



MEMO

To: Board of Directors
From: Company Secretary
Subject: **CONVERTIBLE LOAN**

The WSJ loan facility has been fully drawn down to \$500,000 at a current interest rate of 11.2%pa (The Bank Benchmark Business Lending Rate + 2%) and is due for repayment on 30 September.

However, I have looked at the original Loan Agreement, dated _____, 2000 and, rather than simply repay the loan, under clause 7.5 and following the lender may – at his discretion – convert the amount of the loan on the repayment date into [ordinary fully paid] shares in the company. The wording of clauses 7.5 ~ 7.8 is shown below under ‘Conversion Arrangement’.

Share Conversion Price

If the loan is converted to shares the documentation calls for conversion at the lower of 25¢, the price of any then current capital raising, or the volume weighted average of arm’s length share transfers over the preceding 6 months.

As there have been no transfers since February (average price over recent months till then was about 12¢), and there is no current capital raising, then I believe the applicable price for conversion will be 25¢ per share.

Takeover Provisions

Conversion of the full loan amount into shares will in fact mean that the WSJ group (i.e., WSJ and related parties) will increase their shareholding in the company by approximately 4.6%.

And as the WSJ group already holds some 35% of the company’s shares, then they are governed by the takeover provisions of Section 606 of the Corporations Act and will have to seek shareholder approval under Sec.611(Item7) before conversion can occur.

Sec.606 only allows a shareholder with >20% to increase their holding by up to 3% (creep) in any 6 months without invoking the takeover provisions.

Related Party Benefit

Conversion may also require shareholder approval under Chapter 2E of the Act as there may be a ‘related party benefit’ involved.

This is because:



- (i) the company's director Mr_____ is also director/shareholder in the WSJ group companies, so he is a related party to the transaction; and
- (ii) there is currently a proposed takeover offer for the company itself at 50¢ per share, which Mr_____ is aware of and, in fact, has indicated that he wants to do the conversion before that happens so he will benefit from the higher share price been offered by the bidder.

Where shareholder approval to a related party benefit is being sought the procedure in the Act must be followed, and relevant information provided to shareholders and to ASIC before the general meeting.

Whilst Mr_____ may have every right to follow this route, and is happy that everything be 'transparent', it appears to me that shareholder approval will be required to comply with both elements of the Act.

Conversion Arrangement

The Facility Agreement contains the following clauses covering the conversion arrangement:

7.5 Conversion of Loan

(a) The Lender may request the conversion of all of the Loan into Ordinary Shares by giving a Conversion Notice to the Borrower at the following times:

(i) at any time prior to the Repayment Date if the Borrower attempts to raise capital on any basis whatsoever, including, but not limited to, an initial public offering via a listing of the shares in the Borrower on the Australian Stock Exchange or

(ii) if the Loan has not already been converted into Ordinary Shares prior to the Repayment Date, then, on the Repayment Date.

(b) Subject to clause 7.8, on receipt of the Conversion Notice:

(i) the Loan becomes due and payable by the Borrower in full on the Conversion Date;

(ii) the Borrower must on the Conversion Date convert the Loan into Ordinary Shares on the terms of this clause 7.5 and clause 7.6; and

(iii) the obligation of the Borrower to pay the Loan is set off in full against the obligation to make the conversion under clause 7.5(b)(ii).

(c) On the conversion referred to in clause 7.5(b), the number of Ordinary Shares to be issued by the Borrower will be equal to the amount of the Loan divided by the Purchase Price determined pursuant to clause 7.6. The number of Ordinary Shares issued shall be determined in accordance with the following formula: *Loan/Purchase Price*.



(d) Subject to clause 7.8, each Ordinary Share issued upon conversion must be allotted within 2 Business Days after the Conversion Date and rank equally with the existing Ordinary Shares. Promptly after any allotment the Borrower must issue a share certificate to the Lender representing that allotment.

(e) If the Lender gives a Conversion Notice on or before an entitlement date for any dividend payment or other entitlement in respect of Ordinary Shares, the Ordinary Shares issued on conversion will participate in the dividend or other entitlement.

7.6 Determination of Purchase Price for Conversion

Subject always to clause 7.7, the applicable purchase price for the conversion of the Loan into Ordinary Shares on the Conversion Date (Purchase Price) is to be the lower of the prices determined as follows:

(a) 25¢ (cents) per share;

(b) if at the Conversion Date the Borrower is in the process of undertaking any form of capital raising (Capital Raising), the price for Ordinary Shares payable by the investors in the Capital Raising; and

(c) the volume weighted average of the prices at which the Ordinary Shares were traded on an arms length basis during the six months prior to the Conversion Date.

7.7 Maximum Purchase Price Payable

Notwithstanding anything contained in clause 7.6, the maximum Purchase Price per Ordinary Share payable by the Lender as part of any conversion shall not be greater than 25 cents.

7.8 Where Conversion Requires Approval of Members

If the conversion of the Loan would result in a breach of section 606(1) of the Corporations Act, the conversion will be deferred until the Borrower obtains approval for the conversion from its members pursuant to paragraph 7 of the table contained in section 611 of the Corporations Act. The Loan will continue to accrue interest until conversion.

DISCLAIMER

The comments in this memo reflect some commercial aspects and observations on the matter experienced or observed by the writer in practice as he understands them. The information is given as a guide only and does not represent a definitive or legal view of any of the issues raised, covered or referred to and the reader is urged to seek his own professional advice on all aspects of, or pertaining to, this and any related matter.