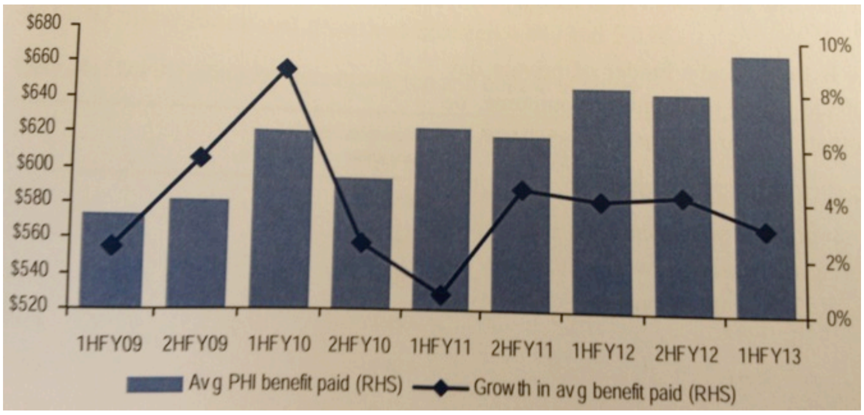
IPO Notes

Background

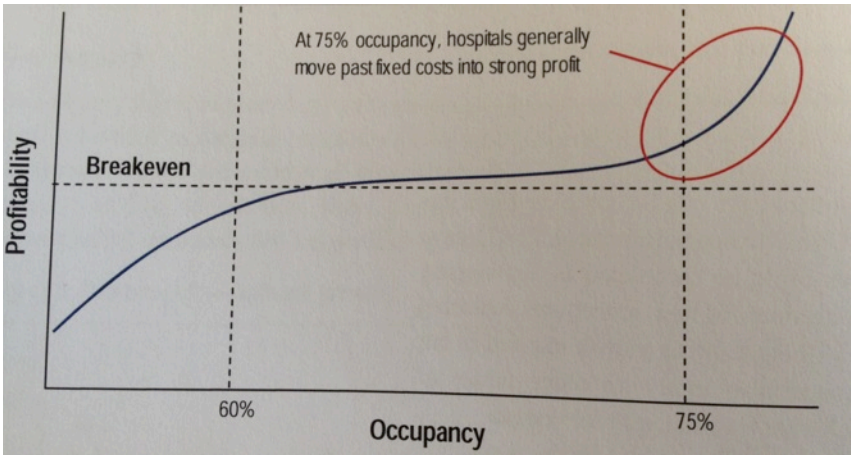
- Assisted Reproductive Technology (ART) provider.
- Vertically integrated network of 36 clinics with 83 fertility doctors
- 16 embryology (female health), 17 andrology (male health) and, 6 diagnostic labs. 6 day hospitals.
- Business is well supported by demographic shift of couples having children later in life. Advancing age (particularly > 35) brings a material reduction in fertility. Less than 10% of original eggs remain at this age. Average age of a woman giving birth in Australia now 30 years of age, 165% higher than one generation ago (1975). Trend continues @ 3.8% CAGR.
- IVF patients require on average ~1.5 cycles before a successful pregnancy. Average cost per cycle $10,125 reimbursed (largest business risk is legislative change and willingness of insurers to rebate e.g. means test brought in Ju-12) as follows:
- 55 per cent of total average cost via Medicare. 37% of this via Medical Benefits Schedule (MBS), 18 per cent balance by Extended Medicare Safety Net (EMSN).
- 10 per cent by private insurance, 35% per cent out-of pocket expenses. This increases to 45% if not privately insured.

Revenue Generation

- Balance of revenue (other 43%) comes from non-ART services to support ART via 5 genetic diagnosis / pathology / screening / cryostorage (banking/freezing) labs and 6 day hospitals. These services can scale 50% with very little additional investment.
- **Day Surgery:** Private Health Insurance is the primary funder for day surgery. Day surgery costs around $1,200 per patient with PHI covering an average of ~$660.



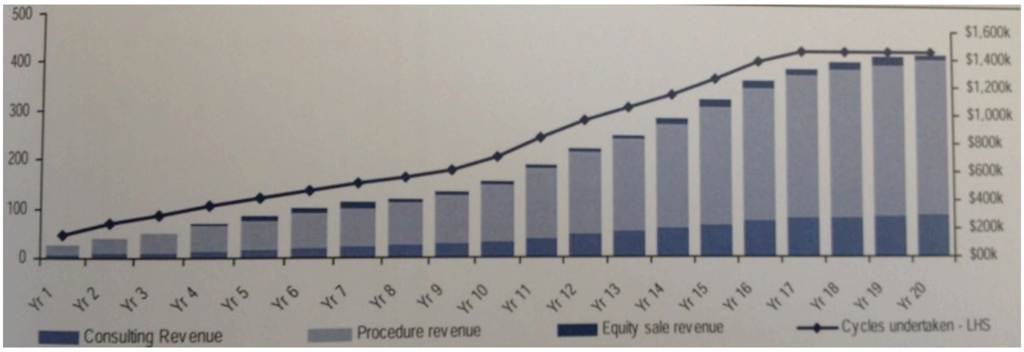
- The scalability in day surgery can be seen in the below chart when occupancy levels are > 60% and exponential profits occur > 75%. Consistent occupancy levels in excess of 75% are the level in which real scale benefits are derived.



- Occupancy level trends have not been provided. However, it is estimated that this number is closer to 50-60% (they are break-even / just profitable) and the trend in capacity is 'slowly' improving.

Potential Market

- Clinical Potential Market = couples/ women aged 18 → 50 years, around 12% of all women and 17% of all couples will have fertility problems. 30% infertility caused by men, 53% woman, balance = both.
- Total market potential for IVF, lab and day surgery, pathology, diagnostic market \$520m - \$290m Medicare (large regulatory risk), \$52m private insurers, \$176m self funded.
- VRT has 35% by no. of cycles, market =111 clinics, Virtus 36 = 32.5% by clinics.
- Market is growing at 5% per annum. ART market is growing significantly stronger than Australia's birth rate of just 1.2% given +3.8% age-related fertility trends.
- As a percentage of the 'clinical potential market', ART is just ~26% penetrated, plenty of potential market growth to come in the years ahead. Upside to these growth levels can come from awareness, affordability, and geographical expansion of offering.



- Whilst the above 'potential' earnings graphic is a nice chart, at year, post the initial contract term, an average fertility specialist still has 13-14 years before earnings peak – how are DR's incentivised to stay? It's an important question given experienced Doctors with established networks clearly drive the majority of ART patients to Virtus.
- An advantage of the Virtus model is the fact that specialists are not purchased, as in the case of Primary Healthcare (which also does not amortise this cost). No goodwill is hence generated. Hence, the equity component of a specialist in Virtus is relatively minor.
- The benefit of this is each doctor will focus on profitability rather than share price. Whilst the cost / revenue is higher under this model initially to Virtus, the ratio smoothes out over time at ~19%, providing high returns on

investment IF specialists stay within the model for > ~8 years.

Competition

- Heavily concentrated market with 70% of clinics operated by four corporate.
- Virtus – 36 Clinics, Health Bridge – 19, Genea – 14, City Fertility – 9.
- 33 are privately owned.
- No fertility specialists have left Virtus to start their own private clinics, although this is a risk. Noting Virtus has acquired 2 private practices.
- Model assumptions:
- Payout ratio historical (not provided) and forecast is the same as UBSe
- NPAT growing to 31.6m is spread out over 2014 and 2015. We know that the industry has and will grow longer-term, hence I'm more comfortable with growths rates of ~10% then ~22% - unless the business achieves scale, which is unlikely until surgeries get > 75% utilisation.
- I'm comfortable using accrual earnings given FCF (OCF – CAPEX) matches. Hence there is another layer of conservatism built in here given some CAPEX is growth investment.
- Discount rate is similar to that applied to RHC, RMD – other healthcare providers – 8%
- This provides a total equity valuation range of \$470m to \$540m. Which is on-par with the high-end range estimate over multiple valuation methods