

Briefing Note: Discussions with Toll

ONTRACK and advisors met with Toll and advisors on Thursday 17 January.

The meeting followed ONTRACK's indicative offer and Toll's rejection of that offer. The main part of the meeting was a presentation by Toll setting out their perspectives on value and valuation methodology.

Points made by Toll included:

- Toll confirmed that they were open to a sale of the rail business at the right price.
- Toll does not wish to sell Toll Tranz Link (TTL), and described the terms of their retention of TTL as a "potential deal-breaker". They indicated that they see value in a close relationship between the rail business and TTL and would seek to formalise an ongoing relationship as a part of a transaction on the rail business.
- Toll indicated that they could provide us with information next week about TTL's value, assets and operations so that we can determine the nature and value of the business to be purchased.
- Toll presented valuation material for the complete business. Broadly, this material sought to justify an Enterprise Value of around \$1,150 million and Equity Value of around \$950 million (approximately \$4.50 per share), and included approximately \$120m for land release in Wellington and a 30% (\$200-250m) premium for control.
- Toll resisted suggestions that they should present material that set out their views on their strategy for the business and business value should the Crown proceed with a non-concessional implementation of the NRAA. They said the outcome of NRAA dispute resolution was highly uncertain and that they wished to reserve their position on how they would respond if ONTRACK ended the interim arrangements.
- They maintained that ONTRACK's indicative offer (\$300 million to \$350 million equity value) was inadequate and did not reflect the 'option value' to the Crown of owning an integrated rail business or the economic cost to New Zealand from a drawn out series of disputes seeking enforcement of the NRAA.
- They concluded by saying that ONTRACK needed to substantially improve its indicative offer if discussions were to progress on the proposed timetable.

In response to these comments ONTRACK made the following points:

- Toll retaining TTL was likely to be acceptable. We made no concession or commitment with respect to ongoing relationships between the rail business and TTL.
- We rejected their valuation methodology and conclusions largely on the grounds that they bore no relationship to the likely future earnings of the business, or the value of rail assets in an alternative use. We noted that, in our view, the ONTRACK indicative offer was substantially in excess of the value of the business were the NRAA to be implemented in a non-concessional manner.
- We made no commitment to responding with an improved indicative offer.

Next Steps

We believe it is unlikely that Toll seriously expects to receive an equity value of around \$950 million or \$4.50 per share from the current process. Toll's behaviour can be seen as a test of ONTRACK's desire to progress a transaction quickly and willingness to pay. In this environment, we believe that an early response to Toll with a higher indicative offer will simply raise their expectations on the proceeds they can extract in a sale.

ONTRACK management and advisors believe the appropriate response is as follows:

- Advise Toll that their expectations are unrealistic and ONTRACK is not willing to proceed with discussions on price while Toll is seeking to justify values around \$950 million.
- Advise Toll that the ONTRACK remains open to discussions at values that reflect the value of the business under realistic NRAA scenarios (equity values of zero to \$550 million).
- Indicative offers will remain subject to due diligence confirming that the forecasts provided by Toll are credible

ONTRACK proposes to communicate this response to Toll as soon as possible and recognises that it may stall negotiations for a period. However, we believe it is an essential part of reaching an outcome that is acceptable to ONTRACK and shareholders.

In the meantime, we will seek to continue the discussions on the business that might be purchased and to frame-up the ongoing relationship (if any) between the business to be sold and TTL. Toll may decline to continue discussing this while price is unresolved.

It is likely that Ministers will need to form a view over the next fortnight on the best and final offer that ONTRACK should make prior to terminating the negotiations.

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