BELL POTTER

30 November 2025

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Integrated Research (IRI)

A flat first half would be a good result

Recommendation
Buy (unchanged)
Price
$2.12
Target (12 months)
$2.90 (unchanged)

Expected Return	
Capital growth	36.8%
Dividend yield	4.0%
Total expected return	40.8%
Company Data & Ratios	
Enterprise value	$346.0m
Market cap	$361.3m
Issued capital	170.4m
Free float	47%
Avg. daily val. (52wk)	$329,490
12 month price range	$0.92 - $2.80
GICS sector	Software and Services

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	2.51	2.11	0.93
Absolute (%)	-15.54	0.47	127.96
Rel market (%)	-12.87	-0.97	130.23

1HFY15 was a very strong result ….

The 1HFY15 result of Integrated Research (IR) was particularly strong with revenue up 28% to $33.5m and NPAT up 67% to $7.5m. The result was strong across the board with all product lines growing, an increase in the NPAT margin from 17.2% to 22.5% and a currency tailwind that generated almost a third of the growth in NPAT. The company also secured three large licence sales in the period with General Motors, Citigroup and Dimension Data which helped lift total licence sales in the half by 43% and was a key driver of the strong revenue growth. In all it was a record six month result for IR and the culmination of many years of work as well as some early success from the recent introduction of strategic initiatives.

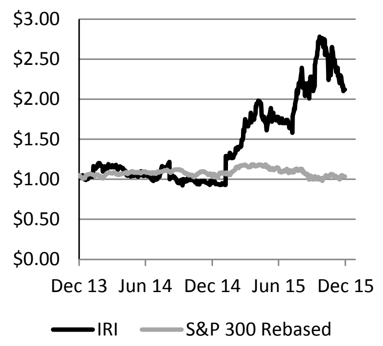
…. so a flat 1HFY16 would actually be good

What this means is that the 1HFY15 result will be hard to beat and a flat or close to flat result would actually be good. Yes there will be a currency tailwind again and also a six month contribution from the IQ Services acquisition but what is unlikely to be repeated is the three large licence sales in 1HFY15 and a more likely outcome is one or two large licence sales in 1HFY16. Put together this means 1HFY16 NPAT is likely to be around or modestly below 1HFY15 NPAT and the key swing factor will be how many large licence sales occur in the period. We forecast 1HFY16 NPAT of $7.2m which is 4% below the 1HFY15 result and assumes two large licence sales. We note this forecast, however, is ahead of the 2HFY15 NPAT of $6.7m.

Investment view: Retain BUY, PT $2.90

We maintain our BUY recommendation and $2.90 price target on IR. There is no change in our earnings forecasts but we have updated each valuation we use in the determination of our price target for recent market movements and the time creep. We have also reduced the premium we apply in the relative valuations from 15% to 10% due to the likelihood of a relatively flat 1HFY16 result. The net result, however, is no change in our $2.90 price target which is a 37% premium to the current share price.

Absolute Price



SOURCE: IRESS

Earnings Forecast

Year end 30 June	2015	2016e	2017e	2018e
Total revenue (A$m)	70.3	85.5	96.0	105.5
EBITDA (A$m)	28.1	32.0	36.2	40.3
NPAT (A$m)	14.3	16.9	19.6	22.3
EPS (diluted) (cps)	8.3	9.8	11.4	13.0
EPS growth (%)	67%	18%	16%	13%
PER (x)	25.4	21.6	18.6	16.4
Price/CF (x)	16.9	12.2	12.6	11.2
EV/EBITDA (x)	12.3	10.6	9.4	8.3
Dividend (¢ps)	7.5	8.5	9.0	10.0
Yield (%)	3.5%	4.0%	4.2%	4.7%
ROE (%)	39.4%	41.9%	44.1%	44.2%
Franking (%)	35%	35%	35%	35%

SOURCE: BELL POTTER SECURITIES ESTIMATES

1HFY16 Preview

Our forecast for the 1HFY16 result is shown in Figure 1 below.

Figure 1 - Forecast 1HFY16 P&L

Year end 30 June	1HFY15	1HFY16e	*Change*
Total revenue (A$m)	**33.5**	**38.5**	*15%*
Expenses			
Sales, consulting and marketing	15.8	20.5	*30%*
R&D	6.2	6.3	*2%*
General & Administrative	2.5	2.6	*4%*
Total operating expenses	**24.5**	**29.4**	***20%***
Expenses as % of revenue	*73.2%*	*76.5%*	
Other income (e.g. forex gains/losses)	0.9	0.5	*-47%*
EBITDA	**14.3**	**14.3**	***0%***
Depreciation	-0.3	-0.4	*8%*
Amortisation	-4.1	-4.4	*8%*
EBIT	**9.9**	**9.5**	***-4%***
Net interest (expense)/revenue	0.1	0.1	*-24%*
Profit before tax	**10.1**	**9.7**	***-4%***
Income tax expense	-2.5	-2.4	*-4%*
NPAT	**7.5**	**7.2**	***-4%***
EBITDA margin	*42.8%*	*37.1%*	*-568bps*
EBIT margin	*29.6%*	*24.8%*	*-483bps*
Effective tax rate	*-25.1%*	*-25.0%*	*5bps*
Weighted average fully diluted shares	169.6m	171.1m	*1%*
Diluted EPS (cents)	**4.5c**	**4.2c**	***-5%***
Interim dividend	3.5c	3.5c	*0%*
Franking	*35%*	*35%*	
Payout ratio (on total dividend)	*78%*	*82%*	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

The key take-outs are:

- **Forecast 15% increase in revenue**: We forecast a 15% increase in 1HFY16 revenue to $38.5m which is being driven by currency, a six month contribution from IQ Services and contributions from new products including Contact Center and Call Recording Assurance. That is, we expect underlying revenue in constant currency to be relatively flat compared to the pcp.
- **Forecast 20% increase in expenses**: We forecast a 20% increase in 1HFY16 operating expenses to $29.4m which is also being driven by currency and a six month contribution from IQ Services but is also due to the additional costs added in 2HFY15. At the recent AGM, CFO Peter Adams made particular mention of the additional costs that were added in 2HFY15 that would apply for a full 12 months in FY16.
- **Forecast flat EBITDA but 4% decrease in NPAT**: We forecast 1HFY16 EBITDA to be flat at $14.3m but, due to an increase in forecast D&A and a decrease in forecast net interest revenue, we forecast a 4% decrease in 1HFY16 NPAT to $7.2m. We note, however, that our 1HFY16 EBITDA and NPAT forecasts are ahead of the 2HFY15 EBITDA and NPAT of $13.7m and $6.7m respectively.

Earnings and Valuation Changes

No Change in Forecasts

There is no change in our earnings forecasts. Despite forecasting a modest decrease in 1HFY16 NPAT, we continue to forecast a strong 18% increase in FY16 NPAT. That is, we forecast a particularly strong 2HFY16 result where we forecast a 43% increase in NPAT relative to 2HFY15 and expect three or more large licence sales to occur. (A number of large term licences are due for renewal in or around 2HFY16 and hence why we expect a greater number of large licence sales compared to 1HFY16.) Note that our FY16 NPAT forecast of $16.9m is still below the required $17.8m for the vesting of performance shares for the CEO. We view the required $17.8m as a stretch target but achievable and depends on such factors as currency, the timing of large licence sales, the performance of IQ Services and the success of new product releases.

A summary of our key forecasts for IR is shown in Figure 2 below.

Figure 2 - Summary of key forecasts

Year end 30 June	2016e	*Change*	2017e	*Change*	2018e	*Change*
Total revenue (A$m)	85.5	*22%*	96.0	*12%*	105.5	*10%*
EBITDA	32.0	*14%*	36.2	*13%*	40.3	*11%*
NPAT	16.9	*18%*	19.6	*16%*	22.3	*14%*
Diluted EPS (Ac)	**9.8c**	*18%*	**11.4c**	*16%*	**13.0c**	*13%*
DPS (Ac)	8.5c	*13%*	9.0c	*6%*	10.0c	*11%*

SOURCE: BELL POTTER SECURITIES ESTIMATES

No Net Change in Price Target

There is no change in our earnings forecasts but we have updated each valuation we use in the determination of our price target for recent market movements and the time creep. We have also reduced the premium we apply in the relative valuations from 15% to 10% due to the likelihood of a relatively flat 1HFY16 result. The key assumptions we employ in the DCF valuation of a 10.4% WACC and 3.0% terminal growth rate remain unchanged.

The change in each valuation and the impact on the price target calculation is shown in Figure 3 below.

Figure 3 - Change in valuations and impact on price target

	Old (as at 7-Oct-15)			New (as at 30-Nov-15)		
	Valuation per share	% weighting	Price target	Valuation per share	% weighting	Price target
Methodology						
PE ratio	$2.85	40%	$1.14	$2.84	40%	$1.13
EV/EBITDA	$3.35	40%	$1.34	$3.36	40%	$1.34
DCF	$2.08	20%	$0.42	$2.11	20%	$0.42
Total			**$2.90**			**$2.90**

SOURCE: BELL POTTER SECURITIES ESTIMATES

Figure 3 shows there is little change in each of the valuations. In the relative valuations of PE ratio and EV/EBITDA, the reduction in the premium from 15% to 10% has effectively been offset by an increase in the average multiples of the listed peers. In the absolute DCF valuation, there has been a modest increase due to the time creep. The net result, however, is no change in our $2.90 price target which is a 37% premium to the current share price.

Integrated Research

Company Description

Integrated Research (IR) is a leading global provider of performance management software for business-critical computing environments. The core product of the company – Prognosis – is an integrated suite of products that provides availability and performance management, diagnostics and insight for systems including Unified Communications, Payments and IT Infrastructure. Prognosis is used by many of the world's largest organisations including major stock exchanges, banks and telecommunication companies.

Investment Thesis

We maintain our BUY recommendation on IR. Our investment thesis is based on:

- **$2.90 price target**: Our 12 month price target for IR is $2.90. The price target is generated from a blend of three valuation methodologies we apply to the company: PE ratio, EV/EBITDA and DCF. The price target is a 37% premium to the current share price and the total expected return (which includes the forecast dividend yield) is 41%.
- **High level of recurring revenue**: IR generates most of its revenue through licence and maintenance fees which combined represent >90% total revenue. The maintenance fees (c.35% of total revenue) are by nature highly recurring but the licence fees (c.55% of total revenue) are also highly recurring as the licences are typically sold on a fixed term and the company has a very high renewal rate (>95%).
- **Tier one global customers**: IR is a truly global company (>95% of total revenue is generated outside of Australia) and has a tier one customer base including many of the world's largest organisations. Companies that use IR's software include six of the ten biggest stock exchanges, seven of the ten biggest telcos, nine of the top ten US banks and four of the ten biggest oil and gas companies.

Key Risks

Key downside risks to our estimates and valuation include (but are not limited to):

- **Technology risk**: IR is a technology company that designs, develops and distributes software. The risk with any such company is that the software does not perform to the clients' expectations or is flawed in some way. Such an occurrence would negatively impact the company's reputation and provide downside risk to our estimates.
- **Competition risk**: IR operates in a competitive market and there is the risk of aggressive or irrational behaviour from one or more competitors who could force down prices and reduce operating margins across the entire market. There is also the risk that a competitor comes out with a superior product to the rest of the market and increases its market share at the expense of IR and other participants.
- **Key product risk**: IR has one key product – Prognosis – and so has key product risk if demand or the outlook for that product changes or, worse, the product becomes superseded or obsolete. IR aims to mitigate this risk by regularly updating the product and adding new functionality and features to the software (e.g. mobile access and interface, cloud-based delivery, etc.) as well as developing various versions for different platforms, vendors and applications. There is still, however, only one core product that drives the future performance and viability of the company.

Integrated Research
as at 30 November 2015

Recommendation	Buy
Price	$2.12
Target (12 months)	$2.90

Table 1 - Financial summary

Integrated Research (IRI)

Share price:	$2.12	**Target price:**	$2.90
No. of issued shares:	170.4m	**Market cap:**	$361.3m

Profit & Loss (A$m)					
Year end 30 Jun	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Total revenue	**53.2**	**70.3**	**85.5**	**96.0**	**105.5**
Change	*9%*	*32%*	*22%*	*12%*	*10%*
Expenses (excl. D&A, int.)	**42.6**	**52.8**	**63.3**	**70.1**	**76.0**
% of revenue	*80.0%*	*75.1%*	*74.0%*	*73.0%*	*72.0%*
Other income (fx gains/losses)	-0.4	1.5	0.0	0.0	0.0
EBITDA	**17.8**	**28.1**	**32.0**	**36.2**	**40.3**
Depreciation	-0.6	-0.7	-0.8	-0.8	-0.8
Amortisation	-6.9	-8.4	-9.0	-9.5	-10.0
EBIT	**10.3**	**19.0**	**22.2**	**25.9**	**29.5**
Net interest (expense)/revenue	0.4	0.3	0.2	0.2	0.2
Pre-tax profit	**10.7**	**19.3**	**22.5**	**26.1**	**29.8**
Income tax expense	-2.2	-5.0	-5.6	-6.5	-7.4
NPAT	**8.5**	**14.3**	**16.9**	**19.6**	**22.3**
Change	*-6%*	*68%*	*18%*	*16%*	*14%*

Cash Flow (A$m)					
Year end 30 Jun	**2014**	**2015**	**2016e**	**2017e**	**2018e**
EBITDA	17.8	28.1	32.0	36.2	40.3
Change in working capital	0.6	-4.9	3.4	-0.9	-0.3
Gross cash flow	**18.5**	**23.2**	**35.4**	**35.3**	**40.0**
Tax paid	-2.4	-1.7	-5.6	-6.5	-7.4
Operating cash flow	**16.0**	**21.4**	**29.8**	**28.8**	**32.6**
Payments for capitalised R&D	-8.0	-9.0	-9.5	-9.7	-10.0
Payments for PPE	-0.6	-1.0	-0.8	-0.8	-0.8
Payments for intangibles	-0.2	-0.1	-0.1	-0.1	-0.1
Divestment of assets	0.0	0.0	0.0	0.0	0.0
Interest received	0.4	0.3	0.2	0.2	0.2
Investing cash flow	**-8.4**	**-9.9**	**-12.1**	**-11.9**	**-12.2**
Proceeds from issue of shares	0.2	0.0	0.0	0.0	0.0
Dividends paid	-9.3	-10.2	-12.8	-15.4	-16.3
Financing cash flows	**-9.1**	**-10.2**	**-12.8**	**-15.4**	**-16.3**
Net change in cash	**-1.5**	**1.4**	**4.9**	**1.5**	**4.1**
Cash at start of period	14.8	13.3	15.3	20.2	21.7
Exchange rate impact	-0.1	0.6	0.0	0.0	0.0
Cash at end of period	**13.3**	**15.3**	**20.2**	**21.7**	**25.8**

Balance Sheet (A$m)					
Year end 30 Jun	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Cash	13.3	15.3	20.2	21.7	25.8
Current receivables	20.2	25.0	29.9	32.7	34.8
Other current assets	1.6	1.5	1.5	1.5	1.5
Non-current receivables	2.6	13.3	8.6	8.6	8.4
Financial assets	0.8	0.8	0.8	0.8	0.8
PPE	1.7	2.0	2.1	2.1	2.2
Deferred tax assets	1.5	1.3	1.3	1.3	1.3
Intangibles - Goodwill	0.0	0.0	1.1	1.9	2.8
Intangibles - Other	16.3	17.0	18.4	19.4	20.1
Total assets	**58.0**	**76.3**	**84.0**	**90.1**	**97.8**
Payables	4.1	7.2	7.7	7.7	7.9
Current provisions	2.1	2.3	2.3	2.3	2.3
Current tax liabilities	0.2	1.7	1.7	1.7	1.7
Current deferred revenue	13.6	18.7	21.4	23.1	24.3
Deferred tax liabilities	3.7	4.4	4.4	4.4	4.4
Non-current provisions	0.8	0.9	0.9	0.9	0.9
Non-current deferred revenue	2.8	3.8	4.3	4.6	4.7
Total liabilities	**27.2**	**40.1**	**43.7**	**45.7**	**47.3**
Issued capital	1.7	1.7	1.7	1.7	1.7
Reserves	-0.4	0.9	0.9	0.9	0.9
Retained earnings/(losses)	29.4	33.5	37.6	41.9	47.9
Total shareholders' equity	**30.7**	**36.1**	**40.2**	**44.5**	**50.6**

Valuation data					
Year end 30 Jun	**2014**	**2015**	**2016e**	**2017e**	**2018e**
NPAT (A$m)	8.5	14.3	16.9	19.6	22.3
Diluted EPS (cps)	5.0	8.3	9.8	11.4	13.0
Change	*-7%*	*67%*	*18%*	*16%*	*13%*
P/E ratio (x)	**42.4**	**25.4**	**21.6**	**18.6**	**16.4**
CFPS (cps)	9.4	12.5	17.4	16.8	18.9
Price/CF (x)	**22.5**	**16.9**	**12.2**	**12.6**	**11.2**
DPS (cps)	5.0	7.5	8.5	9.0	10.0
Yield	**2.4%**	**3.5%**	**4.0%**	**4.2%**	**4.7%**
Franking	33%	35%	35%	35%	35%
EV/EBITDA (x)	**19.5**	**12.3**	**10.6**	**9.4**	**8.3**
EV/EBIT (x)	33.9	18.2	15.3	13.1	11.4
NTA per share (cps)	8.6	11.3	12.2	13.6	16.1
Price/NTA (x)	**24.7**	**18.8**	**17.4**	**15.6**	**13.1**

Performance ratios					
Year end 30 Jun	**2014**	**2015**	**2016e**	**2017e**	**2018e**
EBITDA margin	**33.5%**	**40.0%**	**37.5%**	**37.7%**	**38.2%**
EBIT margin	19.3%	27.0%	26.0%	27.0%	28.0%
Return on assets	14.6%	18.7%	20.1%	21.8%	22.8%
Return on equity	**27.6%**	**39.4%**	**41.9%**	**44.1%**	**44.2%**
ROIC	62.9%	99.2%	109.0%	121.3%	124.5%
Payout ratio	99.4%	89.2%	85.8%	78.4%	76.8%
Effective tax rate	-20.3%	-26.0%	-25.0%	-25.0%	-25.0%

Leverage ratios					
Year end 30 Jun	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Net debt/(cash) (A$m)	-13.3	-15.3	-20.2	-21.7	-25.8
Net debt/equity	**NM**	**NM**	**NM**	**NM**	**NM**
Gearing	NM	NM	NM	NM	NM
Net debt/EBITDA (x)	NM	NM	NM	NM	NM
Net interest cover (x)	NM	NM	NM	NM	NM

Segmentals (A$m)					
Year end 30 Jun	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Revenue by product					
Unified Communications	25.1	36.5	44.7	51.4	57.8
Infrastructure	19.5	23.2	24.9	26.3	27.5
Payments	4.0	5.1	6.1	7.3	8.4
Consulting Services	4.6	5.5	6.1	6.6	6.9
Total revenue	**53.2**	**70.3**	**85.5**	**96.0**	**105.5**
Revenue by fees					
Licence fees	28.0	41.0	46.2	50.9	54.9
Maintenance fees	20.6	23.7	29.5	34.1	38.8
Consulting fees	4.6	5.5	6.1	6.6	6.9
Total revenue	**53.2**	**70.3**	**85.5**	**96.0**	**105.5**
% breakdown by fees					
Licence fees	*53%*	*58%*	*54%*	*53%*	*52%*
Maintenance fees	*39%*	*34%*	*34%*	*35%*	*37%*
Consulting fees	*9%*	*8%*	*7%*	*7%*	*7%*
Total	***100%***	***100%***	***100%***	***100%***	***100%***

Interims (A$m)				
Year end 30 Jun	**1HFY15**	**2HFY15**	**1HFY16e**	**2HFY16e**
Total revenue (A$m)	**33.5**	**36.8**	**38.5**	**0.0**
Change	*28%*	*36%*	*15%*	*0%*
EBIT	**9.9**	**9.0**	**9.5**	**12.7**
Net interest (expense)/revenue	0.1	0.1	0.1	0.1
Pre-tax profit	**10.1**	**9.2**	**9.7**	**12.8**
Income tax expense	-2.5	-2.5	-2.4	-3.2
NPAT	**7.5**	**6.7**	**7.2**	**9.6**

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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