MEMO

To: Board of Directors

From: Company Secretary

Subject: **TAKEOVER APPROACH – ISSUES**

You have advised that the foreign-controlled corporate group has indicated that it is interested in acquiring the company by making an offer of around 35¢ per share for all of the company's share capital, and you have asked me to consider the issues which the board should discuss at its meeting next week.

The issues that come to mind include:

Takeover Provisions

The takeover provisions are set out in Chapter 6 of the Corporations Act and are rather complex, but the principal tenet – as enunciated in Section 602 – is to ensure control of a company does not pass or increase other than in a way that is fair to all other shareholders.

Basically, Section 606 prohibits the acquisition by any entity/group – company, trust, individual, etc ("bidder") of a relevant interest in shares/securities in a company ("target") where it would:

- take the bidder's holding (voting power) over 20%; or
- increase the holding between 20% and 90%

if the target:

- is stock exchange listed; or
- if unlisted – has more than 50 shareholders (regardless of whether it is a Public or Pty Ltd company)

unless it makes a takeover bid or the takeover is approved by the shareholders in general meeting.

So, even though we are unlisted, as our company has around 200 shareholders then the Act applies to us.

I assume that the takeover would be 'friendly' and so a smooth completion would be sought through holding a shareholders' [extraordinary] general meeting (EGM) to approve. Otherwise, the bidder will have to go through the process of making a formal takeover bid, which will include the preparation and dissemination of bidder's and target's written statements which must be in accordance with the Act including being lodged with and approved by ASIC.

Continuous Disclosure

I see no obligation in the Act to have to keep shareholders informed of events, until we send out the EGM notice/documents.

However, as the company is clearly an unlisted Disclosing Entity (DE) under the Act because it has raised funds through a prospectus and has more than 100 shareholders, it is, therefore, subject to 'continuous disclosure' requirements imposed by Section 111AP.

Chapter 6CA covers the obligations of a DE to comply with 'continuous disclosure'.

For an unlisted DE:

- Section 675(2) requires, in summary, lodgement with ASIC of information

  (a) that is not generally / publicly available; and
  (b) that a 'reasonable person' would expect, if it were available, could have a material effect on the price or value of the company's shares (ie, 'price-sensitive information').

- Section 677 provides that a 'reasonable person' would expect information to have a material effect on the price or value of the company's shares if the information would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the shares.

However, there are some 'carve outs' for unlisted DEs, as there are for Australian listed companies, relating to confidentiality, trade secrets, etc, where such information does not have to be disclosed (Regulation 6CA.1.01).

Information is disclosed using a Form 1003 "Disclosure Notice for Unlisted Disclosing Entity" which must be lodged with ASIC as soon as practicable after the DE becomes aware of the information.

In my opinion, the best approach would be to send out a preliminary letter to all shareholders as soon as the deal is 'confirmed', briefly explaining the key parameters of the proposal, and we would then lodge that with ASIC (I believe that would be a far better approach than simply lodging the details with ASIC on a Form 1003 which, most likely, no shareholder will ever know about even though the information is on the public record). Any subsequent shareholder communication/documents would also have to be lodged with ASIC right up to and including the EGM notice/documents.

Prospectus

I understand the foreign-controlled group will be offering cash for the company's shares. But if they were to make an offer of their own shares in exchange for the company's shares then a prospectus or other disclosure document will be required.

Independent Experts Report / Valuation

There are 2 situations where an independent expert's report (IER) and/or valuation of the company may be required.

Firstly, if the takeover is to proceed on the basis of shareholder approval under Section 611 (Item 7) at an EGM, then an IER may have to be obtained by the bidder, whereby the expert must give an opinion on whether the takeover is fair and reasonable so that the shareholders are given all necessary information material to them making a decision on how to vote at the EGM.

Alternatively, to assist shareholders' decision making, an independent valuation of the company may be obtained by the bidder and/or an independent valuation may be sought by the company to enable shareholders to see the true worth of their own company before making a voting decision on a fair value for their shares.

The bidders IER and/or independent valuation would probably also form the basis of the document/s comprising the 'expert's report' to accompany documentation if the bidder needed/wanted to proceed with a compulsory acquisition of shares not accepted under the takeover offer.

Compulsory Acquisition

In certain circumstances a shareholder who holds/controls at least 90% of the shares in a company may move to compulsorily acquire the balance of shares not held by him.

Procedures and requirements governing the compulsory acquisition of shares in a company are detailed in the Corporations Act. The Act contains provisions designed to protect shareholders (in a target company) who are having their shares compulsorily acquired to ensure that they receive adequate information and a fair price for their shares.

Section 664A(3) states that a 90% holder may compulsorily acquire all the other shares in the company – provided he acts within 6 months (Section 664AA) – if either:

- after an objection period (of at least 1 month) set out in a Notice pursuant to Section 664C(1) no shareholder objects to the acquisition or, if any shareholders have objected, they together hold a block of less than 10 percentum of the shares being acquired; or
- if shareholders with a block of 10 percentum or greater of those shares object, the 90% holder applies to the Court within 1 month and the acquisition is approved – Section 664F.

A Section 664C(1) Notice (Form 6024 "Notice of Compulsory Acquisition") must contain the requisite information and be sent to all shareholders and the target company, together with a copy of an expert's report (as per Section 667A – stating

whether, in the expert's opinion, the terms proposed for the compulsory acquisition give a fair value for the shares concerned) and an objection form, and be lodged with ASIC on the prior business day or the same day at the latest – Section 664C(2) & (3). The acquisition consideration must be cash only and the same price paid for all shares – Section 664B.

Foreign Investment Review Board

My understanding is that where the value of the Australian business/company being acquired is valued at $10m or greater then FIRB approval is required before the acquisition can proceed.

Trade Practices Act

Section 50 of the Act prohibits an acquisition of shares which would have the effect of substantially lessening competition in a 'substantial' market for goods and/or services unless authorised by the ACCC.

Escrow Shares

You will also recall that some 2 million of the shares on issue are in 'voluntary escrow' for another 9 months (restricted because of the secondary sales provisions which apply for 12 months when new shares are issued), so the board/bidder will need to consider how to deal with these shares.

Moreover, that is also a contractual obligation to issue a further 1 million shares in about 6 months time to the UK vendors – which shares will also then be escrowed for 12 months – so this too needs consideration by the board/bidder.

Employee Options

Consideration needs to be given as to how the option holders will be treated in this process as no doubt those who hold options which have vested will want to take advantage of any takeover offer, either by first exercising them or by simply being offered a 'net' amount for their options.

Taxation

There may well be tax consequences for holders of both shares and options in the company, but I presume this is really their concern and not for the company to seek or provide advice on.