Virtus Health Limited
Appendix 4D
Half-year report

1. Company details

Name of entity:	Virtus Health Limited
ABN:	80 129 643 492
Reporting period:	For the half-year ended 31 December 2019
Previous period:	For the half-year ended 31 December 2018

2. Results for announcement to the market

The Directors of Virtus Health Limited ('Virtus') announce the results for the half-year ended 31 December 2019 ('H1 FY2020'). Key highlights from the results are:

				$'000
Revenues from ordinary activities	up	1.0%	to	142,050
Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA)	up	21.9%	to	39,536
Earnings Before Interest and Tax (EBIT)	up	3.9%	to	26,861
Profit from ordinary activities after tax	up	3.7%	to	15,469
Profit for the half-year attributable to the owners of Virtus Health Limited	up	2.3%	to	14,968

Dividends

	Amount per security Cents	Franked amount per security Cents
Final ordinary dividend paid for the year ended 30 June 2019 paid in October 2019	12.00	12.00

An interim dividend of 12.00 cents per share fully franked will be paid on 16 April 2020 for shareholders on the register at 26 March 2020.

Comments
The profit for the consolidated entity after providing for income tax and non-controlling interest amounted to $14,968,000 (31 December 2018: $14,635,000).

The implementation with effect from 1 July 2019 of the new accounting standard AASB 16 'Leases' had a significant impact on the EBITDA for the current period. The current EBITDA was increased by $7,406,000 resulting from a reduction in other expenses (reclassification of lease expenses) that was replaced by a depreciation charge in respect of the right of use assets of $5,930,000 (included in operating costs) and interest expense on the recognised lease liabilities of $1,737,000 (included in finance costs). The overall net impact on profit before income tax expense for the current period as a result of the implementation of AASB 16 'Leases' was a reduction of $260,000.

A reconciliation of Segment EBITDA to statutory profit before tax for the financial half-year is as follows:

	Consolidated	
	31 Dec 2019	**31 Dec 2018**
	$'000	**$'000**
Segment EBITDA[1]	46,474	38,936
Share-based payment expense	(629)	(613)
Other non-trading expenses	(7,809)	(6,640)
Fair value adjustment to put liabilities	1,500	758
EBITDA (reported)	39,536	32,441
Depreciation and amortisation expenses[2]	(12,675)	(6,595)
EBIT	26,861	25,846
Net finance costs[3]	(5,510)	(4,891)
Profit before income tax from continuing activities	21,351	20,955

Notes:

1 . Segment EBITDA - Excludes $7.4m of lease payments reclassified to Depreciation and Interest charges on adoption of AASB 16 'Leases'

2 . Depreciation and amortisation - Includes $5.9m of depreciation on Right-of-use assets arising from adoption of AASB 16 'Leases'

3 . Net finance costs - Includes $1.7m of interest on lease liabilities arising from adoption of AASB 16 'Leases'

Key features of the results are:

- Revenue increased 1.0% to $142.1m;
- EBITDA increased 21.9% to $39.5m (see earlier comments on impact of the implementation of AASB 16 'Leases' on EBITDA); and
- Profit before income tax expense increased 1.9% to $21.4m

Profit before income tax for the period was impacted by restructuring costs totalling $1,351,000 (including CEO transition and recruitment costs of $748,000) with the benefit of these restructuring activities to be realised in future periods. Other significant items reflected in profit before income tax were non-cash interest expense of $246,000 and a fair value gain of $1,500,000 on the put option liabilities relating to Sims and TasIVF.

Operating overview

The operating overview commentary below excludes the impact of adopting AASB 16 'Leases' on the EBITDA of $7,406,000 noted above.

Australia

Virtus fresh cycle activity in Australia in the half year increased by 2.7% compared to an increase in Virtus' available market of 1.2%. Key aspects of the volume movements compared to pcp were as follows:

- Premium service volumes reduced by 3.1% with growth in lower margin Queensland volume offset by declines in New South Wales and Tasmania. Premium service volumes in Victoria were unchanged; and
- TFC volumes increased by 30.2% with growth achieved in every TFC clinic compared to pcp.

Overall, EBITDA in the Australian segment increased by approximately $0.3m and there were three main factors contributing to this movement:

- Increased cycle activity in IVF clinics resulted in an improvement in EBITDA of $1.3m with improvement achieved in Victoria, Queensland and Tasmania;
- Specialist diagnostic revenue was unchanged in H1 FY2020 compared to H1 FY2019 reflecting continued weakness in PGT activity and softer pathology volume from premium service cycles. The profitability of the diagnostic activity was also negatively impacted by increased supervision costs resulting from new regulatory requirements which were introduced in October 2019 and higher rental costs from the new diagnostic laboratory. The combination of these factors contributed to a decrease in EBITDA of approximately $1.0m in the half year compared to pcp; and
- In day hospitals, revenue increased by 2.9%, a consequence of improved demand for non-IVF procedures which now account for 50.0% of total day hospital revenue. Non-IVF revenue increased by 6.8% whereas revenue from IVF procedures decreased by 0.7% across all day hospitals. Day Hospital EBITDA was unchanged compared to pcp.

International
Ireland experienced a slightly stronger first half in spite of a cycle volume decline of 1.7%. EBITDA in local currency increased by 17.1% primarily related to effective cost management.

Volumes in Singapore increased by 18.2% and EBITDA in local currency increased by 77.4% compared to pcp.

The Danish clinics experienced a difficult six months with cycles down by 8.7%, impacted by a reduction in cycles from Swedish based patients following the relaxation of donor cycle regulations in Sweden and under resourcing of specialists in the Aagaard clinic. Danish EBITDA declined by 45% compared to pcp. The specialist resourcing issues have been addressed as of 31 December 2019.

In the UK, Complete Fertility increased revenue by 13.4% and this resulted in EBITDA performance more than double that of the pcp.

Operating expenses
Group OPEX was approximately $2.3m higher than pcp and this comprised the following major movements:
- Costs associated with CEO transition and recruitment, $0.75m;
- Employment costs (excluding CEO transition and recruitment costs) were up by $2.2m (4.3%), although this included significant employment termination costs ($0.6m). The benefit of these restructure activities will start to be realised in the second half;
- Facility costs were also up by $0.6m reflecting increased occupancy costs of the Diagnostic laboratory facility relocation completed in April 2019.

Operating cash flow
Net cash from operating activities increased by $8.5m to $23.6m primarily because of a reclassification of $5.7m of lease payments to financing activities as a result of adopting AASB 16 'Leases'. The remaining increase is a result of positive working capital movements and lower interest payments (reflecting the lower debt level).

Capital Expenditure
Total expenditure on tangible and intangible assets was $2.8m in H1 FY2020 (H1 FY2019; $9.0m). H1 FY2019 included significant investments relating to the development of Alexandria Specialist Day Hospital in NSW and Hobart Specialist Day Hospital in Tasmania both of which completed in FY2019.

Debt and interest expense
At 31 December 2019, total facilities drawn were $172.0m in borrowings and $5.2m in guarantees. Unused and available facilities amounted to $84.8m. $92m of the credit facility expires in September 2021, whilst the remaining $170m expires in September 2023. Cash balances at the end of December 2019 were $12.5m.

The company continued to comply with the financial covenants of its facility agreement. Additional debt repayments and lower non-cash interest as a result of the settlement of put option liabilities resulted in reduced interest payments compared to pcp.

Other financial liabilities ($8.6m)
The non-controlling interests of Sims Clinic Limited and TasIVF Pty Limited held put options established at the time of acquisition in 2014. In accordance with accounting standards the group is required to recognise liabilities for the estimated consideration to acquire the non-controlling interests. The liabilities have been discounted at the date of acquisition and the corresponding entry is included in the business combinations reserve. The unwinding of the inherent discounting within the liabilities has resulted in a nil non-cash interest expense in H1 FY2020 (H1 FY2019: $335,000).

The second and final put option in relation to 15% of Sims Clinic Limited was exercised during December 2019 and resulted in a payment of $6.6m. At 31 December 2019 the carrying value of the remaining put option liability in relation to 15% of TasIVF Pty Limited is $0.5m and has been classified as a current liability. This put option was exercised on 31 January 2020 bringing Virtus' ownership of TasIVF to 100%.

The remaining $8.1m of the balance of other financial liabilities relates to contingent consideration ($5.7m) and a vendor loan note ($2.4m) in relation to the acquisition of Fertilitesklinikken Trianglen Aps. The unwinding of the inherent discounting within these liabilities has resulted in a non-cash interest expense of $246,000 in H1FY2020 (H1FY2019: $368,000)

Amortisation of borrowing costs
Amortisation of borrowing cost expense for H1 FY2020 was $205,000 (H1 FY2019: $353,000). H1 FY2019 included a write-off of residual borrowing costs on the previous facility that was refinanced in September 2018.

Taxation
The effective tax rate on operating earnings for H1 FY2020 was 27.5% (H1 FY2019: 28.8%). The decrease reflects a lower effective tax rate expected for the full year from lower non-deductible items as a result of the put option liabilities that have settled.

Earnings per share
Basic earnings per share increased by 2.4% to 18.65 cents per share (H1 FY2019: 18.21 cents per share). Diluted earnings per share increased by 2.1% to 18.48 cents per share (H1 FY2019: 18.10 cents per share).

Dividend
An interim dividend of 12.00 cents per share fully franked (April 2019: 12.00 cents per share) will be paid on 16 April 2020 to shareholders on the register at 26 March 2020.

3. Net tangible assets

	Reporting period Cents	Previous period Cents
Net tangible assets per ordinary security	(208.76)	(205.20)
Net assets per ordinary security	360.06	366.48

4. Control gained over entities

Not applicable.

5. Loss of control over entities

Not applicable.

6. Dividends paid

Current period

	Amount per security Cents	Franked amount per security Cents
Final ordinary dividend paid for the year ended 30 June 2019 paid in October 2019	12.00	12.00

Previous period

	Amount per security Cents	Franked amount per security Cents
Final ordinary dividend paid for the year ended 30 June 2018 paid in October 2018	12.00	12.00

7. Dividend reinvestment plans

Not applicable.

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8. Details of associates and joint venture entities

Name of associate / joint venture	Reporting entity's percentage holding		Contribution to profit/(loss) (where material)	
	Reporting period %	Previous period %	Reporting period $'000	Previous period $'000
Obstetrics & Gynaecological Imaging Australia Pty Limited and City West Specialist Day Hospital Pty Ltd	50.00%	50.00%	291	249
Group's aggregate share of associates and joint venture entities' profit/(loss) (where material)				
Profit/(loss) from ordinary activities before income tax			291	249
Income tax on operating activities			(87)	(75)

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9. Foreign entities

Details of origin of accounting standards used in compiling the report:

Virtus Health Limited's foreign subsidiaries have used the International Financial Reporting Standards in compiling the report.

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10. Audit qualification or review

Details of audit/review dispute or qualification (if any):

The financial statements were subject to a review by the auditors and the review report is attached as part of the Interim Report.

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11. Attachments

Details of attachments (if any):

The Interim Report of Virtus Health Limited for the half-year ended 31 December 2019 is attached.

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12. Signed

Signed ______________________ Date: 18 February 2020

Glenn Powers
Chief Financial Officer and Company Secretary
Sydney

Virtus Health Limited

ABN 80 129 643 492

Interim Report - 31 December 2019

The directors present their report, together with the financial statements, on the consolidated entity (referred to hereafter as the 'consolidated entity') consisting of Virtus Health Limited (referred to hereafter as the 'company' or 'parent entity') and the entities it controlled at the end of, or during, the half-year ended 31 December 2019.

Directors
The following persons were directors of Virtus Health Limited during the whole of the financial half-year and up to the date of this report, unless otherwise stated:

Peter Macourt - (resigned on 20 November 2019)
Susan Channon
Lyndon Hale
Sonia Petering - (appointed chairperson on 20 November 2019)
Greg Couttas
Shane Solomon
Michael Stanford (appointed on 2 September 2019)

Principal activities
During the financial half-year the principal continuing activities of the consolidated entity were the provision of healthcare services which include fertility services, medical day procedure services and medical diagnostic services.

Review of operations
The profit for the consolidated entity after providing for income tax and non-controlling interest amounted to $14,968,000 (31 December 2018: $14,635,000).

The consolidated entity continued to engage in its principal activities, the results of which are disclosed in the attached financial statements.

For a detailed review on the trading results refer to the operating and financial review section in Appendix 4D and to the ASX market announcement on 18 February 2020.

Significant changes in the state of affairs
In October 2019 Virtus announced that existing CEO, Sue Channon will step down from her role on 29 February 2020. There were no other significant changes in the state of affairs of the consolidated entity during the financial half-year.

Events after the reporting period
Subsequent to half year end, Virtus announced that Ms Kate Munnings will commence as Group Chief Executive Officer of Virtus Health Limited on 4 May 2020 (see ASX announcement on 24 January 2020 for further details).

The consolidated entity also exercised its second and final option in January 2020, paying $518,000 to acquire a further 15% stake in TasIVF, through its fully owned subsidiary IVF Finance Limited. The acquisition was funded through existing cash resources and brings Virtus' ownership of TasIVF to 100%.

No other matter or circumstance has arisen since 31 December 2019 that has significantly affected, or may significantly affect the consolidated entity's operations, the results of those operations, or the consolidated entity's state of affairs in future financial years.

Rounding of amounts
The company is of a kind referred to in Corporations Instrument 2016/191, issued by the Australian Securities and Investments Commission, relating to 'rounding-off'. Amounts in this report and the Financial Report have been rounded off in accordance with that Corporations Instrument to the nearest thousand dollars, or in certain cases, the nearest dollar.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out immediately after this directors' report.

This report is made in accordance with a resolution of directors, pursuant to section 306(3)(a) of the Corporations Act 2001.

On behalf of the directors

Sonia Petering
Chairperson

18 February 2020
Sydney

Auditor's Independence Declaration

As lead auditor for the review of Virtus Health Limited for the half-year ended 31 December 2019, I declare that to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and

(b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Virtus Health Limited and the entities it controlled during the period.

Mark Dow
Partner
PricewaterhouseCoopers

Sydney
18 February 2020

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General information

The financial statements cover Virtus Health Limited as a consolidated entity consisting of Virtus Health Limited and the entities it controlled at the end of, or during, the half-year. The financial statements are presented in Australian dollars, which is Virtus Health Limited's functional and presentation currency.

Virtus Health Limited is a listed public company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

Level 3
176 Pacific Highway
Greenwich NSW 2065

A description of the nature of the consolidated entity's operations and its principal activities are included in the directors' report, which is not part of the financial statements.

The financial statements were authorised for issue, in accordance with a resolution of directors, on 18 February 2020. The directors have the power to amend and reissue the financial statements.

Virtus Health Limited
Statement of comprehensive income
For the half-year ended 31 December 2019

	Note	Consolidated 31 Dec 2019 $'000	Consolidated 31 Dec 2018 $'000
Revenue	3	142,050	140,690
Share of profits of associates accounted for using the equity method		291	249
Other income	4	2,135	1,096
Expenses			
Fertility specialists, consumables and associated costs		(38,986)	(38,278)
Employee benefits expense		(51,084)	(48,589)
Depreciation and amortisation expense		(12,675)	(6,595)
Occupancy expense		(2,989)	(9,935)
Advertising and marketing		(2,121)	(2,179)
Practice equipment expenses		(1,257)	(1,209)
Professional and consulting fees		(2,010)	(1,803)
Other expenses		(6,469)	(7,540)
Finance costs	5	(5,534)	(4,952)
Profit before income tax expense		21,351	20,955
Income tax expense		(5,882)	(6,032)
Profit after income tax expense for the half-year		15,469	14,923
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Net change in the fair value of cash flow hedges taken to equity, net of tax		17	134
Foreign currency translation		(1,374)	2,615
Other comprehensive income for the half-year, net of tax		(1,357)	2,749
Total comprehensive income for the half-year		14,112	17,672
Profit for the half-year is attributable to:			
Non-controlling interest		501	288
Owners of Virtus Health Limited		14,968	14,635
		15,469	14,923
Total comprehensive income for the half-year is attributable to:			
Non-controlling interest		475	167
Owners of Virtus Health Limited		13,637	17,505
		14,112	17,672
		Cents	**Cents**
Basic earnings per share	15	18.65	18.21
Diluted earnings per share	15	18.48	18.10

The above statement of comprehensive income should be read in conjunction with the accompanying notes

Virtus Health Limited
Statement of financial position
As at 31 December 2019

	Note	Consolidated 31 Dec 2019 $'000	Consolidated 30 June 2019 $'000
Assets			
Current assets			
Cash and cash equivalents		12,560	18,831
Trade and other receivables		9,374	14,842
Inventories		1,223	1,256
Other		4,437	2,876
Total current assets		27,594	37,805
Non-current assets			
Investments accounted for using the equity method		1,489	1,489
Property, plant and equipment		35,412	38,036
Right-of-use assets	6	85,530	-
Intangibles		457,272	459,576
Deferred tax		9,712	7,143
Other		290	287
Total non-current assets		589,705	506,531
Total assets		617,299	544,336
Liabilities			
Current liabilities			
Trade and other payables		23,569	24,856
Derivative financial instruments		661	764
Income tax		22	1,121
Provisions		4,350	4,642
Other financial liabilities	7	7,007	9,397
Lease liabilities		10,422	-
Unearned income		12,286	16,306
Total current liabilities		58,317	57,086
Non-current liabilities			
Borrowings		170,878	173,678
Derivative financial instruments		1,817	1,738
Deferred tax		754	1,065
Provisions		6,985	6,722
Other financial liabilities	8	1,654	7,750
Lease liabilities		87,445	-
Other payables		-	1,684
Total non-current liabilities		269,533	192,637
Total liabilities		327,850	249,723
Net assets		289,449	294,613
Equity			
Issued capital	9	240,459	241,890
Reserves	10	9,997	5,159
Retained profits		34,657	37,111
Equity attributable to the owners of Virtus Health Limited		285,113	284,160
Non-controlling interest		4,336	10,453
Total equity		289,449	294,613

The above statement of financial position should be read in conjunction with the accompanying notes

Virtus Health Limited
Statement of changes in equity
For the half-year ended 31 December 2019

Consolidated	Issued capital $'000	Reserves $'000	Retained profits $'000	Non-controlling interest $'000	Total equity $'000
Balance at 1 July 2018	242,251	2,837	27,979	10,483	283,550
Profit after income tax expense for the half-year	-	-	14,635	288	14,923
Other comprehensive income for the half-year, net of tax	-	2,870	-	(121)	2,749
Total comprehensive income for the half-year	-	2,870	14,635	167	17,672
Transactions with owners in their capacity as owners:					
Settlement of partly paid shares	115	-	-	-	115
Share-based payments expense	-	613	-	-	613
Dividends payable by subsidiary to non-controlling interest	-	-	-	(486)	(486)
Dividends paid (note 11)	-	-	(9,647)	-	(9,647)
Balance at 31 December 2018	242,366	6,320	32,967	10,164	291,817

Consolidated	Issued capital $'000	Reserves $'000	Retained profits $'000	Non-controlling interest $'000	Total equity $'000
Balance at 1 July 2019	241,890	5,159	37,111	10,453	294,613
Adjustment on adoption of AASB 16 - net of tax (note 1)	-	-	(7,775)	-	(7,775)
Balance at 1 July 2019 - restated	241,890	5,159	29,336	10,453	286,838
Profit after income tax expense for the half-year	-	-	14,968	501	15,469
Other comprehensive income for the half-year, net of tax	-	(1,331)	-	(26)	(1,357)
Total comprehensive income for the half-year	-	(1,331)	14,968	475	14,112
Transactions with owners in their capacity as owners:					
Purchase of treasury shares (note 9)	(1,984)	-	-	-	(1,984)
Settlement of partly paid shares (note 9)	110	-	-	-	110
Issue of shares pursuant to share based payment schemes (note 9)	443	(443)	-	-	-
Share-based payments expenses	-	629	-	-	629
Put option exercise	-	5,983	-	(5,983)	-
Dividends payable by subsidiary to non-controlling interest	-	-	-	(609)	(609)
Dividends paid (note 11)	-	-	(9,647)	-	(9,647)
Balance at 31 December 2019	240,459	9,997	34,657	4,336	289,449

The above statement of changes in equity should be read in conjunction with the accompanying notes

	Note	Consolidated 31 Dec 2019 $'000	Consolidated 31 Dec 2018 $'000
Cash flows from operating activities			
Receipts from customers (inclusive of GST)		139,900	138,722
Payments to suppliers (inclusive of GST)		(105,039)	(113,012)
Other revenue		1,534	1,171
Interest and other finance costs paid		(3,345)	(3,896)
Lease interest paid		(1,737)	-
Income taxes paid		(7,674)	(7,868)
Net cash from operating activities		23,639	15,117
Cash flows from investing activities			
Payment for acquisition of non-controlling interest		(6,591)	-
Payments for property, plant and equipment and intangibles		(2,781)	(9,044)
Other investing activities		404	419
Net cash used in investing activities		(8,968)	(8,625)
Cash flows from financing activities			
Proceeds from partly paid shares	9	110	115
Dividends paid to non-controlling interest in subsidiaries		(609)	(486)
Proceeds from borrowings		-	1,500
Repayment of borrowings		(3,000)	-
Payment of finance facility fees in relation to refinancing		-	(1,110)
Dividends paid	11	(9,647)	(9,647)
Purchase of treasury shares	9	(1,984)	-
Repayment of lease liabilities		(5,709)	-
Net cash used in financing activities		(20,839)	(9,628)
Net decrease in cash and cash equivalents		(6,168)	(3,136)
Cash and cash equivalents at the beginning of the financial half-year		18,831	21,713
Effects of exchange rate changes on cash and cash equivalents		(103)	245
Cash and cash equivalents at the end of the financial half-year		12,560	18,822

The above statement of cash flows should be read in conjunction with the accompanying notes

Note 1. Significant accounting policies

These general purpose financial statements for the interim half-year reporting period ended 31 December 2019 have been prepared in accordance with Australian Accounting Standard AASB 134 'Interim Financial Reporting' and the Corporations Act 2001, as appropriate for for-profit oriented entities. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS 34 'Interim Financial Reporting'.

These general purpose financial statements do not include all the notes of the type normally included in annual financial statements. Accordingly, these financial statements are to be read in conjunction with the annual report for the year ended 30 June 2019 and any public announcements made by the company during the interim reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

The principal accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period, except for the policies stated below.

Basis of Preparation

The financial report has been prepared on a going concern basis.

The Directors continually monitor the group's working capital position, including forecast working capital requirements and have ensured that there are appropriate refinancing strategies and adequate committed funding facilities in place to accommodate financial obligations as and when they fall due.

At 31 December 2019 the consolidated entity's current liabilities exceeded its current assets by $30,724,000 (June 2019: $19,281,000). The increase in this excess of current liabilities over current assets has arisen largely as a result of the inclusion of the following items as a current liability at 31 December 2019:

- TASIVF put option liability of $518,000 and contingent consideration relating to Fertilitesklinikken Trianglen Aps of $5,686,000 as these liabilities are expected to be settled within the next 12 month;
- current lease liabilities of $10,422,000 recognised for the first time as a result of adopting AASB 16 Leases (see note below).

The current liabilities include unearned income of $12,286,000 as well as employee leave liabilities of $10,162,000. Whilst, the leave liabilities are required to be disclosed as a current liability not all of this liability is expected to be settled within 12 months. The cash balance as at 31 December is $12,560,000 and the consolidated entity also has unused and available debt facilities totalling $85,000,000 maturing in September 2021 and September 2023. Refer to note 13 for further details.

New or amended Accounting Standards and Interpretations adopted

The consolidated entity has adopted all of the new or amended Accounting Standards and Interpretations issued by the Australian Accounting Standards Board ('AASB') that are mandatory for the current reporting period.

Any new, revised or amending Accounting Standards or Interpretations that are not yet mandatory have not been early adopted. The following Accounting Standard, AASB 16 Leases is most relevant to the consolidated entity.

AASB 16 Leases

The consolidated entity has adopted AASB 16 with effect from 1 July 2019. The standard replaces AASB 117 'Leases' and for lessees eliminates the classifications of operating leases and finance leases. Except for short-term leases and leases of low-value assets, right-of-use assets and corresponding lease liabilities are recognised in the statement of financial position. Straight-line operating lease expense recognition is replaced with a depreciation charge in respect of the right-of-use assets and an interest expense on the recognised lease liabilities. In the earlier periods of a lease, the expenses associated with the lease under AASB 16 will be higher when compared to lease expenses under AASB 117. However, EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) results improve as the operating lease expense is now replaced by interest expense and depreciation expense in profit or loss. For classification within the statement of cash flows, the interest portion of the lease payments disclosed in operating activities and the principal portion of the lease payments are separately disclosed in financing activities.

Note 1. Significant accounting policies (continued)

Right-of-use assets
A right-of-use asset is recognised at the commencement date of a lease. The right-of-use asset is measured at cost, which comprises the initial amount of the lease liability, adjusted for, as applicable, any lease payments made at or before the commencement date net of any lease incentives received, any initial direct costs incurred, and an estimate of costs expected to be incurred for dismantling and removing the underlying asset, and restoring the site or asset.

Right-of-use assets are depreciated on a straight-line basis over the unexpired period of the lease or the estimated useful life of the asset, whichever is the shorter. Where the consolidated entity expects to obtain ownership of the leased asset at the end of the lease term, the depreciation is over its estimated useful life. Right-of use assets are subject to impairment or adjusted for any remeasurement of lease liabilities.

The consolidated entity has elected not to recognise a right-of-use asset and corresponding lease liability for short-term leases with terms of 12 months or less and leases of low-value assets. Lease payments on these assets are expensed to profit or loss as incurred

Leases Liabilities
A lease liability is recognised at the commencement date of a lease. The lease liability is initially recognised at the present value of the lease payments to be made over the term of the lease, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the consolidated entity's incremental borrowing rate. Lease payments comprise of fixed payments less any lease incentives receivable, variable lease payments that depend on an index or a rate, amounts expected to be paid under residual value guarantees, exercise price of a purchase option when the exercise of the option is reasonably certain to occur, and any anticipated termination penalties. The variable lease payments that do not depend on an index or a rate are expensed in the period in which they are incurred.

Lease liabilities are measured at amortised cost using the effective interest method. The carrying amounts are remeasured if there is a change in the following: future lease payments arising from a change in an index or a rate used; residual guarantee; lease term; certainty of a purchase option and termination penalties. When a lease liability is remeasured, an adjustment is made to the corresponding right-of use asset, or to profit or loss if the carrying amount of the right-of-use asset is fully written down.

(i) Impact of adoption on 1 July 2019
AASB 16 was adopted using the modified retrospective approach and as such the comparatives have not been restated.
The impact of adoption on opening retained profits as at 1 July 2019 was as follows:

	Consolidated 1 July 2019 $'000
Operating lease commitments as at 1 July 2019 (AASB 117)	(85,642)
Short term & low value leases (AASB 16)	88
New leases and option period increases	(37,541)
Discounting using based on the weighted average incremental borrowing rate (AASB 16)	19,500
Lease Liability recognised as at 1 July 2019 (AASB 16)	(103,595)
Net Right-of-use assets - Properties (AASB 16)	91,468
Write back of balances relating to straight lining of leases	2,153
Net tax effect on the above adjustments	2,199
Reduction in opening retained profits as at 1 July 2019	(7,775)

Note 1. Significant accounting policies (continued)

(ii) Amounts recognised in the statement of financial position
The balance sheet shows the following amounts relating to leases:

	Consolidated	
	31 Dec 2019 $'000	31 Dec 2018 $'000
Right-of-use assets		
Properties	85,530	-
Total Right-of-use assets	85,530	-
Lease liabilities		
Current	(10,422)	-
Non-current	(87,445)	-
Total lease liabilities	(97,867)	-

(iii)Amounts recognised in the statement of financial performance
The statement of financial performance contains the following amounts relating to leases:

	Consolidated	
	31 Dec 2019 $'000	31 Dec 2018 $'000
Depreciation charge for right-of-use assets	5,930	-
Interest expense (included in finance costs)	1,737	-
Depreciation and Interest charges included in operating costs	7,667	-

The impact on the consolidated entity 's statements of financial performance is set out below:

	Consolidated	
	31 Dec 2019 $'000	31 Dec 2018 $'000
Increase in earnings before interest tax, depreciation and amortisation (EBITDA)	7,406	-
Increase in earnings before interest and tax (EBIT)	1,476	-
Decrease in net profit after tax (NPAT)	(200)	-

In the statement of cash flows for the half year ended 31 December 2019 cash outflows for repayment of lease liabilities of $5,709,000 have been included within ‘Cash flows from financing activities’ and lease interest of $1,737,000 has been separately disclosed in ‘Cash flows from operating activities’. The cash flows for the half year ended 31 December 2018 have not been restated, with the cash outflow associated with lease payments included in ‘payments to suppliers’ within ‘Cash flows from operating activities’.

Note 2. Operating segments

Identification of reportable operating segments
AASB 8 'Operating Segments' requires operating segments to be identified on the basis of internal reports about components of the consolidated entity that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance. For disclosure purposes the consolidated entity currently has two reportable segments being Healthcare services Australia and Healthcare services International. The consolidated entity has determined that the aggregated segmental reporting for Australia is most appropriate due to the economic characteristics faced by the Australian operating segments and the similar nature of the products and services being delivered to a similar patient base.

Segment revenue
Sales between segments are carried out at arm’s length and are eliminated on consolidation. The revenue from external parties reported to the Board of Directors is measured in a manner consistent with that in the statement of comprehensive income.

Note 2. Operating segments (continued)

Segment EBITDA

Segment performance is assessed on the basis of Segment EBITDA. Segment EBITDA comprises expenses which are incurred in the normal trading activity of the segments and excludes the impact of depreciation, amortisation, interest, share-based payments and other items which are determined to be outside of the control of the respective segments.

Revenue from external customers is derived from the provision of healthcare services. A breakdown of revenue and results is provided below:

Consolidated - 31 Dec 2019	Healthcare services Australia $'000	Healthcare services International $'000	Intersegment eliminations/ unallocated $'000	Total $'000
Revenue				
Sales to external customers	111,886	29,241	-	141,127
Other revenue	899	-	-	899
Interest revenue	24	-	-	24
Total revenue	112,809	29,241	-	142,050
Segment EBITDA	39,696	6,778	-	46,474
Share-based payment expense				(629)
Transaction costs				(4)
Corporate costs				(8,230)
Foreign exchange				425
Depreciation and amortisation expenses				(12,675)
Fair value adjustment to put liability				1,500
Net interest				(5,510)
Profit before income tax expense				21,351
Income tax expense				(5,882)
Profit after income tax expense				15,469

Corporate costs include $748,000 of CEO transition and recruitment costs. Other significant increases from prior period includes $667,000 of IT infrastructure and security related enhancements and $235,000 in process improvement projects.

Consolidated - 31 Dec 2018	Healthcare services Australia $'000	Healthcare services International $'000	Intersegment eliminations/ unallocated $'000	Total $'000
Revenue				
Sales to external customers	111,547	28,249	-	139,796
Other revenue	833	-	-	833
Interest revenue	60	-	1	61
Total revenue	112,440	28,249	1	140,690
Segment EBITDA	33,412	5,524	-	38,936
Share-based payment expense				(613)
Transaction costs				(176)
Corporate costs				(6,274)
Foreign exchange				(190)
Depreciation and amortisation expenses				(6,595)
Fair value adjustment to put liability				758
Net interest				(4,891)
Profit before income tax expense				20,955
Income tax expense				(6,032)
Profit after income tax expense				14,923

Note 3. Revenue

	Consolidated 31 Dec 2019 $'000	Consolidated 31 Dec 2018 $'000
Revenue from contracts with customers		
Rendering of services	141,127	139,796
Other revenue		
Rent	899	833
Interest	24	61
	923	894
Revenue	142,050	140,690

Note 4. Other income

	Consolidated 31 Dec 2019 $'000	Consolidated 31 Dec 2018 $'000
Fair value gain on put liability	1,500	758
Other income	635	338
Other income	2,135	1,096

Note 5. Expenses

	Consolidated 31 Dec 2019 $'000	Consolidated 31 Dec 2018 $'000
Profit before income tax includes the following specific expenses:		
Finance costs		
Interest and finance charges paid/payable on borrowings	3,346	3,896
Interest on lease liabilities	1,737	-
Interest on other financial liabilities - non-cash interest	246	703
Amortisation of bank facility fees	205	353
Finance costs expensed	5,534	4,952
Share-based payments expense		
Share-based payments expense - fertility specialists	731	450
Share-based payments expense - employee benefits	(102)	163
Total share-based payments expense*	629	613

*Share-based payment expense is included in employee benefits expense and fertility specialists, consumables and associated costs in the Statement of comprehensive income.

Note 6. Non-current assets - right-of-use assets

	Consolidated	
	31 Dec 2019 $'000	30 June 2019 $'000
Properties - Right-of-use	91,451	-
Less: Accumulated depreciation	(5,921)	-
	85,530	-

The consolidated entity leases properties for its clinics, day hospitals, laboratories and offices under agreements of between 2 to 15 years with, in some cases, options to extend. On renewal, the terms of the leases are renegotiated.

The consolidated entity leases a number of premises under agreements of 1 year or less. These leases are short-term and low-value, so have been expensed as incurred and not capitalised as right-of-use assets.

Note 7. Current liabilities - Other financial liabilities

	Consolidated	
	31 Dec 2019 $'000	30 June 2019 $'000
Other financial liabilities	6,204	8,582
Loan note	803	815
	7,007	9,397

The other current financial liabilities represent the fair value of the put option held by the non-controlling interests in TasIVF Pty Limited of $518,000 and the fair value of the contingent consideration arising from the acquisition of Fertilitesklinikken Trianglen Aps of $5,686,000. The put option in relation to TasIVF was exercised on 31 January 2020 and the contingent consideration in relation to Fertilitesklinikken Trianglen Aps is expected to be settled within the next 12 months.

Loan note reflects the current portion of a loan owing to the vendor of Fertilitesklinikken Trianglen Aps.

Note 8. Non-current liabilities - other financial liabilities

	Consolidated	
	31 Dec 2019 $'000	30 June 2019 $'000
Other financial liabilities	-	5,656
Loan Note	1,654	2,094
	1,654	7,750

Loan Note reflects the non-current portion of a loan owing to the vendors of Fertilitesklinkken Trianglen Aps.

Note 9. Equity - issued capital

	Consolidated 31 Dec 2019 Shares	30 June 2019 Shares	31 Dec 2019 $'000	30 June 2019 $'000
Ordinary shares - fully paid	80,389,938	80,389,938	242,586	242,476
Treasury Shares	(475,204)	(146,768)	(2,127)	(586)
	79,914,734	80,243,170	240,459	241,890

Movements in ordinary share capital

Details	Date	No of shares	Issue price	$'000
Balance	1 July 2019	80,389,938		242,476
Settlement of partly paid shares	25 October 2019	-	$0.00	110
Balance	31 December 2019	80,389,938		242,586

Treasury shares
Treasury shares are shares in Virtus Health Limited that are held by the Virtus Health Limited Employee Share Trust ('VHLEST') for the purpose of providing shares under selected Group equity plans.

	Number of Shares	$
Balance at 1 July 2019	146,768	586,128
On market acquisitions during the period	439,462	1,984,187
Distribution of shares during the period to fertility specialists	(111,026)	(443,390)
	475,204	2,126,925

Note 10. Equity - reserves

	Consolidated 31 Dec 2019 $'000	30 June 2019 $'000
Foreign currency translation reserve	4,871	6,218
Hedging reserve - cash flow hedges	(1,738)	(1,755)
Share-based payments reserve	14,689	14,504
Put option business combination reserve	(7,825)	(13,808)
	9,997	5,159

Put option business combination reserve reflects the initial recognition of the financial liabilities in relation to a series of put options held by the non-controlling interest in Sims Clinic Limited and TAS IVF Pty Limited.

Note 11. Equity - dividends

Dividends paid during the financial half-year were as follows:

	Consolidated	
	31 Dec 2019 $'000	31 Dec 2018 $'000
Final dividend of 12.0 cents (31 December 2018: 12.0 cents) per fully paid share paid in October 2019	9,647	9,647

Note 12. Fair value measurement

Fair value hierarchy
The following tables detail the consolidated entity's assets and liabilities, measured or disclosed at fair value, using a three level hierarchy, based on the lowest level of input that is significant to the entire fair value measurement, being:
Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date
Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
Level 3: Unobservable inputs for the asset or liability

Consolidated - 31 Dec 2019	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Liabilities				
Derivative financial liabilities	-	2,478	-	2,478
Other financial liabilities	-	-	6,204	6,204
Total liabilities	-	2,478	6,204	8,682

Consolidated - 30 June 2019	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Liabilities				
Derivative financial liabilities	-	2,502	-	2,502
Other financial liabilities	-	-	14,238	14,238
Total liabilities	-	2,502	14,238	16,740

The carrying amounts of financial instruments reflect their fair value. The carrying amounts of trade receivables and trade payables are assumed to approximate their fair values due to their short-term nature.

Valuation techniques for fair value measurements categorised within level 2 and level 3
Derivative financial instruments have been valued using quoted market rates. This valuation technique maximises the use of observable market data where it is available and relies as little as possible on entity specific estimates. Other financial liabilities have been valued using forecast earnings models, discounted using specific borrowing rates.

Note 12. Fair value measurement (continued)

Level 3 assets and liabilities
Movements in level 3 assets and liabilities during the current financial half-year are set out below:

Consolidated	Put Options $'000	Contingent Consideration $'000	Total $'000
Balance at 1 July 2019	8,582	5,656	14,238
Foreign exchange impact	28	(89)	(61)
Amounts paid during the year	(6,592)	-	(6,592)
Interest on unwinding	-	119	119
Fair value adjustment	(1,500)	-	(1,500)
Balance at 31 December 2019	518	5,686	6,204

Note 13. Borrowings and Contingent liabilities

Borrowings-Financial Arrangements

The consolidated entity has total commitments of $262,000,000 through its syndicated debt facilities. At 31 December 2019, total facilities drawn were $172,000,000 in borrowings and $5,169,743 in guarantees. Unused and available facilities amounted to $84,830,257. The consolidated entity complied with the financial covenants of its borrowing liabilities during the financial half-year ended 31 December 2019. Subject to the continued compliance with debt covenants, the bank facilities may be drawn at any time and have an average maturity of 2.5 years (30 June 2019: 3.5 years).

$92,000,000 of the facility expires in September 2021, whilst the remaining $170,000,000 expires in September 2023.

Contingent Liabilities-Claims
The consolidated entity is currently involved in litigations which may result in future liabilities. The consolidated entity has disclaimed liability and is defending the actions. It is not practical to estimate the potential effect of these claims but advice indicates that any liability that may arise in the unlikely event that the claims are successful will not be significant and will be covered by the consolidated entity's insurance policies.

Note 14. Events after the reporting period

Subsequent to half year end, Virtus announced that Ms Kate Munnings will commence as Group Chief Executive Officer of Virtus Health Limited on 4 May 2020 (see ASX announcement on 24 January 2020 for further details).

The consolidated entity also exercised its second and final option in January 2020, paying $518,000 to acquire a further 15% stake in TasIVF, through its fully owned subsidiary IVF Finance Limited. The acquisition was funded through existing cash resources and brings Virtus' ownership of TasIVF to 100%.

No other matter or circumstance has arisen since 31 December 2019 that has significantly affected, or may significantly affect the consolidated entity's operations, the results of those operations, or the consolidated entity's state of affairs in future financial years.

Note 15. Earnings per share

	Consolidated	
	31 Dec 2019 $'000	31 Dec 2018 $'000
Profit after income tax	15,469	14,923
Non-controlling interest	(501)	(288)
Profit after income tax attributable to the owners of Virtus Health Limited	14,968	14,635
Add: interest savings on conversion of options	89	133
Profit after income tax attributable to the owners of Virtus Health Limited used in calculating diluted earnings per share	15,057	14,768

	Number	Number
Weighted average number of ordinary shares used in calculating basic earnings per share	80,241,377	80,389,938
Adjustments for calculation of diluted earnings per share:		
Options over ordinary shares	1,214,805	1,180,722
Weighted average number of ordinary shares used in calculating diluted earnings per share	81,456,182	81,570,660

	Cents	Cents
Basic earnings per share	18.65	18.21
Diluted earnings per share	18.48	18.10

In the directors' opinion:

- the financial statements and notes set out on pages 9 to 18 are in accordance with the Corporations Act 2001, including:

  (i) complying with Accounting standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements, and

  (ii) giving a true and fair view of the consolidated entity's financial position as at 31 December 2019 and its performance for the half-year ended on that date, and

- there are reasonable grounds to believe that Virtus Health Limited will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors

Sonia Petering
Chairperson

18 February 2020
Sydney

Independent auditor's review report to the members of Virtus Health Limited

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Virtus Health Limited (the Company) and the entities it controlled during the half-year (together the Group), which comprises the consolidated statement of financial position as at 31 December 2019, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, selected other explanatory notes and the directors' declaration.

Directors' responsibility for the half-year financial report

The directors of the Company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the half-year financial report that gives a true and fair view and is free from material misstatement whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Australian Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including giving a true and fair view of the Group's financial position as at 31 December 2019 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Virtus Health Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

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Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Virtus Health Limited is not in accordance with the *Corporations Act 2001* including:

1. giving a true and fair view of the Group's financial position as at 31 December 2019 and of its performance for the half-year ended on that date;
2. complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

PricewaterhouseCoopers

Mark Dow
Partner

Sydney
18 February 2020