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16 February 2022

Interview with Dr Sam Hupert, CEO Pro Medicus Ltd

- **First half results and recent contract wins**
- **Shift to Cloud**
- **Increased industry M&A**
- **Recent wins and pipeline**

Q: PME's interim results for the six months to December 31, 2021 look very solid: revenue up 40.3%, net profit up 52.7%. What are your general thoughts on the result?

A: We were very pleased with the result. All our key financial indicators headed in the right direction, not just revenue growth but also profit growth, margin expansion and retained earnings. There were two key drivers behind the result: The first was the significant jump in transaction revenue from our US contracts which grew by 36.8%. We had previously foreshadowed this would happen as we had several large clients that came on-stream towards the end of FY21 namely Northwestern, NYU and Medstar which all contributed a full 6 months of revenue in the half. In addition, we started to see revenue from the new sites we implemented in the half such as Intermountain and UCSF plus growth from existing clients. The second key driver was the extension of the German government contract that we announced in 2015 to a fourth hospital which was a material sale.

Q: What can you say about the key contracts you signed during the half, particularly: Novant Health (A$40m, 7-year deal); your contract renewal with Allegheny Health (A$12m, 5-year deal); and the deal in Europe?

A: It was another very active half on the sales front. We won Novant, our equal largest sale to date and one that increases our presence in the non-academic/IDN space. It was Cloud-based and they are taking multiple products from us, in this case the Visage 7 Viewer and Visage 7 Workflow Manager so it ticks a lot of boxes. We also increased our European footprint with the extension of our German Government Hospital contract to a new region of Germany and there was the renewal of the Allegheny contract.

Q: What were the terms of the Allegheny renewal?

A: It is for another 5 years which is the same term as the original contract which we feel shows their confidence in our offering. As has been the case with our renewals to date, it has been struck at a higher rate than the original contract but less than our current

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market rate which has increased significantly over the years as we feel that clients, such as Allegheny, should benefit from being early adopters of our technology.

Q: EBIT Margin (underlying profit as a percentage of revenue) was close to 65%. Is this in the range you were expecting and how does it relate to the rest of your industry?

A:

This time last year we had a material jump in margins from around 51% to 59%. Our commentary at the time was that this was largely driven by a decrease in our cost base because of Covid; no in person conferences with the RSNA usually our biggest marketing expense, no travel etc. We told the market that as things started to normalise, we anticipated margins would gravitate back to the mid 50's but could grow incrementally as new contracts come on stream but they have stayed above 60% and grown from there. So even though our cost base has increased in line with our projections, our revenue growth has outstripped that.

In terms of where we sit compared to our competitors, I think it is fair to say our margins are most probably the best in the industry and whilst margins are important, they are not our primary focus, the business is. So, if we felt there was a new opportunity or an area of the business where we felt we needed to make a greater investment then we would do that without hesitation if the numbers stacked up. We have plenty of headroom as far as that is concerned.

Q: Your tax rate is now around 30%, a little higher than historic rates. Is this now the new normal?

A: It is. The lower tax rate was a result of the previous tax deductions from our employee share trust. However, this is now normalising, and we anticipate a tax rate somewhere around this level, which is closer to 30% going forward.

Q: Can you talk a little about your multi-product strategy? Are your clients embracing it?

A: Originally, we only offered our cornerstone product– the Visage 7 Viewer in North America adding Visage Open Archive in 2017 and more recently Visage 7 Workflow Manager in 2020. Our expanded product portfolio provides us with unparalleled flexibility in terms of meeting client needs, including providing a single-vendor solution if required as we did for Medstar. And, it has certainly paid dividends with an increasing number of recent sales and opportunities in the pipeline being for more than one of these products. This can have a material impact on the total contract value of a sale as we saw in both the Intermountain and Novant deals. We are also seeing growing interest from our existing user base in these products especially those looking at

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transitioning to Cloud so we think archive and workflow will become a bigger part of the mix going forward.

Q: More and more of your contracts are Cloud-based? Why do Cloud-based solutions appear to be gathering momentum?

A: There has been a huge momentum shift towards Cloud particularly in the last 18 months as witnessed by the fact that the last five of our North American deals have all been Cloud-based. We are also seeing this shift reflected in the RFPs we are receiving, with many of them adopting a Cloud-first strategy. So, Cloud is clearly a trend we see going forward. We think they are a few key drivers for this, the main ones being elasticity/scalability where you can scale up or down computer resources on demand and data security with Cloud providing a safer, more manageable environment than on-premise.

Cloud also provides us a significant strategic advantage in that we are one, if not the only, fully Cloud native solution proven to work at scale as evidenced by our recent Cloud-based successes in Medstar, Intermountain, the UCs and others.

Q: How did Covid affect your operations during the half?

A: We really didn't feel any negative impact. Exam volumes in North America were strong, and in many cases greater than pre-Covid levels. The only region that was marginally affected was Australia where exam volumes dipped a bit in the last 3 months of the half but the majority of our revenue in Australia is not exam-based so that did not impact us financially. In terms of our sales and implementation capability, it was business as usual with a mix of onsite and remote presence which is the model we see going forward.

Q: Your revenue grew in all three key jurisdictions. Can you comment please?

A: As mentioned above the key driver, certainly in North America, was the significant increase in transaction-based revenue, and in Germany it was the extension of the German government contract. Having said that, Australia also grew, albeit by a lower percentage.

Q: Where do you see most growth coming in the second half?

A: We see transaction revenue in North America continuing to increase as a result of implementations in the first half such as Intermountain and the University of California (San Francisco and Irvine) where we will get a full 6-month contribution as well as contributions from implementations that we complete in the current half, which include University of Vermont, which we have recently implemented, UCSD and others.

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Q: Might we see PME make similar inroads into the European market as it has in the USA?

A: We view the European market as more of a medium to long-term opportunity. Europe is not one country but many and most of the health systems are government-run and funded to varying degrees country-to-country. We also see that the opportunities, whilst there are a fair number of them, are much smaller than what we typically see in North America not to mention that the way European health networks buy their informatics is still several years behind the US. For instance, you don't see much Cloud in Europe at least not yet, but we believe this will change in time. When it does it will benefit us given our success in North America.

Q: There has been a lot of press about rising bond rates and inflation affecting technology companies. How might it affect PME's business?

A: Whilst it may affect an analyst's valuation in terms of the discount rate, in the "real world" it has little to no impact on our day-to-day business. If anything, longer term, it may be a positive for us. Healthcare is largely non-discretionary and therefore, as an industry, is to a large degree insulated from fluctuations in interest rates. Our clients are well-funded, and we provide mission-critical systems for them. Our balance sheet also protects us from increasing interest rates as we have no debt. On the positive side of the ledger, we do see potential particularly when it comes to M&A especially if the runway for companies raising VC funding in a high interest rate environment is shortened. This could impact their valuations going forward, making them more attractive to PME.

Q: **There has been unprecedented M&A activity in the Healthcare IT sector recently with Microsoft acquiring Nuance for USD$19.7B and Oracle acquiring Cerner for USD$28.3B, two huge deals. What is your take on this and what does it mean for PME?**

A: Healthcare is the biggest "industry" in the world and accounts for 17% of US GDP so it is not surprising that Big Tech are re-looking at this space. Several of them have had smaller, unsuccessful forays in the past, but these are different times, and they now have Cloud platforms, Data Lakes and the promise of AI to support their efforts so it is a very different ballgame. These two deals are two of the biggest deals done in our industry and not by traditional healthcare companies and I think we will see this trend continuing.

As to what this means for PME, it is a little too early to tell, but I do think we are very well positioned. Imaging is becoming a much larger part of a patient's healthcare record, estimated to be over 90% by volume and growing not to mention the increasing

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roles that Cloud and AI are having in healthcare imaging. So, if anything, we think this increased focus on the sector by Big Tech will be positive for us.

Q: Can you give us some thoughts on your pipeline?

A: It is strong. Those opportunities that were in the pipeline when we last reported continue to progress through the cycle which, in the case of the larger opportunities, can be years not months and we haven't lost any. We are also seeing a lot of new inbound opportunities across multiple segments of the market with a good mix of Cloud opportunities as well as those for multiple PME products. So, all in all, an extremely healthy mix across market and product segments.

Q: The Radiology Society North America (RSNA) conference was held last year in November-December in Chicago in person, but with restrictions. How was it?

A: It was a very interesting conference. Attendee numbers were down by more than 50%, yet we were as busy as we have ever been, it was back to pre-Covid levels, if not busier, at least for us. The other thing we noticed was that new opportunities were a higher percentage of traffic in our booth this year as compared to previous RSNAs. We think this is because those who came to the RSNA were coming for a specific purpose such as assessing informatics systems or purchasing equipment rather than purely for the academic program, much more so than previous years.

Q: Can you comment on your cash reserves, which rose by $14.9 million during the half, despite an increase of $2.1 million in dividend payouts and greater investment in R&D?

A: Clearly, we are pleased that we continue to accrue cash, and we see this trend continuing. We feel this gives us enormous flexibility, particularly when it comes to investment in the business, which as mentioned above, is our primary focus. Examples of this are the establishment of our new R&D hub in New York in August 2021 as part of our agreement with NYU in addition to our increased global spend on R&D both of which underpin our technology leadership position.
We have also been able to increase our dividend while still retaining a "war chest" for possible M&A activity in the future.

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Thank you, Sam
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Authorised by the Board of Pro Medicus Limited.