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Level 8, 14-20 Blackwood St
North Melbourne Vic 3051

www.integraldiagnostics.com.au

The Manager
Company Announcements Office
ASX Limited

2 March 2018

Dear Sir / Madam

Integral Diagnostics Limited (ASX: IDX) – takeover bid by Capitol Health Holdings Pty Limited
Target's Statement

We attach, by way of service pursuant to item 14 of section 633(1) of the *Corporations Act 2001* (Cth), a copy of the target's statement of Integral Diagnostics Limited in response to the off-market takeover bid by Capitol Health Holdings Pty Limited for all of the ordinary shares in Integral.

Yours sincerely

Kathryn Davies
Company Secretary

REJECT

THE DEFICIENT OFFER FROM CAPITOL TO ACQUIRE YOUR INTEGRAL SHARES

TO REJECT CAPITOL'S
DEFICIENT OFFER
DO NOTHING

integral
DIAGNOSTICS

TARGET'S STATEMENT

THIS IS AN IMPORTANT DOCUMENT AND REQUIRES YOUR IMMEDIATE ATTENTION. YOU SHOULD READ ALL OF THE DOCUMENT. IF YOU ARE IN DOUBT AS TO WHAT YOU SHOULD DO, YOU SHOULD CONSULT YOUR INVESTMENT, FINANCIAL, TAXATION OR OTHER PROFESSIONAL ADVISER

Your Directors unanimously recommend that you REJECT the Capitol Offer to acquire all of your shares in Integral Diagnostics by doing nothing

FINANCIAL ADVISER

CREDIT SUISSE

LEGAL ADVISER

HERBERT SMITH FREEHILLS

IF YOU HAVE ANY QUESTIONS, PLEASE CONTACT THE SHAREHOLDER INFORMATION LINE ON 1300 117 908 (WITHIN AUSTRALIA) OR +61 3 9415 4336 (OUTSIDE AUSTRALIA)

Important notices

Nature of this document

This document is a Target's Statement issued by Integral Diagnostics Limited (ABN 55 130 832 816) under Part 6.5 of the Corporations Act in response to the off-market takeover bid made by Capitol Health Holdings Pty Limited (ABN 41 623 058 499), a wholly owned subsidiary of Capitol Health Limited (ABN 84 117 391 812), for all of the ordinary shares in Integral.

A copy of this Target's Statement was lodged with ASIC and given to ASX on 2 March 2018. Neither ASIC nor ASX nor any of their respective officers take any responsibility for the content of this Target's Statement.

Key dates

Date of Capitol's Offer	14 February 2018
Date of this Target's Statement	2 March 2018
Close of Capitol's Offer Period (unless extended or withdrawn)	7pm (Melbourne time) on 28 March 2018

Integral shareholder information

Integral has established a shareholder information line which Integral shareholders may call if they have any queries in relation to Capitol's Offer. The telephone number for the shareholder information line is 1300 117 908 (for calls made from within Australia) or +61 3 9415 4336 (for calls made from outside Australia). Calls to the shareholder information line may be recorded.

Further information relating to Capitol's Offer can be obtained from Integral's website at https://www.integraldiagnostics.com.au/page/for-investors/capitol-health-offer/.

Defined terms

A number of defined terms are used in this Target's Statement. These terms are explained in section 9 of this Target's Statement.

No account of personal circumstances

This Target's Statement does not take into account your individual objectives, financial situation or particular needs. It does not contain personal advice. Your Directors encourage you to seek independent financial and taxation advice before making a decision as to whether or not to accept the Offer.

Disclaimer as to forward looking statements

Some of the statements appearing in this Target's Statement (including in the Independent Expert's Report) may be in the nature of forward looking statements. You should be aware that such statements are only predictions and are subject to inherent risks and uncertainties. Those risks and uncertainties include factors and risks specific to the industry in which Integral operates as well as general economic conditions, prevailing exchange rates and interest rates and conditions in the financial markets. Actual events or results may differ materially from the events or results expressed or implied in any forward looking statement. None of Integral, Integral's officers and employees, any persons named in this Target's Statement with their consent or any person involved in the preparation of this Target's Statement, makes any representation or warranty (express or implied) as to the accuracy or likelihood of fulfilment of any forward looking statement, or any events or results expressed or implied in any forward looking statement, except to the extent required by law. You are cautioned not to place undue reliance on any forward looking statement. The forward looking statements in this Target's Statement (including in the Independent Expert's Report) reflect views held only as at the date of this Target's Statement.

Disclaimer as to information

The information on Capitol, Capitol Health and Capitol Health's securities contained in this Target's Statement has been prepared by Integral using publicly available information. The information in this Target's Statement concerning Capitol and Capitol Health and the companies' assets and liabilities, financial position and performance, profits and losses and prospects, has not been independently verified by Integral. Accordingly, Integral does not, subject to the Corporations Act, make any representation or warranty, express or implied, as to the accuracy or completeness of such information.

Foreign jurisdictions

The release, publication or distribution of this Target's Statement in jurisdictions other than Australia may be restricted by law or regulation in such other jurisdictions and persons who come into possession of it should seek advice on and observe any such restrictions. Any failure to comply with such restrictions may constitute a violation of applicable laws or regulations. This Target's Statement has been prepared in accordance with Australian law and the information contained in this Target's Statement may not be the same as that which would have been disclosed if this Target's Statement had been prepared in accordance with the laws and regulations outside Australia.

Effect of rounding

A number of figures, amounts, percentages, prices, estimates, calculations of value and fractions in this Target's Statement are subject to the effect of rounding.

Accordingly their actual calculations may differ from the calculations set out in this Target's Statement.

Maps and diagrams

Any diagrams, charts, maps, graphs and tables appearing in this Target's Statement are illustrative only and may not be drawn to scale. Unless stated otherwise, all data contained in diagrams, charts, maps, graphs and tables is based on information available at the date of this Target's Statement.

Privacy

Integral has collected your information from the Integral register of shareholders for the purpose of providing you with this Target's Statement. The type of information Integral has collected about you includes your name, contact details and information on your shareholding in Integral. Without this information, Integral would be hindered in its ability to issue this Target's Statement. The Corporations Act requires the name and address of shareholders to be held in a public register. Your information may be disclosed on a confidential basis to Integral, Integral's related bodies corporate and external service providers (such as the share registry of Integral and print and mail service providers) and may be required to be disclosed to regulators such as ASIC. If you would like details of information about you held by Integral, please contact Computershare Investor Services Pty Limited at the address shown in the Corporate Directory. Integral's privacy policy is available at https://www.integraldiagnostics.com.au/page/privacy-policy/. The registered address of Integral is Level 8, 14-20 Blackwood Street, North Melbourne, Victoria 3051.

Contents of this Target's Statement

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Chairman's letter

2 March 2018

Dear Integral Shareholder,

Integral's Board unanimously recommends shareholders REJECT Capitol's deficient takeover offer

You will have recently received from Capitol its unsolicited and predominantly scrip-based offer to acquire your Integral Shares. Capitol is offering 6.9 Capitol Shares and $0.36 cash for every Integral Share you hold (**Offer**).

This document is our Target's Statement, which sets out the unanimous recommendation of your Directors to **REJECT** Capitol's deficient Offer and the reasons for that recommendation.

Importantly, shareholders who hold or control approximately 32.90% of Integral Shares[1], including Integral's Directors, have already informed the Board that they intend to REJECT Capitol's Offer. This means that the Offer's 90% minimum acceptance condition cannot be satisfied.

Your Directors believe that there are seven key reasons why you should reject Capitol's Offer:

1. Integral has attractive prospects as a standalone business;
2. The Offer does not reflect the inherent value of Integral;
3. The Independent Expert has concluded that Capitol's Offer is neither fair nor reasonable;
4. The underlying value of Capitol Health's scrip, which represents the majority of the Offer consideration, is unclear;
5. Capitol Health cannot integrate and effectively manage a business that is substantially larger and more complex;
6. Capitol Health has not demonstrated a track record of creating shareholder value through material acquisitions; and
7. The Offer is highly conditional and the 90% minimum acceptance condition is not capable of being satisfied.

Section 1 sets out in more detail each of the reasons for your Directors' unanimous recommendation to **REJECT** Capitol's deficient Offer. You should read these reasons carefully.

Integral's Board believes there is a fundamental lack of support for the transaction amongst radiologists. Board members and Executive Directors Dr Sally Sojan (Member of the National Clinical Leadership Committee and Member of the Queensland Clinical Leadership Committee) and Dr Chien Ho (Chair of the National Clinical Leadership Committee and member of the Victorian Clinical Leadership Committee) have also informed the Board that, if Capitol is successful in acquiring 50% or more of the shares in Integral, they intend to resign their employment as radiologists with Integral. The

[1] Integral's Directors together hold or control 4,314,512 Integral Shares (2.97%). Integral's four largest shareholders as at 28 February 2018, being Investors Mutual (14,550,000, 10.03%), Adam Smith Asset Management (10,279,843, 7.09%), Perennial Value Management (10,070,027, 6.94%) and Viburnum Funds (8,500,000, 5.86%) hold or control 29.92% of Integral Shares in aggregate. Note the holdings have been rounded to two decimal places.

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Board believes that if the transaction was to proceed there would be further radiologists who would leave Integral.

Past discussions between Integral and Capitol Health were very preliminary and never proceeded beyond a high-level conceptual discussion, with no due diligence conducted by either party. At the time the Integral Board assessed that a transaction would not be value accretive for, or in the best interests of, Integral shareholders.

To REJECT Capitol's Offer, simply ignore all documentation sent to you by Capitol.

Your Directors consider that you will be far better retaining your Integral Shares rather than selling into the predominantly scrip Offer.

Integral has a market leading management and radiologist team that are unique in the industry and is well placed to continue generating strong returns. Our management is delivering on its strategy with material improvements in operating margins and all financial performance measures as demonstrated by our 1H18 results. We have a number of business improvement initiatives that are well developed and which are expected to underpin Integral's outlook for improved performance. Details of these initiatives are outlined in this Target's Statement in section 1.1.

Your Directors will continue to keep you updated on all material developments in relation to Capitol's Offer. In the meantime, if you have any questions in relation to this Target's Statement or your shareholding in Integral, please call your Shareholder Information Line on 1300 117 908 (for calls made from within Australia) or +61 3 9415 4336 (for calls made from outside Australia), Monday to Friday between 8:30am and 5:00pm (Melbourne time). For your convenience, all company announcements and information on the Offer are available on the Integral website at https://www.integraldiagnostics.com.au/page/for-investors/.

Yours sincerely,

Helen Kurincic

Independent Chairman

1. Why you should reject the Offer

1.1. Integral has attractive prospects as a standalone business

Supported by a medically led and diversified business model

Integral offers a unique medical leadership model providing state of the art diagnostic services and employing some of the country's leading radiologists and nuclear medicine specialists. Integral has successfully integrated its three core brands to create a business with a diverse and high quality mix of earnings. As at 2Q18, less than 55% of Integral's revenue was generated by bulk-billing, and the business holds nine fully licensed MRI machines and operates 13 hospital sites.

All of Integral's hospital sites offer overnight services, and nine of these sites operate emergency departments, which are fully supported by Integral's radiology services. Integral is increasing its focus on specialist areas within diagnostic imaging through the Geelong Breast Clinic and Women's Imaging Centre in Southport, the newly opened Spine Centre of Excellence on the Gold Coast and a specialist Prostate Centre of Excellence currently in development in North Melbourne. Integral's business is also geographically diverse, with strong market positions in Victoria, Western Australia and Queensland.

Integral has a well-established clinical governance framework that is medically led, with two practising radiologists being members of the Board. These Board members are also representatives on the National and State Clinical Leadership Committees, which the CEO also attends, driving strategic and operational collaboration between radiologists and the management team.

Multi-layered sustainable growth potential

Integral has a strong "hub-and-spoke" platform from which to leverage further growth opportunities. These opportunities are expected to deliver sustainable growth, and include:

- **Strong revenue outlook and organic growth initiatives** are expected to drive further growth in FY18 and beyond, supported by average historical industry benefit growth rates of 7.5%[2];
- **Continued industry-leading margins achieved by the management team** through targeted cost efficiencies in labour, consumables and equipment which drove a greater than 20% 1H18 EBITDA margin and are expected to deliver further margin improvements in the future;
- **A disciplined approach to growth capital expenditure** through margin enhancing brownfield and greenfield opportunities to expand the breadth and depth of Integral's service offering, and deliver material medium-long term earnings growth; and
- **A healthy balance sheet to capitalise on organic and inorganic opportunities** and invest in strategic relationships with private hospital groups and selective acquisition opportunities which meet Integral's return thresholds.

Strong revenue outlook and organic growth initiatives

Integral management has proven its ability to generate growth organically, as shown by 2Q18 growth of 7.6% compared to the prior corresponding period. This impressive growth was driven by:

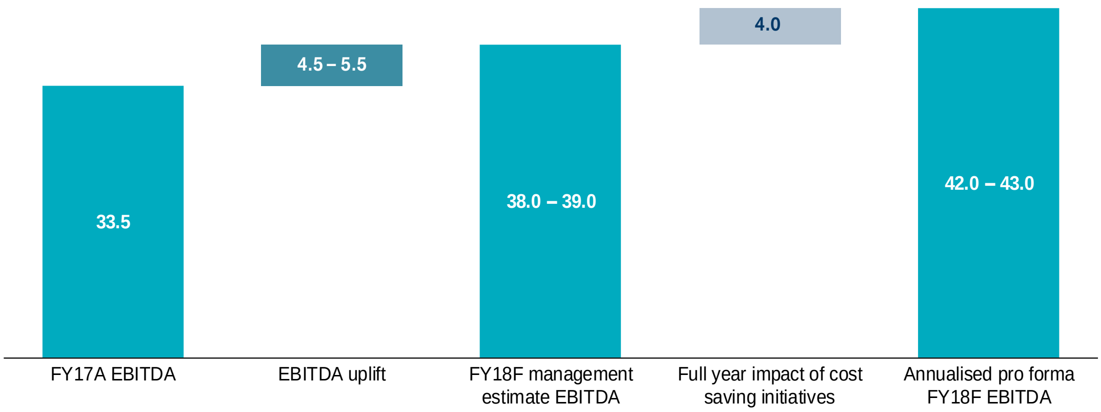
- Radiologist-driven business development;
- Reorganised marketing teams and strategy;
- Restructured call centres; and
- Establishment of a new Spine Centre of Excellence and an additional clinic in Grovedale.

[2] Based on Medicare Australia statistics by Broad Type of Service (BTOS) for the States Integral operates in.

Continued industry-leading margins achieved by the management team

Since July 2017 under the new management team, Integral has successfully executed a number of initiatives to deliver sustainable margin improvement, which resulted in 1H18 EBITDA margins in excess of 20%.

Significant uplift in FY18 EBITDA[3]



Significant EBITDA growth uplift of $4.5 – 5.5m consists of organic growth, return on growth capital expenditure and staff and consumables savings. Management has implemented a number of initiatives for which the full benefit will not be realised in FY18 and, accordingly, is not reflected in management's FY18F estimated EBITDA range of $38 – 39m, which is in line with FY18F broker consensus EBITDA of $38.6m[4]. Integral management has estimated the additional earnings impact based on a combination of actual results to date on initiatives implemented and expected run rate savings. These initiatives cover a range of areas including labour cost savings (across rostering, automated timesheets and award interpreter), consumables and other expenditure savings. Integral management estimates that, if these initiatives were in place for the full financial year, the estimated annualised pro forma FY18F EBITDA would have been between $42m and $43m.

[3] FY18F EBITDA range per Integral management estimates.

[4] FY18F broker consensus EBITDA calculated using four brokers that released research between 19 January 2018 and 29 January 2018, following the release of Integral's 1H18 results. All publicly available broker reports known to Integral during this period were used in the calculation of FY18F broker consensus EBITDA. The FY18 EBITDA estimates used in the calculation were $38.2m, $38.4m, $38.7m and $39.0m. This estimate of EBITDA has been provided as an indicator of market views on Integral's forecast financial performance.

Disciplined approach to growth capital expenditure

Integral demonstrates a proven track record of being able to expand and enhance its operating footprint and depth of services, while delivering value for shareholders through an attractive return on investment. The recent development of the Spine Centre of Excellence in Southport (Gold Coast) is an example of this.

Case Study: Spine Centre of Excellence exceeding expectations

Overview	• Development of new imaging facility in Southport to provide specialist spinal imaging services and develop a presence in the Gold Coast Health and Knowledge Precinct
Cost	• ~$1.0-1.5 million
Financial performance	• EPS accretive and performing better than expectations, exceeding minimum ROI hurdles

Integral intends to continue to invest approximately $5m per annum in growth opportunities over the medium term. Several examples of near-term strategic projects are provided below.

Range of incremental growth projects for FY18/19

Pindara private hospital	• Establishment of a new PET CT service facility.
John Flynn hospital	• Establishment of a new PET CT service facility.
Mackay	• Installing a new wide-bore fully licensed MRI machine.
St John of God (Geelong)	• Establishment of a new PET CT service facility.
Prostate Centre of Excellence in North Melbourne	• Developing a prostate imaging centre of excellence in partnership with the Australian Prostate Cancer Research (APCR) in North Melbourne. The centre will also include a high end next generation cardiac CT machine and state of the art cardiac imaging.
New strategic specialist sites	• Opened a new Spine Centre of Excellence in Southport.
Geographic expansion	• New site opened on Torquay Road in Grovedale. • Opening a new site at Miami Beach in Queensland through the relocation of the non-performing Varsity Lakes clinic.

In addition, Integral expects to spend approximately $10m per annum for scheduled replacement capital expenditure, which is in line with historical depreciation and amortisation expenses, to maintain and improve the quality of existing operations.

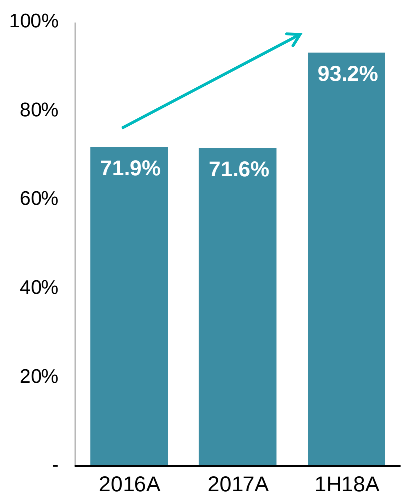
A healthy balance sheet to capitalise on organic and inorganic opportunities

Integral is conservatively geared and is highly cash generative which means the business is well positioned to further invest in its existing network and potential acquisitions.

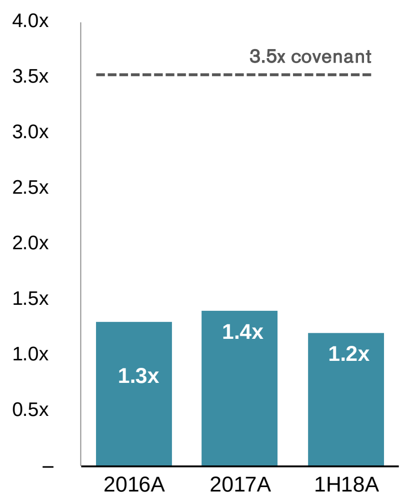
Integral has an impressive track record of successful integration, demonstrated by its experience with Western District Radiology and South West MRI, which were both earnings accretive additions in FY18.

Integral currently has a pipeline of additional bolt-on acquisitions at various stages of execution. Further, Integral will be pursuing larger strategic acquisitions at sensible multiples which would both extend the breadth and depth of Integral's service offering and deliver value to shareholders.

Consistently high cash conversion



Conservative and decreasing leverage with significant headroom



Consistently increasing fully-franked dividends

The Board believes that if Integral Shareholders accept Capitol's Offer they will not benefit from Integral's attractive future growth initiatives or be compensated for the returns the business is expected to generate

1.2. The Offer does not reflect the inherent value of Integral

It is the opinion of your Directors, having regard to Integral's standalone outlook and growth prospects, relative multiples, equity research consensus price targets, consultation with our advisers, and implied control premia, that the Offer significantly undervalues the inherent value of Integral's shares and fails to deliver a premium for a change of control.

The Offer does not take into consideration the recent financial and operating performance of Integral. The Offer was opportunistically announced prior to the release of Integral's 1H18 results and earnings upgrade.

The Offer is value destructive to Integral Shareholders

In transactions involving scrip consideration, the earnings per share impact is relevant when assessing the reasonableness of a takeover offer and potential value accretion or dilution to target shareholders.

According to Capitol's Bidder's Statement, the Offer is earnings per share dilutive to Integral Shareholders. Your Directors estimate that the Offer is approximately 3% earnings per share dilutive in FY18.[5]

In addition, as at 31 December 2017 and after accounting for a 1H18 dividend of 4 cents per share, Integral had a franking account balance of approximately $16.5 million. This is equivalent to $0.11 per share. Capitol's shareholders will potentially benefit from Integral's franking credit balance if the Offer is successful.

The Offer fails to deliver a premium for a change of control

Capitol has stated in its Replacement Bidder's Statement on 31 January 2018 that the implied value of its Offer represents a "significant premium to a range of historical trading prices for Integral Shares".[6]

When considering whether the Offer delivers a premium for a change of control for your Integral Shares, your Directors consider that it is misleading to calculate a premium relative to Integral's share price just prior to Capitol's takeover bid announcement last November.

Your Directors believe the Offer should be compared to the market performance of Integral in the period following the material upgrade to FY18 guidance on 12 January 2018 and 1H18 results announcement on 19 January 2018. This is the period during which the market was fully informed of Integral's financial performance and future prospects.

Based on the trading prices of Integral Shares in this period, the Offer represents a discount and at best a modest premium:

- 0.2% discount to 1 day VWAP as at 30 January 2018[7];
- 1.0% premium to 5 day VWAP to 30 January 2018[8];
- 6.8% premium to 1 day VWAP as at 1 March 2018[9]; and
- 4.3% premium to the 5 day VWAP to 1 March 2018[10].

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5 Integral FY18F NPAT ($18.6m) based on mid-point of forecast range on page 60 of Bidder's Statement. MergeCo FY18F NPAT ($29.9m) based on mid-point of forecast range on page 59 of Bidder's Statement, assuming no synergies ($3.6m post tax adjustment). Assumes 1,003.3m Capitol Health shares issued, resulting in total shares outstanding for MergeCo of 1,805.8m (page 44 of Bidder's Statement). To calculate EPS impact for Integral shareholders, FY18F NPAT adjusted for the cash component of the Offer ($52.3m per page 69 of Bidder's Statement), assuming 4.0% interest and 30% tax, resulting in adjusted Integral FY18F NPAT of $17.1m. Integral shareholders own 55.6% of MergeCo (1,003.3m shares of 1,805.8m MergeCo shares), representing $16.6m of MergeCo NPAT (55.6% x $29.9m). Based on 145,406,742 shares (including performance rights) outstanding (Page 34 Bidder's Statement) this implies a 3% per share dilution.

6 Page 13 of the Bidder's Statement.

7 Integral 1 day VWAP of $2.28 as at 30 January 2018, adjusted for 4.0 cents per share dividend announced 19 January 2018. The date has been selected as it is the date immediately prior to the lodgement of Capitol's Bidder's Statement and is considered to represent an appropriate date after the market had absorbed the 1H18 results and earnings upgrade. Implied Offer value as at 30 January based on Capitol Health's 1 day VWAP of $0.272 and 145,044,157 Integral Shares outstanding. Data sourced from IRESS, which is not required to consent, and has not consented, to the use of any such references in this Target's Statement

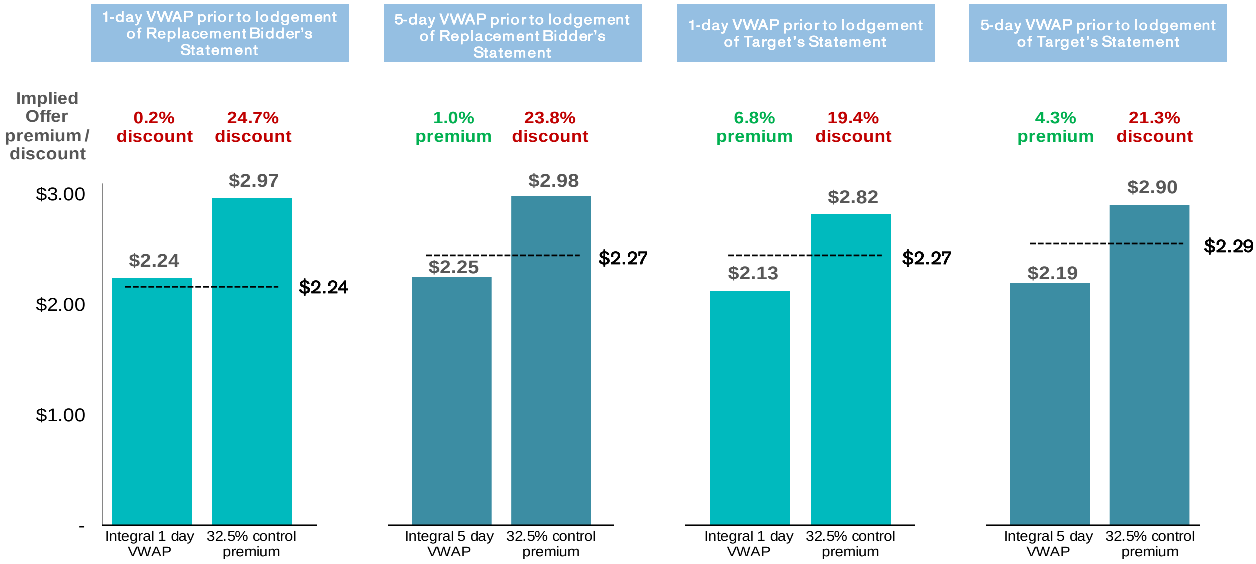
8 IRESS: Represents Integral's 5-day VWAP as at 30 January 2018, adjusted for 4.0 cents per share dividend announced 19 January 2018

9 IRESS: Integral 1 day VWAP of $2.13 as at 1 March 2018, being the date immediately before the date of this Target's Statement. Implied Offer value as at 1 March based on Capitol Health's 1 day VWAP of $0.277 and 145,044,157 Integral Shares outstanding.

10 IRESS: Represents Integral's 5-day VWAP as at 1 March 2018, being the date immediately before the date of this Target's Statement.

This means that the implied value of the Offer is in line with Integral's trading value and significantly below the typical takeover premia in Australia, which are typically in the range of 30% to 35%.[11] This is shown in the chart below.

The Offer fails to deliver a premium for a change of control[12]



Your Directors consider that the Offer does not deliver a premium for a change of control.

The Offer is below analyst price targets

Equity research analysts publish their view of where they expect the value of a company's shares to trade on a fully distributed basis over the next 12 months. This is a published opinion and is considered to be an independent assessment of the trading value of Integral on a standalone basis. It does not reflect a premium for control but is a relevant publicly available factor when assessing the reasonableness of the Offer.

Following Integral's 1H18 results announcement and earnings upgrade, equity research analysts upgraded Integral's price target to reflect the growth potential and future prospects of the business on a standalone basis, as discussed in section 1.1.

The consensus trading price target for Integral is currently $2.29 per share[13]. This represents a 7.8% upgrade to the consensus price target before Integral's earnings upgrade announcement[14].

Capitol's Offer represents a 2.9% discount to the consensus price target as at 30 January 2018 and a 1.4% discount as at 1 March 2018[15], as shown below.

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[11] 30% to 35% premia per Independent Expert's Report page 55.

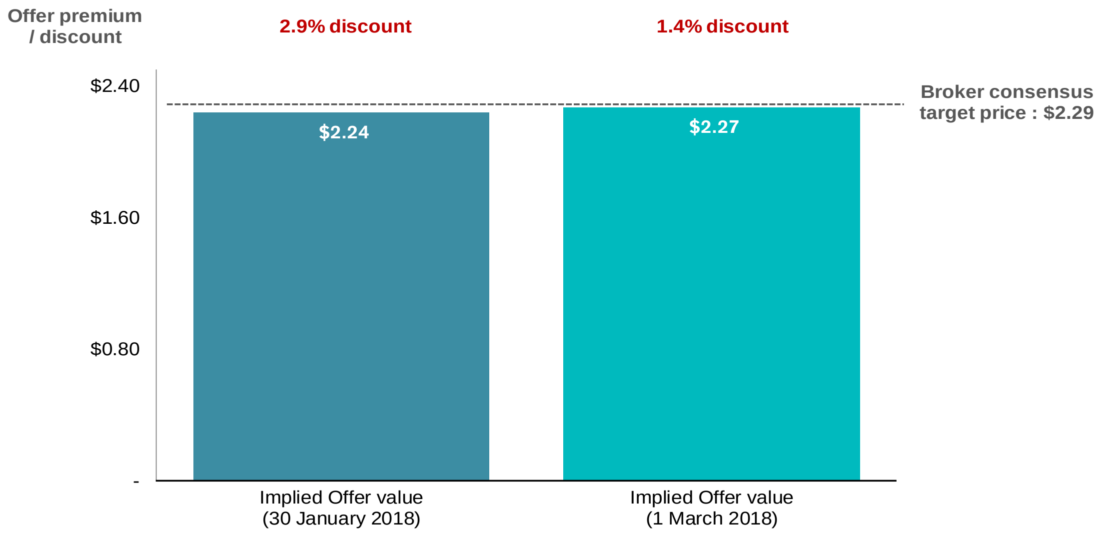
[12] Black dotted line reflects value of the Offer in each case. Control premium calculated as a 32.5% premium to Integral 1 day VWAP or Integral 5 day VWAP as at 30 January 2018 and 1 March 2018 respectively. 32.5% adopts mid-point range of 30% to 35% premia per Independent Expert's Report page 55. Data sourced from IRESS.

[13] The broker target prices have been calculated using two of the four brokers that released research between 19 January 2018 and 29 January 2018. The broker target prices used in the calculation were $2.25 and $2.33. Two brokers have been excluded from this calculation; one with a price target of $2.39 as it includes an adjustment for the takeover, whilst the other broker is restricted from placing a target price on the stock. The broker price targets enable the calculation of an average price attributed to brokers' views on the standalone target trading value of Integral following Integral's 1H18 results release. The broker price targets are included in this Target's Statement solely as an indication of market views as to the value of the Integral Shares at the time.

[14] The broker consensus price target for Integral has been calculated using three brokers that released research between 13 November 2017 and 3 December 2017. The broker price targets used in the calculation were $1.89, $2.15 and $2.33. The broker price targets enable the calculation of an average price attributed to brokers' views on the standalone target trading value of Integral prior to Integral's 1H18 results release. One broker research report has been excluded given the research analyst holds a restricted view on the stock. The broker price targets are included in this Target's Statement solely as an indication of market views as to the value of the Integral Shares at the time.

[15] Implied Offer values as at 30 January 2018 based on Capitol Health's 1 day VWAP of $0.272 and as at 1 March 2018 based on Capitol Health's 1 day VWAP of $0.277, in each case based on 145,044,157 Integral Shares outstanding. Refer to footnote 13 in relation to the broker consensus target price. Data sourced from IRESS.

The Offer is below analyst standalone trading price targets



If a 30% to 35% control premium was applied to the consensus trading price target the implied control value would be approximately $2.98 to $3.09 per share. This implied control value is materially higher than the implied Offer value of $2.24 (as at 30 January 2018) and $2.27 (as at 1 March 2018) shown above.

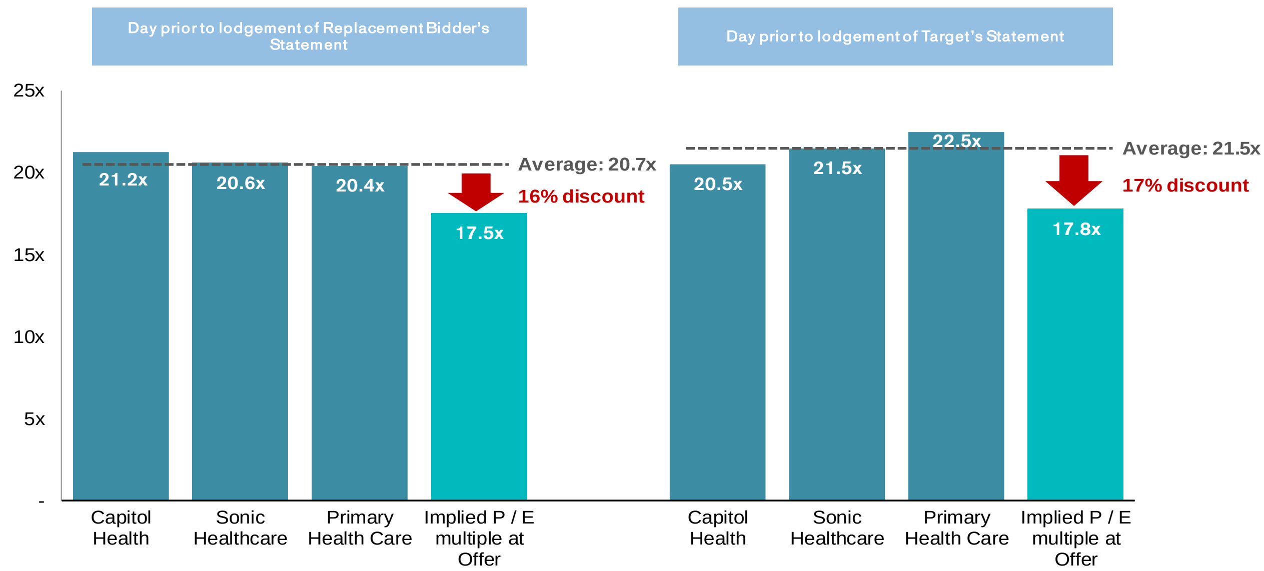
It is the opinion of your Directors, having regard to the consensus trading price target of equity research analysts, that the Offer significantly undervalues Integral Shares and does not deliver a premium for a change of control.

The implied multiple of the Offer is below trading multiples of selected peers

Trading multiples are considered a relevant benchmark when assessing the reasonableness of a takeover offer. However, while they reflect the current trading value of fully distributed shares of a company they do not reflect a premium for control. Acquirers typically pay a premium to the trading value of a company when they want to obtain control to access 100% of the cashflow of a company.

The Offer represents a 16% discount, or 3.2x NPAT, to the average multiple of 20.7x NPAT at which other domestic diagnostic imaging peers were trading as at 30 January 2018.[16] As at 1 March 2018, the Offer represents a 17% discount, or 3.7x NPAT, to the average multiple of 21.5x NPAT.

The Offer's FY18 P/E multiple is below trading multiples of diagnostic imaging peers



Your Directors believe that the Offer does not adequately compensate Integral Shareholders for the inherent value of your shares

16 Peer trading P / E multiples based on FactSet consensus. Implied P / E multiple at Offer as at 30 January 2018 based on Capitol Health's 1 day VWAP of $0.272, 145,044,157 shares outstanding and forecast FY18 Integral NPAT of $18.5 million. Implied P / E multiple at Offer as at 1 March 2018 based on Capitol Health's 1 day VWAP of $0.277, 145,044,157 shares outstanding and forecast FY18 Integral NPAT of $18.5 million. Forecast FY18 Integral NPAT calculated using four brokers that released research between 19 January 2018 and 29 January 2018, following the release of Integral's 1H18 results. All publicly available broker reports known to Integral during this period were used in the calculation of FY18F NPAT.

1.3. The Independent Expert has concluded that Capitol's Offer is neither fair nor reasonable

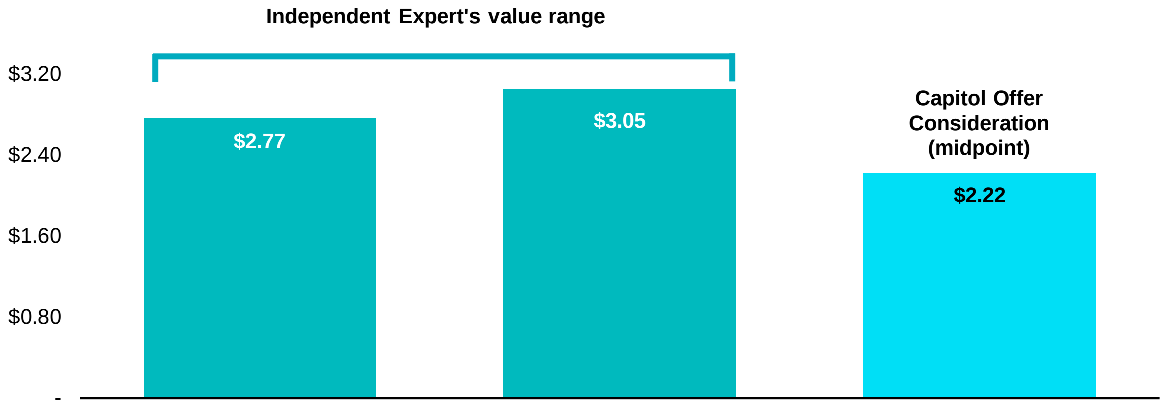
The Independent Expert has assessed the value of Integral Shares as between $2.77 and $3.05 per share

Integral engaged Lonergan Edwards to prepare an Independent Expert's Report in response to Capitol's Offer for the benefit of Integral Shareholders.

The Independent Expert has come to the following conclusions:

- The assessed value of Integral Shares is between $2.77 and $3.05 per share with a midpoint of $2.91 per share;
- The assessed value of Capitol Shares is between $0.26 and $0.28 per share;
- The assessed value of the Offer Consideration is between $2.15 and $2.29 per share; and
- The assessed value of the Offer Consideration is at a 23.7% discount to the assessed value of Integral Shares.[17]

Capitol's Offer is below the Independent Expert's valuation range[18]



The Independent Expert has said regarding Capitol's Offer:

> **"[Lonergan Edwards] has concluded that the Offer is neither fair nor reasonable."**
>
> *Independent Expert Report, 2 March 2018*

The Independent Expert has concluded that Capitol's Offer is valued at $2.22 per share and that the value of Capitol's Offer is 23.7% lower than its assessed valuation range for Integral Shares. The Independent Expert's valuation range is consistent with your Directors view that the Capitol Offer is inadequate and undervalues your Integral Shares. The Independent Expert's Report is included in this Target's Statement as Attachment 1. Your Directors encourage you to review that report as part of your assessment of Capitol's Offer.

The Independent Expert has concluded that Integral Shareholders will not be receiving fair or reasonable consideration

[17] Based on the midpoint of the Independent Expert's assessed value of Integral Shares of $2.91 per share (assessed range of $2.77 to $3.05 per share), and the midpoint of the assessed range of Capitol's Offer Consideration of $2.22 per share (assessed range of $2.15 to $2.29 per share).

[18] $2.22 per share is the midpoint of the Independent Expert's assessed value range of the consideration under Capitol's Offer (assessed range of $2.15 to $2.29 per share).

1.4. The underlying value of Capitol Health's scrip, which represents the majority of the Offer Consideration, is unclear

Capitol Health scrip represents approximately 84% of the Offer Consideration[19]; however the Integral Board has material concerns regarding the sustainability of Capitol Health's share price performance, quality of earnings and financial position and future commitments.

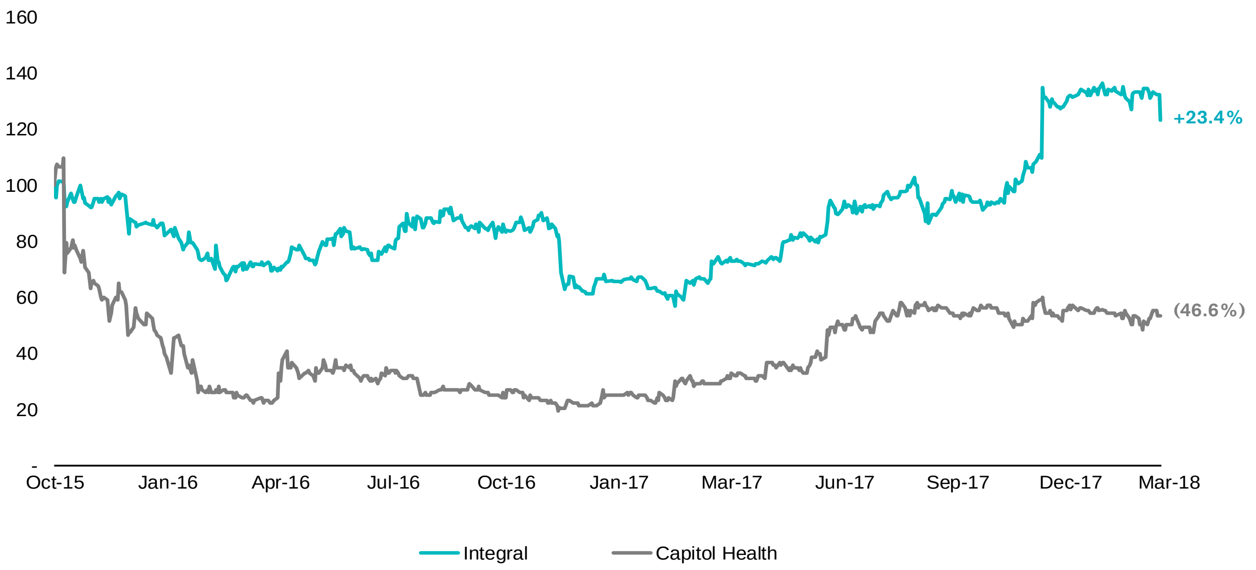
If Integral Shareholders accept the Offer, they need to be aware that they are investing in a company which has a significantly different risk profile to Integral.

> **"It's a heavy scrip component, and I've got great concerns about the Capitol management team and the value of the business."**
>
> *Simon Conn (Investors Mutual, Integral's largest shareholder), 19 January 2018*

Capitol Health has a track record of destroying shareholder value

Integral has significantly outperformed Capitol Health on a total shareholder returns basis since Integral's IPO. Capitol Health's value destruction over the same period has been driven by business decisions executed by the existing Capitol Health board and management team, including the acquisition of Southern Radiology and the subsequent divestment of NSW assets.

Capitol Health has generated negative total shareholder returns (since Integral's IPO)[20]



The Offer is opportunistically timed to take advantage of the recent appreciation in Capitol Health's share price

The Offer Consideration comprises approximately 84% scrip[21]. This should be treated with caution given Capitol Health's share price history and underperformance.

In particular, your Directors note that Capitol Shares:

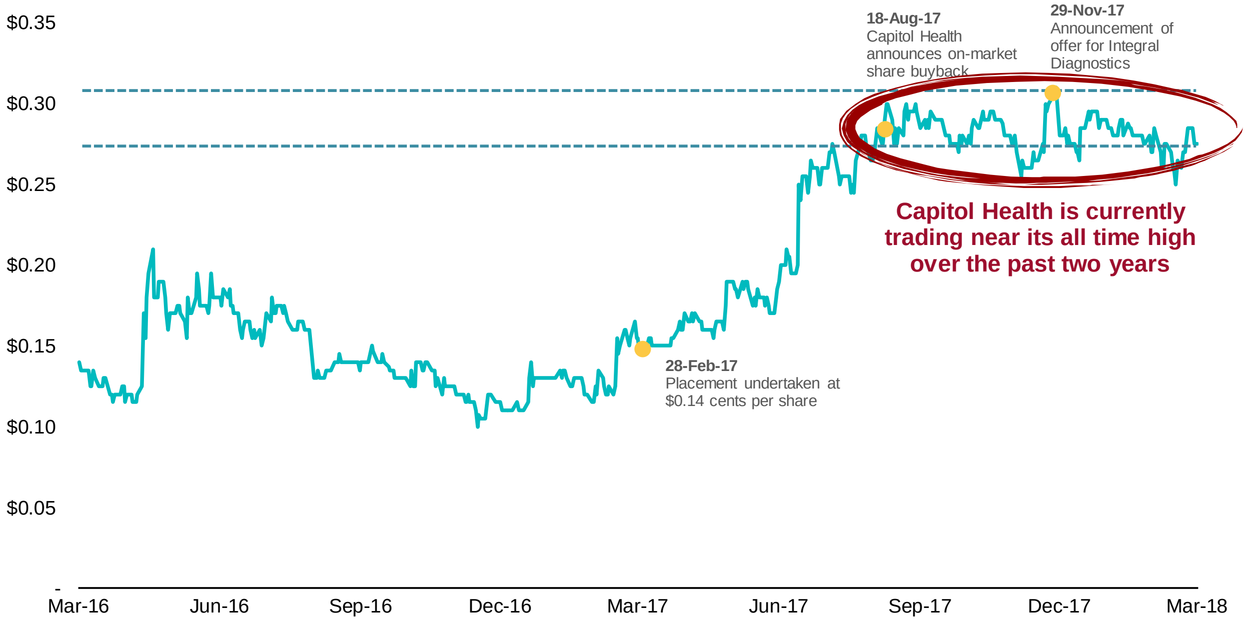
- are trading close to their two-year highs of $0.31 per share; and
- have been supported through an on-market buyback, announced in August 2017.

[19] Based on Capitol Health's close price of $0.275 as at 1 March 2018, being the last trading day prior to the release of this Target's Statement.

[20] Integral and Capitol Health's total shareholder returns as at 1 March 2018, being the last trading day prior to the release of this Target's Statement. Data sourced from Bloomberg, which is not required to consent, and has not consented, to the use of any such references in this Target's Statement.

[21] Based on Capitol Health's close price of $0.275 as at 1 March 2018, being the last trading day prior to the release of this Target's Statement.

Capitol Health is trading near its two year highs[22]



There is no guarantee that Capitol Shares will continue to trade at these levels nor that the value of the Offer will remain at current levels if the Offer is able to be successfully completed.

Integral has concerns regarding the quality of Capitol Health's earnings

Capitol Health has a poor financial track record, having reported losses of $4.7m in FY16 and $4.1m in FY17 which were significantly lower than its reported pro forma numbers. Excluding the divested NSW assets, Capitol Health generated a negative 3.8% NPAT CAGR from FY15 to FY18. [23]

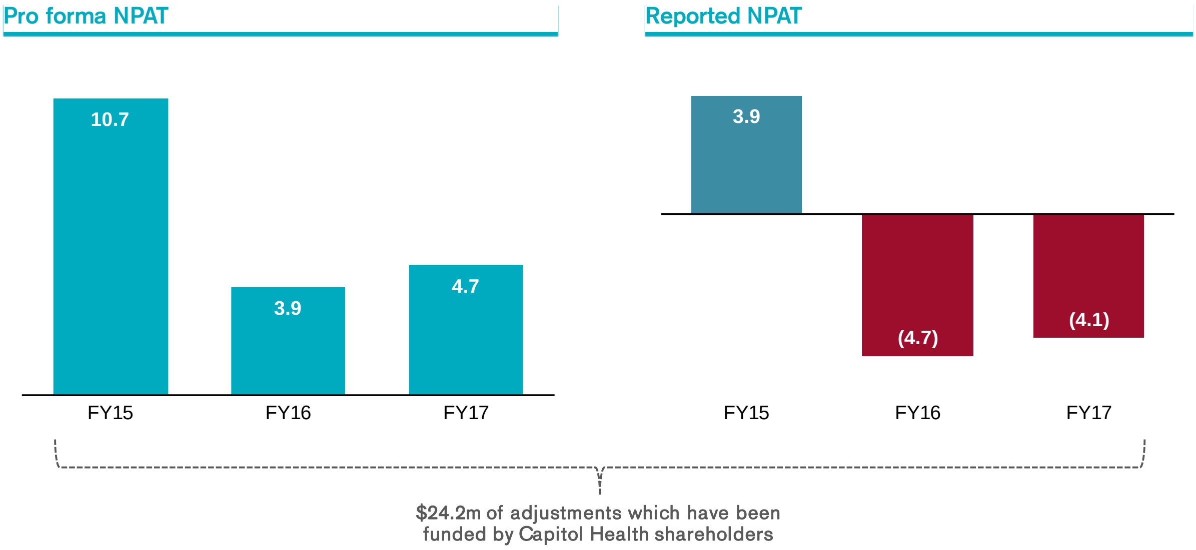
Capitol Health shareholders have funded an average of $8.1m of non-recurring losses per year for the last three years. Capitol Health recorded $8.6m of adjustments in FY16 and $8.8m in FY17 to allow Capitol Health to report a pro forma "profit" despite the business actually reporting real losses.

This results in a significant difference between Capitol Health's pro forma earnings and the actual earnings attributable to its shareholders, as shown below:

22 Sourced from IRESS as at 1 March 2018, being the last trading day prior to the release of this Target's Statement.

23 Capitol historical financials based on pro forma results sourced from Bidder's Statement. Capitol's forecast financials based on mid-point of broker forecast range provided in Capitol's Bidder's Statement and includes statutory adjustments for I-Rad and Radiology Tasmania.

Significant variance between reported and pro forma profit[24]



$16.4 million of Capitol Health's adjustments to profit relate to:

- Consecutive impairment charges relating to poor execution of acquisitions / other investments;
- China JV development costs relating to the CITIC JV; and
- Significant acquisition, termination and restructure charges.

For these reasons, Integral believes it is difficult to assess the underlying quality and sustainability of Capitol Health's earnings. Given the recent acquisition activity of Capitol Health, and its poor acquisition track record, your Directors remain concerned that losses, normalisations and non-recurring items will continue to be recognised and paid for by shareholders of Capitol Health.

The basis of Capitol Health's FY18 standalone forecast is unclear and speculative

In the Bidder's Statement, Capitol Health's standalone FY18 pro forma EBITDA (excluding I-Rad and Radiology Tasmania) was forecast to be $21.2m (midpoint), which is a 46% increase from FY17 EBITDA of $14.5m. As part of Capitol Health's 1H18 results, management provided updated FY18 EBITDA guidance of $24.0m (midpoint), which included I-Rad and Radiology Tasmania. There is no detail on the strategies or initiatives Capitol Health has implemented to achieve such a significant increase in their standalone FY18 pro forma EBITDA, nor any indication as to the sustainability of this level of earnings.

Capitol Health has not substantiated its forecast standalone pro forma EBITDA growth. While it discloses, on page 61 of the Bidder's Statement, a "bridge" showing revenue increasing in the range of $4.2m-$9.2m (3.9% - 8.5%) and costs declining $1.5m or increasing $1.5m, there is no explanation as to how Capitol Health intends to achieve this growth.

Capitol Health has now disclosed it operates branded sites

In response to questions raised by Integral, Capitol Health has disclosed that it has arrangements with clinics at four locations (Woodend, Gisborne, Sunbury and Glenroy), in which Capitol Health provides certain services and a brand licence to those clinics in return for a fee. The method of accounting and the underlying performance for these arrangements is not clear.

As far as Integral is aware, Capitol Health has not made any prior disclosure to the market regarding the nature of these arrangements, which it considers to be fundamentally different from Capitol Health's core operations.

[24] Source: Capitol's Bidder's Statement.

Capitol Health's financial position and investment decisions are questionable

There are identified, material differences in Capitol Health's and Integral's accounting policies

> **"There may be differences in the application of accounting standards and the treatment of certain assets and liabilities between the two companies. As such, it is possible that this could have a material impact on the Combined Group financial information."**
>
> *Capitol's supplementary bidder's statement, page 91, 31 January 2018*

Your Directors have concerns regarding Capitol Health's application of Australian Accounting Standards

Make-good costs and fixed rent increases on leased equipment and property can be a significant cash cost at the back end of a lease. Capitol Health has made no provision for these cash costs, as required by Australian Accounting Standards. These cash costs could be material. For example, Integral has 47 sites with provisions totalling $6.6m for make-good costs and straight-line lease accounting (as at 31 December 2017) with a historical annual profit-and-loss impact of approximately $500,000. In contrast, Capitol Health has 43 sites with no provision or profit-and-loss impact recorded in its accounts.

Capitol is unwilling to disclose any meaningful information about the speculative Enlitic investment and the CITIC JV

Enlitic

Capitol promotes Enlitic as a key reason Integral Shareholders should accept its Offer. But seven days prior to announcing its intention to make the Offer, Capitol Health told shareholders at its AGM that it was considering the future of its investment in Enlitic.

> **"Currently considering opportunities to crystallise value for Capitol [from Enlitic]."**
>
> *1H FY2018 Half Year Results presentation, ASX Announcement, 27 February 2018*

Your Directors consider Capitol's disclosure on Enlitic as grossly inadequate, particularly given the prominence it places on the potential upside and the $14.6m of cash investment it has already made in the venture. Capitol fails to provide any critical performance information for shareholders to assess whether this investment has any value and if it is as attractive as Capitol has so strongly represented.

Integral requested further financial disclosure on Enlitic, such as a balance sheet, which should be readily available. Capitol has refused to provide this information. For this reason, your Directors believe the Enlitic investment has no material value.

CITIC JV

Capitol heavily promotes the CITIC JV as providing Capitol Health with access to Asian markets and as a key reason Integral Shareholders should accept its Offer.

But the facts tell a different story, comprising:

- **Missed deadlines**: The CITIC JV has not yet commenced operations, despite statements that the first centre would open in February 2017 (over 12 months ago);
- **Regulatory delays**: Chinese regulators continue to review the JV and have, on multiple occasions, deferred any decision on its potential commencement[25]; and
- **Financial uncertainty**: There is no certainty operations will ever commence, be successful or provide any material financial benefits to Capitol Health.

25 Capitol Health 2017 Annual General Meeting Presentation, 22 November 2017.

It is unclear what tangible operational or financial benefits will be realised. Capitol Health has confirmed that the CITIC JV has no activity.

Significant financial restatements made by Capitol in the Bidder's Statement

Integral shareholders were not provided with a Bidder's Statement that was complete, accurate or met legal requirements to enable an appropriately informed assessment of the Offer, including errors in the financial statements.

Integral raised matters of material concern regarding the original bidder's statement and subsequent responses from Capitol. This led to extensive revisions in the replacement bidder's statement released to the ASX on 31 January 2018 (including the incorporation of an investigating accountant's report).

Your Directors encourage you to refer to the investor presentation released by Integral on 6 February 2018 for detail on the corrections made to the replacement bidder's statement.

Loss of clinical leadership radiologists under Capitol ownership

Due to the highly specialised nature of diagnostic imaging, Integral's business relies upon its ability to attract and retain high quality radiologists. Radiologists choose to work at Integral over other options for a number of reasons including:

- National and State Clinical Leadership Committees in operation driving strategic and operational collaboration;
- Clinical governance structure core to the business model and culture at every level since inception;
- Diverse and interesting mix of clinical work as a result of hospital sites and higher modality specification;
- Benefit from Integral's relationship with its large referral network;
- Large group of radiologists creates opportunities to develop sub-specialty interests and share clinical workload across the group;
- Integral's technology and systems, which reduce administrative burden and increase time available for clinical work;
- Training and development opportunities;
- Attractive financial arrangements with remuneration in line with other leading private providers and often favourable financial compensation to public hospitals; and
- Potential for long-term equity ownership.

Integral's Board believes there is a fundamental lack of support for the transaction amongst radiologists.

The uncertainty and destabilising nature of the hostile Offer, together with the potential loss of radiologists if the Offer is successful, is likely to have a material operational and financial impact on the business.

Liquidity risks when Capitol Health issues up to a billion new shares

Integral Shareholders should consider the liquidity implications from the shares being issued by Capitol Health and the release of escrowed Integral Shares. The number of Capitol Shares which would be required to be issued to Integral Shareholders under Capitol's Offer is approximately 1 billion. This represents an increase of approximately 125% of Capitol Health's currently issued share capital. There is a risk that Integral Shareholders who accept Capitol's Offer may not intend to hold their shares in the long term, which would lead to an oversupply of shares following the transaction.

However, shareholders who hold or control approximately 32.90% of Integral Shares[26], including Integral's Directors, have already informed the Board that they intend to REJECT Capitol's Offer. This means that the Offer's 90% minimum acceptance condition cannot be satisfied.

Your Directors believe that the issuance of up to 1 billion new Capitol Shares will put significant downward pressure on the realisable value of shares in Capitol Health. There is a material risk that the implied value of the Offer will not reflect the realisable value shareholders could receive after they are issued with new Capitol Shares.

Capitol Health has a mixed track record with paying dividends to its shareholders

Capitol Health suspended paying dividends to its shareholders in September 2015, and has only recommenced payment at its 1H18 results, a 17 month period without dividends for Capitol Health shareholders. The interim 1H18 dividend of 0.4 cents per share is equivalent to just a 2.9% annualised yield based on Capitol Health's one day VWAP of $0.277 at 1 March 2018. This compares to the Integral yield of 3.8% based on the one day VWAP of $2.13 at 1 March 2018. We note that Capitol Health's 1H18 declared dividend of $3.2m represents approximately 111% of 1H18 statutory NPAT of $2.9m.

If Integral Shareholders accept Capitol's Offer they expose themselves to substantial investment risks for which they are not adequately compensated

[26] Integral's Directors together hold or control 4,314,512 Integral Shares (2.97%). Integral's four largest shareholders as at 28 February 2018, being Investors Mutual (14,550,000, 10.03%), Adam Smith Asset Management (10,279,843, 7.09%), Perennial Value Management (10,070,027, 6.94%) and Viburnum Funds (8,500,000, 5.86%) hold or control 29.92% of Integral Shares in aggregate. Note the holdings have been rounded to two decimal places..

1.5. Capitol Health cannot integrate and effectively manage a business that is substantially larger and more complex

Integral and Capitol Health have fundamentally different business models with different financial and operating risk profiles. Integral's superior financial performance is due to its more clinically complex and diversified business model.

Integral has purposefully built its business around high clinical complexity, hospital exposure through a "hub-and-spoke" model.

Its community clinics support referrals to hospital sites, which have specialist MRI and/or PET machines. Integral's management expertise in this more clinically diversified and complex business delivers higher margins and revenue growth than Capitol Health.

		integral DIAGNOSTICS	CAPITOL HEALTH LIMITED[27]
# of clinics		47	48
# of other sites		-	4[28]
Geographical presence / market share[29]		VIC, QLD and WA (#2 in WA, #4 in VIC and QLD)	VIC, TAS (#2 in both)
Hospital Sites[30]	Day surgery	0	1
	Overnight	13	2
	With Emergency Departments	9	0
# of government reporting contracts		5	0
# of radiologists		64[31]	64
# of full MRI licences[32]		9	2
# of partial MRI licences		3	8
PET scans		3 + 1 on order	0
Doctor equity model[33]		Yes; Currently ~23% shareholders, acquisitions typically include scrip	None; Acquisitions typically cash only

Integral has a more attractive revenue mix and growth profile than Capitol Health

Integral has a substantially more diversified revenue mix with less reliance on bulk-billing. Integral's focus on providing a full range of imaging diagnostics modalities results in higher complexity and

27 Number of clinics, hospital sites, radiologists, full MRI licenses and partial MRI licenses for Capitol Health sourced from Bidder's Statement, page 18.

28 Reflects sites where Capitol has an arrangement in respect of clinics at four locations whereby Capitol Health provides certain services and a brand licence to those clinics in return for a fee.

29 Market share based on number of clinics.

30 Capitol day hospital site refers to Vermont Private Hospital. Overnight hospitals refer to Western Private Hospital and Kilmore & District Hospital.

31 Relates to employed radiologists only. In addition Integral has a number of contractor radiologists (~39 as at the date of this Target's Statement).

32 An MRI machine with a Full Licence is eligible for a Medicare rebate for procedures referred by a medical specialist and certain procedures referred by a General Practitioner (GP). Under a Partial MRI Licence, a Medicare rebate is only available for certain procedures referred by a GP.

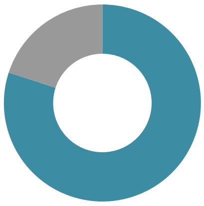
33 Integral is currently undertaking a review of radiologist recruitment, retention, incentive and escrow structures to strengthen the business.

greater diversity in its volume mix through greater use of MRI machines and PET and less reliance on bulk-billed services. This supports revenue opportunities across specialist referrals and margin expansion across the business.

Capitol Health is heavily reliant on Medicare bulk-billing, which means it has greater exposure to regulatory risk than Integral.

The following demonstrates Integral's superior growth profile across various financial metrics, noting that Capitol Health has demonstrated negative EBIT and NPAT growth even with the acquisitions of I-Rad and Radiology Tasmania.

Integral is significantly more profitable than Capitol Health

		integral DIAGNOSTICS	CAPITOL HEALTH LIMITED Incl. I-Rad and Radiology Tasmania
FY17 Revenue		$180m	$108m
Revenue mix[34]		 Bulk billed <55%	 Bulk billed >80%
CAGR (FY15–FY18F)[35]	Revenue	5.8%	6.2%
	EBITDA	3.7%	2.8%
	EBIT	4.0%	(0.8%)
	NPAT	5.5%	(3.8%)

In 1H18, Capitol Health's reported revenue growth was 4.3% (versus Integral's 1H18 revenue growth of 5.8%)[36], which is below the FY18 implied revenue growth of 6.0% in the Bidder's Statement[37].

Integral generates higher margins than Capitol Health

Despite an aggressive cost-cutting program, including the redundancy of the Chief Financial Officer, Capitol Health consistently generates margins that are, on average, 4.1% lower than Integral. This reflects Integral's more clinically diversified and complex business mix.

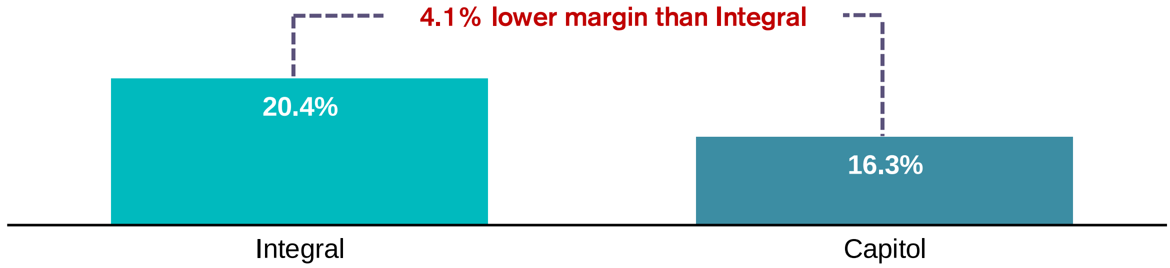
[34] Integral revenue mix reflects fee type split on patient fees for the December 2017 quarter. Estimate of Capitol Health revenue mix based on two broker reports released between 10 August 2017 and 10 November 2017, being the only broker reports to Integral's knowledge that estimate Capitol Health's revenue mix during this period.

[35] Integral's historical financials based on annual reports and full year results investor presentations, representing underlying earnings prior to one off transactions. Integral's forecast financials based on mid-point of broker forecast range provided in Capitol's Bidder's Statement. Capitol Health's historical financials based on pro forma results sourced from Bidder's Statement. Capitol Health's forecast financials based on mid-point of broker forecast range provided in Capitol's Bidder's Statement and includes statutory adjustments for I-Rad and Radiology Tasmania.

[36] Integral and Capitol Health growth rates are based on 1H18 financial statements. In their 1H18 results, Capitol Health also refers to 5.1% revenue growth over the period, which adjusts for 1 less working day in Victoria.

[37] FY17 Capitol Health pro forma revenue of $108.4 million per Bidder's Statement. FY18 pro forma revenue of $114.9 million based on midpoint of pro forma forecast FY18 revenue per page 59 of the Bidder's Statement, which excludes forecast contributions from Radiology Tasmania and I-Rad acquisitions.

Capitol Health achieves lower average EBITDA margins[38] than Integral



Capitol Health's management platform has limited clinical experience and governance structures

Integral has a highly developed governance framework to help manage the clinical aspects of its business. It is a core part of the business and culture. There are currently two practicing radiologist executive directors on Integral's Board, as well as local, State and National Clinical Leadership committees designed to ensure collaboration in operational and strategic decision making.

By comparison, Capitol Health's Board has no executive directors with clinical expertise and has only proposed appointing a medical professional as a non-executive director to the Board and reviewing existing governance arrangements upon a combination with Integral. As such, this new director will not be a radiologist employed in the business.

Lack of depth of Capitol Health's governance and management framework and resources

	integral DIAGNOSTICS	CAPITOLHEALTH LIMITED
Size of Board	7	4[39]
# of practicing radiologists on the Board	2	0
# of executive directors on the Board who are doctors	3	0
# of directors with other healthcare Board experience	5[40]	0[41]
CFO in business	Anne Lockwood	0[42]

Over the last six months, Capitol Health has continued to pursue an aggressive set of cost cutting initiatives that has reduced its senior management team's depth and strength. This includes the

38 Represents average EBITDA margins from FY15 to FY18F. Integral's historical financials based on annual reports and full year results investor presentations, representing underlying earnings prior to one off transactions. Integral's forecast financials based on mid-point of broker forecast range provided in Capitol's Bidder's Statement. Capitol Health historical financials based on pro forma results sourced from Bidder's Statement. Capitol Health's forecast financials based on mid-point of broker forecast range provided in Capitol's Bidder's Statement and includes statutory adjustments for I-Rad and Radiology Tasmania.

39 Capitol has committed to elect a non-executive director who is a medical professional to the Board if the Offer is successful. As such, this will not be a radiologist employed in the business.

40 Includes Dr Ian Kadish, Helen Kurincic, Dr Chien Ho, Dr Sally Sojan and Rupert Harrington.

41 Capitol has committed to elect a non-executive director who is a medical professional to the Board if the Offer is successful. As such, this will not be a radiologist employed in the business.

42 Ken Birchall has fulfilled the role as Head of Finance at Capitol Health since his appointment on 5 October 2015.

significant turnover in the senior management team, with Capitol Health employing three different CFO's since FY15.

It is difficult to effectively integrate a complex, medically led business into a simple bulk billing operation.

The value of Integral Shareholders' majority interest in the merged entity is likely to be detrimentally impacted

There are likely to be material dis-synergies in the transaction

There are likely to be material dis-synergies in the transaction under Capitol Health's leadership given the aforementioned potential radiologist loss and significant clinical governance differences between Capitol Health and Integral. This risk is heightened by Capitol Health's recent announcement of the acquisitions of I-Rad and Radiology Tasmania, which are occurring concurrently with Capitol's proposed hostile takeover of Integral, a business which is larger than Capitol Health. Capitol has not provided any details on how it intends to mitigate the risks of integrating these four different businesses at the same time.

Synergies, which are potentially overstated, cannot be achieved as Capitol cannot acquire 100% of Integral

Given that Integral Shareholders holding or controlling 32.90% of Integral Shares do not intend to accept the Offer, Capitol will not control 100% of the business and no synergies will be achieved.

Despite the inability to reach 100%, as Integral and Capitol Health both operate in the diagnostic imaging sector, they are in largely different regional locations and segments of the market that do not provide a complementary overlap of services. Accordingly, there would be limited synergies from the combination of the two businesses and the potential synergistic benefits that would accrue to Integral Shareholders if the Offer was successful would be lower than that identified by Capitol in relation to the Offer.

There has been no due diligence undertaken by either party on the transaction to confirm the potential synergy benefits or to assess risks in respect of the transaction.

Based on this limited information, Integral's Directors estimate that actual synergies if Capitol was capable of acquiring 100% of Integral Shares are likely to be $2.2 million, which is $2.8 million less than estimated by Capitol.

	integral DIAGNOSTICS	CAPITOL HEALTH LIMITED
Salaries and wages	$0.9m	?
Operational costs	$1.0m	?
Other	$0.3m	?
Total[43]	**$2.2m**	**$5.0m**

Capitol has not provided any details, calculations or assumptions to support their estimate of synergies so they cannot be verified by the Integral Board and management team.

Integral's management team and support functions are likely to be the main source of Capitol's estimated synergies. Capitol Health lacks the depth of Integral's management team and the experience to manage and support the clinical diversity and complexity of Integral's business. Integral already delivers higher margins than Capitol Health, which reflects a best practice business model and the appropriateness of its support structure for the business. Your Directors cannot reconcile how Capitol believes it can pursue such an aggressive set of cost cutting

[43] Integral synergy estimates are based on Integral management. Capitol synergy estimates are based on Capitol's Bidder's Statement.

initiatives to Integral's management and support structure without it having a materially detrimental impact on the business and engagement with radiologists. Your Directors question Capitol's ability to extract further synergies and cost savings at the senior management level given the employee reductions in this area to date.

By accepting Capitol's Offer, Integral Shareholders will have to rely on a Board and management team that lacks depth, runs a fundamentally different business and does not appear capable of managing the integration risks

1.6. Capitol Health has not demonstrated a track record of creating shareholder value through material acquisitions

Capitol Health's acquisition and divestment of Southern Radiology and other NSW businesses, recorded total shareholder losses of $19m within 30 months of purchase

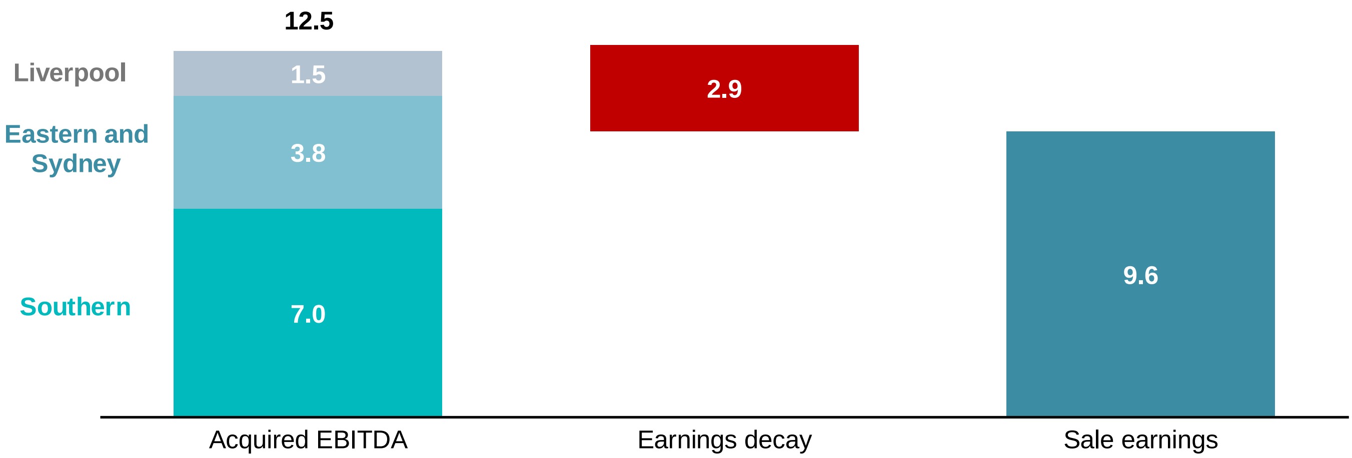
Capitol Health's board oversaw the value destructive acquisition of Southern Radiology in December 2014. At the time of the acquisition of Southern Radiology, Capitol Health said that:

> **"Capitol Health has significant experience in integrating companies… Southern has similar operational and systems set-up to Capitol Health."**
>
> *Investor presentation, Acquisition of Southern Radiology Group, December 2014, ASX Announcement, 10 December 2014*

> **"Southern has five MRI licences… which are expected to drive growth for the enlarged entity. Moreover, Southern provides a platform for Capitol to expand further into NSW."**
>
> *Capitol Health announces the acquisition of Southern Radiology Group and equity raising, ASX Announcement, 10 December 2014*

However, in June 2017, after 30 months of ownership, Capitol Health announced the sale of this business and various other NSW acquisitions.

During Capitol Health's ownership the NSW assets suffered material earnings deterioration[44]



These losses and the sale of the business were, according to Capitol Health, driven by:

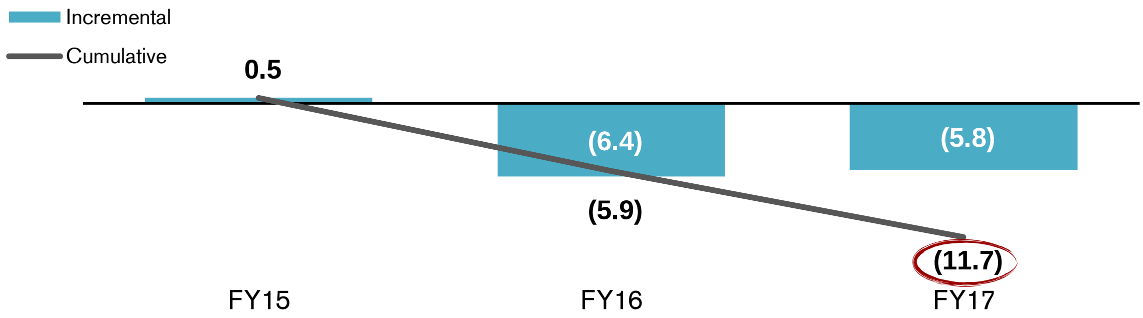
[44] Acquired EBITDA represents summation of EBITDA recorded by each NSW asset in the financial year prior to being acquired by Capitol Health as per Southern Radiology acquisition announcement (10 December 2014), Eastern Radiology and Sydney Radiology acquisition announcement (27 April 2015) and Liverpool Diagnostics acquisition announcement (31 August 2015). Sale earnings calculated as sale price of NSW assets ($81.5m) divided by sale multiple (8.5x) as per Capitol Health's announcement of sale of NSW assets dated 14 June 2017. Implied earnings loss represents acquired EBITDA less sale earnings. EBITDA multiple represents $4.5m Enterprise Value plus $1.5m earn-out divided by FY14 EBITDA of $1.5m.

“The difficulties experienced in integrating the different business models associated with the four NSW acquisitions, including bulk billing, hospitals, research, and private billing.”

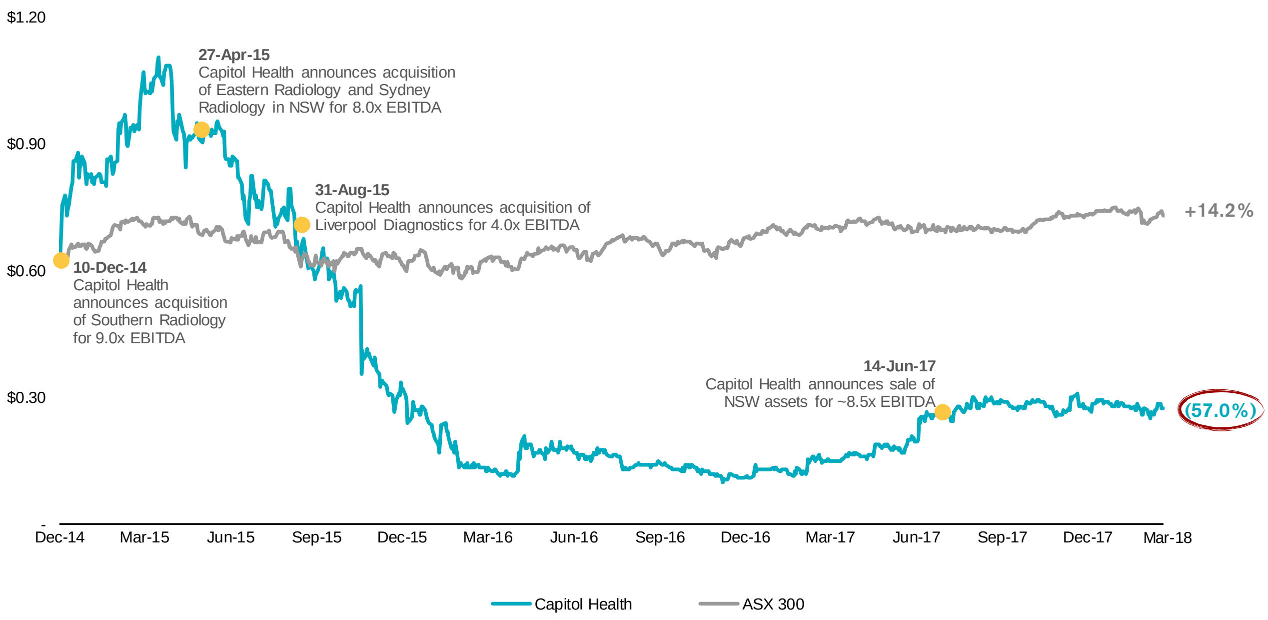
Capitol announces the sale of its NSW Assets to I-Med Radiology Network for $81.5 million, ASX Announcement, 14 June 2017

The acquisition and subsequent sale was seriously damaging to Capitol Health’s shareholders

Shareholders funded approximately $11.7m of losses over three years of ownership (A$m)



Capitol Health’s share price declined by almost 60% following the Southern acquisition[45]



In addition to funding losses over the three years, shareholders lost $7.6m on the sale of the NSW businesses

The total cash payment of $93.5m for NSW asset acquisitions[46] compared to cash received upon sale of Capitol Health’s NSW assets of only $86.0m, leaving a $7.6m deficit which realised a loss for shareholders.

45 ASX 300 rebased to CAJ share price since Southern announcement (10 December 2014).

46 Includes $59.7m for Southern Radiology, $27.8m for Eastern Radiology Services, $4.1m for Liverpool Diagnostics, $1.6m for Sydney Radiology and $0.3m for Sunrise Radiology.

The combined NSW businesses were approximately one third of the size of Integral

Southern Radiology and other NSW businesses had a similar culture and operating model to Integral. However, their combined value was only $93.5m compared to the Integral market cap of $300.2m as at 1 March 2018. These cultural and strategic differences to Capitol Health, combined with Capitol Health's integration history, create material integration risks for Integral Shareholders.

Radiology Tasmania integration

On 1 February 2018, Capitol Health announced the completion of the Radiology Tasmania acquisition for $25.2m [47]. Integral understands that one of Radiology Tasmania's eight radiologists has subsequently resigned their employment.

Integral Shareholders need to be aware that if they accept Capitol's Offer then they will be investing in a Board and management team with a poor track record of integration, exposing them to material risk of value destruction

[47] Acquisition consideration of $24.17 million on a cash free debt free basis and up to $1 million payable under an earnout to the vendors over two years (based on revenue performance). Capital Health ASX Announcement 21 December 2017.

1.7. The Offer is highly conditional and the 90% minimum acceptance condition is not capable of being satisfied

Shareholders who hold or control 32.90% of Integral Shares do not intend to accept the Offer

Investors Mutual, Adam Smith Asset Management, Perennial Value Management and Viburnum Funds (Integral's four largest shareholders) who hold or control 29.92% of Integral shares in aggregate[48], have informed Integral they do not intend to accept the Offer in respect of the shares that they each hold or control.

The 29.92% held or controlled by the institutional investors above, combined with the 2.97% of shares held or controlled by Integral's Directors, results in shareholders representing 32.90% of Integral Shares intending not to accept the Offer.

This means that Capitol will be unable to meet the 90% minimum acceptance condition.

Capitol cannot deliver any synergies

Given that 32.90% of shareholders do not intend to accept the Offer, as disclosed in Capitol's Bidder's Statement, **there will be no synergies generated from the transaction**.

Shareholders are unlikely to receive scrip for scrip rollover relief, which will have negative tax consequences, given Capitol are unable to acquire more than 80% of Integral Shares

Integral Shareholders should be aware of the uncertainty regarding the availability of scrip roll over relief. In order for Integral Shareholders to benefit from scrip for scrip roll over relief from capital gains tax, Capitol must own at least 80% of the voting shares at the conclusion of the Capitol Offer.

Capitol's Offer is subject to a 90% minimum acceptance condition, which may be waived by Capitol at its discretion, and if all other conditions are satisfied or waived would mean Capitol could end up owning less than 80% of the voting shares required at the conclusion of the Capitol Offer. In this regard, Capitol will not be able to achieve this level of acceptance of the Offer, in particular because Integral Shareholders holding or controlling 32.90% of the Integral Shares on issue do not intend to accept the Offer.

Accordingly, it is unlikely that scrip for scrip roll over relief from capital gains tax will be available to Integral Shareholders. This may result in further capital gains tax liability in relation to the scrip component of the Offer Consideration for Integral Shareholders who accept Capitol's Offer.

See Section 6 of this Target's Statement for further details of the tax consequences of Capitol's Offer.

Capitol is unable to acquire 100% of Integral under the Offer, and there are negative consequences for Integral Shareholders who accept the Offer

[48] Integral's four largest shareholders as at 28 February 2018, being Investors Mutual (14,550,000, 10.03%), Adam Smith Asset Management (10,279,843, 7.09%), Perennial Value Management (10,070,027, 6.94%) and Viburnum Funds (8,500,000, 5.86%) hold or control 29.92% of Integral Shares in aggregate. Note the holdings have been rounded to two decimal places.

2. Frequently asked questions

This section answers some commonly asked questions about the Offer. It is not intended to address all relevant issues for Integral Shareholders. This section should be read together with all other parts of this Target's Statement.

Question	Answer
What is Capitol's Offer for my Integral Shares?	Capitol is offering 6.9 Capitol Shares and $0.36 cash for each Integral Share held by you.
What choices do I have as an Integral Shareholder?	As an Integral shareholder, you have the following choices in respect of your shares: • do nothing and reject the Offer; • sell your shares on the ASX (unless you have previously accepted the Offer and you have not validly withdrawn your acceptance); or • accept the Offer. There are several implications in relation to each of the above choices. A summary of these implications is set out in sections 3 and 5 of this Target's Statement.
What are the Directors of Integral recommending?	Each Integral Director recommends that you **REJECT THE OFFER** (and intends to do so in respect of their own Integral Shares).
How do I reject the Offer?	To reject the Offer, simply do nothing. You should take no action in relation to all correspondence from Capitol regarding the Offer.
What are the consequences of accepting the Offer now?	If you accept the Offer, unless withdrawal rights are available (see below), you will give up your right to sell your Integral Shares on the ASX or otherwise deal with your Integral Shares while the Offer remains open.
If I accept the Offer, can I withdraw my acceptance?	You only have limited rights to withdraw your acceptance of the Offer. You may only withdraw your acceptance if Capitol varies the Offer in a way that postpones the time when Capitol is required to satisfy its obligations by more than one month. See section 5.5 of this Target's Statement for further details.
When does the Offer close?	The Offer is scheduled to close at 7pm (Melbourne time) on 28 March 2018 unless extended as required or permitted by the Corporations Act.

What are the conditions to the Offer?	In summary, the conditions to the Offer are: • minimum acceptance condition of 90%; • Capitol receiving all necessary regulatory approvals; • no adverse regulatory action in respect of the Offer or the Integral Group; • no material adverse change in the Integral Group; • no cessation of licences, registrations, certifications or accreditations required for the Integral business; • no material acquisitions, disposals, new commitments or other events by, or in respect of, the Integral Group; • no change of control or other rights triggered by the Offer; • no dividends declared or made by Integral; • Capitol receiving equal access to information provided by Integral to other persons for the purpose of soliciting an alternative proposal; and • no prescribed occurrences. See section 5.1 of this Target's Statement for further detail on certain of the conditions (and sections 11.6 and 11.7 of the Bidder's Statement).
What happens if the conditions of the Offer are not satisfied or waived?	If the conditions are not satisfied or waived before the Offer closes, the Offer will lapse. You would then be free to deal with Integral Shares even if you had accepted the Offer.
Can Capitol withdraw the Offer?	Capitol may not withdraw the Offer if you have already accepted it. Before you accept the Offer, Capitol may withdraw the Offer with the written consent of ASIC and subject to the conditions (if any) specified in such consent.
Can the Offer lapse?	The Offer will lapse if the Offer conditions are not freed or fulfilled by the end of the Offer Period (7pm (Melbourne time) on 28 March 2018, unless extended or withdrawn); in which case, all contracts resulting from acceptance of the Offer and all acceptances that have not resulted in binding contracts are void. In that situation, you will be free to deal with your Integral Shares as you see fit.
When will I be sent my consideration if I accept the Offer?	If you accept the Offer, you will have to wait for the Offer to become unconditional before you will be sent your consideration from Capitol. See section 5.6 of this Target's Statement for further details on when you will be sent your consideration.
What are the tax implications of accepting the Offer?	A general outline of the tax implications of accepting the Offer is set out in section 6 of this Target's Statement. As the outline is a general outline only, shareholders are encouraged to seek their own specific professional advice as to the taxation implications applicable to their circumstances. Shareholders who accept the Offer may be liable for CGT on the disposal of their shares (see section 6 of this Target's Statement).
Is there a number that I can call if I have further queries in relation to the Offer?	If you have any further queries in relation to the Offer, you can call 1300 117 908 (for calls made from inside Australia) or +61 3 9415 4336 (for calls made from outside Australia). Calls to these numbers may be recorded.

3. Your choices as an Integral shareholder

Your Directors unanimously recommend that you REJECT THE OFFER.

However, as an Integral Shareholder you have three choices currently available to you:

a) **Do nothing and reject the Offer**

Shareholders who wish to reject the Offer as unanimously recommended by your Directors should do nothing and ignore all documents sent to them by Capitol in relation to the Offer.

b) **Sell your Integral Shares on market**

During a takeover, shareholders of a target company who have not already accepted the bidder's offer can still sell their shares on market for cash.

The latest price for Integral Shares and Capitol Health's shares may be obtained from the ASX website: www.asx.com.au.

Shareholders who sell their Integral Shares on market may be liable for CGT on the sale (see section 6 of this Target's Statement) and may incur a brokerage charge.

c) **Accept the Offer**

Your Directors unanimously recommend that you REJECT THE OFFER.
However, Integral Shareholders may elect to accept the Offer. If you accept the Offer, and it becomes unconditional, you will receive 6.9 Capitol Shares and $0.36 cash for each of your Integral Shares.

Shareholders who accept the Offer may be liable for CGT on the disposal of their shares (see section 6 of this Target's Statement).

4. Information about Integral

4.1. Overview

Integral is a leading provider of diagnostic imaging services in Australia with a network of 47 sites (including 13 hospital sites) across Victoria, Queensland and Western Australia. Integral's comprehensive service offering, strength in higher-value equipment used to take images (also referred to as modalities) and large team of high quality radiologists and technical professionals puts the company in a strong position to meet the increasing preference of patients and referrers for higher-value modalities that provide best-in-class clinical service and access.

Integral operates under three core brands:

- Lake Imaging in Victoria;
- South Coast Radiology in Queensland; and
- Global Diagnostics in Western Australia.

Integral provides a comprehensive service offering that cover a variety of modalities including MRI, x-ray, ultrasound, CT and nuclear medicine (including PET).

Integral sites are supported by a technology platform and shared operational functions, including localised operations, IT, marketing, equipment supply, call centres, human resources and finance. National and State Clinical Leadership Committees also ensures strategic and operational decision making which occurs collaboratively between management and radiologists and promotes clinical excellence at both National and State levels.

4.2. Operational update

In May 2017, Dr Ian Kadish was recruited as CEO to lead the company in its strategy execution and improve financial returns given the strength and opportunities of Integral's business. Dr Kadish is an experienced CEO who has set a clear focus to capitalise on Integral's existing geographic footprint and scale, bring a disciplined approach to cost management and capital expenditure, and actively pursue value accretive organic growth and acquisition opportunities. Dr Kadish is supported by an experienced management team including Mrs Anne Lockwood, who joined Integral in 2016 and was appointed as Chief Financial Officer in 2017. Dr Kadish and Mrs Lockwood have worked together extremely well over the last eight months and to date have been successful in outperforming expected results on the strategy execution and forming of a strong cohesive senior management and shared services group that are focused and disciplined in delivering value to all stakeholders of Integral.

Integral's strategy is a combination of seeking to grow the business in a sustainable manner by keeping costs contained, and seeking appropriate strategic acquisitions to expand Integral's site network.

Focus on commercial outcomes

The new CEO is reshaping the way Integral interacts with its employee radiologists. Under Dr Kadish's medical leadership, radiologists have the opportunity to become more engaged in business development, strategic and operational matters.

The new management team is also keenly aware of the need to effectively manage resources, with utilisation of machines and staff varied across Integral's network. To reflect management's new view of staff costs as a variable rather than fixed cost, the company introduced 'flex staffing', whereby rostering is tied directly to expected volume or regional needs in order to deliver greater flexibility and increase existing capacity. Other measures designed at improving operational efficiency include investment and adoption of new technologies such as voice recognition, tele-reporting and automated worksheets.

Further operating efficiencies are to be extracted through improved equipment utilisation rates, leading to a reduction in capital expenditure requirements. Such cost savings include management closing or reconfiguring under-performing sites, selling under-utilised diagnostic equipment, and tailoring procurement policies to specific site requirements.

Sub-specialisation centres

A key point of differentiation between Integral and its competitors is Integral's emerging focus on specialisation within the provision of diagnostic imaging services. These Specialty Centres of Excellence are a response to the rapidly changing diagnosis and treatment technologies, and also represent an opportunity for radiologists to further develop their professional skills in a chosen sub-specialty area. Specialisation provides Integral with a competitive advantage as it allows Integral to partner with specialists in the relevant field, building a trusted relationship thereby ensuring a consistent volume of referred patients. The services delivered are also typically at a higher cost, or attract a higher benefit as prescribed by the MBS, meaning these sub-specialty centres operate at a higher margin than other diagnostic imaging sites.

The strategy also helps Integral attract, retain and train radiologists; a critical element in maintaining consistent earnings growth. By offering specialty services within the Integral network, the company can provide further specialist training and opportunities to radiologists, which in turn enhances the quality of work that can be performed for referrers and patients. It perfectly complements the business's existing diversification across hospital, community and comprehensive centres, which together provide a comprehensive training platform.

Acquisitions

The diagnostic imaging industry remains highly fragmented, with prospective businesses ranging from single community clinics to multi-clinic, specialised comprehensive service providers. As part of Integral's strategy for future growth, bolt-on and strategic acquisition opportunities are considered on an ongoing basis.

Bolt-on acquisition opportunities in existing geographical markets are made to strengthen Integral's presence in those regions. Western District Radiology (WDR), which was acquired in FY17, has been successfully integrated into Integral's existing Victorian operations, with WDR following the model of being the leading provider in the regional market in which it operates and offering further hospital contracts through the St John of God Warrnambool hospital site.

Strategic acquisitions aim to establish Integral's operations in new regional or outer-metropolitan regions that have the following characteristics: strong market position, operate with hospital sites, offer a comprehensive range of modalities and/or display strength in higher value modalities and have access to MRI licences. Critical to the success of these acquisition activities is disciplined execution with regard to price expectations, which are generally driven by the size of the potential target, and the transaction to be both earnings enhancing and sustainable.

4.3. Integral Directors

As at the date of this Target's Statement, Integral's Directors are as follows:

Name	Position
Helen Kurincic	Independent Non-Executive Chairman
Dr Ian Kadish	Managing Director and Chief Executive Officer
Dr Chien Ping Ho	Executive Director
Dr Sally Sojan	Executive Director
John Atkin	Independent Non-Executive Director
Rupert Harrington	Independent Non-Executive Director
Raelene Murphy	Independent Non-Executive Director

4.4. Issued capital

As at the date of this Target's Statement, Integral's issued capital consisted of 145,044,157 Integral Shares.

41,606,070[49] Integral Shares are subject to voluntary escrow restrictions. All issued Integral Shares carry one vote per share and the right to dividends.

In addition, Integral has also issued 362,585 Performance Rights, which entitle the holder to receive Integral Shares on vesting (see section 8.2 for further information).

[49] Integral announced on 19 February 2018 that 776,720 Integral Shares will be released from escrow on 5 March 2018.

4.5. Interests in Integral Shares

As at the date of this Target's Statement, your Directors had the following relevant interests in Integral Shares and Performance Rights:

Director	Number of Integral Shares	Number of Performance Rights
Helen Kurincic	420,870	Nil
Dr Ian Kadish	32,000	362,585
Dr Chien Ping Ho	2,445,481	Nil
Dr Sally Sojan	1,026,491	Nil
John Atkin	132,945	Nil
Rupert Harrington	255,890	Nil
Raelene Murphy	835	Nil
Total	**4,314,512**	**362,585**

4.6. Publicly available information about Integral

Integral is a listed disclosing entity for the purposes of the Corporations Act and as such is subject to regular reporting and disclosure obligations. Specifically, as a listed company, Integral is subject to the Listing Rules which require continuous disclosure of any information Integral has concerning it that a reasonable person would expect to have a material effect on the price or value of its securities.

ASX maintains files containing publicly disclosed information about all listed companies. Integral's file is available for inspection at ASX during normal business hours. In addition, Integral is required to lodge various documents with ASIC, copies of which may be obtained from, or inspected at, an ASIC office. A substantial amount of information about Integral is also available in electronic form at https://www.integraldiagnostics.com.au/.

5. Details about Capitol's Offer

5.1. Conditions to the Offer

Capitol's Offer is subject to a number of conditions. Those conditions are set out in full in section 11.6 of the Bidder's Statement.

In respect of the Offer conditions, Integral Shareholders should note the following:

(a) **90% minimum acceptance condition**

Offer condition 11.6(a) is a 90% minimum acceptance condition. As Integral Shareholders who hold or control 32.90% of Integral Shares do not intend to accept the Offer, this is a condition that cannot be satisfied.

Capitol has not indicated whether it will waive this condition.

(b) **No change of control or other rights**

Offer condition 11.6(g) requires that, in summary, no person has or is granted any right to acquire or dispose of a material asset, terminate or vary any material agreements or approvals, licences or permits, or require repayment of moneys borrowed as a result of Capitol's Offer (other than a right which has been waived).

Integral is a party to certain contracts containing 'change of control' provisions which may be triggered as a result of, or as a result of acceptances of, the Offer. A summary of these contracts, and the relevant change of control provisions, is set out below.

(1) Financing arrangements

Integral is a party to a facility agreement (**Facility Agreement**) with a single lender.

Under the Facility Agreement, a change of control of Integral would constitute a 'Review Event'. The consequences of a Review Event may include the lender changing the conditions of one or more facilities made available under the Facility Agreement. If Integral and the lender cannot reach agreement in respect of any changes, the lender may cancel one or more of those facilities and demand repayment.

The Facility Agreement also provides that it is an 'Event of Default' if Integral ceases to be listed on the ASX. If this were to occur as a result of, or following completion of, the Offer, the lender would be entitled to, amongst other things, cancel one or more of the facilities and demand repayment or make the facilities payable on demand. In addition, the lender would be entitled to exercise any other right, remedy, power or discretion under the 'Finance Documents' (including to enforce any security granted by Integral and its subsidiaries).

(2) Hospital contracts

Integral has a number of service agreements and corresponding leases with hospitals under which Integral provides diagnostic and other interventional medical imaging services to the operators of those hospitals.

More than half of Integral's agreements with hospitals are subject to change of control or similar provisions which are likely to be triggered if Capitol becomes the owner of more than 50% of Integral Shares. If triggered, these provisions may lead to adverse consequences for Integral, including through the loss of revenue.

(3) Medical Imaging Services Agreement with Western Australian Country Health Services (**WACHS)**

Integral has a contract with WACHS to provide radiology reporting and procedural services at selected sites in regional Western Australia. This contract is subject to a change of control provision which will be triggered if Capitol becomes the owner of more than 50% of Integral Shares.

(c) **Interim dividend**

As announced on 19 January 2018, the Integral Directors have declared a fully franked interim dividend of 4 cents per share in accordance with the Integral dividend policy. The dividend is to be paid on 5 March 2018. This constitutes a breach of Offer condition 11.6(h), which requires that no dividend be declared or made between 29 November 2017 and the end of the Offer Period.

Capitol has not indicated whether it will waive this condition.

The terms of the Offer also provide that Capitol is entitled to deduct the amount of certain 'rights' received by Integral Shareholders (which includes the interim dividend) from the cash component of the Offer Consideration. However, given the significant amount of time that has passed since the dividend was announced and Capitol's public statements since this announcement (which have continued to refer to the consideration being 6.9 Capitol Shares and $0.36 cash for each Integral Share without qualification), Integral believes that Capitol may have waived its entitlement to make any deduction. If Capitol were to now purport to deduct the dividend, Integral would consider its options, including whether to take any action against Capitol on behalf of all Integral Shareholders.

(d) **Potential competition issues**

Offer conditions 11.6(b) and (c) relate to Capitol receiving all necessary regulatory approvals, and no regulatory action being taken, in respect of the Offer. Capitol has stated in its Bidder's Statement that it has not sought merger clearance from the ACCC on the basis that the Offer does not give rise to competition issues.

Integral believes that there is a risk of intervention by the ACCC, which may result in one or both of these conditions being breached (and could lead to divestments being required) because:

(1) the ACCC has previously shown real interest in these kinds of transactions and adopted a narrow approach to defining markets;

(2) there are geographic areas in Victoria where Integral and Capitol appear to be the only service providers; and

(3) there are other geographic areas where Integral and Capitol appear to be each other's closest competitors.

(e) **Impact of breached conditions**

Given the number of conditions of the Offer which have been breached or cannot be satisfied, and having regard to the Takeovers Panel's policy on frustrating action, Integral requests Capitol to urgently clarify its position about each relevant condition. Integral does not presently regard the policy as inhibiting Integral from conducting its business and pursuing its strategic objectives.

5.2. Notice of status of conditions

Section 11.7(d) of the Bidder's Statement states that Capitol will give a notice of status of conditions to the ASX and Integral on 21 March 2018.

Capitol is required to set out in its notice of status of conditions:

- whether the Offer is free of any or all of the conditions;
- whether, so far as Capitol knows, any of the conditions have been fulfilled; and
- Capitol's voting power in Integral.

If the Offer Period is extended by a period before the time by which the notice of status of conditions is to be given, the date for giving the notice of status of conditions will be taken to be postponed for the same period. In the event of such an extension, Capitol is required, as soon as practicable after the extension, to give a notice to the ASX and Integral that states the new date for the giving of the notice of status of conditions.

If a condition is fulfilled (so that the Offer becomes free of that condition) during the bid period but before the date on which the notice of status of conditions is required to be given, Capitol must, as soon as practicable, give the ASX and Integral a notice that states that the particular condition has been fulfilled.

5.3. Offer period

Unless Capitol's Offer is extended or withdrawn, it is open for acceptance from 14 February 2018 until 7pm (Melbourne time) on 28 March 2018.

Capitol may extend the Offer Period at any time before giving the notice of status of conditions (referred to in section 5.2 of this Target's Statement) while the Offer is subject to conditions. However, if the Offer is unconditional (that is, all the conditions are fulfilled or freed), Capitol may extend the Offer Period at any time before the end of the Offer Period.

In addition, there will be an automatic extension of the Offer Period if, within the last 7 days of the Offer Period:

- Capitol improves the consideration offered under the Offer; or
- Capitol's voting power in Integral increases to more than 50%.

If either of these 2 events occurs, the Offer Period is automatically extended so that it ends 14 days after the relevant event occurs.

5.4. Effect of acceptance

The effect of acceptance of the Offer is set out in section 11.4 of the Bidder's Statement. Integral Shareholders should read these provisions in full to understand the effect that acceptance will have on their ability to exercise the rights attaching to their Integral Shares and the representations and warranties which they give by accepting of the Offer.

5.5. Your ability to withdraw your acceptance

You only have limited rights to withdraw your acceptance of the Offer.

You may only withdraw your acceptance of the Offer if Capitol varies the Offer in a way that postpones, for more than one month, the time when Capitol needs to meet its obligations under the Offer. This will occur if Capitol extends the Offer Period by more than one month and the Offer is still subject to conditions.

5.6. When you will receive your consideration if you accept the Offer

In the usual case, you will be issued your Offer Consideration on or before the later of:

- one month after the date the Offer becomes or is declared unconditional; and
- one month after the date you accept the Offer if the Offer is, at the time of acceptance, unconditional,

but, in any event (assuming the Offer becomes or is declared unconditional), no later than 21 days after the end of the Offer Period.

However, there are certain exceptions to the above timetable for the issuing of consideration. Full details of when you will be issued your consideration are set out in section 11.8 of the Bidder's Statement.

5.7. Lapse of Offer

The Offer will lapse if the Offer conditions are not freed or fulfilled by the end of the Offer Period; in which case, all contracts resulting from acceptance of the Offer and all acceptances that have not resulted in binding contracts are void. In that situation, you will be free to deal with your Integral Shares as you see fit.

6. Taxation consequences

6.1. Introduction

This section provides a guide to the Australian income tax, goods and services tax (GST) and stamp duty consequences for Integral Shareholders, including those Integral Shareholders who are subject to voluntary escrow restrictions, who accept the Offer or whose Integral Shares are compulsorily acquired in accordance with the Corporations Act. This guide is based on the laws and administrative practices of the relevant revenue authorities as at the date of this Target's Statement.

This section is general in nature and it is not intended to be comprehensive advice that is applicable to all Integral Shareholders' particular circumstances. Accordingly, it is recommended that Integral Shareholders who accept the Offer seek independent professional advice that takes into account their specific circumstances.

This section sets out the Australian income tax consequences for Integral Shareholders who hold their Integral Shares on capital account for Australian income tax purposes. This overview does not consider the consequences for Integral Shareholders who:

- hold their Integral Shares on revenue account including, but not limited to, those Integral Shareholders who may be in the business of carrying on a business of trading or dealing in securities or have acquired Integral Shares for the purposes of speculation;
- acquired their Integral Shares under an employee share or option scheme;
- hold performance rights;
- are subject to the taxation of financial arrangements provisions contained in Division 230 of the Income Tax Assessment Act 1997 (Cth);
- are a bank, insurance company, tax exempt organisation or superannuation fund; or
- are deemed to have acquired their Integral Shares prior to 20 September 1985.

Integral Shareholders who are resident of a country other than Australia should take into account the taxation outcomes of the Offer having regard to the laws of the relevant country of which they are a resident.

6.2. Tax consequences of the Offer – Australian resident shareholders

An Integral Shareholder who accepts the Offer or whose Integral Shares are compulsorily acquired will dispose of those Integral Shares to Capitol. As a result of this change in ownership, a capital gains tax (CGT) event will occur. The date of the CGT event will be the date on which the contract to dispose of the Integral Shares is formed being the date the Offer is accepted by the relevant Integral Shareholder or the date the Integral Shares are compulsorily acquired.

Integral Shareholders will realise a capital gain to the extent the capital proceeds from the disposal of their Integral Shares exceeds the cost base of those Integral Shares. Relevantly, the capital proceeds from the disposal of Integral Shares includes the market value of shares received in Capitol Health. Integral Shareholders may qualify for roll-over relief in respect of shares received in Capitol Health (see below).

Conversely, Integral Shareholders may realise a capital loss on the disposal of their Integral Shares to the extent that capital proceeds received are less than the reduced cost base of those Integral Shares

To the extent an Integral Shareholder has current year or carried forward capital losses, they may be able to apply such losses to reduce any capital gain.

Cost base

The cost base of the Integral Shares will generally include the amount paid to acquire those Integral Shares, plus any incidental costs of acquisition. Relevantly, some Integral Shareholders may have acquired their Integral Shares as a result of transactions that gave rise to the formation of the current Integral Group. Such Integral Shareholders may not have paid money to acquire their Integral Shares and may hold Integral Shares with a deemed cost base that relates to shares previously owned in other companies.

Capital proceeds

The capital proceeds of the Offer will include the cash component of $0.36 per Integral Share and the market value of 6.9 Capitol Shares for each Integral Share on the day the transaction occurs.

Roll-over relief

As noted above, where an Integral Shareholder accepts the Offer, they may be eligible to elect to receive roll-over relief in respect of the Capitol Shares received as consideration for transferring their Integral Shares.

Broadly, roll-over relief allows an Integral Shareholder to defer the realisation of any capital gain until such time that they dispose of their newly acquired Capitol Shares.

Roll-over relief will not be available in respect of the cash component of the Offer. That is, only a partial roll-over may be available (see below).

The availability of roll-over relief is subject to satisfaction of certain criteria including that the relevant Integral Shareholder would have made a capital gain on the disposal of their Integral Shares, the Integral Shareholder must elect to obtain roll-over relief, and Capitol becoming the owner of at least 80% of Integral Shares.

Importantly, in circumstances where Capitol frees itself of the 90% minimum acceptance condition and the Offer does not result in Capitol becoming the owner of at least 80% of Integral Shares, roll-over relief will not be available. To the extent that Integral Shareholders who hold or control 32.90% of Integral Shares do not accept the Offer (consistent with their intentions communicated to Integral), Integral Shareholders will be required to include the market value of Capitol Shares they receive in their capital proceeds when determining any capital gain.

To the extent that Capitol becomes the owner of at least 80% of Integral Shares (which could not occur under the terms of the Offer), roll-over relief should be available to those Integral Shareholders who accept the Offer.

In circumstances where roll-over relief is elected, the cost base of any newly acquired Capitol Shares will be equal to the relevant Integral Shareholder's cost base in their Integral Shares (adjusted for the amount calculated below) prior to disposal of those Integral Shares.

Again, to the extent roll-over relief is elected, the Integral Shareholders will be deemed to have acquired their newly acquired Capitol Shares on the date on which they acquired or were deemed to have acquired their Integral Shares.

Partial roll-over

As the Offer includes both Capitol Shares and a cash component, Integral Shareholders may realise a capital gain in respect of the cash component. Broadly, Integral Shareholders must work out the proportion of the cash consideration in relation to the total capital proceeds, being the cash consideration plus the market value of shares in Capitol Health. That proportion is then applied to the cost base of each Integral Share held to determine that part of the cost base which is reasonably attributable to the cash consideration in determining whether the Integral Shareholder will realise a capital gain.

CGT discount

Australian resident shareholders who are an individual, a complying superannuation fund or a trust that have held their Integral Shares for at least 12 months before the CGT event should be entitled to discount the amount of their capital gain arising from the disposal of their Integral Shares by 50% for individuals and trusts and 33.3% for complying superannuation funds. The availability of the CGT discount for a trust will ultimately depend upon the circumstances of the beneficiary who receives a distribution including the capital gain.

6.3. Tax consequences of the Offer – Non-resident Shareholders

Integral Shareholders that are non-residents of Australia for income tax purposes and do not hold their Integral Shares in carrying on a business through a permanent establishment in Australia should not be subject to tax in Australian on disposal of their Integral Shares unless:

(a) the Integral Shareholder together with its associates, held at least 10% in Integral at the time of the CGT event for at least 12 months during the 24 months before the CGT event; and

(b) more than 50% of the market value of Integral is represented by direct and indirect interests in Australian real property, known as the "Principal Asset Test."

To the extent the Principal Asset Test is satisfied, Capitol may be required to withhold tax from proceeds. Integral is of the view that the Principal Asset Test is not satisfied and would not expect Capitol to withhold any amounts.

6.4. Stamp Duty

Integral Shareholders should not be liable to any stamp duty in respect of the acquisition of Capitol Shares.

6.5. GST

Integral Shareholders should not be subject to GST in respect of a disposal of their Integral Shares.

Integral Shareholders may be charged GST on costs relating to the Offer and may be entitled to input tax credits or reduced input tax credits on such costs. Integral Shareholders should seek their own advice on any entitlement to input tax credits.

7. Important matters for Integral Shareholders to consider

7.1. Treatment of overseas shareholders

Any Integral Shareholder whose address (as recorded in the register of members of Integral provided by Integral to Capitol) is in a place outside Australia, will not be issued with Capitol's Shares under the Offer.

Instead, the relevant Capitol Shares (that would otherwise be transferred to such foreign holders) will be allotted to a nominee approved by ASIC who will sell the Capitol Shares and will distribute to each of those foreign holders their proportion of the proceeds of sale net of expenses.

See section 11.8(g) of the Bidder's Statement for further details.

7.2. Minority ownership consequences

Capitol's Offer is presently subject to a 90% minimum acceptance condition. Given Integral Shareholders who hold or control 32.90% of Integral Shares do not intend to accept the Offer, this condition is not capable of being fulfilled.

Capitol has the right to free its Offer from the 90% minimum acceptance condition, although it has not yet indicated whether it will do so. If Capitol frees the Offer from the 90% minimum acceptance condition and acquires more than 50% but less than 90% of the Integral Shares then, assuming all other conditions to the Offer are fulfilled or freed, Capitol will acquire a majority shareholding in Integral.

In that event, shareholders who do not accept the Offer will become minority shareholders in Integral. This has a number of possible implications, including:

- Capitol will be in a position to cast the majority of votes at a general meeting of Integral. This will enable it to control the composition of Integral's Board of Directors and senior management, determine Integral's dividend policy and control the strategic direction of the business of the Integral Group;
- the Integral radiologists may be dissatisfied with Capitol having effective control over the management of Integral, which may cause disruption to the operations of the Integral Group. Board members and Executive Directors Dr Sally Sojan (Member of the National Clinical Leadership Committee and Member of the Queensland Clinical Leadership Committee) and Dr Chien Ho (Chair of the National Clinical Leadership Committee and member of the Victorian Clinical Leadership Committee), have already informed the Board that, if Capitol is successful in acquiring 50% or more of Integral Shares, they intend to resign their employment as radiologists with Integral;
- the Integral share price may fall immediately following the end of the Offer Period and it is unlikely that Integral's share price will contain any takeover premium;
- liquidity of Integral shares may be lower than at present;
- if the number of Integral Shareholders is less than that required by the ASX Listing Rules to maintain an ASX listing then Capitol may seek to have Integral removed from the official list of the ASX. If this occurs, Integral Shares will not be able to be bought or sold on the ASX and will only be able to be bought or sold privately;
- the future Integral dividend policy under the management of Capitol may vary significantly from the current Integral dividend policy;
- the synergies referred to by Capitol in the Bidder's Statement cannot be achieved; and
- if Capitol acquires 75% or more of the Integral Shares, it will be able to pass a special resolution of Integral. This will enable Capitol to, among other things, change Integral's constitution. However, Capitol will not be able to acquire 75% or more of the Integral Shares under the Offer given Integral Shareholders who hold or control 32.90% of Integral Shares do not intend to accept the Offer.

8. Additional information

8.1. Effect of Offer on Integral Shareholders subject to voluntary escrow arrangements

In connection with the initial public offering of Integral in 2015 and the acquisition of Western District Radiology in 2016, certain Integral Shareholders have entered into voluntary escrow deeds with Integral in relation to their Integral Shares (**Escrowed Shareholders**).

The Integral Shares subject to these arrangements represent approximately 28.69%[50] of the total number of Integral Shares on issue. Under each voluntary escrow deed, the relevant Escrowed Shareholder agrees not to deal in those Integral Shares, other than in certain circumstances.

Under the terms of the voluntary escrow deeds, Escrowed Shareholders may accept the Offer in relation to their Integral Shares if holders of at least half of the Integral Shares the subject of the Offer that are not escrowed, have accepted the Offer.

The Integral Board has exercised its discretion under the voluntary escrow deeds to remove the restrictions on dealing in Integral Shares with immediate effect if the Offer becomes unconditional and holders of at least half of the Integral Shares the subject of the Offer that are not escrowed have accepted the Offer. This decision was made to address the inequality between Escrowed Shareholders who accept the Offer (and who will therefore be able to freely trade the Capitol Shares they receive as consideration), and Escrowed Shareholders who reject the Offer and retain their Integral Shares (and will therefore not have the ability to freely trade those shares). The Integral Board considered that this inequality could be detrimental to the Integral business.

Capitol has not provided Integral Shareholders with the ability to accept the Offer for part of their holding under the Offer terms. Accordingly, Escrowed Shareholders will not be able to accept the Offer solely in respect of any Integral Shares that they hold which are not subject to voluntary escrow arrangements.

8.2. Effect of Offer on Integral Equity Incentive Plan and securities issued under the Plan

Integral currently operates the Equity Incentive Plan pursuant to which Performance Rights have been granted.

The terms of the Equity Incentive Plan provide that the Board may, in its absolute discretion, determine that all or a specified number of granted Performance Rights vest where there is, or is likely to be, a change of control of Integral.

In the event of an actual change of control of Integral, unless the Board determines otherwise, a pro rata portion of all unvested Performance Rights will immediately vest based on the portion of the vesting period that has elapsed.

As at the date of this Target's Statement, the Integral Board has not made a determination in relation to the vesting of Performance Rights.

On vesting, each Performance Right entitles the holder to one Integral Share.

The Integral Board intends to formally grant Performance Rights to certain senior executives under the Equity Incentive Plan with an aggregate face value of $375,540 (239,222 Performance Rights). These Performance Rights will be subject to an earnings per share performance condition which does not expire until 30 June 2021. Due to restrictions on issuing such Performance Rights under the terms of the Offer, the Board has resolved that, if prior to formally granting the Performance Rights, there is an event that would have led to an acceleration of some or all of the Performance Rights (such as a

[50] Integral announced on 19 February 2018 that 776,720 Integral Shares (0.54% will be released from escrow on 5 March 2018).

change of control), the relevant senior executives are entitled to receive a cash-equivalent of the value of the Performance Rights that would have vested.

8.3. Consents

(a) Lonergan Edwards & Associates Limited has given, and not withdrawn before the lodgement of this Target's Statement with ASIC, its written consent to be named in this Target's Statement as Integral's Independent Expert in the form and context it is so named and to the inclusion of the Independent Expert's Report contained in the Attachment to this Target's Statement. Lonergan Edwards & Associates Limited have not caused or authorised the issue of this Target's Statement and, other than any references to its name and the Independent Expert's Report, takes no responsibility for any part of this Target's Statement.

(b) The following persons have given, and not withdrawn before the lodgement of this Target's Statement with ASIC, their written consent to be named in this Target's Statement in the form and context in which it appears:

- Computershare Investor Services Pty Limited, to being named as Integral's share registrar;
- Credit Suisse (Australia) Limited, to being named as Integral's financial adviser;
- Herbert Smith Freehills, to being named as Integral's legal adviser;
- Investors Mutual Limited, Adam Smith Asset Management Pty Ltd, Perennial Value Management Limited and Viburnum Funds Pty Ltd, to being named and to the inclusion of statements relating to their intention not to accept the Offer;
- each Integral Director specified in section 4.3, to being named and to the inclusion of statements made by them, including, in the case of Dr Sally Sojan and Dr Chien Ho, to the inclusion of statements relating to their intention to resign their employment if Capitol is successful in acquiring 50% or more of Integral Shares; and
- Simon Conn, to the inclusion of the statement made by him in section 1.4

Other than each of the Integral Directors, none of these persons have caused or authorised the issue of this Target's Statement, and does not make or purport to make any statement in this Target's Statement or any statement on which a statement in this Target's Statement is based (other than a statement included in this Target's Statement with the consent of that party) and takes no responsibility for any part of this Target's Statement other than any reference to its name and the statements (if any) included in this Target's Statement with the consent of that party.

(c) As permitted by ASIC Class Order 13/521, this Target's Statement contains statements which are made, or based on statements made, in documents lodged by Capitol with ASIC or given to the ASX, or announced on the Company Announcements Platform of the ASX, by Capitol. Pursuant to the Class Order, the consent of Capitol is not required for the inclusion of such statements in this Target's Statement. Any Integral Shareholder who would like to receive a copy of any of those documents may obtain a copy (free of charge) during the Offer Period by contacting the Integral Shareholder line on 1300 117 908 (for calls made from within Australia) or +61 3 9415 4336 (for calls made from outside Australia). Any telephone calls to these numbers will, as required by the Corporations Act, be tape recorded, indexed and stored.

(d) As permitted by ASIC Corporations (Consents to Statements) Instrument 2016/72, this Target's Statement:

- may include or be accompanied by certain statements:
  - which fairly represent what purports to be a statement by an official person; or
  - which are a correct and fair copy of, or extract from, what purports to be a public official document; or
  - which are a correct and fair copy of, or extract from, a statement which has already been published in a book, journal or comparable publication;
- contains trading data sourced from FactSet, Bloomberg and IRESS provided without their consent.

8.4. No other material information

This Target's Statement is required to include all the information that Integral shareholders and their professional advisers would reasonably require to make an informed assessment whether to accept the Offer, but:

- only to the extent to which it is reasonable for investors and their professional advisers to expect to find this information in this Target's Statement; and
- only if the information is known to any director of Integral.

The Directors of Integral are of the opinion that the information that Integral Shareholders and their professional advisers would reasonably require to make an informed assessment whether to accept the Offer is:

- the information contained in the Bidder's Statement (to the extent that the information is not inconsistent or superseded by information in this Target's Statement);
- the information contained in Integral's releases to the ASX, and in the documents lodged by Integral with ASIC before the date of this Target's Statement; and
- the information contained in this Target's Statement (including the information contained in the Independent Expert's Report).

The Directors of Integral have assumed, for the purposes of preparing this Target's Statement, that the information in the Bidder's Statement is accurate (unless they have expressly indicated otherwise in this Target's Statement). However, the Directors of Integral do not take any responsibility for the contents of the Bidder's Statement and are not to be taken as endorsing, in any way, any or all statements contained in it.

In deciding what information should be included in this Target's Statement, the Directors of Integral have had regard to:

- the nature of the Integral Shares;
- the matters that shareholders may reasonably be expected to know;
- the fact that certain matters may reasonably be expected to be known to shareholders' professional advisers; and
- the time available to Integral to prepare this Target's Statement.

9. Glossary and interpretation

9.1. Glossary

The meanings of the terms used in this Target's Statement are set out below.

Term	Meaning
$**, **A$ or **AUD**	Australian dollar.
ACCC	Australian Competition and Consumer Commission.
ASIC	Australian Securities and Investments Commission.
ASX	ASX Limited.
Bidder's Statement	the replacement bidder's statement of Capitol dated 31 January 2018, as supplemented by the second supplementary bidder's statement dated 16 February 2018.
Capitol	Capitol Health Holdings Pty Ltd (ABN 41 623 058 499).
Capitol Health	Capitol Health Limited (ABN 84 117 391 812).
Capitol Share	a fully paid ordinary share in the capital of Capitol Health.
CGT	capital gains tax.
Corporations Act	the *Corporations Act 2001* (Cth) (as modified or varied by ASIC).
CT	computed tomography.
EBIT	earnings before interest and taxation.
EBITDA	earnings before interest, taxation, depreciation and amortisation.
Equity Incentive Plan	the equity incentive plan adopted by the Board, the terms and conditions of which are summarised in the explanatory memorandum accompanying the notice of Integral's 2017 annual general meeting dated 23 October 2017.
Independent Expert or **Lonergan Edwards**	Lonergan Edwards & Associates Limited (ABN 53 095 445 560).
Independent Expert's Report	the independent expert's report prepared by Lonergan Edwards and dated 2 March 2018 which is contained in the Attachment to this Target's Statement.
Integral	Integral Diagnostics Limited (ABN 55 130 832 816).
Integral Group	Integral and its Subsidiaries.
Integral Share	a fully paid ordinary share in the capital of Integral.
Integral Shareholder	a holder of Integral Shares.
Listing Rules	the official listing rules of ASX, as amended and waived by ASX from time to time.
MRI	magnetic resonance imaging.
NPAT	net profit after tax.
Offer or **Capitol's Offer**	the offer by Capitol for the Integral Shares, the terms and conditions of which are set out in section 11 of the Bidder's Statement.

Term	Meaning
Offer Consideration	6.9 Capitol Shares and $0.36 cash for each Integral Share.
Offer Period	the period during which the Offer will remain open for acceptance in accordance with section 11.2 of the Bidder's Statement.
Performance Rights	a performance right issued under the Equity Incentive Plan.
PET	positron emission tomography.
Subsidiaries	has the meaning given in section 9 of the Corporations Act.
Target's Statement	this document (including the Attachment), being the statement of Integral under Part 6.5 of the Corporations Act.
VWAP	the volume weighted average price.

9.2. Interpretation

In this Target's Statement:

1) Other words and phrases have the same meaning (if any) given to them in the Corporations Act.
2) Words of any gender include all genders.
3) Words importing the singular include the plural and vice versa.
4) An expression importing a person includes any company, partnership, joint venture, association, corporation or other body corporate and vice versa.
5) A reference to a section, clause, attachment and schedule is a reference to a section of, clause of and an attachment and schedule to this Target's Statement as relevant.
6) A reference to any legislation includes all delegated legislation made under it and amendments, consolidations, replacements or re-enactments of any of them.
7) Headings and bold type are for convenience only and do not affect the interpretation of this Target's Statement.
8) Unless otherwise specified, a reference to time is a reference to Melbourne time.

10. Authorisation

This Target's Statement has been approved by a resolution passed by the Directors of Integral. All Integral Directors voted in favour of that resolution.

Signed for and on behalf of Integral:

2 March 2018

Helen Kurincic

Chairman

Integral Diagnostics Limited

Attachment 1

Independent Expert's Report

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The Directors
Integral Diagnostics Limited
Level 8
14-20 Blackwood Street
North Melbourne VIC 3051

2 March 2018

Subject: Takeover offer for Integral Diagnostics Limited

Dear Directors

Introduction

1 On 29 November 2017, Capitol Health Limited (Capitol Health) announced an intention to make a takeover offer for all the ordinary shares in Integral Diagnostics Limited (Integral Diagnostics or the Company). The consideration under the offer is 6.9 Capitol Health shares plus $0.36 cash for each Integral Diagnostics share (the Offer). The Replacement Bidder's Statement in respect of the Offer was subsequently dated 31 January 2018[1] and despatched to Integral Diagnostics shareholders on 14 February 2018.

2 The announcement of the intention to make the Offer indicated a value for the total equity in Integral Diagnostics of approximately $357 million[2]. The Offer is subject to a number of conditions which are outlined in Section I.

3 Integral Diagnostics is an Australian healthcare services company that specialises in the provision of diagnostic imaging services to general practitioners, medical specialists and allied health professionals (Referrers) and their patients. It operates through a network of 47 sites (including 13 hospital sites) located in regional areas in Victoria, Queensland and Western Australia (WA). Integral Diagnostics comprises three core brands, being Lake Imaging, South Coast Radiology and Global Diagnostics.

4 Capitol Health is a provider of diagnostic imaging and related services to the Australian healthcare market. It owns and operates a number of radiology clinics throughout Victoria (operating under the Capital Radiology brand) that provide infrastructure for radiologists and related medical practitioners. Capitol Health also holds an investment in diagnostic imaging artificial intelligence company Enlitic LLC (Enlitic).

1 The Original Bidder's Statement was lodged with the Australian Securities & Investments Commission (ASIC) on 22 December 2017 and was subject to revision.

2 Based on the closing price of Capitol Health shares on the day before the announcement of the intention to make the Offer. This report includes our assessed value of Capitol Health shares for the purpose of forming our opinion in relation to the Offer.

5 Whilst there is no statutory requirement for Integral Diagnostics to obtain an independent expert's report (IER), the Directors of Integral Diagnostics have requested that Lonergan Edwards & Associates Limited (LEA) prepare an IER stating whether, in LEA's opinion, the Offer is fair and reasonable.

6 LEA is independent of Integral Diagnostics and Capitol Health and has no other involvement or interest in the outcome of the Offer, other than the preparation of this report.

Summary of opinion

7 LEA has concluded that the Offer is neither fair nor reasonable based on the guidelines set out in ASIC Regulatory Guideline 111 – *Content of expert reports* (RG 111).

8 The reasons for our opinion are set out below.

Value of Integral Diagnostics shares

9 Our assessed value of Integral Diagnostics shares is set out below:

Value of Integral Diagnostics	Low $m	High $m
Enterprise value[1]	450.0	490.0
Less net debt	(47.0)	(47.0)
Equity value	403.0	443.0
Fully diluted shares on issue (million)	145.4	145.4
Value per share ($)	$2.77	$3.05

Note:
1 We have assessed the enterprise value of Integral Diagnostics adopting both the capitalisation of earnings before interest, tax, depreciation and amortisation (EBITDA) and discounted cash flow (DCF) methodologies.

Value of consideration

10 In assessing the value of the Capitol Health shares offered as part of the consideration we have had regard to:

(a) the recent trading range of Capitol Health shares

(b) the significant number of shares to be issued by Capitol Health under the Offer compared to the enlarged number of Capitol Health shares on issue post completion of the Offer

(c) the likely level of on-market trading in Capitol Health shares subsequent to completion of the Offer, having regard to factors including:

(i) any potential oversupply of Capitol Health shares from those shareholders in Integral Diagnostics not wishing to retain the Capitol Health shares received as consideration

(ii) the dilution effect implicit in any control premium being paid by Capitol Health

(d) recent stock market conditions; and

(e) the earnings multiples implied by our adopted range.

11 The volume weighted average market price (VWAP) of Capitol Health shares in periods prior and subsequent to the announcement of the intention to make the Offer up until 28 February 2018 has been as follows:

(a) in the period subsequent to the announcement of the intention to make the Offer up until 28 February 2018 – $0.28 per share

(b) in the 14-day period prior to the date of this report – $0.27 per share

(c) in the three-month period prior to the announcement of the intention to make the Offer – $0.28 per share.

12 We also note that since the announcement of the intention to make the Offer up to 28 February 2018, trading in Capitol Health shares has been at a comparable liquidity level to pre-announcement trading levels (which indicated a reasonable to high level of share market liquidity).

13 Pursuant to the Offer new shares equivalent to approximately 55.6% of the enlarged capital base of Capitol Health are proposed to be issued. Given the large number of new Capitol Health shares to be issued under the Offer, if (in the event the Offer is successful) a significant number of Integral Diagnostics shareholders elect not to retain the shares in Capitol Health received as consideration there may be an oversupply of Capitol Health shares, which may have an adverse impact on the Capitol Health share price in the short term.

14 In this regard, Integral Diagnostics doctors / management currently hold a collective interest in Integral Diagnostics shares of around 28.7%[3], in respect of which a significant component of the aggregate shareholding is subject to escrow arrangements that extend to 2026 (and potentially beyond). Capitol Health has indicated that in the event the Offer is successful, it intends to release accepting shareholders from these escrow arrangements[4]. In this event, it is reasonable to assume that there will be an increase in those shareholders seeking to sell their acquired interest in Capitol Health than would otherwise be the case.

15 Furthermore, we consider that the release of the Integral Diagnostics doctors / management from the existing escrow arrangements implicitly increases the risk that some of these specialists may subsequently seek alternative employment, thereby potentially negatively impacting on future earnings performance and (by correlation) the Capitol Health share price[5].

16 However, partly offsetting these considerations, we note that in the Replacement Bidder's Statement Capitol Health stated that it had received pre-bid acceptance agreements from three major Integral Diagnostics shareholders collectively representing 16.3% of the issued shares in Integral Diagnostics[6]. Whilst uncertain, given these indicated commitments, these Integral Diagnostics shareholders are potentially more likely to retain the Capitol Health shares received as consideration, at least in the short term.

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3 This includes former radiologists and management.

4 Capitol Health Australian Securities Exchange (ASX) announcement dated 29 November 2017.

5 We note that Capitol Health suffered previous integration / earnings retention issues in respect of the New South Wales (NSW) assets which were acquired in 2015 and divested in 2017 with a materially lower earnings base.

6 These shareholders include Regals Funds Management Pty Ltd, Wilson Asset Management (International) Pty Limited and Microequities Asset Management Pty Ltd.

17 Having regard to the above factors, we have assessed the realisable value of the Capitol Health shares offered as consideration at between $0.26 and $0.28 per share[7].

18 We have therefore assessed the total value of the consideration under the Offer at the amounts below:

Value of consideration per Integral Diagnostics share	Low $ per share	High $ per share
Assessed realisable value of Capitol Health shares[(1)]	0.26	0.28
Offer ratio	6.9	6.9
Assessed value of scrip consideration	1.79	1.93
Cash consideration	0.36	0.36
Total consideration	2.15	2.29

Note:

1 Our assessed realisable value of Capitol Health shares is based on trading subsequent to the announcement of the intention to make the Offer. This trading reflects a period of entitlement to the interim dividend of 0.4 cents per share declared by Capitol Health for 1HY18. Capitol Health has not stated whether the interim dividend will be paid to Integral Diagnostics shareholders that accept the Offer.

Assessment of fairness

19 Pursuant to RG 111 an offer is "fair" if:

"The value of the offer price or consideration is equal to or greater than the value of the securities the subject of the offer."

20 This comparison is shown below:

Comparison of Offer consideration and Integral Diagnostics share value	Low $ per share	High $ per share	Mid-point $ per share
Value of Offer consideration	2.15	2.29	2.22
Value of 100% of ordinary shares in Integral Diagnostics	2.77	3.05	2.91
Extent to which the Offer consideration is less than the value of the ordinary shares in Integral Diagnostics	(0.62)	(0.76)	(0.69)

21 When assessing the "fairness" of scrip takeovers under RG 111, in our opinion, it is appropriate to have regard to the overall range of values (particularly as the scrip consideration is subject to daily fluctuation). As indicated above the range of values for the Offer consideration is consistently lower than our assessed value of 100% of the ordinary shares in Integral Diagnostics. Accordingly, in our opinion, the Offer is not fair based on the guidelines set out in RG 111.

7 The high end of this range is broadly consistent with the VWAP of Capitol Health shares post the announcement of the intention to make the Offer up to 28 February 2018. The low end of the range reflects more recent trading in Capitol Health shares, together with the significant number of new shares proposed to be issued by Capitol Health pursuant to the Offer.

Assessment of reasonableness

22 Pursuant to RG 111, an offer may be reasonable if, despite not being fair but after considering other significant factors, the expert is of the view that there are sufficient reasons for shareholders to accept the offer in the absence of any higher bid before the close of the offer.

23 Whilst in our opinion the Offer is also not reasonable (primarily due to the significant difference between our assessed values of Integral Diagnostics and the Offer consideration), we note that:

(a) the Offer consideration represents a significant premium to the market price of Integral Diagnostics shares prior to the announcement of the intention to make the Offer[8]

(b) in our opinion, if the Offer lapses and no higher offer or alternative proposal emerges, it is likely (at least in the short term) that Integral Diagnostics shares will trade at a discount to our valuation, consistent with the difference between the value of Integral Diagnostics on a portfolio basis and the value on a 100% controlling interest basis.

Other matters

24 As indicated in Section I of our report, the Offer is subject to a number of conditions which include achieving a level of acceptances sufficient to give Capitol Health a relevant interest of at least 90% in Integral Diagnostics by the end of the Offer period.

25 In an ASX announcement dated 6 February 2018 in response to the Offer, Integral Diagnostics stated, "*shareholders who hold or control 32.88% of Integral Diagnostics' shares have informed us they do not intend to accept the Offer*".

26 In considering their response to the Offer, Integral Diagnostics shareholders should note therefore that (as it currently stands) this key condition of the Offer will not be met.

General

27 In preparing this report we have considered the interests of Integral Diagnostics shareholders as a whole. Accordingly, this report only contains general financial advice and does not consider the personal objectives, financial situations or requirements of individual shareholders.

28 The taxation consequences of accepting the Offer depend on the individual circumstances of each investor. Shareholders should read the taxation advice set out in the Replacement Bidder's Statement and Target's Statement and should consult their own professional adviser if in doubt as to the taxation consequences of the Offer.

29 The ultimate decision whether to accept the Offer should be based on each shareholder's assessment of their own circumstances, including their risk profile, liquidity preference, tax position and expectations as to value and future market conditions. If shareholders are in doubt about the action they should take in relation to the Offer or matters dealt with in this report, shareholders should seek independent professional advice.

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8 As set out in Section VII, due to the subsequent earnings upgrades announced by Integral Diagnostics, we do not consider the market price of Integral Diagnostics shares prior to the announcement of the intention to make the Offer to be a representative basis on which to assess the value of Integral Diagnostics.

30 For our full opinion on the Offer, and the reasoning behind our opinion, we recommend that Integral Diagnostics shareholders read the remainder of our report.

Yours faithfully

Craig Edwards	Martin Holt
Authorised Representative	Authorised Representative

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Appendices

I Outline of the Offer

31 On 29 November 2017, Capitol Health announced an intention to make a takeover offer for all the ordinary shares in Integral Diagnostics. The consideration under the offer is 6.9 Capitol Health shares plus $0.36 cash for each Integral Diagnostics share (the Offer). The Replacement Bidder's Statement in respect of the Offer was lodged on 31 January 2018[9] and despatched to Integral Diagnostics shareholders on 14 February 2018.

Conditions

32 The Offer is subject to a number of conditions, which are summarised below:

(a) achieving a level of acceptances sufficient to give Capitol Health a relevant interest of at least 90% in Integral Diagnostics (during or by the end of the Offer period)[10]

(b) Capitol Health receiving all required ministerial and other regulatory approvals in relation to the Offer and the transactions contemplated by the Bidder's Statement

(c) there is no preliminary, or final order, or other action, investigation or application which either prohibits, impedes or otherwise materially adversely impacts on the making of the Offer or the rights of Capitol Health

(d) no "Material Adverse Change" in respect of Integral Diagnostics (as defined in the Bidder's Statement)

(e) between 29 November 2017 and the close of the Offer period, Integral Diagnostics does not cease to hold (for whatever reason) any licenses, registrations, certifications or accreditations required for the provision of diagnostic imaging services or Medicare eligibility

(f) other than as previously announced (or within the parameters set out in section 11.6(f) of the Bidder's Statement), between 29 November 2017 and the close of the Offer period, Integral Diagnostics does not incur or commit to any expenditure, or enter into any agreement in respect of any material acquisition, disposal, new commitment or other event

(g) as a result of the making of the Offer, no person is granted or is able to enforce a right (as set out in section 11.6(g) of the Bidder's Statement) which would have a detrimental effect on the operations and (net) assets of Integral Diagnostics

(h) between 29 November 2017 and the end of the Offer period no dividends or distributions (of any kind) are made or declared by Integral Diagnostics[11]

(i) Integral Diagnostics provides Capitol Health with equal access to any information not generally available that is provided to a third-party to solicit, encourage or facilitate a potential transaction that could be considered a competing proposal to the Offer

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9 The Original Bidder's Statement was lodged with ASIC on 22 December 2017 and was subject to revision.

10 Based on an ASX announcement dated 6 February 2018 in response to the Offer, which indicated that shareholders who hold or control 32.88% of Integral Diagnostics' shares did not intend to accept the Offer, this condition will not be met.

11 On 19 January 2018 Integral Diagnostics declared a fully franked interim dividend in respect of 1H18 of 4.0 cents per share (payable on 5 March 2018). Accordingly, this condition will not be met.

(j) no “prescribed occurrence” occurs in respect of Integral Diagnostics, being an occurrence listed at sections 11.6(j) and (k) of the Bidder’s Statement.

33 More detail on the above conditions is set out in the Replacement Bidder’s Statement dated 31 January 2018.

II Scope of our report

Purpose

34 Whilst there is no statutory requirement for Integral Diagnostics to obtain an IER, the Directors of Integral Diagnostics have requested that LEA prepare an IER stating whether, in LEA's opinion, the Offer is fair and reasonable.

35 This report has been prepared to assist the Directors of Integral Diagnostics in making their recommendation to Integral Diagnostics shareholders in relation to the Offer and to assist the shareholders of Integral Diagnostics assess the merits of the Offer. The sole purpose of this report is to set out LEA's opinion as to whether the Offer is fair and reasonable. This report should not be used for any other purpose.

36 The ultimate decision whether to accept the Offer should be based on each shareholders' assessment of their own circumstances, including their risk profile, liquidity preference, tax position and expectations as to value and future market conditions. If in doubt about the Offer or matters dealt with in this report, shareholders should seek independent professional advice.

Basis of assessment

37 In preparing our report we have given due consideration to the Regulatory Guides issued by ASIC, particularly RG 111.

38 RG 111 distinguishes "fair" from "reasonable" and considers:

(a) an offer to be "fair" if the value of the offer price or consideration is equal to or greater than the value of the securities that are the subject of the offer. A comparison must be made assuming 100% ownership of the target company

(b) an offer to be "reasonable" if it is fair. An offer may also be "reasonable" if, despite not being "fair", the expert believes that there are sufficient reasons for security holders to accept the offer in the absence of any higher bid before the close of the offer.

39 Our report has therefore considered:

Fairness

(a) the market value of 100% of the shares in Integral Diagnostics

(b) the value of the consideration offered (i.e. 6.9 shares in Capitol Health and $0.36 cash for each Integral Diagnostics share)

(c) the extent to which (a) and (b) differ (in order to assess whether the Offer is fair under RG 111)

Reasonableness

(d) the extent to which a control premium is being paid to Integral Diagnostics shareholders

(e) the extent to which a share of the synergies identified by Capitol Health as likely to arise upon an acquisition of Integral Diagnostics by Capitol Health is being shared with Integral Diagnostics shareholders

(f) the listed market price of Integral Diagnostics shares:

(i) prior to the announcement of the intention to make the Offer

(ii) subsequent to the announcement of the intention to make the Offer

(iii) if the Offer is not successful

(g) the value of Integral Diagnostics to an alternative offeror and the likelihood of an alternative offer emerging, either prior to the close of the Offer, or sometime in the future

(h) other qualitative and strategic issues, risks, advantages and disadvantages associated with the Offer.

Limitations and reliance on information

40 Our opinions are based on the economic, share market, financial and other conditions and expectations prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time.

41 Our report is also based upon financial and other information provided by Integral Diagnostics and its advisers. We understand the accounting and other financial information that was provided to us has been prepared in accordance with the Australian equivalents to International Financial Reporting Standards. We have considered and relied upon this information and believe that the information provided is reliable, complete and not misleading and we have no reason to believe that material facts have been withheld.

42 The information provided was evaluated through analysis, enquiry and review to the extent considered appropriate for the purpose of forming an opinion on the Offer from the perspective of Integral Diagnostics shareholders. However, we do not warrant that our enquiries have identified or verified all of the matters which an audit, extensive examination or "due diligence" investigation might disclose. Whilst LEA has made what it considers to be appropriate enquiries for the purpose of forming its opinion, "due diligence" of the type undertaken by companies and their advisers in relation to (for example) prospectuses or profit forecasts is beyond the scope of an IER.

43 Accordingly, this report and the opinions expressed therein should be considered more in the nature of an overall review of the anticipated commercial and financial implications of the proposed transaction, rather than a comprehensive audit or investigation of detailed matters.

44 An important part of the information base used in forming an opinion of the kind expressed in this report is comprised of the opinions and judgement of management. This type of information has also been evaluated through analysis, enquiry and review to the extent practical. However, it must be recognised that such information is not always capable of external verification or validation.

45 We in no way guarantee the achievability of budgets or forecasts of future profits. Budgets and forecasts are inherently uncertain. They are predictions of future events which cannot be assured and are necessarily based on assumptions of future events, many of which are beyond the control of management. Actual results may vary significantly from forecasts and budgets with consequential valuation impacts.

III Profile of Integral Diagnostics

Overview

46 Integral Diagnostics is an Australian healthcare services company that specialises in the provision of diagnostic imaging services to general practitioners, medical specialists and allied health professionals (Referrers) and their patients. It operates through a network of 47 sites (including 13 hospital sites) located in regional areas in Victoria, Queensland and WA. Integral Diagnostics comprises three core brands, being Lake Imaging (established in 2002), South Coast Radiology (established in 1967) and Global Diagnostics (established in 1977).

History

47 Lake Radiology was established as a private practice by a small group of radiologists and radiographers with the intention of offering Referrers and patients high quality specialised radiology services. It was also the first private radiology practice in Australia to operate a fully digital model.

48 Lake Imaging initially grew through a combination of adding services and expanding into new hospital sites. It also made a series of acquisitions, including:

(a) Western Medical Imaging in Victoria in 2011

(b) Ballarat MRI[12] in Victoria in 2012

(c) the creation of a joint venture with Western District Radiology in Warrnambool, Victoria in 2013 (South West MRI).

49 In April 2014, Lake Imaging acquired a 60% interest in Global Diagnostics, a diagnostic imaging services provider based in the south west region of WA that was founded in 1977. This acquisition marked the company's first expansion outside its home state of Victoria. In June 2015, Lake Imaging acquired the remaining 40% interest in Global Diagnostics for approximately $8.1 million.

50 In August 2014, Lake Imaging undertook a merger with South Coast Radiology to expand its clinical capacity and geographic coverage. Consideration included a combination of cash and Lake Imaging shares totalling $89.2 million. South Coast Radiology is a Queensland based diagnostic imaging company that was founded in 1967 in Southport on the Gold Coast. At the date of acquisition it owned established practices in the Gold Coast, Tweed Heads, Toowoomba and Mackay.

51 Lake Imaging became a public company and was renamed Integral Diagnostics on 1 October 2015. The company listed on the ASX on 21 October 2015 through an initial public offering (IPO) at a price of $1.91 per share.

52 Since listing, Integral Diagnostics has focused on growth by both the expansion of capacity at existing sites (for example, by adding more diagnostic imaging machines) as well as the establishment of new sites. In addition, Integral Diagnostics acquired 100% of Western

[12] Magnetic resonance imaging (MRI).

District Radiology in Warrnambool, Victoria and the remaining 50% interest in South West MRI for combined consideration of $5.0 million on 1 July 2016.

Current operations

53 Integral Diagnostics is the fourth largest diagnostic imaging provider in Australia. It operates from a Melbourne head office and provides a range of diagnostic imaging services under its three core brands, being Lake Imaging, South Coast Radiology and Global Diagnostics. An overview of each of these core brands, including key locations, number of sites and employee numbers is summarised in the following table:

Integral Diagnostics – overview of current operations

	Lake Imaging	South Coast Radiology	Global Diagnostics	Integral Diagnostics
State of operation	Victoria	Queensland	WA	As indicated
Key markets	Ballarat, Geelong, Warrnambool and outer western Melbourne	Gold Coast area, Toowoomba and Mackay	South west WA and services to WA Country Health Service	As indicated
Sites (including hospitals)	25	13	9	47
Hospital sites	7	2	4	13
MRI machines	7	7	2	16
Full / Partial MRI Licences	4 / 0	3 / 3	2 / 0	9 / 3
Employed radiologists	25	31	8	64
Other employees	351	348	155	854

Note:
1 An MRI machine with a Full Licence is eligible for a Medicare rebate for procedures referred by a medical specialist and certain procedures referred by a General Practitioner (GP). Under a Partial MRI Licence, a Medicare rebate is only available for certain procedures referred by a GP.
2 In addition to the three core brands outlined above, the operations at Warrnambool, Toowoomba and Mackay operate under separate brands, viz Western District Radiology, Southwest MRI, Darling Downs Radiology and Mackay Radiology

54 In respect of the above we note that Integral Diagnostics:

(a) has leading market positions in each of the regional areas it operates

(b) operates 16 MRI machines

(c) owns nine Full MRI Licences (for specialist and GP referrals)

(d) owns three Partial MRI Licences (for GP referrals)

(e) operates four MRI machines without Medicare licences (for non-Medicare referrals such as WorkCover, private health insurance and self-pay)

(f) has 13 sites co-located at hospitals, which provide access to higher value modalities and more specialist services

(g) provides coverage to 48 public hospitals in regional WA; and

(h) works with approximately 39 contractor radiologists in addition to the 64 radiologists that are employed by the company.

Business model

55 Integral Diagnostics operates under a "hub and spoke" business model, which is based around its clinic sites (the "spokes") and hospital and comprehensive sites (the "hubs"). Clinics generally offer lower value modalities like X-ray, ultrasound and lower end computed tomography (CT), with the more complex modalities such as MRI, high end CT and positron emission tomography (PET) generally referred to its hospital sites, where such specialist equipment is located. Integral Diagnostics management consider this model to be effective as it facilitates referrals to the hub sites with the more specialised equipment, it allows radiologists to subspecialise in clinical areas of interest (with such specialist work attracting specialist referrals) and it provides cost-effective access to higher value services with improved margins.

56 Integral Diagnostics has also announced its intention to focus on specialist areas within the diagnostic imaging sector. This includes the established Geelong Breast Clinic (operating under the Lake Imaging brand) and Women's Imaging Centre in Southport, the newly opened Spine Centre of Excellence on the Gold Coast and a specialist prostate centre of excellence currently in development in North Melbourne. These centres add another layer of specialisation to the Integral Diagnostics offering and essentially provide additional hubs to the "hub and spoke" model. The centres also provide additional referral and networking opportunities with relevant specialist professionals (for example, with orthopaedic surgeons for the Spine Centre of Excellence).

57 Integral Diagnostics' business model is dependent on a number of key factors, including:

(a) **attracting patients and Referrers –** this can be impacted by the quality of clinical services and capabilities provided, accessibility, including convenience of locations and waiting times, availability of MRI licences and range of clinical services provided. Integral Diagnostics has a large network of more than 29,000 Referrers, excluding Referrers under reporting contracts

(b) **attracting and retaining radiologists / technical professionals** – retention of key staff such as radiologists and technical professionals is essential to the operation of a successful diagnostic imaging service business. Integral Diagnostics provides its radiologists with professional autonomy to achieve clinical best practice within a well-established clinical governance framework and supports further education and professional development. Radiologists also benefit from a diverse mix of clinical work as a result of Integral Diagnostics' hospital sites and higher modality specifications as well as its superior technology and systems, which allow radiologists to focus on clinical work and delivering patient and referrer services

(c) **hospital sites –** patients at hospitals use the co-located diagnostic imaging facilities, which are integrated with the hospital's service delivery to its patients. Integral Diagnostics' operations conducted within hospitals are undertaken via individual service level agreements that have a typical contract length of five to 10 years with renewal options

(d) **patient co-payments** – Integral Diagnostics charges patients a co-payment for selected specialised services that it provides, typically for high-end specialist referrals that require radiologist intervention and possibly consultation with either the patient or the referrer. Co-payments account for a significant proportion of Integral's revenues (i.e. 20% to 25%)

(e) **quality of equipment –** the age of equipment impacts Medicare reimbursements, with equipment past capital sensitivity being ineligible for Medicare reimbursements. Integral Diagnostics operates high quality equipment that is within the prescribed age limits under the Medicare Benefits Schedule (MBS). The company also sources a significant proportion of its revenue from higher-value, more complex modalities

(f) **State Government contracts** – Integral Diagnostics provides reporting services to the Western Australian Country Health Services (WACHS). These services are provided to 48 regional public hospitals, mostly through the use of teleradiology services. Integral also provides onsite radiologist support to some of the larger WACHS hospitals. These services are currently provided under a contract executed in November 2016. Expected revenue over the life of the contract is some $50 million

(g) **Federal Government funding –** Commonwealth Government reimbursements (in the form of Medicare rebates) account for approximately 87% of revenues of the total diagnostic imaging market in Australia and hence changes to this level of funding have the potential to impact operations. However, Integral Diagnostics provides a greater level of higher value modalities than the industry in general, resulting in a comparatively significantly lower proportion of revenue from Medicare rebates (around 55%) and higher contributions from patients and other sources (such as insurance companies). As a result Integral Diagnostic's revenue is materially more diversified than typical industry participants.

Site locations

58 Integral Diagnostics operates through a geographically diversified network of hospital sites, comprehensive sites and community clinics focused on the Victorian, Queensland and WA major regional markets. Its locations are as follows:

Integral Diagnostics – operating locations

Services

59 Diagnostic imaging services offered by Integral Diagnostics cover a variety of modalities including (alongside the number of machines owned by Integral Diagnostics):

(a) MRI – 16 machines

(b) radiography (X-ray) – 56 machines

(c) ultrasound – 95 machines

(d) CT – 29 machines; and

(e) nuclear medicine– 14 machines, including three PET machines (which will be expanded to four in FY18).

60 Services are provided by radiographers, sonographers, nuclear medicine technologists, MRI technicians and nurses. The medical component of the services offered are performed by radiologists and nuclear medicine physicians, who review patient images, undertake procedures, consult with referrers, participate and/or lead multidisciplinary specialist meetings and produce and present diagnostic reports. Integral Diagnostics provides a collegiate working environment and encourages its radiologists and other technical staff to invest in teaching, training and development.

Financial performance

61 The financial performance of Integral Diagnostics for the three years ended 30 June 2017 (FY17) and half year to 31 December 2017 (1HY18), is set out below:

Integral Diagnostics – statement of financial performance[1]

	FY15 Pro forma[2] $m	FY16 Audited $m	FY17 Audited $m	1HY18 Reviewed $m
Sales revenue	160.0	167.8	179.7	93.6
Underlying EBITDA (before significant items)	34.6	35.2	33.5	19.0
Depreciation	(8.5)	(8.1)	(9.2)	(4.6)
Underlying EBITA (before significant items)	26.1	27.1	24.3	14.4
Amortisation of acquired intangible assets	(0.6)	(0.6)	(0.6)	(0.3)
Underlying EBIT (before significant items)	25.4	26.5	23.7	14.0
Net financial expense	(2.9)	(3.1)	(2.5)	(1.1)
Significant items[3]	-	(7.0)	0.1	(1.3)
Profit before tax	22.5	16.4	21.3	11.6
Income tax expense	(6.7)	(5.1)	(5.8)	(3.3)
Net profit after tax	15.8	11.4	15.5	8.3
Number of facilities (end of period)	44	45	45	47
Patient examinations (000's)[4]	975	1,019	1,074	573
Average patient fee per examination ($)[4]	152.1	151.7	153.6	154.2
Revenue growth	6.7%	4.9%	7.1%	5.8%
Underlying EBITDA growth	12.6%	1.8%	(4.9%)	12.4%
Underlying EBITDA margin	21.6%	21.0%	18.6%	20.3%

Note:
1 Rounding differences exist.
2 Pro forma FY15 results are sourced from Integral Diagnostics October 2015 prospectus.
3 Significant items reflect transaction costs of $7.0 million associated with the IPO in October 2015 (FY16), asset impairments of $0.8 million (FY17), restructuring provision expenses of $0.3 million (FY17), fair value gain of $1.2 million on the acquisition of the remaining 50% interest in South West MRI (FY17) and transaction and takeover response costs of $1.3 million (1HY18).
4 Patient examinations and average patient fee per examination exclude reporting contracts.

62 As shown above, to enhance comparability between years we have considered the FY14 and FY15 financial results for Integral Diagnostics on a pro forma basis. The pro forma accounts adjust Integral Diagnostics' results to reflect an assumption that the South Coast Radiology and Global Diagnostics businesses were 100% owned throughout these financial periods.

63 The three key variables that have the most material impact on the financial performance of Integral Diagnostics are the number of patient examinations (i.e. volume), the average patient fee per examination (price) and employee expenses (which represent around two thirds of total costs for Integral Diagnostics).

64 The key factors that have impacted the financial performance of Integral Diagnostics in FY15, FY16 and FY17 are summarised below:

Year to 30 June 2015 (FY15)

- revenue increased by 6.7%, primarily driven by a 5.9% increase in patient examinations and higher levels of more complex modalities such as MRI, CT and Nuclear Medicine services. In addition, a new site was opened during the period in West Springs, Victoria
- underlying (pro forma) EBITDA increased by 12.6% due to higher revenue, higher equipment utilisation levels and cost containment
- overall costs increased by only 5.3%, notwithstanding a 7.6% increase in employee costs due to the addition of technical staff to service growth in patient examinations. Cost growth was also partially offset by a decline in equipment related expenses as Integral Diagnostics exited certain operating equipment leases

Year to 30 June 2016 (FY16)

- revenue increased by 4.9%, driven primarily by growth in patient examination volumes of 4.8%. This was above industry growth of 3.7%[13] in the states in which Integral Diagnostics operates. However, FY16 actual revenue was slightly below the pro forma forecast of $169.6 million (as set out in the October 2015 prospectus) due to uncertainty associated with the Federal Government's policy regarding bulk-billing incentives to diagnostic imaging providers (refer to section V, Industry overview, for further details)
- underlying EBITDA increased by 1.8% to $35.2 million, however this was below the pro forma forecast of $37.3 million set out in the October 2015 prospectus. The lower than anticipated profitability was primarily due to lower revenue growth combined with committed expenditures for the year, including increased costs associated with new radiologists employed in late FY15 and investments in both staff and information technology systems

13 Based on Medicare data.

Year to 30 June 2017 (FY17)

- revenue increased by 7.1% due to a combination of organic growth and a full 12 month contribution from the acquisitions made in FY16 (South West MRI and Western District Radiology collectively contributed an additional $4.7 million in revenue)
- examination volumes increased by 4.6% (normalised for acquisitions), however this was below industry growth of 5.1%[14] (in the states in which the Integral Diagnostics operates) as a result of increased competition at selected sites in Victoria and Queensland
- underlying EBITDA decreased by 4.9% due to significant increases in employee costs relating to additional investment in radiologists, imaging and other staff to service expanded capacity (which had not yet been fully utilised by the end of the period), as well as the addition of staff from recent acquisitions. Due to the impact of the above, EBITDA margins reduced to 18.6% (from 21.0% in FY16)

Half year to 31 December 2017 (1HY18)

- revenue increased by 5.8% in comparison to the previous half year period due to volume growth of 8.5%[15]
- consistent with the company's recently stated focus to rebuild margins, Integral Diagnostics is currently undertaking a comprehensive review of its operating cost structure and has made substantial progress to date, including:
  - fully integrating the Western District Radiology and South West MRI businesses
  - a reduction of labour costs through better roster management and flexible staffing arrangements
  - employing technology such as voice recognition, tele-radiology (work sharing between clinics and hospitals etc.) and automated timesheets to increase efficiency
  - consolidation of software systems and call centre operations
  - more efficient supply chain management, which has resulted in a material reduction in waste to date
- underlying EBITDA increased by 12.4% in comparison to the previous corresponding half year period and EBITDA margins improved to 20.3%, primarily due to higher revenue on a lower cost base

Year to 30 June 2018 (FY18) outlook

- Integral Diagnostics has provided earnings guidance for FY18 in its Target's Statement in the range of $38.0 million to $39.0 million, primarily due to organic growth, returns on growth capital expenditure and staff and consumable cost savings
- after allowance for the full year impact of these cost saving initiatives[16] (which Integral Diagnostics has estimated at $4.0 million), Integral Diagnostics has estimated annualised pro forma FY18 EBITDA in the range of $42.0 million to $43.0 million.

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14 Based on Medicare data.

15 Revenue growth is lower than volume growth due to an increased proportion of reporting contracts. Excluding reporting contracts, average fee per exam has increased.

16 These initiatives cover a range of areas including labour cost savings (including rostering, automated timesheets and award interpreter), consumables and other expenditure savings.

Cash conversion ratio

65 The historical free cash flow conversion (a comparison of underlying EBITDA to free cash flow) for Integral Diagnostics is set out below:

Integral Diagnostics – free cash flow conversion[1]	FY15 Pro forma[2] $m	FY16 Audited[2] $m	FY17 Audited[2] $m	1HY18 Reviewed[2] $m
Underlying EBITDA	34.6	35.2	33.5	19.0
Non-cash items included in EBITDA	0.5	0.1	-	(0.2)
Movement in net working capital	1.2	(0.5)	1.6	1.2
Maintenance capital expenditure	(7.2)	(9.4)	(11.1)	(2.3)
Free cash flow	29.0	25.4	24.0	17.7
Growth capital expenditure	(2.7)	(7.8)	(2.3)	(1.3)
Net cash flow before financing and taxation	26.4	17.6	21.7	16.4
Free cash flow / underlying EBITDA (%)	84.0	72.2	71.6	93.2

Note:
1 Rounding differences exist.
2 As provided in Integral Diagnostics' October 2015 prospectus and FY17 and 1HY18 results presentations.

66 Based on its business model, Integral Diagnostics would typically expect to exhibit a relatively high level of free cash flow in comparison to underlying EBITDA. However, in FY16 and FY17 free cash flow was impacted by higher levels of investment in maintenance capital expenditure than previous years due to the replacement profile of medical equipment and the upgrade of information technology (IT) systems for digital reporting.

67 Growth capital expenditure in FY16 reflected the installation of an additional MRI at the SJOG Hospital in Geelong, Victoria and expenditure on new premises at Toowoomba (Queensland), Ocean Grove and Sunbury (both Victoria), to meet growing demand in these areas. FY17 growth capital expenditure related to purchases of additional equipment, including a mobile MRI and infrastructure at Port Hedland, WA.

68 In its FY18 guidance upgrade dated 12 January 2018, Integral Diagnostics stated that total capital expenditure for FY18 was expected to be $17 million, comprised of $9 million maintenance capital expenditure and $8 million of growth capital expenditure. Growth capital expenditure is primarily associated with the opening of the Spine Centre of Excellence on the Gold Coast, the Prostate Centre of Excellence in North Melbourne, new community clinics at Torquay Road and Miami Beach, as well as upgrades to facilities at the SJOG Hospital in Geelong, including a new PET service.

Financial position

69 The financial position of Integral Diagnostics as at 31 December 2016, 30 June 2017 and 31 December 2017 is set out below:

Integral Diagnostics – statement of financial position[1]	31 Dec 16 $m	30 Jun 17 $m	31 Dec 17 $m
Debtors and prepayments	10.5	8.7	9.1
Inventories	0.3	0.4	0.4
Creditors, accruals and provisions	(22.6)	(19.0)	(22.4)
Net working capital	(11.8)	(9.9)	(12.8)
Property, plant and equipment	51.2	50.5	49.6
Intangible assets	102.1	103.9	103.6
Deferred tax assets (net)	5.2	2.7	3.3
Provisions (non-current)	(7.8)	(8.1)	(8.6)
Total funds employed	138.8	139.1	135.0
Cash and cash equivalents	21.4	24.2	25.4
Interest bearing liabilities	(72.0)	(72.9)	(67.6)
Derivative financial instruments (net)	(0.2)	(0.1)	-
Net cash / (borrowings)	(50.8)	(48.7)	(42.2)
Net assets attributable to Integral Diagnostics shareholders	88.1	90.4	92.8

Note:
1 Rounding differences exist.

Working capital

70 Integral Diagnostics generally operates with a negative net working capital position. This is primarily due to the operating nature of the diagnostic imaging sector, whereby payments for services are largely received upfront (receipts are received within several days from Medicare post lodgement for bulk-billed visitations), or are partially funded upfront by patients (i.e. co-payments). Working capital is also impacted by labour costs, as accounting standards require certain employee provisions to be classified as current even though these provisions are unlikely to all be paid in cash within a 12 month period.

Property, plant and equipment

71 The carrying value of Integral Diagnostics' property, plant and equipment is as follows:

Integral Diagnostics – property, plant and equipment	31 Dec 16 $m	30 Jun 17 $m	31 Dec 17 $m
Plant and equipment	35.5	34.7	32.4
Leasehold improvements	11.1	10.9	12.8
Office furniture and equipment	4.5	4.8	4.3
Motor vehicles	0.1	0.1	0.1
Property, plant and equipment	51.2	50.5	49.6

72 Property, plant and equipment is carried at historical cost less accumulated depreciation and impairment. The majority of Integral Diagnostics' property, plant and equipment relates to medical equipment such as X-ray and MRI machines and CT scanners (some of which are secured under finance leases). These items are reported under plant and equipment.

Intangible assets

73 The composition of Integral Diagnostics' intangible assets is shown below:

Integral Diagnostics – intangible assets[1]	31 Dec 16 $m	30 Jun 17 $m	31 Dec 17 $m
Goodwill	94.2	96.4	96.4
Brand names	7.2	7.2	7.2
Customer contracts	0.7	0.4	0.1
Intangible assets	102.1	103.9	103.6

Note:
1 Rounding differences exist.

74 The majority of Integral Diagnostics' intangible assets relate to goodwill that arose on the acquisitions of South Coast Radiology and Global Diagnostics. Goodwill is tested annually for impairment using the value in use method.

Net debt

75 A summary of Integral Diagnostics' net debt position is set out below:

Integral Diagnostics – net debt[1]	31 Dec 16 $m	30 Jun 17 $m	31 Dec 17 $m
Cash and cash equivalents	(21.4)	(24.2)	(25.4)
Borrowings	43.7	43.8	43.7
Lease liability	28.3	29.1	23.9
Derivative financial liabilities	0.2	0.1	-
Net debt	50.8	48.7	42.2

Note:
1 Rounding differences exist.

76 Integral Diagnostics' net debt primarily relates to bank borrowings and finance leases associated with its diagnostic imaging equipment. As at 30 June 2017, the company's borrowings and lease liabilities had a weighted average interest rate of 3.8% and 4.0% per annum respectively[17]. The current debt facilities expire in September 2018 and we understand that Integral Diagnostics has recently negotiated new debt arrangements on improved terms and with an updated expiry of December 2020.

Share capital and performance

77 As at 28 February 2018, Integral Diagnostics had 145,044,157 fully paid ordinary shares and 362,585 performance rights (being zero exercise priced options) on issue. Of the ordinary shares, a proportion owned by current and former radiologists and management are subject to voluntary escrow arrangements which were entered into in connection with the IPO (vendors of Lake Imaging and South Coast Radiology) and the Western District Radiology acquisition. As at 28 February 2018, the number of ordinary shares subject to escrow was 41,606,070, representing 28.7% of Integral Diagnostics' total shares on issue. Summarised details of these arrangements are as follows:

17 The average cost of debt for 1HY18 was 3.4%.

(a) **short term escrow** – the short term escrowed shares were / are to be released in three equal tranches after the release of the FY16, 17 and FY18 results (FY17, FY18 and FY19 for the Western District Radiology escrow arrangements)

(b) **medium term escrow** – these shares are released from escrow on the earlier of:

(i) the release of the FY25 (FY26 for the Western District Radiology escrow arrangements) results to the ASX

(ii) a shareholder reaching 60 years of age or older and being continuously employed by Integral Diagnostics for more than seven years

(c) **long term escrow** – these shares are released from escrow when a shareholder has reached 60 years of age or older and has been continuously employed by Integral Diagnostics for more than seven years (noting that certain shares are retained and released, subject to Board satisfaction that the shareholder is permanently retired and has signed an acceptable non-compete, after a further 12 months).

78 In addition, a New Partner Physician Plan was introduced at the time of the IPO to support recommended new radiologists to acquire Integral Diagnostics shares through an interest free limited recourse loan. A Regional Incentive Plan was also established in which radiologist shareholders may be eligible to participate in an incentive pool in a region in which profitability grows more than 5% compared to the previous year. The incentive pool is capped at 2% of Integral Diagnostics pro forma profit. No awards have been made in FY16 or FY17 under either the New Partner Physician Plan or the Regional Incentive Plan.

79 Integral Diagnostics commenced a review in October 2017 of the escrow arrangement structures, the New Partner Physician Plan and the Regional Incentive Plan to simplify and align these arrangements and as part of broader radiologist recruitment, retention and incentive initiatives. Ernst & Young has been engaged to assist with the review.

Significant shareholders

80 As at 28 February 2018, based on substantial shareholder notices lodged with ASX, the significant shareholders in Integral Diagnostics (i.e. shareholders with an interest in Integral Diagnostics of more than 5%) were as follows:

Integral Diagnostics – substantial shareholders(1)

	Shares held	
Shareholder	**Millions**	**% interest**
Investors Mutual Limited	13.5	9.3
IOOF Holdings Limited	11.4	7.8
Adam Smith Asset Management Pty Ltd	9.9	6.9
Regal Funds Management Pty Limited	8.1	5.6
Viburnum Funds Pty Ltd	7.3	5.0
	50.3	34.7

Note:
1 Rounding differences exist.
2 Capitol Health holds pre-bid acceptance agreements of 17.2 million shares (refer below).

81 On 31 January 2018 (i.e. the date of the Replacement Bidder's Statement), Capitol Health lodged a revised substantial shareholder notice with the ASX in respect of the pre-bid acceptance agreements that it had executed with certain Integral Diagnostics' shareholders.

Collectively, the pre-bid acceptance agreements provided Capitol Health with an 11.8% interest in Integral Diagnostics as shown below:

Capitol Health – pre-bid acceptance agreements[(1)]

Agreement counterparty	Shares held Millions	% interest
Regal Funds Management Pty Ltd	8.1	5.6
Wilson Asset Management (International) Pty Limited	6.2	4.3
Microequities Asset Management Pty Ltd	2.9	2.0
	17.2	11.8

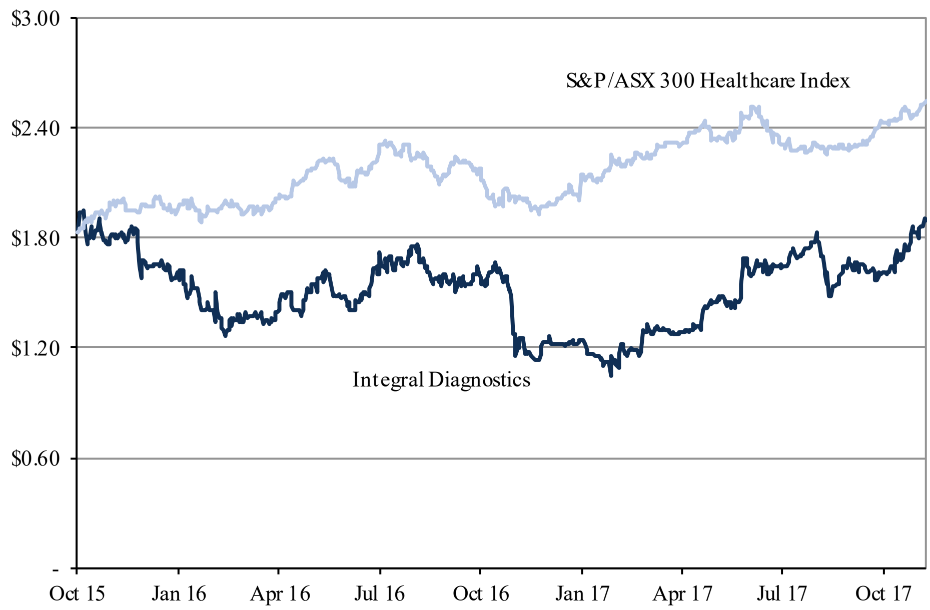
Note:
1 Rounding differences exist.

82 Under the pre-bid acceptance agreements, Regal Funds Management Pty Ltd is also obligated to procure the acceptance of an additional 6.5 million shares in Integral Diagnostics (or 4.46% of the total shares on issue), which in total provides Capitol Health with pre-bid acceptances of 16.3% of the Integral Diagnostics shares on issue.

Share price performance

83 The following chart illustrates the movement in the share price of Integral Diagnostics in comparison to the S&P / ASX 300 Healthcare Index from its ASX listing date of 21 October 2015 to 28 November 2017[18]:

Integral Diagnostics – share price history[(1)]
21 October 2015 to 28 November 2017



Note:
1 Based on closing prices. The S&P/ASX300 Healthcare Index has been rebased to Integral Diagnostics' closing share price on 21 October 2015 (being $1.83).
Source: Bloomberg.

18 Being the last trading day prior to the announcement of the intention to make the Offer.

84 As indicated above, Integral Diagnostics shares have underperformed the S&P / ASX 300 Healthcare Index since listing on the ASX. However, in the period leading up to the ASX listing and up to May 2017 there was uncertainty with respect to the level of Medicare bulk billing for diagnostic imaging, details of which are summarised as follows (refer to Section V for further details):

(a) in May 2015, the Federal Government released a Regulation Impact Statement regarding diagnostic imaging in Australia which considered potential changes to the Diagnostic Imaging Accreditation Scheme with the aim of reducing costs. At this time there was speculation that Referrers would be subject to Medicare audits, which had a negative impact on industry referral volumes over the following months

(b) on 15 December 2015, the Federal Government proposed to align bulk billing incentives for diagnostic imaging services with those that apply to the GP Services. Integral Diagnostics announced on 18 December 2015 that if the changes were ratified and it did not take any mitigating steps, then revenue would decline by approximately 2% to 3% per annum

(c) in June 2016, the Federal Government announced that it would delay any proposed changes to the bulk billing incentives for diagnostic imaging until 1 January 2017 to allow for an independent evaluation to be carried out

(d) on 9 May 2017, the Federal Government announced that bulk billing incentives for diagnostic imaging services would be retained and that indexation for targeted diagnostic imaging services would be introduced from 1 July 2020. We note that since the May 2017 Federal Government announcement the Integral Diagnostics share price has responded favourably.

Liquidity in Integral Diagnostics shares

85 The liquidity in Integral Diagnostics shares based on trading on the ASX over the 12 month period prior to 29 November 2017[19] is set out below:

Integral Diagnostics – liquidity in shares

Period	Start date	End date	No of shares traded 000	WANOS(1) outstanding 000	Implied level of liquidity Period(2) %	Implied level of liquidity Annual(3) %
1 month	29 Oct 17	28 Nov 17	8,899	145,044	6.1	73.6
3 months	29 Aug 17	28 Nov 17	23,656	145,044	16.3	65.2
6 months	29 May 17	28 Nov 17	46,609	145,044	32.1	64.3
1 year	29 Nov 16	28 Nov 17	67,881	145,044	46.8	46.8

Note:
1 Weighted average number of shares outstanding (WANOS) during relevant period.
2 Number of shares traded during the period divided by WANOS.
3 Implied annualised figure based upon implied level of liquidity for the period.

86 Having regard to the escrow arrangements in place with radiologists and former management, together with the presence of several large institutional investors as noted above, the total share turnover (on an annualised basis) in Integral Diagnostics indicates a relatively high level of market liquidity for a company of its size.

19 Being the announcement date of the intention to make the Offer.

IV Profile of Capitol Health[20]

Overview

87 Capitol Health is a provider of diagnostic imaging and related services to the Australian healthcare market. It owns and operates a number of radiology clinics throughout Victoria (operating under the Capital Radiology brand) that provide infrastructure for radiologists and related medical practitioners. Capitol Health also holds an investment in diagnostic imaging artificial intelligence company Enlitic LLC (Enlitic).

History

88 Capitol Health was established in December 2005 with a focus on acquiring and owning dental surgeries. These surgeries were leased to dentists who were then offered administration support and other related management services. Initially two dental surgeries were acquired and on 7 June 2006 Capitol Health listed on the ASX. A third dental surgery was acquired shortly after listing.

89 On 26 July 2007, Capitol Health broadened its healthcare focus into radiology, acquiring seven diagnostic imaging clinics located in Melbourne for $14.8 million. Over the following year Capitol Health expanded its Melbourne based diagnostic imaging operations through the opening of a number of new clinics, and the acquisitions of South East Medical Imaging (two clinics) and Bell Imaging (nine clinics) in January and March 2008 respectively.

90 During FY08, Capitol Health undertook a detailed review of its dental operations and decided to exit the business in order to place greater focus on its diagnostic imaging operations. As a result, the three dental surgeries were divested over the period November 2007 to August 2008.

91 Over the following years, Capitol Health added a number of new centres and renamed its clinics "Capital Radiology". It also made a number of further acquisitions, including:

(a) IM Medical Limited in March 2012 for $2.4 million, which included five radiology clinics located in Melbourne

(b) MDI Group Pty Ltd in March 2013 for $8.0 million, which included 11 diagnostic imaging clinics primarily located in south-east Melbourne

(c) Imaging @ Olympic Park in January 2015 for $25.0 million, which is a state of the art facility situated at Melbourne's AAMI Park sporting complex.

92 In December 2014, Capitol Health acquired Southern Radiology Group for $64.6 million, which operated 14 clinics throughout Sydney. This was followed by the acquisitions of Eastern Radiology Services (located in Bondi Junction, Sydney) and Sydney Radiology (located in Cremorne, Sydney) in April 2015 for combined consideration of $30.0 million. In August 2015, Capitol Health also acquired Liverpool Diagnostics for $4.5 million (excluding a $1.5 million earn-out), which operated five clinics across western Sydney.

93 Following a strategic review of its operations, on 14 June 2017 Capitol Health announced the subsequent sale of its NSW assets to I-MED Radiology Network (I-MED) for

[20] This profile is based on publicly available information with respect to Capitol Health.

$81.5 million[21]. This decision was made in the context of the poor financial performance of the assets since acquisition, the difficulties encountered in integrating the different business models (i.e. bulk billing, hospitals, research and private billing) and the Board's view that funds could be utilised more effectively to improve shareholder returns. This sale completed on 31 August 2017.

94 On 18 December 2017, Capitol Health announced it had agreed to acquire the I-Rad Radiology practice based in Sunshine, Victoria for $3.0 million (excluding a $0.5 million earn-out)[22]. Concurrently, it stated that it was in discussions to buy Radiology Tasmania Group, which was subsequently confirmed for consideration of $24.2 million (excluding a $1.0 million earn-out) in an ASX announcement on 21 December 2017[23]. The Radiology Tasmania Group includes five diagnostic imaging practices in the greater Hobart and Launceston regions, nine radiologists and two MRI machines (one of which has Full Licence).

Current operations

95 Capitol Health operates from a Melbourne head office and owns and operates 43 diagnostic imaging clinics (including three located at hospital sites) throughout Victoria[24]. It employs 55 radiologists, plus an additional 443 employees, and operates 15 MRI machines (one MRI machine operates under a Full Licence and eight operate under Partial Licences)[24]. The company has also invested in diagnostic imaging artificial intelligence through a 25% share of Enlitic and has plans to expand into the Chinese diagnostic imaging market, through a joint venture arrangement.

Victorian radiology clinics

96 The location of Capitol Health's Victorian clinics, the majority of which are located within metropolitan Melbourne, are as follows:

21 Less a $1.2 million cash adjustment for employee entitlements.

22 Completion of this acquisition was announced on 23 January 2018.

23 Completion of this acquisition was announced on 1 February 2018.

24 Excluding the December 2017 announced acquisitions.

Capitol Health – radiology clinic locations[(1)]

Note:

1 Sourced from the Capitol Health investor presentation, dated 10 December 2014, which was prior to the acquisitions of Imaging @ Olympic Park, I-Rad Radiology and Radiology Tasmania Group.

97 Capitol Health also operates Imaging @ Olympic Park, a specialist sports imaging clinic with a primary focus on the diagnosis and treatment of musculoskeletal conditions. The centre offers comprehensive imaging services across a range of modalities including MRI, CT, ultrasound and digital radiography.

Investment in Enlitic

98 On 28 October 2015, Capitol Health announced that it had entered into a memorandum of understanding (MOU) with Enlitic to commercialise Enlitic's deep learning and artificial intelligence protocols in radiology and healthcare in Australia. The MOU also provided for collaboration on international deployment. Subsequent to the MOU, Capitol Health invested US$10 million for a 25% interest in Enlitic. Under the existing agreement, Capitol Health holds exclusive marketing rights to Enlitic's technology in Australia for a period of five years and is entitled to a percentage of Enlitic's revenue generated from China.

99 Enlitic is a start-up company based in San Francisco, California that leverages proprietary algorithms developed by data scientists, machine learning practitioners and medical experts to analyse a wide variety of healthcare data sources (including billions of clinical cases) to improve diagnostic accuracy, speed and patient outcomes.

Joint venture agreement in China

100 On 20 February 2017, Capitol Health entered into an equity joint venture agreement with CITIC Pharmaceutical (Shenzhen) Co., Ltd (CITIC) and Xiamen Zhouxin Medical Image Co., Ltd (Zhouxin) to provide design, consulting and clinic management services to independent diagnostic imaging centres to be created by CITIC and Zhouxin across mainland China. Capitol Heath plans to contribute $0.6 million for a 30% interest in the joint venture. The commencement of operations has been delayed by regulatory issues.

Financial performance

101 The financial performance of Capitol Health for the three years ended FY17 and 1HY18 is set out below:

Capitol Health – statement of financial performance[1]

	FY15 Audited $m	FY16 Audited $m	FY17 Audited $m	1HY18 Reviewed $m
Sales revenue	110.6	104.3[3]	108.1[3]	56.1
Underlying EBITDA (before significant items)	21.6	13.1	14.4	10.4
Depreciation	(4.9)	(4.6)	(5.6)	(2.7)
Underlying EBIT (before significant items)	16.7	8.4	8.7	7.7
Net financial expense	(1.0)	(2.2)	(2.3)	(1.8)
Significant items[2]	(8.0)	(3.2)	(4.0)	(1.6)
Profit before tax	7.8	3.0	2.5	4.3
Income tax expense	(3.9)	(1.3)	(0.7)	(1.5)
Net profit after tax (continuing operations)	3.9	1.7	1.7	2.7
Net loss after tax from discontinued operations	-[4]	(6.4)[4]	(5.8)[4]	0.2[4]
Net profit / (loss) after tax	3.9	(4.7)	(4.1)	2.9
Revenue growth[3]	22.7%	(5.8)%	3.6%	5.1%
Underlying EBITDA growth[3]	50.1%	(39.6)%	10.0%	108.0%
Underlying EBITDA margin	19.6%	12.5%	13.3%	18.5%

Note:

1 Rounding differences exist.

2 Significant items comprise:

	FY15	FY16	FY17	1HY18
Impairment of assets[5]	(0.0)	(1.8)	(0.9)	-
Acquisition, restructure & termination costs	(7.9)	(0.6)	(3.9)	(1.6)
China business development costs	-	(0.8)	(0.4)	-
Forfeiture of share options	-	-	(0.5)	-
Net gain from sale of plant and equipment	-	-	0.2	-
Reversal of contingent consideration[6]	-	-	1.5	-
Total significant items	(8.0)	(3.2)	(4.0)	(1.6)

3 Excludes revenue and EBITDA associated with the NSW business in FY16 and FY17.

4 The financial impact of the discontinued NSW operations has been removed for FY16, FY17 and 1HY18, but not for FY15. The NSW businesses were acquired between December 2014 and August 2015 and the revenue and net profit before tax included from these operations in FY15 is $9.8 million and $0.7 million respectively.

5 Excludes the impairment of goodwill associated with the NSW business of $7.1 million and $6.2 million in FY16 and FY17 respectively, which is included in the losses from discontinued operations.

6 Relates to the discontinued NSW operations.

Historical performance

102 In FY14 and FY15, Capitol Health experienced significant revenue growth (before discontinued operations), however in the subsequent FY16 and FY17 years revenue has been largely static. During the four-year period underlying EBITDA margins (with the exception of FY15) have declined. Over the period there were also a high level of significant items and losses associated with the discontinued NSW operations. After allowance for these items, Capitol Health reported losses in both FY16 and FY17.

103 During FY17, Capitol Health announced planned overhead cost reductions of approximately $6.0 million per annum. These relate to the reduction of marketing and IT costs, lower overheads and the removal of the Chief Financial Officer (CFO) role, as well as a number of staff in accounting, administration and IT. Approximately $2.2 million of cost reductions were reported as having been achieved in FY17, with the full extent of the savings expected to be realised in FY18.

FY18 outlook

104 In its half year results announced on 27 February 2018, Capitol Health provided revenue and EBITDA guidance for FY18 of $129.0 million to $132.0 million and $23.0 million to $25.0 million respectively[25]. This announcement also noted that high operational leverage and cost reductions (as detailed above) were anticipated to improve EBITDA margins to approximately 19% (which we note represents a significant increase from the level of around 13% achieved in FY16 and FY17).

105 The FY18 guidance included two months revenue and EBITDA contribution from the discontinued NSW operations, which were sold on 31 August 2017. Excluding this contribution, Capitol Health's guidance infers revenue and EBITDA of $120.4 million to $123.4 million and $21.7 million to $23.7 million respectively. The Capitol Health FY18 guidance indicates that the company expects to generate revenues above those achieved in FY17 (adjusted to exclude discontinued operations) from a significantly lower operating cost base.

Financial position

106 The financial position of Capitol Health as at 30 June 2017 and 31 December 2017 is set out below:

Capitol Health – statement of financial position[1]	30 Jun 17 $m	31 Dec 17[4] $m
Debtors, prepayments and other	8.3	8.3
Creditors, accruals and provisions	(20.0)	(15.9)
Net working capital	(11.6)	(7.6)
Property, plant and equipment	23.3	24.1
Goodwill	53.2[2]	53.2
Net deferred tax assets	3.6	3.6
Net assets held for sale	79.3[3]	0.8
Investment in Enlitic (carried at cost)	14.6	14.4
Other assets (non-current)	-	0.2
Provisions (non-current)	(1.9)	(1.9)
Total funds employed	160.5	86.7
Cash and cash equivalents	18.2	85.4
Interest bearing liabilities	(59.7)	(52.6)
Net cash / (borrowings)	(41.5)	32.8
Net assets attributable to Capitol Health shareholders	119.0	119.5

25 This was the second upgrade to FY18 guidance provided by Capitol Health, the first being in November 2017. The rationale for the initial guidance upgrade was more robust market growth than previously expected. The reason for the second guidance upgrade was inclusion of forecast earnings from the I-Rad Radiology and Radiology Tasmania Group acquisitions.

Note:
1 Rounding differences exist.
2 Goodwill of $70.6 million associated with the NSW assets was included in assets held for sale.
3 As at 30 June 2017, this reflects the NSW assets, the sale of which was subsequently completed on 31 August 2017.
4 Prior to completion of the acquisitions of I-Rad Radiology and Radiology Tasmania Group.

Working capital

107 Capitol Health generally operates with a negative net working capital position. This is primarily due to the operating nature of the diagnostic imaging sector, whereby payments for services are largely received upfront (receipts are received within several days from Medicare post lodgement for bulk-billed visitations), or are partially funded upfront by patients (i.e. co-payments).

Property, plant and equipment

108 The carrying value of Capitol Health's property, plant and equipment was as follows:

Capitol Health – property, plant and equipment[1]	30 Jun 17 $m	31 Dec 17 $m
Plant and equipment	16.1	na
Leasehold improvements	6.0	na
Other operating assets	0.4	na
Assets under construction	0.7	na
Property, plant and equipment	23.3	24.1

Note:
1 Rounding differences exist.
na – not available.

109 Property, plant and equipment is carried at historical cost less accumulated depreciation and impairment. The majority of Capitol Health's property, plant and equipment relates to medical equipment such as X-ray and MRI machines and CT scanners.

Goodwill

110 As at 30 June 2017, Capitol Health's goodwill was split between its Victorian operations and its NSW radiology business (which had been reclassified under assets held for sale[26]), detailed as follows:

(a) **Victorian operations** – goodwill is tested for impairment using the value in use method. As at 30 June 2017, a post-tax discount rate of 12.0% was used to discount the future cash flows of this cash generating unit

(b) **NSW operations** – the goodwill associated with the NSW business ($70.6 million) had been tested for impairment by measuring the total net assets at the lower of carrying value and fair value less associated selling costs. As a result of this exercise, goodwill for the NSW operations was impaired by $6.2 million in FY17 (having previously been impaired by $7.1 million in FY16).

26 The sale of this business completed on 31 August 2017.

Assets held for sale

111 Capitol Health completed the sale of its NSW radiology businesses to I-MED on 31 August 2017 for consideration of $81.5 million[27]. As at 30 June 2017, the assets associated with these operations (primarily goodwill, plant and equipment and leasehold improvements) had been classified as held for sale.

Net debt

112 A summary of Capitol Health's net debt position is set out below:

Capitol Health – net debt[(1)]	30 Jun 17 $m	31 Dec 17[(2)] $m
Cash and cash equivalents	18.2	85.4
Short term borrowings	(1.2)	(1.1)
Long term borrowings	(58.6)	(51.5)
Net debt / (cash)	(41.5)	32.8

Note:
1 Rounding differences exist.
2 Prior to completion of the acquisitions of I-Rad Radiology and Radiology Tasmania Group.

113 On 11 April 2017, Capitol Health completed a capital raising of $40.2 million (at a price of $0.14 per Capitol Health share), with the proceeds employed to reduce debt. As at 31 December 2017, the remaining debt primarily related to Capitol Health's senior unsecured notes with a value of $50.0 million. The notes have a maturity of four years, have a fixed interest rate of 8.25% per annum and expire in May 2020.

Share capital and performance

114 Based on disclosures in the Replacement Bidder's Statement, as at 31 January 2018, Capitol Health had 802.5 million fully paid ordinary shares on issue and 1.695 million performance rights on issue. The performance rights are convertible into fully paid ordinary shares subject to the terms of the company's Employee Incentive Plan and various service and performance conditions. In addition the company had 12.0 million options on issue at exercise prices of $0.18 to $0.20 per share, detailed as follows:

Capitol Health – employee share options				
Grant date	Vest date	Expiry	Strike Price $	Options (million)
17 Nov 16	17 Nov 16	17 Nov 20	0.1785	5.0
17 Nov 16	17 Nov 17	17 Nov 20	0.1785	5.0
22 Dec 16	22 Dec 17	22 Dec 20	0.1979	1.0
22 Dec 16	22 Dec 18	22 Dec 20	0.1979	0.6
22 Dec 16	22 Dec 19	22 Dec 20	0.1979	0.4
				12.0

27 Less a $1.2 million cash adjustment for employee entitlements.

Substantial shareholders

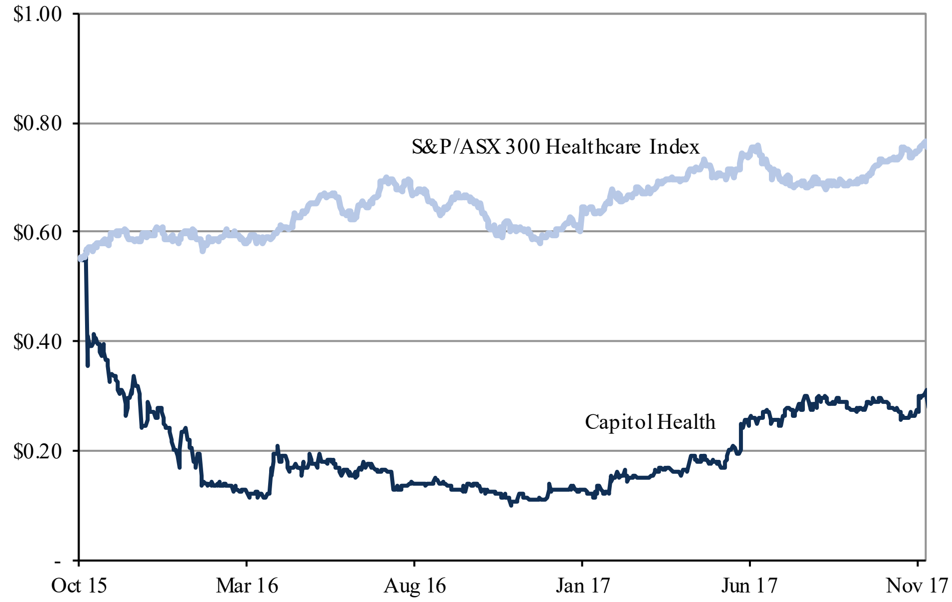
115 As at 28 February 2018 there was one substantial shareholder in Capitol Health (i.e. a shareholder with an interest in Capitol Health of more than 5%), being Paradice Investment Management Pty Ltd, which held 9.5% of the ordinary shares on issue.

Share price performance

116 The following chart illustrates the movement in the share price of Capitol Health from 21 October 2015[28] to 28 November 2017[29]:

Capitol Health – share price history(1)

21 October 2015 to 28 November 2017



Note:

1 Based on closing prices. The S&P / ASX 300 Healthcare Index have been rebased to Capitol Health's last traded price on 21 October 2015, being $0.55.

Source: Bloomberg.

117 As indicated above, Capitol Health shares have underperformed the S&P / ASX 300 Healthcare Index since 21 October 2015. In this respect we note that:

(a) on 27 October 2015, Capitol Health announced that gross revenue for year to date (FY16) was 4% to 6% below expectations due to regulatory uncertainty and subsequent disruption to referral patterns from the Federal Government's Medicare Benefits Schedule review

(b) after a period of underperformance, the Capitol Health share price appears to have responded favourably to:

(i) the capital raising announced on 28 February 2017 and completed on 11 April 2017 (at a price of $0.14 per Capitol Health share), with the (net) proceeds of $40.2 million employed to reduce debt

28 Consistent with the date at which Integral Diagnostics listed on the ASX.

29 Being the last trading day prior to the announcement of the intention to make the Offer.

(ii) the announced sale of the underperforming NSW business on 14 June 2017 (which completed on 31 August 2017)

(iii) the on market share buyback for up to 52.3 million shares announced on 18 August 2017. In the subsequent period up to 25 September 2017, 8.64 million shares (representing around 1% of the then issued capital of Capitol Health) were bought back at an average price of approximately $0.29 per share[30]

(c) in addition, on 9 May 2017, the Federal Government announced that bulk billing incentives for diagnostic imaging services would be retained and that indexation for targeted diagnostic imaging services would be introduced from 1 July 2020, which reduced industry uncertainty and appears to have also favourably impacted the Capitol Health share price.

Liquidity in Capitol Health shares

118 The liquidity in Capitol Health shares based on trading on the ASX over the 12 month period prior to 29 November 2017[31] is set out below:

Capitol Health – liquidity in shares

Period	Start date	End date	No of shares traded 000	WANOS[(1)] outstanding 000	Implied level of liquidity Period[(2)] %	Implied level of liquidity Annual[(3)] %
1 month	29 Oct 17	28 Nov 17	61,490	802,457	7.7	92.0
3 months	29 Aug 17	28 Nov 17	179,086	805,075	22.2	89.0
6 months	29 May 17	28 Nov 17	449,903	807,621	55.7	111.4
1 year	29 Nov 16	28 Nov 17	800,901	705,576	113.5	113.5

Note:
1 WANOS during relevant period.
2 Number of shares traded during the period divided by WANOS.
3 Implied annualised figure based upon implied level of liquidity for the period.

119 In each of the above periods disclosed, total share turnover in Capitol Health (as a percentage of issued share capital) has been relatively high for a company of its size.

30 The share buyback was subsequently put on hold to take advantage of acquisition opportunities, as per the 22 November 2017 Annual General Meeting presentation.

31 Being the announcement date of the intention to make the Offer.

V Industry overview

Introduction

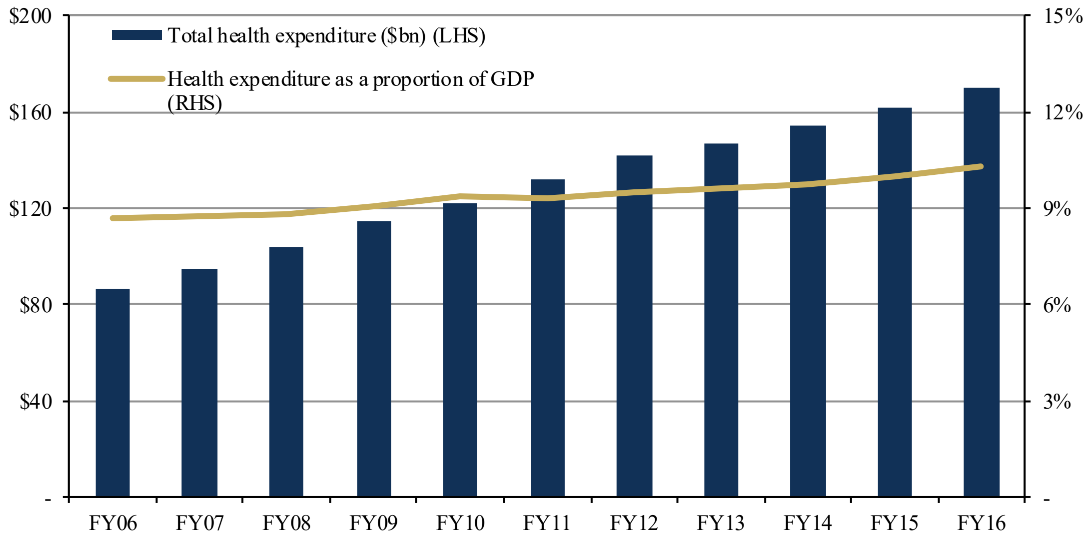
120 Integral Diagnostics and Capitol Health operate in the Australian diagnostic imaging industry. Diagnostic imaging covers the use of practices and processes to create images of the structures and activities inside the human body for diagnostic and treatment purposes. It uses imaging technologies (modalities) to create a visual representation of the body for non-invasive diagnosis. The type of image required depends on the symptoms and part of the body being examined and includes five core modalities, including radiography (X-ray), ultrasound, CT, MRI and nuclear medicine (which includes PET).

121 Integral Diagnostics provides a comprehensive diagnostic imaging service offering. However, consistent with its "hub and spoke" strategy, and the provision of both specialist services and more complex modalities (such as MRI, high end CT and PET), the company essentially targets the premium end of the market.

Australian healthcare industry

122 The value of the Australian healthcare industry was estimated at $170.4 billion in FY16 (the latest available data), having grown at a compound annual growth rate (CAGR) of 7.0% over the ten years to FY16[32]. It represents 10.3% of Australia's gross domestic product (GDP), an increase from 8.7% in FY06[32].

Medicare funding of healthcare procedures



Source: Australian Institute of Health and Welfare (AIHW) (2017) *Health expenditure Australia 2015-16*.

123 In FY16, Federal and State governments accounted for $114.6 billion or 67.3% of total Australian health expenditure. The remaining expenditure is from non-government sources such as individuals ($29.4 billion), health insurance funds ($14.9 billion) and other non-government sources, such as injury compensation insurers ($11.5 billion).

32 Source: AIHW (2017) *Health Expenditure in Australia 2015-16.*

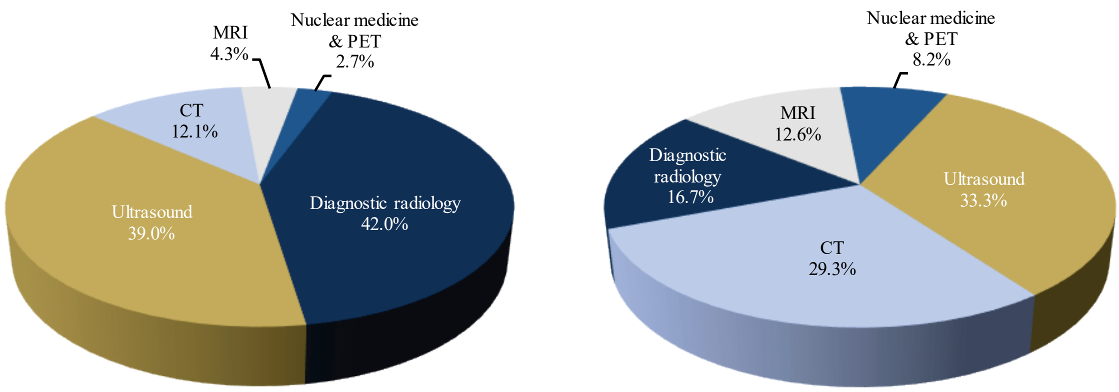
124 The increasing proportion of Australia's GDP represented by the healthcare industry is a function of increasing average health expenditure per person combined with population growth. Average health expenditure per person (of $7,096 in FY16) has increased at a rate of 5.2% per annum over the ten years to FY16[33] which has been driven, inter alia, by an aging population and a general expectation for higher quality healthcare services. Australia's population has grown at 1.7% per annum over the ten years to FY17[34], which is a high growth in comparison to other western nations over this period.

Diagnostic imaging services

125 Five primary modalities are employed to produce the majority of diagnostic images in Australia. The choice of modality is influenced by the nature and location of the patient's condition and the evidence or information the doctor is seeking. In the case of MRI, CT and diagnostic radiology, the diagnostic imaging procedure is undertaken by an accredited radiographer who operates the specialised equipment. The images are then assessed by a radiologist to detect, diagnose and monitor a patient's medical condition.

Diagnostic imaging modalities in FY17

Proportion of procedures | **Proportion of Medicare payments**



Source: Medicare Benefits Schedule (MBS).

126 Further, interventional radiology (IR), where the radiologist assists other medical specialists (for example surgeons) in the diagnosis and treatment of conditions such as cancer and arthritis, is a growing area. IR refers to a range of techniques which rely on the use of radiological image guidance (X-ray fluoroscopy, ultrasound, CT or MRI) to help target therapy. Most IR treatments are minimally invasive alternatives to open and laparoscopic (keyhole) surgery. Many IR procedures involve passing a needle through the skin to the target.

127 The costs of providing diagnostic imaging procedures also vary by modality as shown in the following chart, with services such as X-rays costing a fraction of the more complex modalities such as MRI, CT scans and PET.

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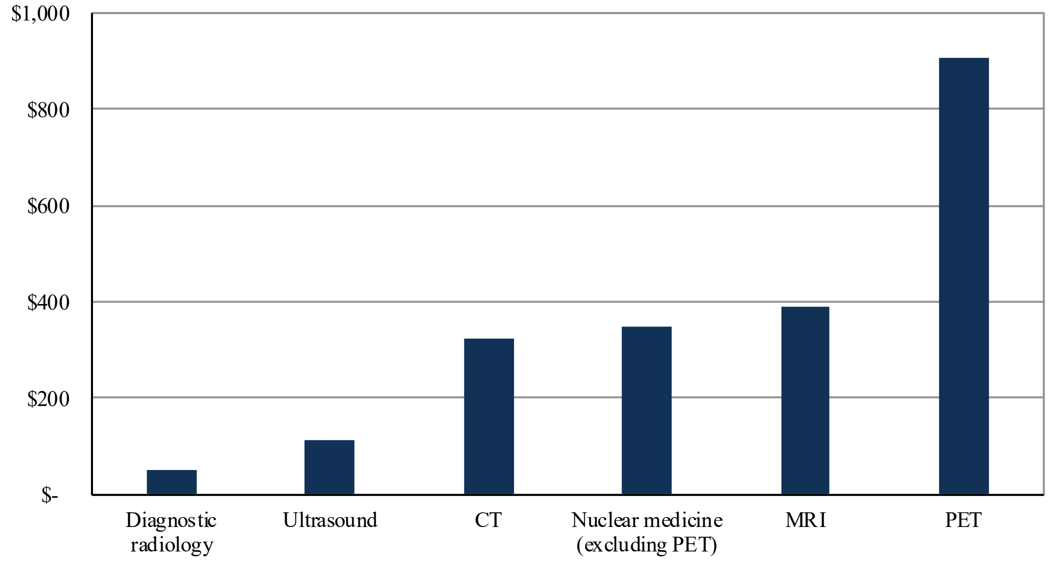
33 Source: AIHW (2017) *Health Expenditure in Australia 2015-16.*

34 Source: Australian Bureau of Statistics (ABS).

Average cost of modalities[1]



Note:
1 Information relates to FY17, with the exception of PET for which FY16 is the latest available year.
Source: MBS.

Radiology (X-ray)

128 X-rays are a form of electromagnetic radiation emitted when matter is bombarded with electrons. X-rays have wavelengths shorter than that of ultraviolet radiation. An X-ray image, also called a radiograph, is produced by passing a very small amount of radiation through the body and onto a film or detector on the other side. Harder tissues, like bones, stop the X-rays more efficiently than soft tissues, therefore X-rays are often used to detect breaks or fractures. X-rays can also provide images of some soft tissues, particularly the lungs.

129 A mammogram is a low dose X-ray image that provides detail of the internal structure of the breast. Mammograms are used to detect early forms of breast cancer without symptoms, and to detect and diagnose breast disease in people experiencing symptoms such as a lump, pain or nipple discharge. Mammography plays a key role in the early detection of breast cancers as it can show changes in the breast tissue before a patient or doctor can feel them.

Computed tomography (CT)

130 A CT scan uses special X-ray equipment to obtain multiple images of the body from different angles. Special computer processing is then used to generate cross-sectional and three dimensional images of a particular organ or area of the body. CT scans provide better images than regular X-rays (i.e. it can image every type of body structure at once, including bone, blood vessels and soft tissue) and is often used to detect cancer, cardiovascular disease, dementia, pneumonia, abnormalities in the chest and bleeding in the brain.

Ultrasound

131 Ultrasound uses high frequency sound waves which are bounced off soft tissue structures to produce detailed real-time images of the body. It is used to gain information about a variety of conditions, including pregnancy, gallstones and varicose veins and has no known harmful

effects. Ultrasound imaging is generally undertaken by a sonographer, with images assessed by a radiologist. Referred ultrasound services may also be provided by sonologists (medical specialists with ultrasound expertise) with backgrounds other than in radiology.

Magnetic resonance imaging (MRI)

132 MRI uses very powerful magnetic field and radio-frequency pulses to collect information. A computer then uses this to form images. MRI gives a detailed view of the soft tissues, such as muscles, ligaments, brain tissue, discs and blood vessels. The most frequent uses are head, neck and spine imaging. The magnetic field has no known side effects but it does interact with metal, so some patients with cardiac pacemakers, cerebral aneurysm clips, vascular stents, infusion pumps, neurostimulators and cochlear implants cannot be scanned (noting that most metal implanted at surgery is safe).

Nuclear medicine

133 Nuclear medicine uses very small amounts of radioactive materials to diagnose and sometimes treat disease. Radiopharmaceuticals are attracted to specific parts of the body and they emit gamma radiation which is detected by a gamma camera. Nuclear medicine records information on organ function and structure, as opposed to X-rays which only show structure. It is usually able to detect conditions earlier than other tests allowing earlier treatment and can be used to investigate bones as well as all major organs. Nuclear medicine imaging is undertaken by a nuclear medicine technologist, with the images assessed by a nuclear medicine physician or a radiologist who has undertaken additional specialised training.

134 PET is a precise imaging procedure often used as a tool for cancer diagnosis, staging and monitoring. It is also used to help in the diagnosis of brain disorders and heart conditions. PET essentially administers small amounts of radioactive material to the patient, which helps identify different structures within the body.

Referrers and providers

135 Diagnostic imaging services require a referral from a GP, medical specialist or allied health professional (collectively defined as Referrers) in order for a Medicare benefit to be paid. The Referrer usually specifies the type of imaging to be provided. Images and reports prepared by the diagnostic imaging provider are passed to the Referrer to assist in the diagnosis and associated management plans of patient conditions.

136 When making referrals, doctors select a radiology practice based on a range of factors including quality, convenience, price, location, services available and clinical relationship with the reporting radiologist. While patients may elect to be treated at a provider of their own preference, patients often follow the recommendation of the Referrer in selecting a diagnostic imaging provider.

Medical consultations

137 The number of GP consultations has increased at a CAGR of 3.1% from 95.9 million in FY07, to 130.0 million in FY17. This is attributable to both population growth and an increasing number of GP consultations per person, which have increased from 4.58 to

5.25 per person (CAGR of 1.4%) over the last ten years[35]. Medical specialist consultations have also increased at a CAGR of 3.7% over the ten years to FY17[36].

Hospitals

138 Hospital referrals are typically provided by a medical specialist and may be provided to admitted patients (inpatients) and patients who are referred, but not admitted, to hospital for treatment (outpatients). Patients may use a referral to obtain services from any diagnostic imaging provider, although services to inpatients are typically performed by the hospital's onsite diagnostic imaging provider.

Providers

139 There are around 2,100 locations in Australia which provide diagnostic imaging services[37]. In Australia, diagnostic imaging services are performed in public and private hospitals, and in private (non-hospital) clinics, with hospitals generally offering a more comprehensive range of services (including more complicated and specialist services) than private clinics:

(a) **private hospitals** – diagnostic imaging services are typically performed by a third party operator with an exclusive agreement to lease a designated area of the hospital. The third party operator is permitted to undertake diagnostic imaging procedures for both inpatients and outpatients

(b) **public hospitals** – diagnostic imaging providers in public hospitals generally focus on inpatient diagnostic imaging services, although outpatient services are sometimes undertaken. In some cases, patients may elect to be treated as a private patient

(c) **private clinics** – private clinics focus on outpatient diagnostic imaging services and may be located in close proximity to hospitals, other medical facilities or in a suburban location. Private clinics are typically smaller than clinics located in hospitals and tend to offer a smaller range of services (i.e. generally focussing on radiology, ultrasound and lower end CT scans).

Technical professionals

140 The major professional group involved in diagnostic imaging in Australia is radiologists. Radiologists are medical practitioners who have at least two years of general hospital experience as an intern or resident, followed by a minimum of five years of specialist training in a program accredited by the Royal Australian and New Zealand College of Radiologists (RANZCR). Once accredited by RANZCR, radiologists may choose to undertake further sub-speciality training to focus on particular services or areas of the human body such as interventional radiology, breast imaging or paediatric imaging. In order for Medicare benefits to be payable for diagnostic imaging services and reports the radiologist must hold a current Medicare provider number[38].

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35 Source: Medicare Group Report (by Broad Type of Service). Downloaded 15 December 2017.

36 Source: Medicare Group Report (by Broad Type of Service). Downloaded 15 December 2017.

37 Source: RANZCR (February 2017) *Radiology at a Glance 2016 Australia*.

38 A separate number is required for each location at which the radiologist works.

141 Other professional groups involved in diagnostic imaging in Australia are:

(a) **radiographers** – also known as medical imaging technologists, radiographers facilitate patient diagnosis through the creation of medical images

(b) **sonographers** – utilise ultrasound to undertake diagnostic medical sonographic examinations

(c) **nuclear medicine technologists** – assist radiologists by preparing and administering radioactive chemical compounds used to take diagnostic images.

Funding

142 The diagnostic imaging industry in Australia is funded primarily by the Federal Government through the Medicare program and by private co-payments received from either patients or private health insurers. The balance is funded by other sources such as State Governments (in the case of public hospital inpatients), the Australian government's Department of Veterans' Affairs and workers compensation insurers.

Medicare

143 Medicare pays healthcare service providers according to a schedule of fees (known as the Medicare Benefits Schedule or MBS) which nominates a fee for each of the approximately 870 diagnostic imaging items listed on the MBS. The proportion of the nominal fee per item that is reimbursed by Medicare depends on whether the patient is an inpatient or outpatient, and whether the provider bulk bills (note that the following excludes the impact of gap rebates under the Medicare Safety Net)[39]:

(a) inpatient rebate, 75% (whether or not bulk billed)

(b) outpatient rebate, not bulk billed, 85%

(c) outpatient rebate, bulk billed, 95% (or 100% in the case of MRI).

144 Annual indexation of diagnostic imaging schedule fees has not been applied since November 1998 which has resulted in a shortfall between Medicare rebates and the cost of providing services[40]. Consequently, patient gaps (i.e. out of pocket expenses) have increased over time to cover this shortfall. As announced in the 2017-18 Budget, the Federal Government will reinstate indexation of MBS fees for targeted diagnostic imaging services from 1 July 2020 including mammography, fluoroscopy, CT scans and interventional procedures.

145 The level of bulk billing has increased as a proportion of total Medicare procedures from 61% to 77% between FY07 and FY17, largely as a result of the introduction of a bulk billing incentive in 2009[41], which was increased in 2012[42]. Medicare funding now accounts for

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[39] When a medical services provider bills Medicare directly for any medical or allied health service that the patient receives, the provider accepts the relevant Medicare benefit as a full payment for the service and the patient assigns their right to a Medicare benefit to the service provider, allowing the benefit to be paid directly to the provider.

[40] Source: Australian Diagnostic Imaging Association (January 2017) *2017-18 Budget submission*.

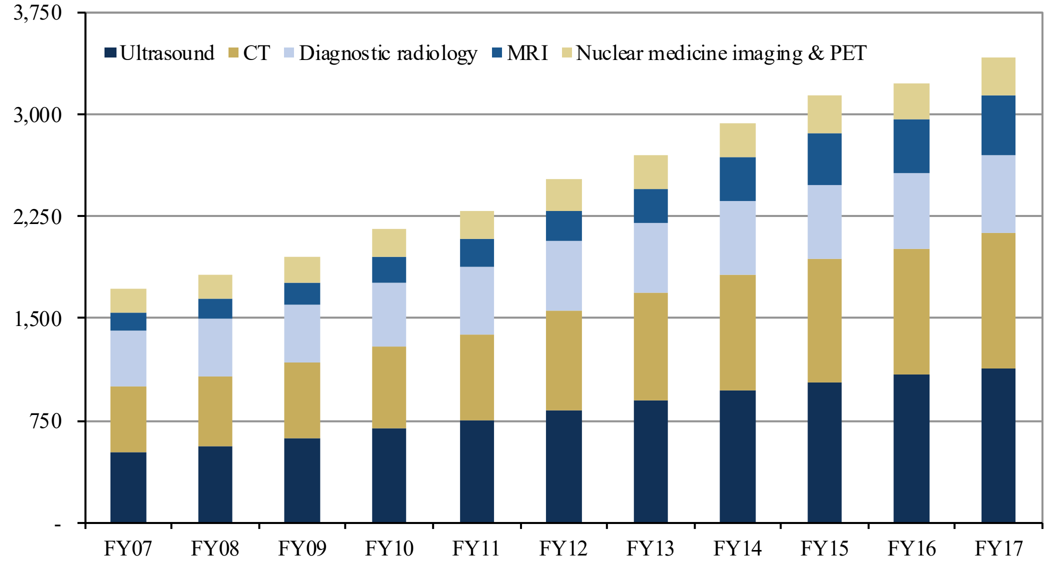
[41] From November 2009, the percentage of the schedule fee that providers were paid for bulk billing MRI services went from 85% to 95%.

[42] As part of the 2011 reform package, the bulk billing rate for MRI services went up a further 5% to 100% of the scheduled fee from 1 May 2012. Source: ANAO Report No. 12 2014-15 *Diagnostic imaging reforms*.

around 87% of funding for Medicare-related diagnostic imaging procedures[43]. Diagnostic imaging funding as a proportion of overall Medicare funding has also increased to 15.5%, up from 13.7% in FY09[43].

146 Medicare funding for diagnostic imaging procedures was $3.4 billion in FY17 and has increased at a CAGR of 7.1% over the last ten years, as shown in the following chart.

Medicare funding of diagnostic imaging procedures
($ million)



Source: MBS.

Bulk billing incentives

147 Diagnostic imaging providers in Australia currently receive incentives from the Federal Government to bulk bill patients for out of hospital services. For diagnostic imaging services other than MRI, the bulk billing incentive is 95% of the schedule fee. For MRI services, the bulk billing incentive is a 100% rebate of the schedule fee.

148 The Federal Government recently considered removing bulk billing incentives for certain healthcare services. In the Mid-Year Economic and Fiscal Outlook delivered on 15 December 2015, the Federal Government outlined savings of $650.4 million to be achieved over four years from 2015-16 by:

(a) removing bulk billing incentives for pathology services

(b) aligning bulk billing incentives for diagnostic imaging services with those that apply to GP services; and

(c) reducing the bulk billing incentive for MRI services from 15% to 10% of the MBS, thus aligning it with other diagnostic imaging services.

149 Subject to ratification in the Senate, the proposed changes were intended to become effective from 1 July 2016, however, they were subsequently delayed until 1 January 2017 and

43 Source: Medicare Statistics 2016-17.

eventually scrapped altogether as part of the Federal Government's 2017-18 Budget delivered on 9 May 2017.

MBS review

150 On 22 April 2015, the Federal Government announced that a review of the MBS would be undertaken to ensure that the more than 5,700 items on the MBS were aligned with contemporary clinical evidence and practice, thereby ensuring better health outcomes for patients. While the review process is currently in progress, certain recommendations regarding diagnostic imaging services have already been provided to and implemented by the Federal Government. These include restrictions on bone densitometry tests for osteoporosis for patients aged 70 years or over and restrictions and limits on allied health professionals requesting spinal X-ray items (both implemented on 1 November 2017).

MRI licences

151 The Federal Government controls funding for MRI procedures through Medicare, which will only make a payment under the MBS where the procedure is performed on an MRI machine which is eligible for a Medicare rebate (known as a Medicare eligible licence). MRI machine licences are categorised as:

(a) **full Medicare eligible licence (Full Licence)** – full Medicare-eligible MRI units may provide all the MRI items listed on the MBS with a Medicare rebate for the patient

(b) **partial Medicare eligible licence (Partial Licence)** – eligible MRI units may only provide a subset of MRI items listed on the MBS for which there is a Medicare benefit.

152 There are currently 341 licenced and operational MRI machines in Australia, of which 168 operate under a Full Licence and 173 operate under a Partial Licence[44]. The number of eligible MRI machines in Australia has increased substantially in recent years due to MRI expansion initiatives implemented by the Federal Government as part of the reform package that was introduced in the 2011-12 Budget. Prior to the reform package announcement there were 125 eligible MRI machines in Australia[45].

Aged equipment

153 The Federal Government has implemented capital sensitivity measures to improve the quality of diagnostic imaging services by encouraging providers to upgrade and replace ageing equipment. Under the capital sensitivity rules, the Medicare reimbursement for diagnostic imaging procedures provided on equipment over a certain age is reduced by approximately 50%. The reduction applies after ten to 15 years for most diagnostic imaging equipment, although eligibility for full Medicare reimbursement may be extended by an additional five to ten years if the equipment is upgraded within the specified effective life.

Private health insurance

154 As at September 2017, 55% of the Australian population (13.5 million people) held private health insurance[46]. The Australian Government encourages the uptake of private health insurance through a number of initiatives such as the private health insurance rebate, Lifetime

[44] Source: Australian Government – Department of Health website: http://www.health.gov.au/internet/main/publishing.nsf/Content/mri-index. Accessed 18 December 2017.

[45] Source: ANAO Report No. 12 2014-15 *Diagnostic imaging reforms.*

[46] Source: Private Health Insurance Administration Council (2017) *Quarterly statistics September 2017.*

Health Cover and the Medicare levy surcharge. In Australia, private health insurance is not "risk-rated" like most forms of insurance. Private health insurers cannot refuse to insure any person, and must charge everyone the same premium for the same level of cover, despite their specific risk profile and likelihood of using health services.

155 When a diagnostic imaging provider chooses not to bulk bill and charges the patient an amount greater than the Medicare reimbursement, a private co-payment will be required to cover the gap between the Medicare funding and the total cost of the procedure. In the case of an outpatient, the private co-payment is funded by the patient. In the case of an inpatient, the patient is typically able to recover part or all of the private co-payment from their private health insurer. The amount of funding contributed by the patient's private health insurer is regulated by an agreement negotiated between the private health insurer and the diagnostic imaging provider.

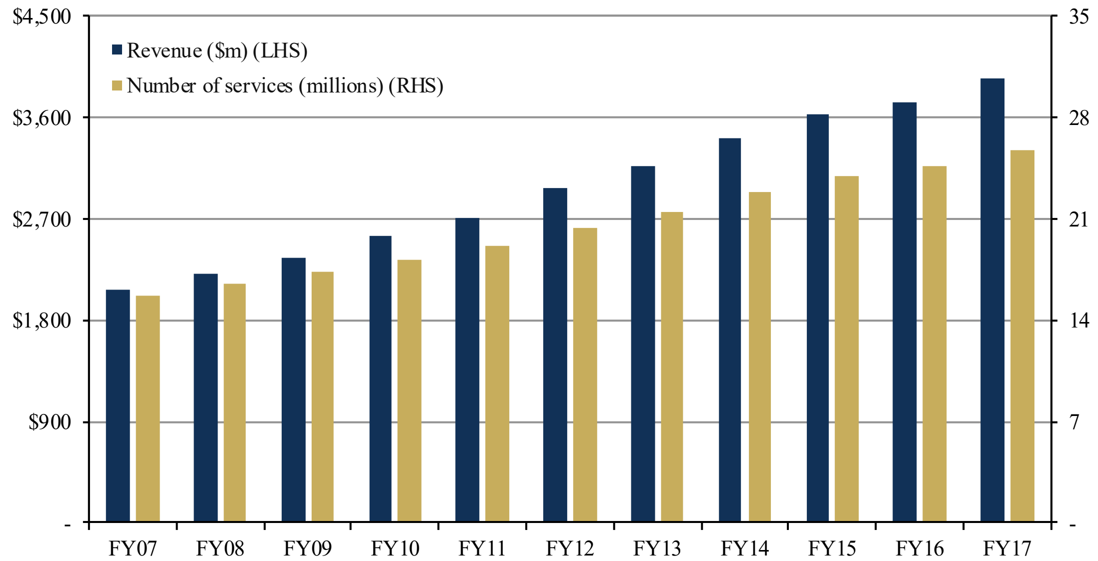
Public hospitals

156 Diagnostic imaging procedures undertaken in public hospitals for inpatients are typically provided at no cost to the patient and are typically not eligible for Medicare funding. Public hospitals are funded by State Governments and accordingly inpatient diagnostic imaging procedures are funded by the hospital, including where the public hospital has outsourced its diagnostic imaging services to a private provider.

Historical industry performance

157 Revenue for diagnostic imaging services has increased at a CAGR of 6.6% over the ten years to FY17 to reach $3.9 billion, as shown in the following chart.

Diagnostic imaging services and revenue

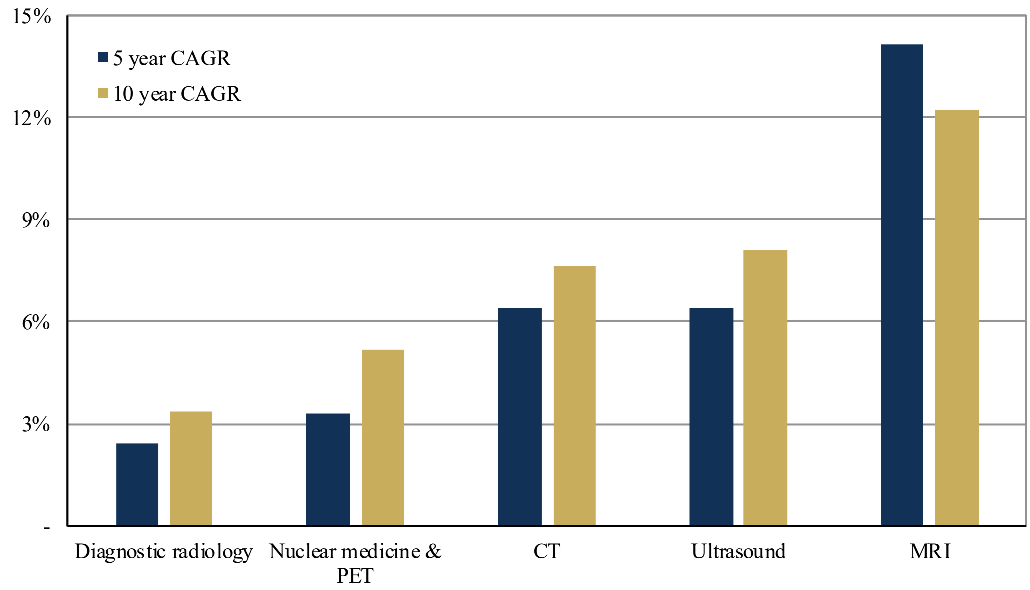


Source: Medicare.

158 Growth over this period is largely attributable to a 5.1% CAGR in the number of services provided, which reflects the increasing clinical utility of diagnostic imaging in patient management, driven by increased patient access, the ageing population and technological advancements allowing for a wider range of targeted diagnosis. Growth has also been

favourably impacted by increased utilisation of high cost modalities, most notably MRI, as set out below.

Growth in value of modality revenue

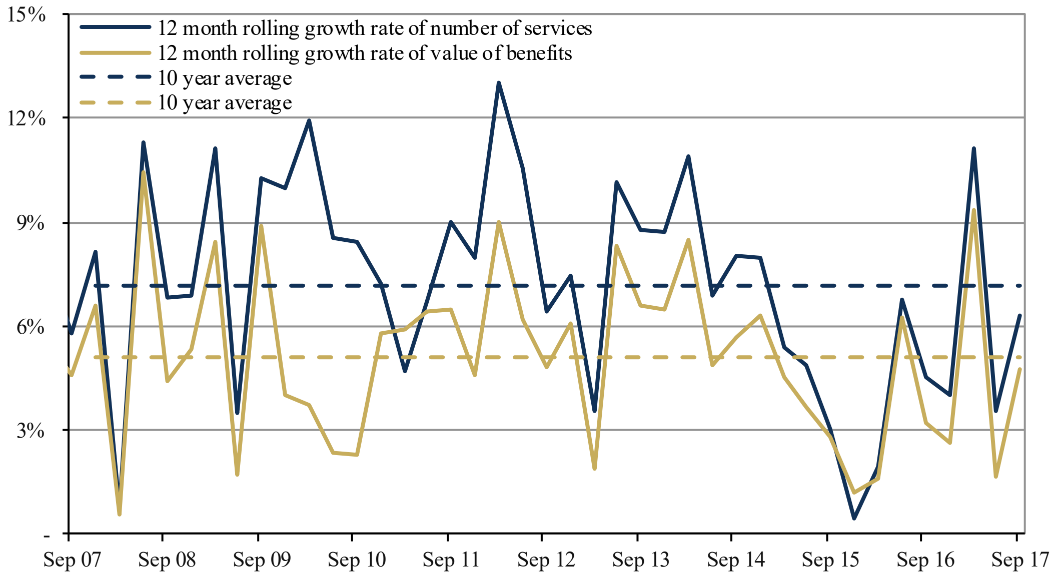


Source: Medicare.

159 The number and value of MRI services has outpaced diagnostic imaging industry growth due to supportive Government reforms that have increased the number of MRI machines eligible for Medicare rebates. Notwithstanding this, Australia still lags the average number of MRI procedures per thousand of population undertaken by countries in the Organisation for Economic Co-operation and Development.

160 Notwithstanding positive industry tends over the longer term, uncertainty surrounding the proposed changes to Medicare funding, which commenced in April 2015 (as discussed above), as well as media coverage claiming unnecessary testing and industry speculation with respect to Medicare auditing GPs and specialists, impacted referrals negatively. As a result the volume of diagnostic imaging services provided and value of benefits paid by Medicare both dropped to below longer term industry trends. Industry volumes have since recovered, however are still marginally below long term trends.

Diagnostic imaging industry volume growth



Source: Medicare.

Industry structure and competition

161 The revenue share of the diagnostic imaging market by State and Territory, as well as the major diagnostic imaging providers within these regions, are shown below:

Key participants

State or territory	Revenue share	Key providers
NSW / ACT	36.5%	I-MED, Primary Health Care, Sonic Healthcare
Victoria	25.0%	I-MED, Primary Health Care, Capitol Health, Integral Diagnostics
Queensland	20.1%	I-MED, Primary Health Care, Sonic Healthcare, Integral Diagnostics
WA	9.1%	Perth Radiological Clinic, Sonic Healthcare, Integral Diagnostics
South Australia	6.8%	Dr Jones (I-MED JV), Benson
Tasmania	1.9%	I-MED, Radiology of Tasmania
Northern Territory	0.6%	I-MED

Source: IBISWorld and LEA analysis.

162 The Australian diagnostic imaging industry consists of a broad range of providers, including:

(a) large corporatised providers that operate across many States and Territories

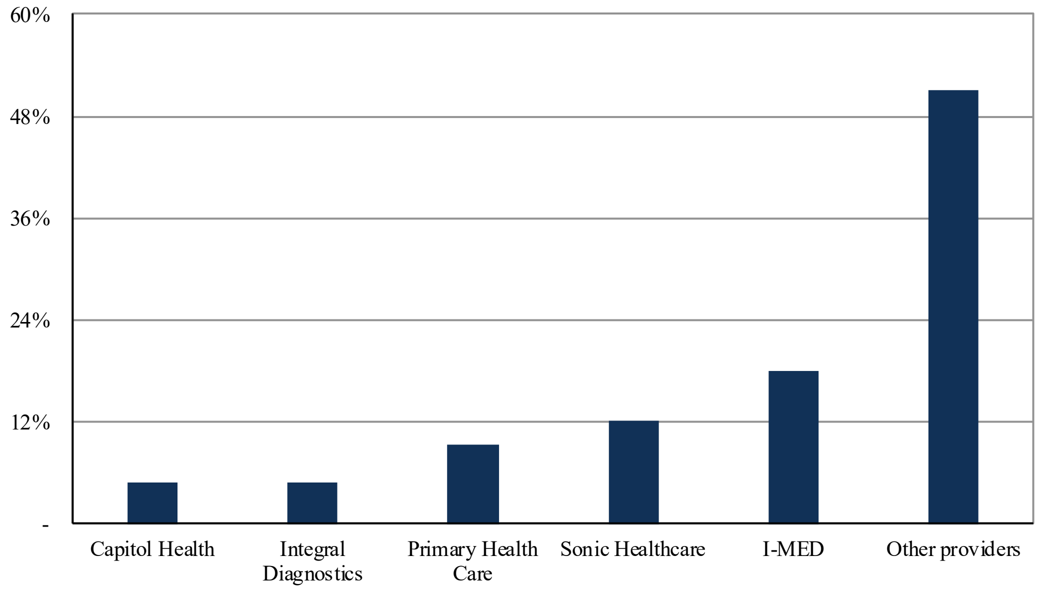
(b) smaller corporatised providers that are typically focused on more discrete regions

(c) a number of multi-radiologist partnerships that are generally focused on a single region or metropolitan area; and

(d) a large number of small radiologist-owned providers that tend to operate one or a small number of clinics in discrete geographic locations.

163 As shown below, while the five largest diagnostic imaging providers account for around 49% of industry revenue, the balance of the industry is represented by a large number of smaller radiologist-owned providers.

Diagnostic imaging services industry participants



Source: IBISWorld and LEA analysis.

164 Consolidation in the industry is expected to continue due to increasing capital intensity, increasing demand for complex modalities, the benefits of scale that larger corporate operators can extract from their networks such as investment in systems and technology (to allow sites to deliver high quality services to patients and Referrers), sharing best practice techniques across the network of sites and procuring and utilising equipment more efficiently across a network of sites.

165 Industry participants tend to compete on a range of factors, including quality of services (including access to latest technologies / equipment and the range of services provided in a single location), relationships with hospitals and Referrers and reputations of radiologists, including expertise in several modalities.

Growth drivers

166 Growth in the Australian diagnostic imaging industry is underpinned by a number of socio-economic and macro-economic factors, including a growing and ageing population, improving technology, a continuation in the trend towards prevention and early diagnosis and a shift to more complex modalities.

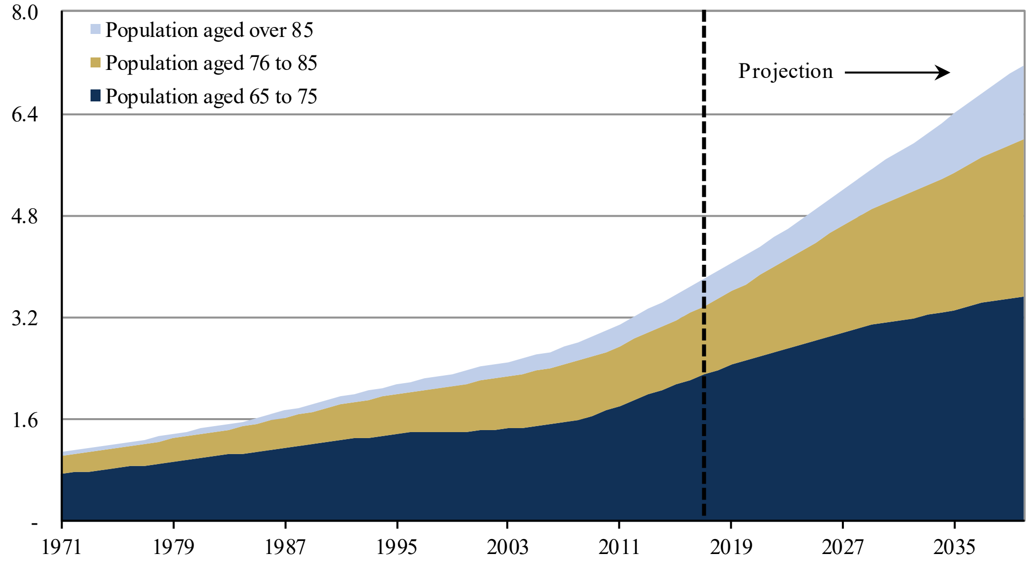
Population growth and ageing

167 Australia's population has grown at a CAGR of 1.7% over ten years to FY17, which ranked among the highest in the developed world[47]. In addition to a growing population, Australia's population is ageing at an increasing rate. The number of Australians aged 65 and over is projected to increase at a CAGR of 2.8% per annum from around 3.8 million in FY17 (or

47 ABS 3101 and LEA analysis.

15% of the total population), to around 7.2 million (or 20% of the total population) by FY40[48].

Projected increase in the population aged 65 and over
Millions



Source: ABS 3222 and 3101.

168 The combination of an ageing Australian population and the high correlation between age and disease and chronic illness provides medium to long term support for diagnostic imaging services.

Technological advances

169 Diagnostic imaging has transformed patient care, and thus the practice of medicine, by improving diagnosis and treatment and avoiding unnecessary invasive procedures. This in turn lowers costs through, for example, reducing unnecessary hospital admissions. Modern developments in technology have expanded the range of clinical indications for which diagnostic imaging equipment can be used. There are further opportunities to harness technology to the benefit of the industry through:

(a) increased computer processing speeds, which provides the ability to provide faster and better quality images

(b) better 3-D and 4-D images, which has the potential to increase the use of diagnostic imaging services

(c) faster CT and MRI scans (which has the potential to increase capacity and lower costs)

(d) improved accuracy and capability of imaging techniques

(e) reduction in the dose of radiation required to acquire CT images

(f) large data management and artificial intelligence developments that assist with interrogating data, help improve accuracy and efficiency and augment radiologist expertise.

48 ABS 3222 and LEA analysis.

Government policy

170 Medical imaging is generally less expensive and safer than alternative invasive procedures, such as exploratory surgery. This is reflected in the trend in public policy to manage the Australian healthcare spending burden and improve patient outcomes by focussing on early detection and prevention. These policy changes have included:

(a) allowing GPs to refer for MRI services

(b) increasing the Medicare rebate for bulk billing of outpatient diagnostic imaging procedures; and

(c) increasing the number of licenced MRI machines.

VI Valuation methodology

Valuation approaches

171 RG 111 outlines the appropriate methodologies that a valuer should consider when valuing assets or securities for the purposes of, amongst other things, share buy-backs, selective capital reductions, schemes of arrangement, takeovers and prospectuses. These include:

(a) the DCF methodology

(b) the application of earnings multiples appropriate to the businesses or industries in which the company or its profit centres are engaged, to the estimated future maintainable earnings or cash flows of the company, added to the estimated realisable value of any surplus assets

(c) the amount that would be available for distribution to shareholders in an orderly realisation of assets

(d) the quoted price of listed securities, when there is a liquid and active market and allowing for the fact that the quoted market price may not reflect their value on a 100% controlling interest basis

(e) any recent genuine offers received by the target for any business units or assets as a basis for valuation of those business units or assets.

172 Under the DCF methodology the value of the business is equal to the net present value (NPV) of the estimated future cash flows including a terminal value. In order to arrive at the NPV the future cash flows are discounted using a discount rate which reflects the risks associated with the cash flow stream.

173 Methodologies using capitalisation multiples of earnings or cash flows are commonly applied when valuing businesses where a future "maintainable" earnings stream can be established with a degree of confidence. Generally, this applies in circumstances where the business is relatively mature, has a proven track record and expectations of future profitability and has relatively steady growth prospects. Such a methodology is generally not applicable where a business is in start-up phase, has a finite life, or is likely to experience a significant change in growth prospects and risks in the future.

174 Capitalisation multiples can be applied to either estimates of future maintainable operating cash flow, EBITDA, EBITA, EBIT or net profit after tax. The appropriate multiple to be applied to such earnings is usually derived from stock market trading in shares in comparable companies which provide some guidance as to value and from precedent transactions within the industry. The multiples derived from these sources need to be reviewed in the context of the differing profiles and growth prospects between the company being valued and those considered comparable. When valuing controlling interests in a business an adjustment is also required to incorporate a premium for control. The earnings from any non-trading or surplus assets are excluded from the estimate of the maintainable earnings and the value of such assets is separately added to the value of the business in order to derive the total value of the company.

175 An asset based methodology is applicable in circumstances where neither a capitalisation of earnings nor a DCF methodology is appropriate. It can also be applied where a business is no longer a going concern or where an orderly realisation of assets and distribution of the proceeds is proposed. Using this methodology, the value of the net assets of the company are adjusted for the time, cost and taxation consequences of realising the company's assets.

Methodologies selected

176 The market value of Integral Diagnostics has been assessed by aggregating the market value of the business operations, together with the realisable value of any surplus assets and deducting net borrowings.

177 The valuation of the business has been undertaken on the basis of market value as a going concern. The primary valuation methodology used to determine the enterprise value of Integral Diagnostics is the capitalisation of future maintainable earnings approach (using EBITDA). Under this methodology, the value of the business is represented by its (normalised) underlying EBITDA capitalised at a rate (or EBITDA multiple) reflecting the risks inherent in those earnings.

178 We have adopted this method when valuing the business operations of Integral Diagnostics for several reasons:

(a) Integral Diagnostics has both a demonstrated history of profitability and an expectation of ongoing profitability

(b) Integral Diagnostics operates in a relatively mature (albeit growing) industry, in which it has well established market positions in the geographies in which it operates

(c) the EBITDA multiples for listed companies operating in the healthcare sector can be derived from publicly available information

(d) transaction evidence in the healthcare sector is generally expressed in terms of EBITDA multiples.

179 As a secondary valuation methodology we have also assessed the enterprise value of Integral Diagnostics adopting the DCF methodology, based on cash flow projections prepared by Integral Diagnostics management (which we have adjusted where appropriate).

180 We have cross-checked our valuation of Integral Diagnostics by comparison with the listed market prices of Integral Diagnostics shares on the ASX prior to the announcement of the intention to make the Offer, which we have adjusted to reflect a premium for control.

181 For the purpose of assessing the value of the consideration we have had primary regard to the recent listed market prices of Capitol Health shares. This is principally because the listed market prices of Capitol Health shares are likely to represent a reasonable proxy for the amount that Integral Diagnostics shareholders could expect to realise if they sold any Capitol Health shares received as consideration either immediately or in the short term.

182 We have also cross-checked the reasonableness of our assessed value of Capitol Health shares being offered as consideration by reference to implied earnings multiples.

VII Valuation of Integral Diagnostics

183 As stated in Section VI, in assessing the enterprise value of Integral Diagnostics we have:

(a) adopted the capitalisation of EBITDA method as our primary valuation method. Under this method the normalised (underlying) EBITDA is capitalised at an appropriate EBITDA multiple

(b) as a secondary valuation method adopted the DCF methodology, based on cash flow projections prepared by Integral Diagnostics management (which we have adjusted where appropriate).

184 The value of the shares in Integral Diagnostics is then derived by adding the realisable value of any surplus assets and deducting net borrowings.

185 The resulting values have been cross-checked by reference to the listed market prices of Integral Diagnostics shares on the ASX prior to the announcement of the intention to make the Offer, which we have adjusted to reflect a premium for control.

Capitalisation of EBITDA methodology

Assessment of normalised EBITDA

186 In order to assess the appropriate level of EBITDA for valuation purposes we have had regard to the historical and forecast results of the business, and have discussed the financial performance, operating environment and prospects with Integral Diagnostics management.

187 A summary of Integral Diagnostics revenue and underlying EBITDA for the three years ended FY17 and 1HY18, is set out below:

Integral Diagnostics – historical performance	FY15 $m	FY16 $m	FY17 $m	1HY18 $m
Revenue	160.0	167.8	179.7	93.6
Underlying EBITDA (before significant items)	34.6	35.2	33.5	19.0
Revenue growth	6.7%	4.9%	7.1%	5.8%
Underlying EBITDA growth	12.6%	1.8%	(4.9%)	12.4%
Underlying EBITDA margin	21.6%	21.0%	18.6%	20.3%

188 Revenue increased relatively consistently over the two years to FY17, however underlying EBITDA decreased (both in dollar and percentage margin terms). We understand that this was primarily attributable to challenging industry conditions due to adverse Federal Government policy initiatives (which reduced referrals and hence patient volumes to below their long term trend), as well as increased competition at select locations. This situation was compounded by overstaffing in FY17, with employee numbers at levels more appropriate for (and in expectation of) higher volumes of patient examinations.

189 In its FY17 results announcement dated 24 August 2017, Integral Diagnostics stated the following in respect to FY18:

"The Company's focus for FY18 is to:

- *Improve utilisation of existing capacity and infrastructure*
- *Contain costs so revenue growth delivers improved returns*
- *Develop dedicated sub-specialty centres (such as the recently opened Spine Clinic)*
- *Execute value accretive acquisition."*

190 On 19 January 2018, Integral Diagnostics released its 1HY18 results that reflected operating revenue and underlying EBITDA increases of 5.8% and 12.4% respectively in comparison to the previous half year period. This improved operating performance was attributable to a number of initiatives to reduce costs and increase efficiency, including the integration of the Western District Radiology and South West MRI businesses, a reduction of labour costs through better roster management and flexible staffing arrangements, employing technology such as voice recognition and tele-radiology, consolidation of software systems and call centre operations, as well as more efficient supply chain management. The Company also advised that it would be making further investment in organic growth (e.g. investment in PET scans, cardiac CT, centres of excellence) and earnings accretive acquisitions.

191 The half year results announcement also provided the following earnings guidance for FY18:

"As announced on 12 January 2018 the Company now expects achievement of full year normalised NPAT growth of around 20% (before takeover response costs and transaction costs) (FY17: $15.1m)."

192 Further earnings guidance in respect of FY18 has been provided in the Target's Statement (being released concurrent with this report). Based on trading to date subsequent to the release of the 1HY18 results, Integral Diagnostics management estimate:

(a) FY18 forecast EBITDA in the range of $38.0 million to $39.0 million

(b) pro forma FY18 forecast EBITDA in the range of $42.0 million to $43.0 million. The pro forma earnings estimate reflects the full-year benefit of a number of initiatives commenced in FY18.

Conclusion on EBITDA

193 Having regard to the above, we have adopted EBITDA for valuation purposes of $42.0 million. This reflects in particular:

(a) 1HY18 EBITDA of $19.0 million and the material improvement in 1HY18 earnings in comparison to the previous half year period

(b) Integral Diagnostics management's FY18 forecast EBITDA range of $38.0 million to $39.0 million[49], which reflects an inherent assumption that EBITDA for the second half of FY18 is expected to be no less than achieved in 1HY18

(c) allowance for the full year earnings benefit of the cost savings and efficiency initiatives implemented to date, on the assumption that these initiatives had been introduced effective 1 July 2017.

EBITDA multiple

194 The selection of the appropriate EBITDA multiple to apply is a matter of judgement but normally involves consideration of a number of factors including, but not limited to:

- The stability and quality of earnings
- The quality of the management and the likely continuity of management
- The nature and size of the business
- The spread and financial standing of customers
- The financial structure of the company and gearing level
- The multiples attributed by share market investors to listed companies involved in similar activities or exposed to the same broad industry sectors
- The multiples that have been paid in recent acquisitions of businesses involved in similar activities or exposed to the same broad industry sectors
- The future prospects of the business including the growth potential of the industry in which it is engaged, strength of competitors, barriers to entry, etc.
- The cyclical nature of the industry
- Expected changes in interest rates
- The asset backing of the underlying business of the company and the quality of the assets
- The extent to which a premium for control is appropriate
- Whether the assessment is consistent with historical and prospective earnings

195 We discuss below specific factors taken into consideration when assessing the appropriate EBITDA multiple range for Integral Diagnostics.

Listed company multiples

196 A summary of the EBITDA multiples for the listed companies operating in the Australian healthcare sector is set out below[50]:

49 We note this earnings range is consistent with consensus analyst EBITDA estimates for FY18 of $38.6 million.

50 We have also had regard to international diagnostic imaging companies. However, these companies / businesses operate in different geographic regions and are therefore subject to different economic cycles and healthcare markets (i.e. with respect to government and private healthcare payments and associated regulatory factors). Accordingly, we have not placed any reliance on the trading multiples of these companies.

Listed company trading multiples[(1)]					
		Enterprise	EBITDA multiples		
		value	FY17	FY18	Forecast
	Sub sector	$m	x	x	growth[(2)]
Integral Diagnostics	Diagnostic imaging	323	9.6	8.7	7.4%
Capitol Health	Diagnostic imaging	191	13.3	9.0	17.1%
Australian healthcare companies					
Sonic Healthcare	Pathology / other[(3)]	12,697	14.6	13.3	7.6%
Primary Healthcare	Medical centres / other[(4)]	2,663	8.6	8.9	1.8%
Virtus Health	In vitro fertilisation	587	9.2	8.6	5.4%
Monash IVF Group	In vitro fertilisation	399	8.2	8.8	0.4%
Pacific Smiles Group	Dentistry	243	11.6	10.5	13.9%
1300SMILES	Dentistry	148	11.9	10.1	10.7%

Note:
1 Enterprise value and earnings multiples calculated as at 16 February 2018 except for Integral Diagnostics and Capitol Health which are calculated as at 28 November 2017, being the last trading day prior to the announcement of the intention to make the Offer.
2 CAGR for EBITDA over the three years to FY20.
3 Diagnostic imaging represents 8.6% and 7.5% of FY17 revenue and EBITDA respectively.
4 Diagnostic imaging represents 19.8% and 18.6% of FY17 revenue and EBITDA respectively.
Source: Bloomberg, latest full year statutory accounts, latest interim accounts, company announcements and LEA analysis.

197 In relation to the above multiples we note that:

(a) the above multiples are based on the listed market price of each company’s shares and therefore exclude a premium for control. Empirical evidence undertaken by LEA indicates that the average premium paid above the listed market price in successful takeovers in Australia ranges between 30% and 35% (assuming the pre-bid market price does not reflect any speculation of the takeover). This broadly translates to a premium of 20% to 25% at the EBITDA multiple or enterprise value level, although this varies depending on the level of debt funding employed in each company

(b) the implied EBITDA multiples for companies operating in the Australian healthcare industry are relatively high and have been underpinned by historical healthcare industry growth of 7.0% over the ten years to FY16[51]. Future growth is also supported by a number of socio-economic and macro-economic factors, including a growing and ageing population and a general expectation for high quality healthcare services

(c) as shown above, those companies with the highest growth expectations typically trade at higher implied EBITDA multiples than those with lower growth expectations.

198 With regard to the Australian listed healthcare companies generally we note that:

(a) these incorporate a range of healthcare related industries, including hospital and day surgeries, medical diagnostics, medical centres, in vitro fertilisation, dental and pathology

51 The latest available data.

(b) these companies are generally exposed to the same industry drivers and market trends as Integral Diagnostics (e.g. healthcare related expenditure and an ageing population), but are also driven by sector specific factors

(c) the in vitro fertilisation and dentistry companies share some similarities to the diagnostic imaging industry, such as operating clinics and providing similar services (for example, dentists use X-rays and in vitro fertilisation specialists use ultrasounds etc.). However these sectors of the healthcare industry are also driven by industry specific trends unrelated to diagnostic imaging.

Integral Diagnostics trading multiples

199 We have also considered the observed trading multiples of Integral Diagnostics over time. We set out below the one year forecast EBITDA multiple[52] for Integral Diagnostics (based on consensus analyst forecasts) from listing on the ASX on 21 October 2015 until 28 November 2017[53]:

Integral Diagnostics – one year forecast EBITDA multiple
21 October 2015 to 28 November 2017

Source: Bloomberg and LEA analysis.

200 As indicated above, Integral Diagnostics shares have generally traded between 6.5 and 8.0 times forecast EBITDA, with an average of 7.2 times. However, over the three months trading prior to the announcement of the intention to make the Offer this range increased to between 7.1 and 8.6 times forecast EBITDA, with an average of 7.8 times.

201 Consistent with the listed companies above, these multiples also exclude a premium for control. Adjusting for a 20% to 25% control premium (at the enterprise value level) would broadly imply an average controlling interest EBITDA multiple for Integral Diagnostics of around 8.8 times (over the period since listing) and 9.6 times (over the last three months).

52 Being the enterprise value divided by EBITDA forecast for the subsequent 12 months.

53 Being the announcement date of the intention to make the Offer.

202 In this regard, we note that on 19 January 2018 Integral Diagnostics significantly upgraded its FY18 guidance (with further clarification of this improved earnings performance provided in the Target's Statement). The improved financial performance and future prospects announced were previously unavailable to share market analysts and investors and accordingly would not have been reflected in share market trading in Integral Diagnostics and the implied EBITDA trading multiples.

Transaction evidence

203 There have been a number of transactions in the private healthcare sector in recent years, including a number in the diagnostic imaging sector. A summary of the EBITDA multiples implied by these transactions (which reflected the acquisitions of controlling interests) is set out below:

Transaction evidence[(1)]	Enterprise value[(2)] $m	EBITDA multiple[(3)] x
Australian diagnostic imaging companies		
Range	24.7 – 1,260.0	7.5 – 11.3
Simple average	216.6	8.5
Median	30.1	8.0
Other Australasian healthcare services companies		
Range	21.5 – 2,733.5	6.3 – 13.7
Simple average	450.0	9.8
Median	156.6	9.0

Note:
1 Further details are set out in Appendix D.
2 On a 100% basis.
3 Represents forecast multiples where available, otherwise historical multiples are used.

204 In relation to this transaction evidence it should be noted that:

(a) most of the transactions related to the acquisition of 100% of the businesses and therefore implicitly incorporated a premium for control

(b) the multiples for transaction evidence in the Australian diagnostic imaging sector range between 7.5 and 11.3 times EBITDA, with an average of 8.5 times EBITDA. However, of the seven transactions, all but the I-MED transaction involved consideration of less than $85.0 million (with four of these transactions around $30.0 million or less)[54]. Accordingly we believe the appropriate EBITDA multiple for Integral Diagnostics should be higher than this average multiple

(c) based on publicly available information, the acquisition of I-MED by Permira in January 2018 for a reported $1.26 billion implied an EBITDA multiple of 11.1 times historical earnings

(d) the multiples for transaction evidence in the Australian healthcare sector generally since 2010 range between 6.3 and 13.7 times EBITDA, with an average of 9.8 times

[54] Smaller companies generally trade on lower multiples than larger companies provided the outlook for earnings growth and the market sectors in which the businesses operate are similar.

EBITDA. The multiples for the larger transactions, which are more comparable on a size basis, tend to be at the higher end of this multiple range

(e) the transaction multiples are calculated based on the most recent actual earnings (historical multiples) or expected future earnings for the current year at the date of the transaction (forecast multiples). The multiples are therefore not necessarily reflective of the multiple which would be derived from an assessment of each target company's "maintainable" earnings; and

(f) the companies acquired differ in terms of their size and nature of operations. Accordingly, in our view, the median or average multiples implied by these transactions are not necessarily representative of the multiples which should be applied to Integral Diagnostics.

Potential synergies

205 In its Replacement Bidder's Statement, Capitol Health has indicated that it expects to generate synergies from the acquisition of Integral Diagnostics, primarily by way of ongoing cost savings of approximately $5.0 million per annum. These potential synergies are considered in Section IX of our report.

206 As set out in RG 111, synergies that are not available to other potential bidders should not be taken into account in the valuation of the target company when assessing whether an offer is fair. In our view, a large proportion of the potential synergies likely to be available should the Offer be successful could be generated by other diagnostic imaging companies (particularly those with an existing corporate reporting / management / shared services structure). In this regard we note that Integral Diagnostic's public company costs totalled approximately $1.0 million in FY17.

207 The existence of such cost saving synergies from business combinations is one of the key reasons why bidders pay a control premium to acquire a company. Accordingly, in our opinion, it is inappropriate (in the circumstances of Integral Diagnostics) to incorporate a separate value for synergies over and above that implicitly reflected in the controlling interest multiple applied.

Conclusion on appropriate EBITDA multiple

208 Based on the above, in our opinion, an EBITDA multiple range of 10.5 to 11.5 times is appropriate when applied to the underlying EBITDA adopted for valuation purposes.

209 This range includes a premium for control and reflects in particular:

(a) the quality of earnings of the Integral Diagnostics business, noting that:

(i) Integral Diagnostics has a diversified revenue stream (i.e. it receives a large proportion of its revenue from sources outside Medicare), including a higher proportion of revenues derived from the provision of more specialised and hence higher value services

(ii) a significant component of Integral Diagnostics revenues are secured under long term contractual arrangements with major hospitals

(iii) Integral Diagnostics is Australia's highest margin diagnostic imaging operator

(b) the company is exposed to the growing Australian healthcare industry sector and diagnostic imaging in particular has favourable industry dynamics due to improving technology, a continuation in the trend towards prevention and early diagnosis and a shift to more complex modalities

(c) future earnings are expected to benefit from further cost saving initiatives that have been identified and are in the process of gradual implementation

(d) Integral Diagnostics is currently investing in growth capital expenditure ($8.0 million in FY18) and plans to continue this investment (at $5 million per annum for the FY19 to FY22 years) to drive future growth in revenue and earnings

(e) the range of transaction multiples implied by recent transaction evidence in the Australasian healthcare sector involving businesses with an enterprise value exceeding $0.4 billion (which we consider more representative when assessing the value of Integral Diagnostics).

Enterprise value under the EBITDA methodology

210 Having regard to the above, we have adopted a capitalisation of earnings based value for the Integral Diagnostics business of $441 million to $483 million, as follows:

Enterprise value	Low $m	High $m
Maintainable EBITDA	42.0	42.0
EBITDA multiple (x)	10.5	11.5
Enterprise value	441.0	483.0

DCF methodology

Cash flow projections

211 As noted above, as a secondary method we have assessed the enterprise value of Integral Diagnostics adopting the DCF methodology. Under the DCF methodology the value of the business is equal to the NPV of the estimated future cash flows including a terminal value. In order to arrive at the NPV the future cash flows are discounted using a discount rate which reflects the risks associated with the cash flow stream.

212 Our DCF valuation is based on free cash flow projections derived by LEA having regard to, inter alia, cash flow projections prepared by Integral Diagnostics management[55] and related discussions with Integral Diagnostics management.

213 Whilst LEA believes the assumptions underlying the cash flow projections are reasonable and appropriate, it should be noted in respect of these projections that:

(a) the major assumptions underlying the projections were formulated in the context of current economic, financial and other conditions

[55] These cash flow projections are used by Integral Diagnostics to assist in business management and reporting and are updated monthly for actual performance and annually in respect to the key assumptions adopted.

(b) the projections and the underlying assumptions have not been reviewed by an investigating accountant for reasonableness or accuracy of compilation and application of assumptions

(c) future profits and cash flows are inherently uncertain

(d) by their nature, the projections do not take into account the operational flexibility available to management to react to changes in the market conditions in which Integral Diagnostics operates

(e) the achievability of the projections is not warranted or guaranteed by Integral Diagnostics or LEA, as they are predictions of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of Integral Diagnostics and its management; and

(f) actual results may be significantly more or less favourable.

214 Free cash flow represents the operating cash flows on an un-geared basis (i.e. before interest) less taxation payments[56], capital expenditure and working capital requirements. The free cash flow on an ungeared basis is adopted to enable the value of the business to be determined irrespective of the level of debt funding employed.

215 The free cash flow projections cover the period to 30 June 2022 (being a period of five years from 1 July 2017 (forecast period)). For valuation purposes we have assumed a commencement date of 1 January 2018. A terminal value has been adopted at the end of the forecast period.

216 As the detailed cash flow projections are commercially sensitive they have not been set out in our report. However, we set out below information on the major assumptions underlying the free cash flow projections.

Major assumptions

Revenue

217 Revenue is forecast to grow over the five year period to 30 June 2022 at a CAGR of 6.5%. This is broadly consistent with industry growth rates in the geographies in which Integral Diagnostics provides its services and is slightly below the growth in revenue achieved in FY17 (7.1%) but above that achieved in 1HY18 (5.8%).

218 Forecast growth in revenue reflects a combination of:

(a) organic volume growth in the number of patient examinations in line with the expected corresponding growth in industry volumes[57]

(b) increased revenue from investment in new modalities, reflecting the planned annual level of growth capital expenditure. This expenditure is to be targeted towards the increased provision of more specialised and hence higher value services

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56 Also calculated on an ungeared basis.

57 Industry volume growth in the number of patient examinations increased at a CAGR of 5.1% between FY05 and FY17. Source: Integral Diagnostics management.

(c) planned increases in the number of operating sites in the period to FY19, with no additional sites allowed for in the forecasts post FY19.

219 Integral Diagnostics management consider the revenue forecasts to be conservative as no benefit has been assumed from the Government announced reintroduction of MBS indexation for selected diagnostic imaging services from July 2020.

Labour costs

220 Labour is the largest operating cost of the Integral Diagnostics business, currently comprising around 57% of revenue. This percentage is expected to decline slightly over the forecast period to around 56% of revenue by June 2022, reflecting the benefit of a number of labour cost savings initiatives that have been identified and are being gradually implemented by management[58].

Other expenses

221 Other expenses primarily comprise consumables, equipment and occupancy. Whilst occupancy costs as a percentage of revenue are forecast to remain relatively constant, savings (as a percentage of revenue) are expected in relation to:

(a) **consumables** – based on revised procurement arrangements currently being implemented

(b) **equipment** – based on the planned renegotiation of contracts with equipment providers for servicing of machinery.

Operating margins

222 Operating margins (EBITDA) are forecast to increase from the current level of around 20% to around 22% to 23% over the forecast period. This forecast increase reflects the combined benefit of:

(a) a component of projected increases in revenues being attributable to the targeted provision of more specialised and hence higher value services

(b) the expected reduction (as a percentage of revenue) in the operating cost base, associated with the labour and other operating expense savings noted above.

Capital expenditure

223 Capital expenditure comprises a mix of maintenance capital and growth capital expenditure.

224 Maintenance capital expenditure is projected over FY19 to FY22 at around $10.5 million per annum, which is slightly lower than the corresponding level of expenditure in FY17 ($11.1 million) but higher than the forecast for FY18 ($9.0 million, of which $2.3 million was spent in 1HY18).

225 Growth capital expenditure is projected at $8.0 million for FY18 (of which $1.3 million was spent in 1HY18) and at $5.0 million per annum over the remainder of the forecast period.

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58 As noted in the Integral Diagnostics ASX announcement dated 19 January 2018, the earnings performance of the Company is already benefiting from the initiatives that have been implemented to date.

This growth capital expenditure is to be targeted at a combination of increasing the modality offerings at current sites, together with an expansion of the business to new sites to FY19 (site additions are assumed up to FY19, but not thereafter). As noted above, an increase in the ability to provide more specialised and hence higher value services will be a key objective.

226 Integral Diagnostics management have advised that whilst a number of potential business acquisitions are under consideration, no business acquisition opportunities are assumed in the management forecasts. In addition, certain organic growth initiatives that have been identified and are also under consideration have similarly been excluded from the management forecasts.

Working capital

227 As noted in Section III, reflective of its business model, Integral Diagnostics operates with the benefit of negative working capital. Accordingly, it is reasonable to assume that as the business continues to grow (as reflected in the management forecasts), this benefit will increase (and provide additional positive cash flow to the Company).

228 For the purpose of our report however we have conservatively assumed no related cash flow working capital benefit over the forecast period.

Taxation

229 We have allowed for taxation at the current company tax rate of 30%[59].

Discount rate

230 We have applied a (mid-point) discount rate of 8.8% per annum (after tax) which reflects:

(a) a risk-free rate of 4.0% per annum. This exceeds the average yield to maturity currently prevailing on 30 year Australian Government bonds (of approximately 3.4% per annum as at 31 December 2017[60]) as we believe current yields (notwithstanding their long term nature) are well below historical levels due to, inter-alia, the prevailing relatively weak outlook for the Australian economy and the continuing effect of quantitative easing measures by major overseas central banks, which has reduced interest rates on overseas government bonds to, in our view, unsustainably low levels

(b) a market risk premium (MRP) of 6.0% per annum, reflecting our view on the additional return above the risk-free rate sought by equity investors in Australia in the current market conditions

(c) a beta of 0.8 to 0.9, broadly consistent with recent beta estimates for the healthcare sector

(d) an additional equity risk premium of 1% in our high discount rate scenario to recognise the risk associated with achievement of the forecast growth in revenues reflected in the management cash flows[61]

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59 Integral Diagnostics has advised a lower effective tax rate over the forecast period of 28.5% (with an expectation that the cash tax rate will be slightly lower). The enterprise value of Integral Diagnostics is not particularly sensitive to the tax rate adopted.

60 The average yield to maturity prevailing as at 31 December 2017 on 10 year and 20 year Australian Government bonds was 2.6% per annum and 3.1% per annum respectively.

61 The enterprise value of Integral Diagnostics is more sensitive to the rate of growth in revenues than either the operating margins achieved or the discount rate adopted.

(e) a cost of debt of 6.0% per annum, which reflects an appropriate borrowing margin of 2.0% over the adopted risk-free rate

(f) the prevailing corporate tax rate of 30%

(g) an assumption that over the long term the business operations of Integral Diagnostics are financed by a combination of 85% equity and 15% debt (broadly consistent with the existing funding mix of the business).

231 Based on the above our adopted discount rate is derived as follows:

Integral Diagnostics – adopted discount rate	Low %	High %
Risk-free rate	4.0	4.0
MRP	6.0	6.0
Beta	0.8	0.9
Cost of equity	8.8	9.4
Additional equity risk premium	-	1.0
Cost of equity including additional equity risk premium	8.8	10.4
Cost of debt pre-tax	6.0	6.0
Cost of debt after tax	4.2	4.2
Proportion of equity funding	85.0	85.0
Proportion of debt funding	15.0	15.0
Weighted average cost of capital (WACC)	8.1	9.5
WACC – adopted	**8.8**	

Terminal value

232 We have estimated the terminal value of the Integral Diagnostics business as at 30 June 2022 based on the free cash flow projected in the year ending 30 June 2023.

233 Growth in perpetuity of 3.0% to 3.5% per annum has been assumed after 30 June 2022. The selection of this growth rate has been based on our review of:

(a) the growth in revenue and EBITDA projected over the period to 30 June 2022

(b) the projected scale of operations as at 30 June 2022, and the potential for facility growth beyond that date. In this regard we note that the Australian healthcare market generally, whilst relatively mature, is expected to continue to exhibit real growth

(c) projected and targeted long term inflation rates.

234 Notwithstanding the projected growth levels inherent in the management forecasts, our adopted growth rate reflects a modest assumption as to continued real growth in the Integral Diagnostics business beyond June 2022. We note however that a key component of projected business growth over the forecast period is the annual level of projected growth capital expenditure. For terminal value purposes we have only allowed for maintenance capital expenditure, at a level consistent with the forecast FY22 depreciation expense.

235 The terminal value of the Integral Diagnostics business as at 30 June 2022 represents 9.5 times projected EBITDA in FY22 (which we consider reasonable).

Sensitivity analysis

236 As noted in paragraph 213 above, there are inherent qualifications that apply to cash flow projections on which DCF valuations are based. In addition, the cost of capital can vary between industry participants based on factors such as differing perceptions / acceptance of risk and willingness to assume debt funding obligations.

237 It is important therefore not to credit the output of DCF models with a precision it does not warrant. It follows that any DCF valuation process should consider a range of scenarios, having regard to the respective key valuation drivers of the business being valued.

238 We set out below therefore the sensitivity of the Integral Diagnostics business value (on a cash and debt free basis) to changes in the key value drivers, including:

(a) differences in the terminal growth rate and the WACC:

Sensitivity analysis						
				Terminal growth rate		
		2.75%	3.00%	3.25%	3.50%	3.75%
WACC	8.4%	474.2	493.8	515.3	539.0	565.2
	8.6%	457.6	475.7	495.6	517.4	541.4
	8.8%	442.0	458.9	477.3	497.4	519.5
	9.0%	427.5	443.2	460.2	478.9	499.3
	9.2%	413.8	428.5	444.4	461.6	480.5

(b) differences in the revenue growth rate and the EBITDA margin:

Sensitivity analysis						
				Revenue growth		
		-1.50%	-0.75%	-	+0.75%	+1.50%
EBITDA margin	-1.00%	417.7	433.3	449.3	465.6	482.2
	-0.50%	431.0	447.0	463.3	479.9	496.9
	-	444.2	460.6	477.3	494.3	511.6
	+0.50%	457.5	474.2	491.3	508.6	526.4
	+1.00%	470.8	487.8	505.3	523.0	541.1

Enterprise value under the DCF methodology

239 Having regard to the above, we have adopted a DCF value for the Integral Diagnostics business of $460 million to $500 million.

Enterprise value

240 Based on the above, we set out below a summary of our valuation ranges under both methodologies, and our assessed valuation range for the Integral Diagnostics business:

Integral Diagnostics– assessed business value	Low $m	High $m
Capitalisation of EBITDA method	441	483
DCF method	460	500
Adopted valuation range	450	490

Net debt

241 As at 31 December 2017 Integral Diagnostics had net debt of $42.2 million.

242 As noted above, on 19 January 2018 Integral Diagnostics advised a fully franked interim dividend in respect of 1H18 of 4.0 cents per share, which is planned to be paid on 5 March 2018. Shares in Integral Diagnostics have traded ex-entitlement in relation this interim dividend since 31 January 2018. Integral Diagnostics shareholders will therefore receive this dividend irrespective of the outcome of the Offer. In assessing the value of Integral Diagnostics shares subject to the Offer we have therefore allowed for the total payment of this dividend of $5.8 million.

243 For valuation purposes we have therefore adopted net debt of $47.0 million, based on advice from management as to the net debt position after payment of the dividend and with allowance for positive operational cash flows in 2HY18 to date.

Share capital

244 As at the date of this report, Integral Diagnostics had 145.0 million fully paid ordinary shares on issue. In addition Integral Diagnostics had 0.36 million performance rights granted under the Company's long term incentive plan.

245 The performance rights vest subject to the achievement of specified performance hurdles[62]. However, in the event of a takeover or other control event the Integral Diagnostics Board retains the discretion to waive the performance hurdles. Accordingly, when valuing 100% of the shares in Integral Diagnostics, in our opinion, it is appropriate to assume that additional shares in respect of the outstanding performance rights will be issued.

246 For valuation purposes, we have therefore adopted fully diluted shares on issue of 145.4 million.

Valuation summary

247 Based upon the above, the value of 100% of Integral Diagnostics on a controlling interest basis is as follows:

62 Being the satisfaction of an earnings per share performance condition over a performance period from 1 July 2017 to 30 June 2021.

Value of Integral Diagnostics	Low $m	High $m
Enterprise value	450.0	490.0
Less net debt	(47.0)	(47.0)
Equity value	403.0	443.0
Fully diluted shares on issue (million)	145.4	145.4
Value per share ($)	$2.77	$3.05

Cross-check to pre-announcement share trading range

248 We have cross-checked our assessed value of the equity in Integral Diagnostics to the listed market price of Integral Diagnostics shares prior to the announcement of the intention to make the Offer. Specifically, we have considered the listed market price of Integral Diagnostics shares up to 28 November 2017 (the last day of trading prior to the announcement of the intention to make the Offer), adjusted for a premium for control.

249 The volume weighted average share prices for Integral Diagnostics in the one and three month periods up to 28 November 2017 were $1.77 and $1.63 respectively. Empirical evidence undertaken by LEA indicates that the average premium paid above the listed market price in successful takeovers in Australia ranges between 30% and 35% (assuming the pre-bid market price does not reflect any speculation of the takeover). Adding a 30% to 35% premium for control to these share prices would therefore result in a theoretical "control" value of $2.12 to $2.39 per share.

250 Our assessed valuation range is significantly above these implied theoretical control values. We note that subsequent to the announcement of the intention to make the Offer, updated information as to Integral Diagnostics' improved financial performance and future prospects on which our valuation is based was released to the market on 19 January 2018, with further clarification regarding its earnings prospects set out in the Target's Statement. Accordingly, this information was previously unavailable to market analysts and investors.

251 In the circumstances therefore we do not consider the market prices of Integral Diagnostics shares prior to the announcement of the intention to make the Offer to be an appropriate reference point from which to assess the value of Integral Diagnostics.

VIII Valuation of Offer consideration

Approach

252 As set out in Section I, if Integral Diagnostics shareholders accept the Offer and all conditions are satisfied, then Integral Diagnostics shareholders will receive 6.9 Capitol Health shares plus $0.36 cash for each Integral Diagnostics share.

253 As stated in Section VI it is customary in transactions where scrip is offered as consideration to rely upon the listed market price of the bidder's shares[63] (in this case Capitol Health) as the primary reference point for estimating the realisable value of the consideration offered. This is principally because:

(a) the listed market prices of Capitol Health shares are likely to represent a reasonable proxy for the amount that Integral Diagnostics shareholders could expect to realise if they sold any Capitol Health shares received as consideration either immediately, or in the short term

(b) any decision to continue to hold Capitol Health shares beyond the immediate to short term is a separate investment decision which should be made by shareholders having regard to their risk profile, liquidity preference, tax position and expectations as to value and future market conditions. It is also not possible to accurately predict future share price movements

(c) whilst there may be a future opportunity for Integral Diagnostics shareholders to share in a control premium in the event Capitol Health was subsequently acquired, this is not a scenario that we consider likely in the short term.

254 Accordingly, in our opinion, the recent market prices of Capitol Health shares are the appropriate reference point for estimating the realisable value of the scrip component of the consideration offered. However, in doing so, we have also considered the depth of the market for those securities and the volatility of the share price.

255 We have also cross-checked the reasonableness of our assessed value of Capitol Health shares being offered as consideration by reference to implied earnings multiples.

Recent share prices

Recent share trading history (pre and post announcement)

256 The historical share prices for Capitol Health are set out in Section IV. More recent trading in Capitol Health shares prior to the announcement of the intention to make the Offer is shown below:

63 Provided there is sufficient liquidity in the bidder's shares.

Capitol Health – share price history (pre announcement)					
Time periods up to and including 28 November 2017	**Low $**	**High $**	**VWAP $**	**Number traded (m)**	**Value traded $m**
1 month	0.22	0.32	0.27	61.5	16.9
3 months	0.22	0.32	0.28	179.1	50.8
6 months	0.17	0.33	0.27	449.9	120.6
12 months	0.11	0.33	0.22	800.9	176.5

257 For the purpose of assessing the value of the Capitol Health shares offered as consideration we believe more regard should be given to the price of Capitol Health shares since the intention to make the Offer was announced on 29 November 2017. This is because we consider the Capitol Health share price subsequent to and including 29 November 2017 to be more representative of the share price assuming the Offer is accepted than the prices prior to 29 November 2017.

258 The following table sets out the prices at which Capitol Health shares have traded in the period subsequent to the announcement of the intention to make the Offer up to 28 February 2018:

Capitol Health – share price history (post announcement)					
Time period	**Low $**	**High $**	**VWAP $**	**Number traded (m)**	**Value traded $m**
29 November 2017 to 28 February 2018	0.23	0.32	0.28	116.6	33.1
14 days to 28 February 2018	0.25	0.29	0.27	19.6	5.4

259 As indicated above, the VWAP at which shares in Capitol Health have traded in the period subsequent to the announcement of the intention to make the Offer is broadly similar to the VWAP at which shares in Capitol Health traded in the three months prior to that date. However, in the more recent period, shares in Capitol Health have traded at lower price levels.

Share trading restrictions and liquidity

260 We are not aware of any significant shareholding restrictions on trading in Capitol Health which would prevent sufficient trading (on a day-to-day basis) to produce an unbiased share price.

261 Furthermore, as set out in Section IV, the volume of shares traded in Capitol Health as a proportion of the number of shares on issue indicates a reasonable to high level of share market liquidity. We also note that since the announcement of the intention to make the Offer on 29 November 2017 to 28 February 2018, trading in Capitol Health shares has been at a comparable liquidity level to pre-announcement trading levels.

Information disclosures

262 As Capitol Health is a relatively small listed company and is considerably smaller than other listed companies in the healthcare sector, it is not well researched and analysed by share broking (analyst) firms and institutional investors.

263 Notwithstanding, significant information in relation to the operations of Capitol Health has been disclosed in its financial reports and ASX announcements. Further, Capitol Health has an obligation under the ASX Listing Rules (subject to certain exemptions) to notify the ASX immediately of any information that it becomes aware of concerning Capitol Health which a reasonable person would expect to have a material effect on the price or value of Capitol Health shares.

Number of Capitol Health shares to be issued as consideration

264 As at 31 January 2018 Capitol Health had 802.5 million ordinary shares, 12.0 million options (all of which were in the money and the majority of which had vested) and 1.7 million performance rights on issue. The performance rights and the majority of the options expire in 2020[64].

265 The number of shares to be issued by Capitol Health as part consideration under the Offer will therefore significantly exceed the current issued capital of Capitol Health and represent approximately 55.6% of the enlarged capital base of Capitol Health, calculated as follows:

Scrip consideration as a % of enlarged capital base		
		Million
Number of existing Capitol Health shares on issue[(1)]		802.5
Number of shares to be issued pursuant to the Offer[(2)]	(A)	1,003.3
Total issued shares in Capitol Health post transaction	(B)	1,805.8
Integral Diagnostics shareholders' interest[(3)] in Capitol Health post transaction	(A) / (B)	55.6%

Note:
1 Excluding options and performance rights.
2 Being 145.4 million shares in Integral Diagnostics converted to Capitol Health shares at the Offer ratio of 6.9 Capitol Health shares for every one Integral Diagnostics share.
3 Representing the collective interest of Integral Diagnostics shareholders.

266 In our opinion, the issue of shares by Capitol Health as part consideration for the acquisition of Integral Diagnostics shares is equivalent to a significant capital raising by Capitol Health. Large capital raisings are generally priced at a discount to the prevailing share market price. The size of discount is dependent on the circumstances of the particular issue, having regard to factors such as the amount of money being raised, the purpose of the issue and the size of the raising in percentage terms. Observed discounts can range between 5% and 20% (depending on market conditions and the above factors).

267 Given the large number of new Capitol Health shares to be issued under the Offer, if (in the event that the Offer is successful) a significant number of Integral Diagnostics shareholders elect not to retain the shares in Capitol Health received as consideration there may be an oversupply of Capitol Health shares, which may have an adverse impact on the Capitol Health share price in the short term.

268 In this regard, as set out in Section III, Integral Diagnostics radiologists and managers currently hold a collective interest in Integral Diagnostics shares of around 28.7%[65], in respect of which a significant component of the aggregate shareholding is subject to escrow

64 1.0 million options with an exercise price of $0.1979 per share expire on 28 February 2018.
65 This includes former radiologists and management.

arrangements that extend to 2026 (and potentially beyond). Capitol Health has indicated that in the event the Offer is successful, it intends to release accepting shareholders from these escrow arrangements[66]. In this event, it is reasonable to assume that there will be an increase in those shareholders seeking to sell their acquired interest in Capitol Health than would otherwise be the case.

269 Furthermore, we consider that the release of the Integral Diagnostics radiologists / management from the existing escrow arrangements implicitly increases the risk that some of these specialists may subsequently seek alternative employment, thereby potentially negatively impacting on future earnings performance and (by correlation) the Capitol Health share price[67].

270 However, partly offsetting these considerations, we note that Capitol Health stated in its Replacement Bidder's Statement that it had received pre-bid acceptance agreements from three major Integral Diagnostics shareholders collectively representing 16.5% of the issued shares in Integral Diagnostics[68]. Whilst uncertain, given these indicated commitments, these Integral Diagnostics shareholders are potentially more likely to retain the Capitol Health shares received as consideration, at least in the short term.

Dilution and synergies

271 To the extent that Capitol Health is paying a control premium (above the listed market price) for Integral Diagnostics there will be a dilution effect on the value of Capitol Health shares subsequent to a successful conclusion of the Scheme. This is because the listed market price of Capitol Health shares will reflect a portfolio rather than a controlling interest in the enlarged group. In the absence of synergies (which in this instance are relatively modest) this dilution often results in a fall in the share price of the bidder.

272 Further information on the synergies expected to be generated by Capitol Health is set out in the Replacement Bidder's Statement and Target's Statement.

Conclusion

273 In summary, in assessing the value of the Capitol Health shares offered as part consideration under the Scheme, we have had regard to:

(a) the recent trading range of Capitol Health shares

(b) the significant number of shares to be issued by Capitol Health under the Offer compared to the enlarged number of Capitol Health shares on issue post completion of the Offer

(c) the likely level of on-market trading in Capitol Health shares subsequent to completion of the Offer, having regard to factors including:

(i) any potential oversupply of Capitol Health shares from those shareholders in Integral Diagnostics not wishing to retain the Capitol Health shares received as consideration

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66 Capitol Health ASX announcement dated 29 November 2017.

67 We note that Capitol Health suffered previous integration / earnings retention issues in respect of the NSW assets which were acquired in 2015 and divested in 2017 with a materially lower earnings base.

68 These shareholders include Regals Funds Management Pty Ltd, Wilson Asset Management (International) Pty Limited and Microequities Asset Management Pty Ltd.

(ii) the dilution effect implicit in any control premium being paid by Capitol Health

(d) recent stock market conditions; and

(e) the earnings multiples for Capitol Health implied by our adopted range (see below).

274 Based on the above we have assessed the realisable value of the Capitol Health shares offered as part consideration at between $0.26 and $0.28 per share[69].

Implied EBITDA multiple

275 As stated above, we have cross-checked our assessment of the realisable value of Capitol Health shares by considering the EBITDA multiple implied based on the standalone earnings of Capitol Health in the absence of the Offer.

Market capitalisation

276 The market capitalisation of Capitol Health based on our assessed value of Capitol Health shares is shown below:

Capitol Health – estimated market capitalisation based on assessed share value		
	Low	**High**
Existing shares on issue (million)(1)	802.5	802.5
Adopted share price (trading range)($)(2)	0.26	0.28
Market capitalisation ($m)	208.6	224.7

Note:
1 Excluding options and performance rights.
2 Assessed realisable value of Capitol Health shares.

Net cash

277 Based upon the latest reported financial position contained in the ASX release dated 27 February 2018, Capitol Health had net cash of $32.8 million (prior to settlement of the acquisitions of I-Rad Radiology and Radiology Tasmania Group)[70].

Investment in Enlitic

278 As at 31 December 2017, Capitol Health had invested US$10 million to acquire an approximate 25% interest in Enlitic LLC (Enlitic), a medical deep learning company dedicated to revolutionising diagnostic healthcare, headquartered in San Francisco, California[71]. The carrying value of the investment as at that date was $14.4 million (which, in the absence of further information, we have accepted as representative of market value for implied EBITDA calculation purposes).

69 The high end of this range is broadly consistent with the VWAP of Capitol Health shares post the announcement of the intention to make the Offer up to 28 February 2018. The low end of the range reflects more recent trading in Capitol Health shares, together with the significant number of new shares proposed to be issued by Capitol Health pursuant to the Offer.

70 We have not adjusted the reported 31 December 2017 net cash position for the purpose of this report as we are not aware of any factors that would suggest that the value of the acquisitions was other than the cash consideration paid.

71 Further information with respect to Enlitic is set out in the Replacement Bidder's Statement.

Enterprise value

279 Based on the above the implied enterprise value of Capitol Health is as follows:

Capitol Health – implied enterprise value	Low $m	High $m
Market capitalisation	208.6	224.7
Less net cash	(32.8)	(32.8)
Less book value of investment in Enlitic	(14.4)	(14.4)
Implied enterprise value	161.4	177.5

Implied EBITDA multiple

280 For the purpose of calculating the EBITDA multiple implied by the above enterprise value we have adopted normalised FY18 EBITDA of $21.2 million for Capitol Health, based on the mid-point of the guidance contained in the AGM presentation released to the ASX on 22 November 2017, adjusted to exclude the EBITDA contribution from the NSW operations which have been sold[72].

281 On this basis, the implied EBITDA multiple is as follows:

Capitol Health – implied EBITDA multiple	Low $m	High $m
Enterprise value	161.4	177.5
Normalised EBITDA	21.2	21.2
Implied EBITDA multiple (x)	7.6	8.4

282 We note that the implied EBITDA multiples for Capitol Health are lower than the EBITDA multiples adopted in our assessed valuation of Integral Diagnostics. However, the implied Capitol Health EBITDA multiples reflect the value of a portfolio interest in the company, whereas the EBITDA multiples adopted in our assessed valuation of Integral Diagnostics reflect the value of a controlling interest in the company[73].

283 If the implied Capitol Health EBITDA multiples were adjusted to reflect a controlling interest value in the company, we note that they would be lower than the EBITDA multiples adopted in our assessed valuation of Integral Diagnostics. We consider this appropriate given our view that the quality of earnings of Integral Diagnostics is superior to the corresponding earnings of Capitol Health due to factors including (inter alia):

(a) Integral Diagnostics has a more diversified revenue stream, including a higher proportion of revenues derived from the provision of more specialised and hence higher value services (with less reliance on Medicare)

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[72] Consistent with the approach set out above, adopted normalised EBITDA for Capitol Health excludes any earnings contribution in respect of either I-Rad Radiology or Radiology Tasmania Group.

[73] Other things being equal, implied portfolio interest multiples are generally lower (by definition) than controlling interest multiples.

(b) a significant component of Integral Diagnostics revenues are secured under long term contractual arrangements with major hospitals

(c) Integral Diagnostics has higher operating margins than those reported by Capitol Health.

284 We note that the implied EBITDA multiples calculated above are slightly lower than the forward EBITDA multiples implied by recent trading in Capitol Health shares, prior to the announcement of the intention to make the Offer[74].

285 Based on the above, we consider our assessed range of realisable values for Capitol Health shares to be reasonable and appropriate.

Assessed value of the Offer

286 We have therefore assessed the value of the Offer to be received by Integral Diagnostics shareholders as follows:

Value of Offer per Integral Diagnostics share	Low $ per share	High $ per share
Assessed realisable value of Capitol Health shares[(1)]	0.26	0.28
Offer ratio	6.9	6.9
Assessed value of scrip consideration	1.79	1.93
Cash consideration	0.36	0.36
Assessed value of the Offer	2.15	2.29

Note:

1 Our assessed realisable value of Capitol Health shares is based on trading subsequent to the announcement of the intention to make the Offer. This trading reflects a period of entitlement to the interim dividend of 0.4 cents per share declared by Capitol Health for 1HY18. Capitol Health has not stated whether the interim dividend will be paid to Integral Diagnostics shareholders that accept the Offer.

Other considerations

287 Integral Diagnostics shareholders should note that the listed market price of Capitol Health shares is subject to daily fluctuation. The price at which Capitol Health shares may be sold may therefore be greater or less than our assessed realisable value of Capitol Health shares of $0.26 to $0.28 per share.

288 Integral Diagnostics shareholders should also note that any decision to hold Capitol Health shares beyond the short term is a separate investment decision. As it is not possible to accurately predict future share price movements, any decision to hold Capitol Health shares should be made by shareholders having regard to their risk profile, liquidity preference, tax position and expectations as to value and future market conditions.

74 We note that share market trading in Capitol Health shares in this period reflected a period of implicit share price support subsequent to the announced share market buyback in August 2017.

IX Evaluation of the Offer

Summary of opinion

289 LEA has concluded that the Offer is neither fair nor reasonable based on the guidelines set out in RG 111.

290 The reasons for our opinion are set out below.

Assessment of fairness

291 Pursuant to RG 111 an offer is "fair" if:

"The value of the offer price or consideration is equal to or greater than the value of the securities the subject of the offer."

292 This comparison is shown below:

Comparison of Offer consideration and Integral Diagnostics share value	Low $ per share	High $ per share	Mid-point $ per share
Value of Offer consideration	2.15	2.29	2.22
Value of 100% of ordinary shares in Integral Diagnostics	2.77	3.05	2.91
Extent to which the Offer consideration is less than the value of the ordinary shares in Integral Diagnostics	(0.62)	(0.76)	(0.69)

293 When assessing the "fairness" of scrip takeovers under RG 111, in our opinion, it is appropriate to have regard to the overall range of values (particularly as the scrip consideration is subject to daily fluctuation). As indicated above, our assessed range of values for the Offer consideration is consistently lower than our assessed value of 100% of the ordinary shares in Integral Diagnostics. Accordingly, in our opinion, the Offer is not fair based on the guidelines set out in RG 111.

Assessment of reasonableness

294 Pursuant to RG 111, an offer may be reasonable if, despite not being fair but after considering other significant factors, the expert is of the view that there are sufficient reasons for shareholders to accept the offer in the absence of any higher bid before the close of the offer.

295 In assessing whether the Offer is reasonable LEA has also considered:

(a) the extent to which a control premium is being paid to Integral Diagnostics shareholders

(b) the extent to which a share of the synergies identified by Capitol Health as likely to arise upon an acquisition of Integral Diagnostics by Capitol Health is being shared with Integral Diagnostics shareholders

(c) the listed market price of Integral Diagnostics shares:

- (i) prior to the announcement of the intention to make the Offer
- (ii) subsequent to the announcement of the intention to make the Offer
- (iii) if the Offer is not successful

(d) the value of Integral Diagnostics to an alternative offeror and the likelihood of an alternative offer emerging, either prior to the close of the Offer, or sometime in the future

(e) other qualitative and strategic issues, risks, advantages and disadvantages associated with the Offer.

296 These issues are discussed in detail below.

Extent to which a control premium is being paid

297 Empirical evidence indicates that average premiums paid in successful takeovers in Australia generally range between 30% and 35% above the listed market price of the target company's shares three months prior to the announcement of the bid (assuming no speculation of the takeover is reflected in the pre-bid price). This premium reflects the fact that:

(a) the owner of 100% of the shares in a company obtains access to all the free cash flows of the company being acquired, which it would otherwise be unable to do as a minority shareholder

(b) the controlling shareholder can direct the disposal of surplus assets and the redeployment of the proceeds

(c) a controlling shareholder can control the appointment of directors, management policy and the strategic direction of the company

(d) a controlling shareholder is often able to increase the value of the entity being acquired through synergies and/or rationalisation savings.

298 We have calculated the premium implied by the Offer consideration by reference to the market prices of Integral Diagnostics shares prior to the announcement on 29 November 2017 of the intention to make the Offer. For the purpose of calculating the implied offer premium we have adopted the mid-point of $2.22 per share of our assessed value of the consideration, as set out in Section VIII of our report.

Implied offer premium relative to recent share prices(1)

	Integral Diagnostics share price $	Implied control premium %
Closing share price on 28 November 2017(2)	1.89	17.5
1 month VWAP to 28 November 2017	1.77	25.4
3 months VWAP to 28 November 2017	1.63	36.2

Note:
1 Rounding differences may exist.
2 Being the closing price on the last day of trading prior to the announcement of the intention to make the Offer.

299 As indicated above, the Offer consideration represents a significant premium to the market price of Integral Diagnostics shares prior to the announcement of the intention to make the Offer. However, with the exception of the three months VWAP to 28 November 2017, the range of implied control premiums is below the range of observed premiums paid in

successful takeovers generally. Furthermore, as set out in Section VII, we do not consider the market price of Integral Diagnostics shares prior to the announcement of the intention to make the Offer as an appropriate reference point from which to assess the value of Integral Diagnostics.

Extent to which Integral Diagnostics shareholders are being paid a share of synergies

300 In its Replacement Bidder's Statement, Capitol Health has indicated that it expects to generate synergies from the acquisition of Integral Diagnostics, primarily by way of ongoing cost savings of approximately $5.0 million per annum. As noted above, we have assessed the Offer as below our assessed valuation range of Integral Diagnostics shares. Accordingly, in our opinion, Integral Diagnostics shareholders are not being offered a share of the expected synergies.

301 Furthermore, we have discussed the potential for synergies arising from a combination of the two companies with Integral Diagnostics management. Based on a detailed exercise undertaken (which incorporates publicly available information in respect of Capitol Health), Integral Diagnostics management have assessed the potential annual earnings synergy benefit from a combination of the two companies (ignoring the risk of dis-synergies) to be $2.2 million.

302 This assessment is significantly lower (in relative terms) than the indicated annual synergies of $5.0 million determined by Capitol Health. We understand the difference primarily reflects the extent to which potential operating cost savings have already been achieved by Integral Diagnostics, together with lower potential savings at the senior management level given the employee reduction in this area effected by Capitol Health in 2017.

Recent share prices subsequent to the Offer

303 In the period subsequent to the announcement of the intention to make the Offer up until 30 January 2018[75], shares in Integral Diagnostics and Capitol Health (when adjusted for the cash component of the consideration) traded at prices that reflect an implied ratio of 6.6 Capitol Health shares for each Integral Diagnostics share. This implied ratio is below the Offer ratio of 6.9 Capitol Health shares for each Integral Diagnostics share.

Likely price of Integral Diagnostics shares if the Offer lapses

304 In our opinion, if the Offer lapses and no higher offer or alternative proposal emerges, it is likely (at least in the short term) that Integral Diagnostics shares will trade at a discount to our valuation, consistent with the difference between the value of Integral Diagnostics on a portfolio basis and the value on a 100% controlling interest basis. In this respect we note that since the announcement of the intention to make the Offer, Integral Diagnostics has released upgraded earnings guidance that, in the absence of the Offer, we would normally expect to have a positive impact on the share price.

Likelihood of an alternative offer

305 We have been advised by the Directors of Integral Diagnostics that no formal alternative offers have been received subsequent to the announcement of the intention to make the Offer on 29 November 2017.

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[75] Effective 31 January 2018, shares in Integral Diagnostics traded ex-entitlement to the 1H18 interim dividend of 4.0 cents per share.

306 Whilst the Offer and the response thereto in the Target's Statement may increase investor interest in Integral Diagnostics, in our opinion, it is uncertain as to whether any alternative offer is likely to be made for Integral Diagnostics prior to the close of the Offer.

Conclusion

307 Based upon the above we have concluded that the Offer is neither fair nor reasonable.

Other matters

308 The taxation consequences of accepting the Offer depend on the individual circumstances of each investor. Shareholders should read the taxation advice set out in the Replacement Bidder's Statement and Target's Statement and should consult their own professional adviser if in doubt as to the taxation consequences of the Offer.

309 The ultimate decision whether to accept the Offer should be based on each shareholders' assessment of their own circumstances, including their risk profile, liquidity preference, tax position and expectations as to value and future market conditions. If shareholders are in doubt about the action they should take in relation to the Offer or matters dealt with in this report, shareholders should seek independent professional advice.

Financial Services Guide

Lonergan Edwards & Associates Limited

1 Lonergan Edwards & Associates Limited (ABN 53 095 445 560) (LEA) is a specialist valuation firm which provides valuation advice, valuation reports and independent expert's reports (IER) in relation to takeovers and mergers, commercial litigation, tax and stamp duty matters, assessments of economic loss, commercial and regulatory disputes.

2 LEA holds Australian Financial Services Licence No. 246532.

Financial Services Guide

3 The *Corporations Act 2001* (Cth) authorises LEA to provide this Financial Services Guide (FSG) in connection with its preparation of an IER to accompany the Target's Statement to be sent to Integral Diagnostics shareholders in connection with the Offer.

4 This FSG is designed to assist retail clients in their use of any general financial product advice contained in the IER. This FSG contains information about LEA generally, the financial services we are licensed to provide, the remuneration we may receive in connection with the preparation of the IER, and if complaints against us ever arise how they will be dealt with.

Financial services we are licensed to provide

5 Our Australian financial services licence allows us to provide a broad range of services to retail and wholesale clients, including providing financial product advice in relation to various financial products such as securities, derivatives, interests in managed investment schemes, superannuation products, debentures, stocks and bonds.

General financial product advice

6 The IER contains only general financial product advice. It was prepared without taking into account your personal objectives, financial situation or needs.

7 You should consider your own objectives, financial situation and needs when assessing the suitability of the IER to your situation. You may wish to obtain personal financial product advice from the holder of an Australian Financial Services Licence to assist you in this assessment.

Fees, commissions and other benefits we may receive

8 LEA charges fees to produce reports, including this IER. These fees are negotiated and agreed with the entity who engages LEA to provide a report. Fees are charged on an hourly basis or as a fixed amount depending on the terms of the agreement with the person who engages us. In the preparation of this IER, LEA is entitled to receive a fee estimated at $150,000 plus GST.

9 Neither LEA nor its directors and officers receives any commissions or other benefits, except for the fees for services referred to above.

10 All of our employees receive a salary. Our employees are eligible for bonuses based on overall performance and the firm's profitability, and do not receive any commissions or other benefits arising directly from services provided to our clients. The remuneration paid to our directors reflects their individual contribution to the company and covers all aspects of performance. Our directors do not receive any commissions or other benefits arising directly from services provided to our clients.

11 We do not pay commissions or provide other benefits to other parties for referring prospective clients to us.

Complaints

12 If you have a complaint, please raise it with us first, using the contact details listed below. We will endeavour to satisfactorily resolve your complaint in a timely manner.

13 If we are not able to resolve your complaint to your satisfaction within 45 days of your written notification, you are entitled to have your matter referred to the Financial Ombudsman Services Limited (FOS), an external complaints resolution service. You will not be charged for using the FOS service.

Contact details

14 LEA can be contacted by sending a letter to the following address:

Level 7
64 Castlereagh Street
Sydney NSW 2000
(or GPO Box 1640, Sydney NSW 2001)

Appendix B

Qualifications, declarations and consents

Qualifications

1 LEA is a licensed investment adviser under the Corporations Act. LEA's authorised representatives have extensive experience in the field of corporate finance, particularly in relation to the valuation of shares and businesses and have prepared hundreds of IERs.

2 This report was prepared by Mr Craig Edwards and Mr Martin Holt, who are each authorised representatives of LEA. Mr Edwards and Mr Holt have over 23 years and 31 years' experience respectively in the provision of valuation advice (and related advisory services).

Declarations

3 This report has been prepared at the request of the Directors of Integral Diagnostics to accompany the Target's Statement to be sent to Integral Diagnostics shareholders. It is not intended that this report should serve any purpose other than as an expression of our opinion as to whether or not the Offer is fair and reasonable to Integral Diagnostics shareholders.

Interests

4 At the date of this report, neither LEA, Mr Edwards nor Mr Holt have any interest in the outcome of the Offer. With the exception of the fee shown in Appendix A, LEA will not receive any other benefits, either directly or indirectly, for or in connection with the preparation of this report.

5 We have considered the matters described in ASIC RG 112 – *Independence of experts*, and consider that there are no circumstances that, in our view, would constitute a conflict of interest or would impair our ability to provide objective independent assistance in this engagement.

Indemnification

6 As a condition of LEA's agreement to prepare this report, Integral Diagnostics agrees to indemnify LEA in relation to any claim arising from or in connection with its reliance on information or documentation provided by or on behalf of Integral Diagnostics which is false or misleading or omits material particulars or arising from any failure to supply relevant documents or information.

Consents

7 LEA consents to the inclusion of this report in the form and context in which it is included in the Target's Statement.

Appendix C

Listed company multiples

1 A summary of the implied EBITDA multiples for listed companies operating in the Australian healthcare sector is set out below, with a brief description of their business activities following:

Listed company trading multiples[1]

	Enterprise value[2] $m	EBITDA multiples FY17[3] x	FY18[4] x	FY19[4] x	Forecast growth[5]
Integral Diagnostics	323	9.6	8.7	8.2	7.4%
Capitol Health	191	13.3	9.0	8.9	17.1%
Australian healthcare companies					
Sonic Healthcare	12,697	14.6	13.3	12.4	7.6%
Primary Health Care	2,663	8.6	8.9	8.5	1.8%
Virtus Health	587	9.2	8.6	8.2	5.4%
Monash IVF Group	399	8.2	8.8	8.3	0.4%
Pacific Smiles Group	243	11.6	10.5	9.0	13.9%
1300SMILES	148	11.9	10.1	9.3	10.7%

Note:
1 Enterprise value and earnings multiples calculated as at 16 February 2018 except for Integral Diagnostics and Capitol Health which are calculated as at 28 November 2017, being the last trading day prior to the announcement of the intention to make the Offer.
2 Enterprise value includes net debt (interest bearing liabilities less non-restricted cash), net derivative liabilities, market capitalisation adjusted for material option dilution, share placements (for the purpose of reducing debt) and buybacks and excludes surplus assets.
3 Historical earnings are based on latest statutory full year accounts and exclude non-recurring items, significant write downs, realised investment gains or losses and restructuring charges.
4 Forecast earnings are based on Bloomberg broker average forecasts (excluding outliers and outdated forecasts).
5 CAGR for EBITDA over the three years to FY20.
Source: Bloomberg, latest full year statutory accounts, latest interim accounts, company announcements and LEA analysis.

Comparable company descriptions[76]

Sonic Healthcare Limited

2 Sonic Healthcare is an international medical diagnostics company with operations in Australia, New Zealand, the United Kingdom, Germany, Switzerland, Belgium, Ireland and the United States of America (US). The company provides laboratory and radiology services to medical practitioners, hospitals and community health services. Sonic Healthcare is the largest pathology company in Australia and Germany with over 500 specialist pathologists. It also operates Australia's largest network of primary care medical centres and Australia's

76 Information in respect of Integral Diagnostics and Capitol Health is set out in Sections III and IV respectively.

second largest diagnostic imaging provider. The company also employs 2,800 general practitioners, 180 radiologists and thousands of medical scientists and technicians.

Primary Health Care Limited

3 Primary Health Care is an Australian healthcare company providing services to medical and allied health professionals. The company operates 76 medical centres, 109 pathology labs (with over 2,200 collection centres) and 141 diagnostic imaging sites (it operates Australia's third largest network of diagnostic imaging clinics). One in every three pathology samples taken in Australia are tested in the company's laboratories. Primary Health Care is also a leading provider of healthcare technology solutions and offers clinical software, online content and information resource tools.

Virtus Health Limited

4 Virtus Health is the largest network provider of fertility services in Australia. It also has international operations in Ireland, Denmark and Singapore. The company provides a variety of assisted reproductive services including specialised diagnostics and day surgery services for reproductive and fertility patients. Virtus Health serves its patients through a network of fertility clinics, embryology laboratories and specialised diagnostic testing laboratories. It employs more than 100 fertility specialists and over 1,000 professional staff.

Monash IVF Group Limited

5 Monash IVF Group is a fertility research and treatment company with operations in Australia and Malaysia. The company specialises in assisted reproductive technology with a strong focus on specialised diagnostics and IVF ultrasound. In addition, Monash IVF Group researches and develops reproduction supportive medication. The company operates 22 fertility clinics, 17 specialist women's imaging sites, five service centres, two specialised diagnostic laboratories and two day hospitals.

Pacific Smiles Group Limited

6 Pacific Smiles Group operates 70 dental centres around Australia at which independent dentists practice and provide clinical treatments and services. The company provides general dentistry services, dental treatments and advanced dentistry including dental implants. It also provides specialist dentistry comprising orthodontics, prosthodontics, endodontics and periodontics, as well as other treatments under general anaesthetic and intravenous sedation.

1300SMILES Limited

7 1300SMILES provides dental and management services in Australia. It enables the delivery of services to patients by providing the use of dental surgeries, practice management and other services to self-employed dentists carrying on their own dental practices. The company offers services in the areas of marketing, administration, billing, facilities certification and licensing to all participating dentists. It also provides equipment and facilities, support staff and consumable goods.

LONERGAN EDWARDS & ASSOCIATES LIMITED

Appendix D

Transaction evidence

1 The following table sets out the implied EBITDA multiples for recent transactions of Australian diagnostic imaging companies as well as other healthcare services companies:

Private hospital and day surgery transactions						
				Enterprise	EBITDA multiple	
				value[2]	Historical	Forecast
Date[1]	Target	Acquirer	Description	(millions)	x	x
Australian diagnostic imaging companies						
Jan 18	I-MED	Permira	Diagnostic imaging	A$1,260.0	11.1[3]	na
Dec 17	Radiology Tasmania	Capitol Health	Diagnostic imaging	A$24.7[4]	na	7.5
Jun 17	NSW radiology assets	I-MED Radiology Network	Diagnostic imaging	A$81.5	8.5	na
Apr 15	Two Sydney radiology clinics	Capitol Health	Diagnostic imaging	A$30.0	8.0	na
Mar 15	Sydney Ultrasound	Monash IVF	Diagnostic imaging	A$30.1	7.8	na
Jan 15	Imaging @ Olympic Park	Capitol Health	Diagnostic imaging	A$25.0	7.6	na
Dec 14	Southern Radiology Group	Capitol Health	Diagnostic imaging	A$64.6	9.0	na
Other Australian and New Zealand healthcare services companies						
Aug 17	Healthscope's medical centres	Fullerton Health	Medical centres	A$55.0	6.3	na
Mar 17	Icon Group	QIC / Goldman Sachs Private Equity / Pagoda Investment	Cancer care	A$1,100.0	na	12.2
Mar 17	Illawarra Healthcare	Healthe Care	Hospitals	A$53.0	na	11.0
Feb 17	Cura Day Hospitals Group	Fresenius	Day hospitals	A$425.0[5]	13.7[6]	Na
Oct 16	Pulse Health	Healthe Care	Hospitals / day surgeries	A$153.3	nm	8.6-10.6[7]
Jul 16	GenesisCare	China Resources / Doctors & Management	Cancer care / cardiac disease	A$1,700.0	15.5	12.1
Dec 15	Healthwoods and Hobson	Pulse Health	Day surgeries	A$21.5	8.4	na
Dec 15	Healthe Care	Luye Medical	Hospitals	A$938.0	13.4	na
Nov 15	Hunter Valley Private Hospital	Healthscope	Private hospital	A$71.6	11.0	na
Aug 15	Vision Eye Institute	Jangho Group	Day surgeries	A$205.4	7.8	7.9[8]
Jun 15	Healthscope's Aus. pathology business	Crescent Capital Partners	Pathology	A$105.0	11.3[9]	na
Apr 15	The Hills Clinic	Pulse Health	Mental health facility	A$33.3	10.4	8.3[10]

Appendix D

Private hospital and day surgery transactions						
				Enterprise	EBITDA multiple	
				value[2]	Historical	Forecast
Date[1]	Target	Acquirer	Description	(millions)	x	x
Jul 14	Acurity Health Group	Evolution Healthcare	Hospitals	NZ$175.0	8.6	8.3[8]
Jan 14	Cura Day Hospitals Group	Intermediate Capital Group	Day hospitals	A$200.0	14.2	8.5[11]
Jul 12	Acurity Health Group	Austron	Hospitals	NZ$155.6[12]	7.6	6.9[8]
Jul 11	Norfolk Investments	Wakefield Health	Hospital	NZ$30.8	8.3	8.3
Jun 11	Healthe Care	Archer Capital	Hospitals	A$240.0	9.0	na
May 10	Healthscope	TPG Capital & Carlyle Group	Pathology / medical centres	A$2,733.5	10.4	na

Note:
1 Date of announcement.
2 On a 100% basis.
3 Based on forecast earnings for the year ended 30 June 2017.
4 Includes allowance for half the potential earn out payment of $1.0 million.
5 Consideration shown is for 100% of the business, noting that the transaction was for a 70% interest in the company.
6 Historical results do not allow for refurbishments / expansions and three hospital acquisitions made prior to the date of the transaction. After inclusion of a contribution from these refurbishments / expansions and acquisitions, EBITDA would be higher and the implied EBITDA multiple would be lower.
7 The low forecast multiple is based on future maintainable earnings assessed by the independent expert opining on the transaction and includes an estimate of the potential normalised earnings from two hospitals that were ramping up at the time of the transaction. The high forecast multiple is based on an average of broker forecasts and company guidance and is adjusted for the expected additional investment at one of the company's hospitals.
8 Multiple is based on future maintainable earnings assessed by the independent expert opining on the transaction.
9 Multiple is based on EBITDA averaged over the two years to FY15.
10 Multiple is based on annualised month of May 2015 plus synergies captured to May 2015.
11 Multiple is based on actual financial results for the year ended 30 June 2014.
12 Consideration shown is for 100% of the business, noting that the transaction was for a 50.01% interest in the company.

Source: LEA analysis using data from ASX announcements, media articles, broker reports and company annual reports.
na – not available. nm – not meaningful.

Appendix E

Glossary

Abbreviation	Definition
ABS	Australian Bureau of Statistics
AIHW	Australian Institute of Health and Welfare
ASIC	Australian Securities & Investments Commission
ASX	Australian Securities Exchange
CAGR	Compound annual growth rate
Capitol Health	Capitol Health Limited
CFO	Chief Financial Officer
CITIC	CITIC Pharmaceutical (Shenzhen) Co., Ltd
CT	Computed tomography
DCF	Discounted cash flow
EBIT	Earnings before interest and tax
EBITA	Earnings before interest, tax and amortisation
EBITDA	Earnings before interest, tax, depreciation and amortisation
Enlitic	Enlitic LLC
FOS	Financial Ombudsman Services Limited
FSG	Financial Services Guide
Full Licence	Full Medicare eligible licence
FY	Financial year
GDP	Gross domestic product
GP	General Practitioner
Hubs	Integral Diagnostics' hospital and comprehensive sites
HY	Half year
IER	Independent expert's report
I-MED	I-MED Radiology Network
Integral Diagnostics or the Company	Integral Diagnostics Limited
IPO	Initial public offering
IR	Interventional radiology
IT	Information technology
LEA	Lonergan Edwards & Associates Limited
MBS	Medicare Benefits Schedule
MOU	Memorandum of understanding
MRI	Magnetic resonance imaging
MRP	Market risk premium
NPV	net present value
NSW	New South Wales
Offer	The offer by Capitol Health to acquire all the ordinary shares in Integral Diagnostics in exchange for 6.9 Capitol Health shares plus $0.36 cash for each Integrated Diagnostics share
Partial Licence	Partial Medicare eligible licence
PET	Positron emission tomography
RANZCR	Royal Australian and New Zealand College of Radiologists
Referrers	General practitioners, medical specialists and allied health professionals
RG 111	ASIC Regulatory Guide 111 – *Content of expert reports*
South West MRI	Western District Radiology in Warrnambool, Victoria in 2013
Spokes	Integral Diagnostics' clinic sites
US	United States of America
VWAP	Volume weighted average price
WA	Western Australia
WACC	Weighted average cost of capital
WACHS	Western Australian Country Health Services
WANOS	Weighted average number of shares outstanding
Zhouxin	Xiamen Zhouxin Medical Image Co., Ltd

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