in Latin America, we're seeing some growth emerging for the first time this year in China, and we're seeing signs of more activity in Australia.

However, all of this is going to be eclipsed by what's happening in the US given the stimulus package and the US\$34 billion that's going into healthcare IT over the next two or three years. It will make the US market account for more than two thirds of the world's spend in healthcare IT. Importantly the US is directing the money into areas where we have strength and where there aren't many US companies with the appropriate skills.

With our recently established US base in Boston and our investment in innovations such as interoperability, we believe we're well positioned for coming developments in the US market: we're one of the few companies with innovative healthcare IT solutions designed to

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operate in a socialised context. From our experience in the UK and Europe, we understand how to connect healthcare systems from primary care to acute care, to community care and so on. We expect the US opportunity to emerge over the coming one to two years, so it is unlikely to translate into dollars over the next six months. But we'd certainly expect to see benefits emerging in the next fiscal year and beyond.

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What is the outlook for iSOFT's earnings in relation to the NPfIT, outside of the CSC contract? Do you anticipate a change in activity following the UK election which is to be held before 3 June 2010?

**Executive Chairman & CEO, Gary Cohen**

We see a number of opportunities from the NPfIT that are outside our contract with CSC, particularly with the South and the London regions.

It's worth noting that while those markets will be open to a number of vendors, the solutions will need to satisfy all the compliance requirements of NPfIT to be accepted in any tender, and that limits the number of competing providers. Clearly we meet all the requirements.

The South has approximately 90 healthcare trusts, including hospital, community and primary care trusts. Of the 45 hospital trusts in the South, around half are already iSoft customers. Only 14 of these trusts have nominated Cerner, which originally had the contract for the area, as their supplier. The rest are totally open to approach and we're confident we can win at least 20 of the remaining trusts. We believe these contracts will have substantial value over the next few years. Given that the funding arrangements are unlikely to be put in place until after the election, we wouldn't expect that revenue to begin flowing until well into fiscal year 2011.

In the London region, the more significant teaching hospitals are engaging earlier because they don't depend on government funding for their decision making. We wouldn't be surprised to see some further tender opportunities occurring there this fiscal year.

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Thank you Gary.

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