

Tatts determines the Pacific Consortium's proposal is not superior to the proposed Tabcorp merger

Brisbane, 23 December 2016 – Tatts Group Limited (**Tatts**) announces that it has concluded its assessment of the unsolicited, non-binding, indicative and conditional proposal from four financial investors (**Pacific Consortium**) to acquire 100% of Tatts for a combination of cash and scrip consideration (**Indicative Proposal**).

The identity of the Pacific Consortium members and the underlying financial assumptions, and key terms and conditions of the Indicative Proposal were attached to Tatts' ASX announcement of 14 December 2016.

The Tatts Board has now assessed the Indicative Proposal and determined it is not a Superior Proposal, and cannot reasonably be expected to result in a Superior Proposal, as defined in Tatts' Merger Implementation Deed (**MID**) with Tabcorp Holdings Limited (**Tabcorp**) announced on 19 October 2016 (**Proposed Tabcorp Merger**).

In making this determination, Tatts notes the Indicative Proposal is predicated on a number of key assumptions (see below) that are either incorrect, inconsistent with Tatts' current expectations or unknown, and Tatts is unable to assess what impact, if any, these factors might have on the terms and conditions of the Indicative Proposal.

Regardless, even if the Pacific Consortium were to update its key assumptions with no consequential impact on its key terms and conditions, the Tatts Board would still make the same determination given Tatts believes the total value offered is not superior to the Proposed Tabcorp Merger. In particular, the price ascribed to LotteryCo is inadequate and the assumed trading and control price estimates for Wagering & Gaming Co are overly optimistic, together with other factors relating to conditionality (see below).

Accordingly, having made these determinations and under the terms of the MID, Tatts is unable to grant the Pacific Consortium due diligence or otherwise engage in discussions regarding the Indicative Proposal.

The Board continues to believe that the Proposed Tabcorp Merger is in the best interests of Tatts shareholders and unanimously recommends the Proposed Tabcorp Merger, in the absence of a Superior Proposal and subject to an independent expert concluding the Proposed Tabcorp Merger is in the best interests of Tatts shareholders.

In the event of any material developments in relation to this Indicative Proposal, receipt of any other bona fide competing proposal, or in relation to the Proposed Tabcorp Merger, Tatts will make a further announcement.

The Board remains fully committed to acting in the best interests of, and maximising value for, Tatts shareholders.

Assessment of Key Assumptions

- **FY17 Lottery EBITDA:** 1H FY17 Lotteries trading performance has been negatively impacted by a relatively unfavourable jackpot sequence noting there has only been 15 jackpots at or above \$15 million since the start of the current financial year, compared to 24 in 1H FY16 and 18 in 1H FY15. As such, Tatts currently expects (on a preliminary and unaudited basis) its 1H FY17 Lotteries EBITDA result to be approximately \$153 million, down approximately 13.8% on 1H FY16. The Indicative Proposal assumes Lotteries FY17 EBITDA performance will be \$353.6 million, up 2.3% on FY16's \$346 million result, which was generated from an exceptionally favourable jackpot sequence. Given 1H FY17 performance is expected to be down, the Indicative Proposal's assumption for FY17 Lotteries EBITDA is likely to be too high.
- **Current Net Debt:** The Indicative Proposal assumes Tatts' net debt is no greater than \$1.04 billion, which was Tatts' net debt as at 30 June 2016. Tatts' current net debt is approximately \$1.20 billion. The major movements during 1H FY17 were the FY16 dividend payment and instalment payments for the Queensland wagering licence and the NSW CMS monitoring rights.
- **Victorian Lottery Licence Renewal:** The Indicative Proposal assumes Tatts will renew its Victorian Lottery Licence and on materially the same terms. It remains unknown whether Tatts' Victorian Lottery Licence will be renewed or on what terms. Tatts does not currently expect the outcome of that process will be known before June 2017. It is not clear what assumptions the Pacific Consortium has made in relation to premium payments (licence fees) with respect to the licence.
- **Allocation of Corporate Overheads:** The Indicative Proposal does not make clear what assumptions have been made with respect to the allocation of Tatts' corporate overheads (approximately \$52 million in FY16) between LotteryCo and Wagering & Gaming Co. In assessing the Indicative Proposal, Tatts has assumed corporate overheads would be allocated approximately 50% to LotteryCo and 50% to Wagering & Gaming Co.
- **Impact of Separating Wagering & Gaming Co:** The Indicative Proposal does not make clear what assumptions have been made with respect to the one-time costs and the ongoing costs (dis-synergies) that would arise from separating Wagering & Gaming Co from LotteryCo. In assessing the Indicative Proposal, Tatts has assumed there will be approximately \$75 million of one-time costs and approximately \$12.5 million of ongoing annual costs, which would be fully allocated to Wagering & Gaming Co.

Assessment of Valuation

- **Interim Dividend:** Under the Proposed Tabcorp Merger, Tatts shareholders will receive \$0.425 cash and 0.80 Tabcorp shares plus an interim dividend of up to \$0.095 per Tatts share, such that Tatts shareholders will benefit from the cash flow generated from the business during 1H FY17. This compares to the cash portion of the Indicative Proposal of \$3.40 cash per share, which includes a \$0.095 per Tatts share interim dividend. As such, on a like for like basis, Tatts has assessed the Indicative Proposal to be \$3.305 cash per Tatts share plus 1 share in a Wagering & Gaming Co.
- **Price for LotteryCo:** Tatts believes the price being offered for LotteryCo under the Indicative Proposal of \$3.305 cash per share (excluding the interim dividend) is inadequate. LotteryCo is a unique and highly strategic franchise underpinned by a number of long-term licences that should provide a stable and growing annuity style income stream well into the future. Further, the ability to enhance this franchise through digital distribution and products over time remains significant.
- **Estimated Trading Price of Wagering & Gaming Co:** Tatts believes the Indicative Proposal's estimated trading price of Wagering & Gaming Co of \$1.00 per share is too high. Tatts also notes the proposed amount of debt (including the Dec-17 CMS monitoring rights payment) for Wagering & Gaming Co is relatively high, which Tatts believes could negatively impact its trading price.
- **Estimated Control Price for Wagering & Gaming Co:** Tatts believes the Indicative Proposal's estimated potential control price of Wagering & Gaming Co of \$1.60 per share is too high. Tatts also believes that control prices for Wagering & Gaming Co are, to some degree, speculative given that a control transaction for Wagering & Gaming Co is not what is being offered to Tatts shareholders under the Indicative Proposal. In this regard Tatts confirms that it has not, in the past two years, received an approach from any bona fide buyer for either of its Wagering or Gaming businesses. Further, there is no basis for assuming that any buyer for Wagering & Gaming Co could achieve \$130m of net run-rate synergies. Finally, there is no certainty that Tabcorp would be interested in bidding for Wagering & Gaming Co or on what terms.

Assessment of Conditionality

- **Due Diligence:** The Indicative Proposal is subject to a six-week due diligence period focusing on accounting, tax, commercial, legal and regulatory matters customary for a transaction of this nature. No further information or scope of due diligence was provided with the Indicative Proposal. In this regard Tatts notes that the majority of members of the Pacific Consortium conducted a significant amount of due diligence on Tatts earlier this year, including access to senior management and an electronic data room. Further, Tatts notes that as a listed public company it is subject to ongoing disclosure requirements.
- **Financing:** Whilst the Pacific Consortium has confirmed it has indicative financing support from banks for the debt required to fund the proposed transaction, no other information regarding the debt financing (identity of the lenders, specific level of commitment or support, status of credit committee approvals, or indicative terms and conditions) was provided with the Indicative Proposal. Given the amount of debt financing required (approximately \$2.3bn), and the relatively high leverage multiple being applied to LotteryCo, the confirmation provided by the Pacific Consortium is insufficient in this respect.

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