

20 December 2010

Company Announcements Office
ASX Limited
20 Bridge Street
SYDNEY NSW 2000

By electronic lodgement

Total Pages: 119 (including covering letter)

Dear Sir/Madam

In accordance with Listing Rule 15.2, attached is a copy of the following:

1. Notice of Meeting of Engin Shareholders to be held on 31 January 2011;
2. Notice of Meeting of Minority Shareholders to be held on 31 January 2011;
3. Explanatory Statement;
4. Independent Expert's Report;
5. Independent Tax Opinion; and
6. Proxy Forms.

The attached will be despatched to shareholders.

Yours faithfully

For and on behalf of Engin Limited



Warren Coatsworth
Company Secretary



ENGIN LIMITED

ABN 46 063 582 990

NOTICE OF MEETING and
NOTICE OF MEETING OF MINORITY SHAREHOLDERS
including Explanatory Statement and Independent Expert's Report
in relation to a proposed selective capital reduction

For Meetings to be held at **Room 7, 38-42 Pirrama Road, Pyrmont, NSW,
2009 on Monday, 31st January 2011 commencing at 11.00am**

**This proposal affects your shareholding and your vote is
important. Please take action by voting in person or by proxy.**

This is an important document and requires your immediate attention. You should read this document in its entirety. If you are in doubt as to what you should do, you should consult your investment or other professional adviser.

Key dates

Latest date and time for lodgment of proxy forms

- For General Meeting 11.00am Saturday 29 January 2011
 - For Special Meeting of Minority Shareholders 11.45am Saturday 29 January 2011
-

Date and time for determining eligibility to vote

- For General Meeting 11.00am Saturday 29 January 2011
 - For Special Meeting of Minority Shareholders 11.45am Saturday 29 January 2011
-

General Meeting 11.00am Monday 31 January 2011

Special Meeting 11.45am Monday 31 January 2011

Suspension of trading of Shares 15 February 2011*

Record date for determining entitlements 22 February 2011*

Payment / despatch of return of capital* 23 February 2011*

Delisting of Engin* 24 February 2011*

Dates marked with an asterisk (*) are indicative only and may be sooner or later than these indicative dates. Any change to these indicative dates will be announced to the Australian Stock Exchange (ASX).

All times referred to are the time in Sydney, Australia.

Important notices

Read this document

You should read this document in its entirety before making a decision as to how to vote.

Responsibility statement

The information concerning Seven Group Holdings Limited (**SGH**) contained in:

- section 9 of the Explanatory Statement on pages 29 to 32; and
- section 18 of the Explanatory Statement on page 39,

including information as to the views and intentions of SGH (**SGH Information**), has been provided by SGH and is the responsibility of SGH.

The information concerning Engin Limited (**Engin**) contained in this document, including financial information and information as to the views, intentions and decisions of Engin (**Engin Information**) has been provided by Engin and is the responsibility of Engin.

Engin does not assume any responsibility for the accuracy or completeness of the SGH Information except to the extent that the information has been provided by Engin. SGH does not assume any responsibility for the accuracy or completeness of the Engin Information.

Role of ASIC and the ASX

A copy of this document has been lodged with ASIC. Neither ASIC nor any of its officers takes any responsibility for the contents of this document.

A copy of this document has been lodged with the ASX. Neither the ASX nor any of its officers take any responsibility for the contents of this document.

Defined terms

Capitalised terms used in this document are defined in the Definitions section commencing on page 42.

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The Proposal

1 The Proposal

- All Engin Shares held by Minority Shareholders will be cancelled for a consideration of \$0.70 per Share.
- The Proposal is subject to Shareholder approvals at the Meetings.
- Engin to become a wholly owned subsidiary of SGH if the Proposal is approved.

2 Advantages of the Proposal

- Opportunity for Minority Shareholders to realise immediate value.
- ASX listing no longer provides capital markets benefits and incurs costs.
- Illiquidity makes trading in Engin Shares difficult, particularly for those with larger parcels of Shares.

Please read the Independent Expert's Report in full

3 What the Independent Expert Says

The Independent Expert has concluded that the Proposal is fair and reasonable. The Independent Expert is of this opinion because:

- The Proposal consideration of \$0.70 per Engin Share contains an implied premium which is well above the range of control premiums paid in takeovers generally;
- Given Network Investment's 57.33% holding in Engin, it is unlikely that an alternate offer or proposal will be made;
- If the Proposal does not proceed, the price of Engin Shares is likely to trade at a significant discount to the Independent Expert's valuation of between \$0.67 and \$0.77 per Share, and at a significant discount to the Proposal consideration of \$0.70 per Engin Share; and
- Given the illiquidity of the Engin Shares, the Proposal provides Engin Minority Shareholders with a means of realising immediate value for their investment.

You should read the Independent Expert's Report in full.

The Independent Expert has concluded that the Proposal is fair and reasonable.

4 What the Independent Chairman recommends

Mr Ian Smith, the Independent Chairman, has closely considered the Proposal, the information contained in this Explanatory Statement, the Independent Expert's Report and the Independent Tax Opinion.

The Independent Chairman recommends that you:

- Vote in favour of the first resolution, and not vote on the second resolution, proposed in the Notice of Meeting, and
- Vote in favour of the resolution proposed in the Notice of Meeting of Minority Shareholders.

5 Implications of Rejecting the Proposal

- The Share price may decline to the levels it traded at prior to the announcement that Engin was considering the Proposal. In the 6 months prior to announcement of the Proposal on 2 December 2010, Engin Shares traded in the range of \$0.35 to \$0.50.
- Shares in Engin may continue to be illiquid.
- An alternative to the Proposal is unlikely to emerge from a third party.

Please read the Independent Expert's Report in full.

The benefits of the Proposal as described earlier may not be obtained if the Proposal is not implemented.

6 Frequently Asked Questions

Q. What will happen to Engin if the Proposal is approved?

A. All Shares will be held by SGH and Engin will be de-listed.

Q. Who is SGH?

A. SGH is a significant Australian diversified operating and investment group that is listed on the ASX. SGH has key assets and investments in media and the Agricultural Bank of China and ASX listed stocks, cash and other liquid investments. It also has the operating business of WesTrac Group.

The SGH group comprises the WesTrac Group; Seven Media Group, a joint venture with Kohlberg Kravis Roberts comprising Australia's leading television network, Seven Network; Pacific Magazines, one of Australia's two largest magazine publishing companies, and Yahoo!7

Q. Will Engin be de-listed, and when?

A. If the Proposal is approved, unless the ASX agrees to an earlier suspension, it is intended that trading in Engin Shares will be suspended at the close of business on 15 February 2011, being the Business Day following the 14th day after the Meetings. After the Proposal is implemented, an application will then be made to the ASX to have Engin de-listed. Any change to the suspension date will be announced to the ASX before the Meetings.

Q. When is the consideration being paid?

A. If the Proposal is approved, it is intended that consideration will be paid approximately 23 days after the Meetings.

Q. What approvals are required for the Proposal?

A. For the Proposal to be implemented, the proposed Capital Reduction must be approved by:

- a special resolution at the General Meeting at which votes cast in favour of the resolution by Minority Shareholders will be disregarded; and
- a special resolution at the Special Meeting of Minority Shareholders.

Each special resolution must be passed by at least 75% of the votes cast by Shareholders who are present and entitled to vote on the resolution. Each special resolution is conditional upon the special resolution to be considered at the other meeting being passed. In effect, the Proposal must be approved by a special resolution of Minority Shareholders and separately by a special resolution of all Shareholders where only Network Investment is entitled to vote in favour of the resolution.

Q. Can I sell my Shares before the Proposal is implemented?

- A. You may, if you choose, sell your Shares on market before trading in Shares is suspended and realise a cash amount for your investment, although in doing so you will forgo the opportunity to receive the amount payable under the Proposal. You may also be subject to different tax consequences.
-

Q. What are the tax implications?

- A. On the basis set out in the Independent Tax Opinion (a copy of which is attached to this document, the Independent Tax Expert considers that the Capital Reduction should be excluded from the definition of dividend for tax purposes. On this basis no part of the payment of \$0.70 should be treated as a dividend in the hands of the Minority Shareholders. However the Capital Reduction payment will be relevant for calculating any taxable capital gain, or capital loss, realised by you upon the cancellation of your Shares. The taxation consequences to individual Shareholders are set out in more detail in the Independent Tax Opinion and referred to in section 16 of the Explanatory Statement on pages 35 to 37. **You should seek your own advice to clarify your own position.**
- You should read the Independent Tax Opinion in full.**
-

Q. How do I vote?

- A. Details on how to vote are contained on pages 15 and 16 of this document.
-

7 What to do Next

- You should read and consider the enclosed documents carefully and note the date of the Meetings.
- Having considered the information provided, you should decide how you wish to vote.
- You are encouraged to vote on the Proposal, either in person at the meeting, or by proxy. Details on how to vote are attached.
- If you have any questions, please email investorrelations@engin.com.au or contact Matthew Gepp, Engin Limited on (02) 8985 5835

How to Vote

How to Vote

Venue

The General Meeting for Shareholders will be held at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on **Monday, 31st January 2011 commencing at 11.00 am.**

The Special Meeting for Minority Shareholders will be held at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on **Monday, 31st January 2011 commencing at 11.45 am,** or as soon as the general meeting of Engin scheduled to take place at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 at 11.00am has concluded or been adjourned, whichever is earlier.

Take Action

This proposal affects your shareholding and **your vote is important.** Please take action by voting in person or by proxy.

Voting

Voting in person

If you wish to vote in person, you should attend the Meetings.

Voting by proxy

If you are unable to attend the Meetings, please vote by completing and signing the relevant proxy form enclosed with this document as soon as possible but so that it is received **no later than:**

11.00am on 29 January 2011 for proxy forms for the General Meeting. Proxy forms received after this time will be invalid.

11.45am 29 January 2011 for proxy forms for the Special Meeting for Minority Shareholders. Proxy forms received after this time will be invalid.

You may return the relevant proxy forms by posting them in the reply paid envelope provided or by delivering them to:

BY MAIL - Share Registry – Registries Limited, GPO Box 3993,
Sydney NSW 2001 Australia
or
Company Secretariat, Level 2, 38 – 42 Pirrama Road,
Pyrmont NSW 2009 Australia

BY FAX - Share Registry: + 61 2 9290 9655 or
Company Secretariat: +61 2 8777 7192

IN PERSON - Share Registry – Registries Limited,
Level 7, 207 Kent Street, Sydney NSW 2000 Australia

ONLINE - www.registries.com.au/vote/engingm2011

If the appointment of proxy is signed by an attorney, the power of attorney or a certified copy of it must also be sent.

If you have any questions, please email investorrelations@engin.com.au or contact Matthew Gepp, Engin Limited on (02) 8985 5835.

Notice of Meeting

Notice of Meeting

Notice is hereby given that a general meeting of Engin will be held at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 commencing at 11.00 am.

Important:

- 1 For information relevant to your decision as to how to vote, please refer to the Explanatory Statement. You should also read the Explanatory Notes to this Notice of Meeting.
- 2 Certain terms used below are defined in the Definitions section commencing on page 42.

Special Business

Amendment of the Constitution

Item 1

To consider and, if thought fit, pass the following resolution as a special resolution:

"That the Constitution of Engin Limited be amended by inserting the following after paragraph (h) of rule 5.8, as paragraph (i) of rule 5.8:

- (i) *A member is not entitled to vote on a resolution if, under the Corporations Act 2001 (Cth) or the Listing Rules, the notice which called the meeting specified that a vote on the resolution by the member must or will be disregarded for any purposes, and if the member or a person acting as proxy, attorney or representative of the member does tender a vote on that resolution, their vote must not be counted."*

Capital Reduction

Item 2

Important: This resolution is conditional upon the approval of the special resolution set out in the Notice of Meeting of Minority Shareholders of Engin dated 20 December 2010.

To consider and, if thought fit, pass the following resolution pursuant to section 256C(2)(a) of the Corporations Act as a special resolution:

"That pursuant to sections 256B and 256C(2) of the Corporations Act 2001 (Cth), the share capital of Engin Limited be reduced by cancelling all ordinary shares held by all holders of ordinary shares other than Network Investment Holdings Pty Limited ACN 078 448 512 (Minority Shareholders) in consideration for the payment by Engin Limited to each Minority Shareholder of \$0.70 for each share held by that Minority Shareholder and cancelled."

By order of the Board


Warren Coatsworth, Secretary

DATED: 20 December 2010

Notes:

1. *A member is entitled to appoint a proxy. A member who is entitled to cast two or more votes is entitled to appoint two proxies. If two proxies are appointed by a member, that member may specify the proportion or number of votes each proxy is appointed to exercise. If a member appoints two proxies and the appointment does not specify the proportion or number of the member's votes each proxy may exercise, each proxy may exercise half the votes.*
2. *For the purpose of determining a person's entitlement to vote at the meeting, a person will be recognised as a member and the holder of shares if that person is registered as a holder of those shares at:*

*For General Meeting: 11.00am Saturday 29 January 2011
(Entitlement Time)*

3. *A proxy need not be a member of the Company.*
4. *A proxy form and the power of attorney or authority (if any) under which it is signed or a copy of the power of attorney or authority certified as a true copy by statutory declaration, must be duly completed and returned to the Secretary, Engin Limited, either at the Company Secretariat, Level 2, 38 – 42 Pirrama Road, Pyrmont NSW 2009 fax number: 02 8777 7192 or at Registries Limited, Level 7, 207 Kent Street, Sydney NSW 2000 GPO Box 3993 fax number: 02 9290 9655 or completed online at www.registries.com.au/vote/engingm2011 by no later than:
11.00am on 29 January 2011 for proxy forms for the General Meeting. Proxy forms received after this time will be invalid.*

Explanatory Notes to the Notice of Meeting

Item 1

Section 256C(2)(a) of the Corporations Act provides that a selective reduction be approved by shareholders by:

“a special resolution passed at a general meeting of the company, with no votes being cast in favour of the resolution by any person who is to receive consideration as part of the reduction or whose liability to pay amounts unpaid on shares is to be reduced, or by their associates”.

The purpose of the proposed amendment to the Constitution is to confirm that, in accordance with section 256C(2)(a) of the Corporations Act, any votes cast in favour of the resolution in Item 2 by Minority Shareholders or their Associates (being persons who are to “receive consideration as part of the reduction” under section 256C(2)(a) of the Corporations Act) will be disregarded.

All Shareholders as at the Entitlement Time are entitled to attend and vote at the General Meeting.

Item 2

This resolution provides for a selective reduction of the capital of Engin. For information relevant to your decision as to how to vote, please refer to the Explanatory Statement accompanying this Notice of Meeting.

Important: This resolution is conditional upon the approval of the special resolution set out in the Notice of Meeting of Minority Shareholders of Engin dated 20 December 2010.

Section 256B(1) of the Corporations Act requires that a share capital reduction be approved by shareholders under section 256C. In accordance with section 256C(2)(a) of the Corporations Act, Engin must disregard any votes cast in favour of this resolution by:

- any Minority Shareholder (being a person who is to receive consideration as part of the proposed reduction); and
- an Associate of any Minority Shareholder.

However, Engin need not disregard a vote cast in favour if:

- (a) it is cast by a person as proxy for a person who is entitled to cast a vote in favour, in accordance with the directions on the proxy form; or
- (b) it is cast by the person chairing the General Meeting as proxy for a person who is entitled to cast a vote in favour, in accordance with a direction on the proxy form to vote as the proxy decides.

Further, Engin need not disregard a vote cast against this resolution by a Minority Shareholder or an Associate of a Minority Shareholder.

Notice of Meeting of Minority Shareholders

Notice of Meeting of Minority Shareholders

Notice is hereby given that a special meeting of Minority Shareholders of Engin will be held at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 commencing at 11.45 am or as soon as the general meeting of Engin scheduled to take place at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 at 11.00am has concluded or been adjourned, whichever is earlier.

Important:

- 1 **For information relevant to your decision as to how to vote, please refer to the Explanatory Statement. You should also read the Notes to this Notice of Meeting of Minority Shareholders.**
- 2 **Certain terms used below are defined in the Definitions section commencing on page 42.**

Special Business

Capital Reduction

Item 1

Important: This resolution is conditional upon the approval of the special resolution set out in item 2 in the Notice of Meeting of Engin dated 20 December 2010.

To consider and, if thought fit, pass the following resolution pursuant to section 256C(2)(a) of the Corporations Act as a special resolution:

*"That pursuant to sections 256B and 256C(2) of the Corporations Act 2001 (Cth), the share capital of Engin Limited be reduced by cancelling all ordinary shares held by all holders of ordinary shares other than Network Investment Holdings Pty Limited ACN 078 448 512 (**Minority Shareholders**) in consideration for the payment by Engin Limited to each Minority Shareholder of \$0.70 for each share held by that Minority Shareholder and cancelled."*

By order of the Board



Warren Coatsworth

Secretary

DATED: 20 December 2010

Notes:

1. *A member is entitled to appoint a proxy. A member who is entitled to cast two or more votes is entitled to appoint two proxies. If two proxies are appointed by a member, that member may specify the proportion or number of votes each proxy is appointed to exercise. If a member appoints two proxies and the appointment does not specify the proportion or number of the member's votes each proxy may exercise, each proxy may exercise half the votes.*
2. *For the purpose of determining a person's entitlement to vote at the meeting, a person will be recognised as a member and the holder of shares if that person is registered as a holder of those shares at:*

*For Special Meeting of Minority Shareholders 11.45am Saturday 29 January 2011
(Entitlement Time)*

3. *A proxy need not be a member of the Company.*
4. *A proxy form and the power of attorney or authority (if any) under which it is signed or a copy of the power of attorney or authority certified as a true copy by statutory declaration, must be duly completed and returned to the Secretary, Engin Limited, either at the Company Secretariat, Level 2, 38 – 42 Pirrama Road, Pyrmont NSW 2009 fax number: 02 8777 7192 or at Registries Limited, Level 7, 207 Kent Street, Sydney NSW 2000 GPO Box 3993 fax number: 02 9290 9655 or completed online at www.registries.com.au/vote/engingm2011 by no later than:
11.45am 29 January 2011 for proxy forms for the Special Meeting for Minority Shareholders. Proxy forms received after this time will be invalid.*

Explanatory Notes to the Notice of Meeting of Minority Shareholders

Voting Entitlement

All Minority Shareholders as at the Entitlement Time are entitled to attend and vote at the Special Meeting.

Special Business

Capital Reduction

Item 1

This resolution provides for a selective reduction of the capital of Engin. For information relevant to your decision as to how to vote, please refer to the Explanatory Statement accompanying this Notice of Meeting of Minority Shareholders.

Important: This resolution is conditional upon the approval of the special resolution set out in item 2 in the Notice of Meeting of Engin dated 20 December 2010.

Explanatory Statement

Explanatory Statement

1 Purpose of this document

On 2 December 2010, Engin announced that it had received from Network Investment, being a wholly owned subsidiary of SGH, member's requests under section 249D of the Corporations Act to call and arrange to hold shareholder meetings to consider the Proposal. Pursuant to section 249D(5) of the Corporations Act, the directors of Engin are required to call the shareholder meetings requested by Network Investment.

This Explanatory Statement has been prepared for the purpose of section 256C(4) of the Corporations Act. The purpose of this Explanatory Statement is to provide Shareholders with all the information known to Engin that is material to Shareholders in deciding whether or not to approve the proposed Capital Reduction.

This Explanatory Statement is dated **20 December 2010**.

2 Background

SGH, through its related company Network Investment, owns 57.33% of the Shares in Engin.

On 2 December 2010, SGH, through its wholly owned subsidiary Network Investment, requested that the Board of Engin put the following Proposal to Shareholders, and the Independent Chairman, has resolved to do so:

- all Shares held by persons other than Network Investment will be cancelled in return for a cash payment of \$0.70 per Share.

Importantly:

- the Independent Expert has concluded that the Proposal is fair and reasonable;
- the current trading conditions in Engin's core markets remain competitive and, notwithstanding good medium term prospects, the Proposal creates immediate value for Shareholders;
- Shares in Engin may continue to be illiquid; and
- Given that a single shareholder holds 57.33% of Engin's shares, it is unlikely that Shareholders will receive an alternate offer or proposal from a third party.

Please read the Independent Expert's Report in full.

3 Capital Reduction

The Capital Reduction involves the reduction of Engin's Share capital from 12,960,145 Shares to 7,429,945 Shares. This will be effected by the cancellation of 5,530,200 Shares

held by Minority Shareholders in consideration for a cash payment of \$0.70 for every Share cancelled. After the Capital Reduction is completed, all Shares on issue will be held by SGH through Network Investment.

4 Benefits of Proposal

The benefits of the Proposal can be viewed from the perspective of the Minority Shareholders and of SGH, the continuing Shareholder.

4.1 Minority Shareholders

The benefits of the Proposal to the Minority Shareholders are as follows.

- The immediate realisation of value through the Proposal. The Proposal price of \$0.70 per share represents:
 - a premium of 70.7% to the market price of Engin Shares as at close of trading on 1 December 2010 (\$0.41) and a premium of 75% to their 6 month volume-weighted average price (\$0.40); and
 - a price earnings ratio of 18 times projected 2011 net profit after tax. 2010 Net profit after tax was (\$2,411,643), as this was negative a price earnings ratio is not applicable.
- The Independent Expert has concluded that the Proposal is fair and reasonable.
- Shares in Engin may continue to be illiquid.
- Given that a single shareholder holds 57.33% of Engin's shares, it is unlikely that Shareholders will receive an alternate offer or proposal from a third party.

Please read the Independent Experts Report in full.

4.2 SGH

The benefits of the Proposal to SGH are as follows.

- The ability to manage the business of Engin without the additional regulatory obligations and administrative and other costs associated with being listed on the ASX and having in excess of 1,000 shareholders.
- An enhanced focus on the operations of the business without the distraction of being a public listed company.
- SGH, through Network Investment, will participate in 100% of any increase in value in the future and will control 100% of the cashflows of Engin.

5 Disadvantages of proposal

The disadvantages of the Proposal can also be viewed from the perspective of the Minority Shareholders and SGH.

5.1 Minority Shareholders

After the proposed Capital Reduction is implemented, the Minority Shareholders will cease to enjoy any rights as Shareholders of Engin, including attendance and voting at meetings of Engin and participation in any future dividend payments. In addition, to the extent that Engin benefits from any improved trading conditions that may arise in the future (for example, cost reductions and product development), the Minority Shareholders will not obtain any subsequent benefits arising from such improvements (for example, increase in value).

5.2 SGH

SGH, through Network Investment, will be the holder of 100% of the Shares and therefore will be exposed to 100% of the downside of any adverse trading conditions that Engin may suffer in the future. Also, as Engin will be delisted after completion of the Capital Reduction:

- Engin will no longer be able to raise funds from the market through rights issues and similar offerings, and accordingly SGH will be responsible for meeting Engin's future capital needs; and
- the liquidity of SGH's investment in Engin will be reduced.

6 Implications of not pursuing the proposal

If the Proposal is not implemented, it is intended that Engin will continue to maintain a conservative balance sheet, conserve its cash position and continue to seek to pursue growth opportunities as and when such opportunities arise. However, Shareholders should be aware that in these circumstances:

- the Share price may return to the levels it traded at prior to the announcement of the Proposal on **2 December 2010**. In the six month period ending on **1 December 2010**, Shares traded in the range of \$0.35 to \$0.50;
- the Shares of Engin may continue to be illiquid;
- an alternative to the Proposal is unlikely to emerge from a third party because 57.33% of the Shares of Engin are owned by a single Shareholder; and
- the benefits of the Proposal as described above may not be obtained if the Proposal is not implemented.

Please read the Independent Expert's Report in full.

7 Independent Expert's Report

Attached to this Explanatory Statement is the Independent Expert's Report. The Independent Expert has concluded that the Proposal is fair and reasonable.

Please read the Independent Expert's Report in full.

8 Recommendation

Messrs Ryan Stokes and Bruce McWilliam are also directors of SGH and various subsidiaries of SGH. Messrs Timothy Howard and Martin Mercer are also directors of Vividwireless Pty Ltd, which is a wholly-owned subsidiary of SGH. These directors accordingly abstain from making a recommendation on the proposed Capital Reduction.

Mr Charles Solomon, as is customary for directors who are full time employee executive directors, has abstained from making a recommendation on the proposed Capital Reduction.

Mr Ian Smith, the Independent Chairman, has closely considered the Proposal, the information contained in this Explanatory Statement, the Independent Expert's Report and the Independent Tax Opinion.

The Independent Chairman recommends that you:

- **vote in favour of the first resolution, and not vote on the second resolution, proposed in the Notice of Meeting, and**
- **vote in favour of the resolution proposed in the Notice of Meeting of Minority Shareholders.**

Other than as disclosed in this Explanatory Statement, the Independent Chairman confirms that there are no circumstances which may reasonably be expected to be capable of influencing his decision to recommend the Proposal to Shareholders.

9 SGH

Network Investment is a wholly-owned subsidiary of SGH.

9.1 Information

SGH is a significant Australian diversified operating and investment group that is listed on the ASX. SGH has media assets and other investments and the operating business of WesTrac Group.

The SGH group comprises the WesTrac Group; Seven Media Group, a joint venture with Kohlberg Kravis Roberts comprising Australia's leading television network, Seven Network; Pacific Magazines, one of Australia's two largest magazine publishing companies, and Yahoo!7.

The registered office of SGH is:

Level 2
38 – 42 Pirrama Road
Pyrmont NSW 2009

AUSTRALIA

More information on SGH is available from its website at www.sevengroup.com.au.

The directors of SGH are:

- Mr Kerry Matthew Stokes AC (Executive Chairman)
- Mr Peter David Ritchie AO (Deputy Chairman and Lead Independent Director)
- Mr Peter Gammell (Director and Group Chief Executive Officer)
- Mr David Leckie (Director and Chief Executive Officer, SGH Media Group)
- Mr James Walker (Director and Chief Executive Officer, WesTrac Group)
- Mr Bruce McWilliam (Commercial Director)
- Mr Ryan Stokes (Executive Director)
- Mr Robin Waters (Alternate Director to Mr Peter Gammell)
- Mrs Dulcie Boling (Independent Director)
- Mr Terry Davis (Independent Director)
- Mr Christopher Mackay (Independent Director)
- Mr Richard Uechtritz (Independent Director)
- Professor Murray Wells (Independent Director)

The Company Secretary of SGH is Mr Warren Coatsworth.

9.2 Intentions regarding Engin

This section sets out SGH's intentions on the basis of facts and information concerning Engin which are known to SGH at the time of preparation of this Explanatory Statement, and the existing circumstances affecting the business of Engin.

However, final decisions will only be reached by SGH in light of material facts and circumstances following the review which SGH intends to conduct. Accordingly, the statements set out in this section are statements of current intentions only which may vary as circumstances require.

Intentions for Engin as a wholly owned subsidiary of SGH

(a) Delisting and possible conversion to proprietary company

If the Capital Reduction is approved by shareholders and SGH (through Network Investment) becomes the holder of 100% of the issued shares in Engin, it intends to procure the removal of Engin from the official list of ASX. Once Engin is delisted and 100% owned by SGH, SGH may also consider the conversion of Engin from a public company to a proprietary company upon an analysis of the comparative benefits for Engin of changing status to a proprietary company.

(b) Business review

SGH reviews its investment in Engin on an ongoing basis. SGH anticipates that if the proposal is implemented and SGH becomes the holder of 100% of the Shares, it will be able to save costs through the delisting of Engin and through the change in ownership structure eliminating the administrative costs of maintaining the minority shareholdings. Beyond these changes SGH has not considered what changes may be made to the operations of Engin. However, SGH intends to undertake a detailed review of Engin's

activities to evaluate their performance, profitability and prospects for SGH in the context of the Australian prevailing regulatory and economic environment, in particular the highly competitive nature of the markets in which Engin carries on its activities. SGH intends to seek professional legal, accounting and tax advice in connection with this review.

SGH's review of Engin will include financial analysis involving the application of quantitative factors, such as rate of return on assets and gross margin analysis, to existing operations to determine whether those operations can continue to be profitable or can become profitable. The review will seek to identify areas of potential cost savings and consider divestment, rationalisation or other methods of value enhancement for any operations that are determined not to be consistent with growth in the business and profitability. If a decision is made to divest a particular business, SGH will procure that the business is carried on in the ordinary course and in the normal manner prior to divestment. Any divestment will be conducted in an orderly and price maximising fashion at a time chosen by the board of Engin.

SGH also intends the following in relation to Engin's board, head office and the options held by executives.

(c) Board of directors

While Engin remains a public company it must continue to have a board of three directors of whom two are resident in Australia. If Engin converts to a proprietary company it will require a board which includes at least one director in Australia. SGH will consider reducing the size of Engin's board if there are administrative, efficiency and cost benefits in doing so.

(d) Head Office and Employees

As part of its review, SGH intends to:

- evaluate the head office, management structures and personnel in the context of the post Capital Reduction regulatory environment with a view to optimising the benefits from those existing resources and making cost savings;
- identify methods to improve the efficiency of operations through integrating management reporting lines.

Following completion of the review, SGH intends, subject to compliance with contractual and other legal requirements, to implement the measures it identifies to optimise the resources, effect cost savings and integrate management reporting lines.

(e) Options

Engin currently has 250,000 options on issue.

SGH is aware that the board of Engin intends, if the proposal is implemented, to negotiate with the holders of the Options to procure the cancellation of the Options by Engin for consideration to be agreed with the Optionholders. If such negotiations are not concluded satisfactorily with all the holders of the Options within a short period after the implementation of the Proposal, SGH intends to exercise its rights to compulsorily acquire the Options pursuant to the Corporations Act within the six month period after implementation as permitted by the Corporations Act.

(f) Business, assets and employees

Except for the changes and intentions set out in this section, it is the present intention of SGH (based on the information presently available to it) to:

- continue the business of Engin;

- not to make any major changes to the business of Engin (including the redeployment of the fixed assets of Engin); and
- continue the employment of Engin's present employees.

9.3 SGH's voting intentions

SGH has informed Engin that it intends, through Network Investment, to vote in favour of the proposed Capital Reduction at the General Meeting.

10 Procedure

A company may reduce its share capital if the proposed capital reduction:

- (a) is fair and reasonable to the company's shareholders as a whole;
- (b) does not materially prejudice the company's ability to pay its creditors; and
- (c) is approved by shareholders.

The Corporations Act specifies different procedures for the necessary shareholder approval depending on whether the capital reduction is a selective capital reduction or an equal capital reduction. The proposed reduction of Engin's Share capital is a selective capital reduction as it does not apply to each holder of Shares in proportion to the number of Shares they hold, and the terms of the proposed reduction are not the same for each holder of Shares.

11 Shareholder approvals required

The proposed amendment of the Constitution requires a special resolution of shareholders. The proposed Capital Reduction must be approved by 2 special resolutions of Shareholders which are described in sections 11.1 and 11.2 below.

11.1 Special Resolution – General Meeting

The first special resolution must be passed at the General Meeting. The terms of this special resolution are set out in the Notice of Meeting. No votes may be cast in favour of the resolution by any person who is to receive consideration as part of the Capital Reduction or whose liability to pay amounts unpaid on Shares is to be reduced, or by their Associates.

Under the proposal, Minority Shareholders will receive consideration for the cancellation of their Shares. Accordingly, Engin must disregard any votes cast in favour on this resolution by Minority Shareholders. That is, only Network Investment will be entitled to cast votes in favour on this special resolution. As a special resolution, the resolution must be passed by at least 75% of the votes cast by Shareholders who are present and entitled to vote on the resolution.

This special resolution is conditional upon the special resolution to be considered at the Special Meeting also being passed.

11.2 Special Resolution – Special Meeting

The second special resolution must be passed at a meeting of the Shareholders whose Shares are to be cancelled, being the Special Meeting. The terms of the special resolution are set out in the Notice of Meeting of Minority Shareholders. As the Shares held by Network Investment will not be cancelled, Network Investment will not be entitled to vote on this resolution. Again, this special resolution must be passed by at least 75% of the votes cast by Minority Shareholders present and entitled to vote on the resolution.

This special resolution is conditional upon the special resolution to be considered at the General Meeting also being passed.

12 Timetable

The General Meeting will be held at at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 commencing at 11.00am.

The Special Meeting will be held at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 at 11.45am, or as soon as the General Meeting has concluded or been adjourned, whichever is earlier.

If the proposed Capital Reduction is approved, it is intended that trading of Shares on ASX will be suspended at the close of trading on 15 February 2011, being the Business Day following the 14th day after the Meetings.

If the proposed Capital Reduction is approved, unless the ASX agrees to an earlier suspension, it is intended that the Record Date for determining entitlements to the reduction of capital payment of \$0.70 per Share will be 22 February 2011, being 5 Trading Days after suspension of the Shares of Engin on ASX. Any change to the suspension date will be announced to the ASX.

It is intended that payment of the consideration payable to Minority Shareholders in respect of any cancelled Shares will be made on 23 February 2011, being 6 Business Days after the suspension of trading of the Shares of Engin on ASX. The payment will be made to Minority Shareholders by cheque, posted to each Minority Shareholder at the address of the Minority Shareholder as it appears on the Register.

13 Details of our Shareholders

As at 16 December 2010, the 20 largest Shareholders of Engin were:

Name	No. of Shares	% of total Shares
NETWORK INVESTMENT HOLDINGS PTY LIMITED	7,429,945	57.33
DIRECT GROUP PTY LIMITED	726,011	5.60

AVONDALE MANAGEMENT LIMITED	562,001	4.34
INTERFINE INVESTMENTS PTY LIMITED	355,438	2.74
J P MORGAN NOMINEES AUSTRALIA LIMITED	233,635	1.80
MRS JEAN SUSANNA GAMBLE	143,207	1.11
ROTHERLEIGH PROPERTIES PTY LIMITED	114,285	0.88
MR ANGUS STUART MARTIN	100,001	0.77
MR JOHN MCINTYRE WATERMAN	87,130	0.67
HENLEY GROUP HOLDINGS LTD	85,714	0.66
TRESDAM PTY LTD	80,898	0.62
MR MICHAEL ROTH & MS BIRGIT ROTH <GEFILTA FISH S/F A/C>	76,176	0.59
MR DON LAZZARO & MRS ANN LAZZARO <SUPER FUND A/C>	70,989	0.55
MR CHARLES SOLOMON	62,500	0.48
MRS SHIRLEY JANE MC KENZIE	58,000	0.45
MR THEO CLARK	57,025	0.44
MR STUART FRANCIS HOWES	50,001	0.39
MR GRAEME DOLLAR	50,000	0.39

MR MATTHEW GEPP	50,000	0.39
MARLINN SUPER PTY LTD <DON JOY WILL S/F A/C>	47,750	0.37
Totals for Top 20	10,440,706	80.56

Network Investment is a related company of SGH. All other holders of Shares listed are Minority Shareholders.

14 Sources of funds

If the proposed Capital Reduction is approved, Engin will return capital of \$3,871,140 to the Minority Shareholders.

Engin will fund the entire amount of the Capital Reduction payment of \$3,871,140 from cash reserves. As at the date of this Explanatory Statement, Engin has funds on deposit with various banks totalling \$4.3 million.

15 Financial impact on Shareholders and creditors

If the proposed Capital Reduction is approved by Shareholders and implemented, the Minority Shareholders will receive \$0.70 per Share, the Shares of the Minority Shareholders will be cancelled and the Minority Shareholders will cease to have any interest in Engin.

SGH has committed to Engin to provide such funding as Engin requires in order to repay its current creditors and meet its debts as and when they fall due, to the extent that Engin does not have sufficient cash available to make the payment at the relevant time.

16 Taxation consequences

The following description of the Australian taxation consequences to Shareholders if the Proposal is carried out is of a general nature only and is based on current Australian taxation law. Shareholders should consult their own independent taxation advisers to ascertain the Australian taxation consequences of the Proposal in relation to their particular circumstances.

16.1 Australian resident Minority Shareholders

The Independent Tax Expert, at the request of Engin, has provided an independent tax opinion summarising the general Australian income tax implications for an Australian resident (for income tax purposes) of the payment for the Capital Reduction. A copy of

the Independent Tax Opinion provided by the Independent Tax Expert is attached to this Explanatory Statement.

On the basis set out in the Independent Tax Opinion, the Independent Tax Expert considers that the Capital Reduction should be excluded from the definition of dividend for tax purposes. On this basis no part of the payment of \$0.70 should be treated as a dividend in the hands of the Minority Shareholders.

This is because:

- the payment is to be debited to the share capital account of Engin; and
- Engin will have taken any necessary action, including payment of untainting tax of approximately \$350K, to ensure that the share capital account of Engin is untainted before payment of the Capital Reduction amounts to shareholders; and
- it is unlikely that the Australian Taxation Office will consider that the Capital Reduction was entered into with any purposes (other than a merely incidental purpose) of the taxpayer obtaining a tax benefit from the capital return when compared to the receipt of a dividend.

However, the cancellation of the Shares held by the Minority Shareholders will be a taxable event for Australian Capital Gains Tax (CGT) purposes. Where Shares held by a Minority Shareholder were acquired before 20 September 1985, CGT will not be payable in respect of the cancellation of those Shares.

If the Capital Reduction amount exceeds a Minority Shareholder's cost base for CGT purposes, the Minority Shareholder will realise a capital gain equal to the amount of the excess. Alternatively, if the Capital Reduction amount is less than a Minority Shareholder's reduced cost base for CGT purposes, the Minority Shareholder will realise a capital loss equal to the amount of the difference. Capital losses may only be offset against capital gains realised by the Minority Shareholder in the same, or in subsequent, years of income. Capital losses cannot otherwise be utilised to reduce the income tax payable by a Minority Shareholder.

The amount of any capital gain realised by a Minority Shareholder will, after being reduced by any available capital losses, be included in the taxable income of that Minority Shareholder.

Where Shares were acquired before 11.45am AEST on 21 September 1999 by a Minority Shareholder which is not an individual or a trust, expenditure incurred prior to that time in respect of the acquisition of the Shares will be indexed for inflation up to 30 September 1999, in calculating the CGT cost base.

Where Shares were acquired by a Minority Shareholder who is an individual or a trust before 11.45am AEST on 21 September 1999, that Minority Shareholder will be entitled to choose between paying tax on:

- the difference between the Capital Reduction amount and the indexed cost base of the Shares (indexed to 30 September 1999); or
- 50% of the difference between the Capital Reduction amount and the unindexed cost base of the Shares (or 66.67% where the non-corporate Minority Shareholder is a Complying Superannuation Entity).

Where Shares were acquired by a Minority Shareholder who is an individual or a trust after 11.45am AEST on 21 September 1999, the Minority Shareholder will be entitled to reduce any capital gain realised upon the cancellation of the Shares by 50% (or 33.33% if the non-corporate Minority Shareholder is a Complying Superannuation Entity) provided

the Minority Shareholder has held those Shares for at least 12 months (excluding the day on which the Shares were acquired and the day on which they were cancelled). This concession is referred to as the CGT discount. The CGT discount is not available to corporate Minority Shareholders.

Where Minority Shareholders hold their Shares on revenue account (such as share traders) the gains realised by them upon the cancellation of the Shares may be taxed as ordinary income without any adjustment for inflation or for the CGT discount.

You should read the Independent Tax Opinion in full.

16.2 Non-resident Minority Shareholders

Non-resident Minority Shareholders will not be liable to CGT in respect of the cancellation of their Shares provided they and their associates have not, at any time during the 5 years preceding the cancellation of the Shares, beneficially owned at least 10% (by value) of the Shares.

Non-resident Minority Shareholders should consult their own taxation advisers in relation to how the cancellation of their Shares will be taxed in the country in which they are tax resident.

17 Additional information

17.1 Directors

The directors of Engin are:

- Ian Smith (Independent Chairman and Non-executive director)
- Bruce McWilliam (Non-executive director)
- Ryan Stokes (Non-executive director)
- Timothy Howard (Non-executive director)
- Martin Mercer (Non-executive director)
- Charles Solomon (Executive director and Chief Executive Officer)

17.2 Director holdings

(a) Engin

Mr Stokes and Mr McWilliam are directors of SGH, which ultimately owns 7,429,945 shares in Engin. Mr Charles Solomon holds 62,500 shares in Engin and 62,500 Options. Other than Mr Charles Solomon, no director or director-related entities as at the date of this Explanatory Statement hold a beneficial interest in any Shares of Engin other than the SGH shareholding disclosed.

(b) SGH

As at 24 September 2010, there are no marketable securities of SGH (or Network Investment) held by or on behalf of directors of Engin as at the date of this Explanatory Statement other than:

Name	Ordinary Shares	Options
Bruce McWilliam	280,447	2,000,000
Ryan Stokes	93,000	Nil

17.3 Changes in financial position

So far as is known to the directors of Engin, the financial position of Engin has not materially changed since 31 July 2010, that being the date of the last audited accounts of Engin despatched to the Shareholders in accordance with the Corporations Act, other than as previously disclosed to Shareholders and as set out in this Explanatory Statement.

17.4 Options

Engin currently has 250,000 Options on issue.

The board of Engin intends, if the proposal is implemented, to negotiate with the holders of the Options to procure the cancellation of the Options by Engin for consideration to be agreed with the Optionholders. If such negotiations are not concluded satisfactorily with all the holders of the Options within a short period after the implementation of the Proposal, SGH intends to exercise its rights to compulsorily acquire the Options pursuant to the Corporations Act within the six month period after implementation as permitted by the Corporations Act.

17.5 Payments or other benefits

In connection with the Proposal, no payment or other benefit is proposed to be made or will be given to any director, secretary or executive officer of Engin or any related body corporate as compensation for the loss of, or as consideration for or in connection with his or her retirement from, office in Engin or any related body corporate.

17.6 No agreement or arrangement

There is no agreement or arrangement made between any director of Engin and any other person in connection with or conditional upon the outcome of the Capital Reduction other than as set out in this Explanatory Statement.

17.7 Capital structure of Engin

The issued share capital of Engin is 12,960,145 Shares at the date of this Explanatory Statement. Engin also has 250,000 Options on issue.

17.8 Consents

The Independent Expert has consented in writing to the inclusion of its report, and statements based on its report, in the form and context in which they appear in this document and has not withdrawn its consent.

The Independent Tax Expert has consented in writing to the inclusion of its opinion, and statements based on its opinion, in the form and context in which they appear in this document and has not withdrawn its consent.

17.9 ASX announcements

Where statements in this Explanatory Statement refer to or are based on statements made in or announcements made by Engin to ASX, Engin will provide a copy of those announcements free of charge to any Shareholder who asks for it prior to the Meetings. Any requests for copies of those announcements may be made by emailing investorrelations@engin.com.au or calling (02) 8985 5835. Shareholders are also able to obtain copies of Engin's most recent financial reports from Engin's website at www.engin.com.au.

17.10 Other material information

Other than as contained in this document there is no information material to the making of a decision (being information that is within the knowledge of any director of Engin) that has not previously been disclosed to Shareholders.

18 Disclosures by SGH

18.1 Securities in Engin to which SGH has a relevant interest

As at the date of this Explanatory Statement, Network Investment is the registered holder of 7,429,945 Shares.

These are the only securities in Engin in which SGH or any of its Associates has a relevant interest.

18.2 Dealings in Shares

There have been no dealings in Shares by SGH or any Associate of SGH over the past 4 months.

18.3 No benefits to be given by SGH to directors of Engin

Neither SGH nor Network Investment proposes to make or give any payment or other benefit to any director, secretary or executive officer of Engin or any subsidiary of Engin as compensation for the loss, or as consideration for or in connection with his or her retirement from office in Engin or any subsidiary of Engin.

18.4 No other agreement between SGH and the directors of Engin

Neither SGH nor Network Investment has entered into any arrangements or agreements with any of the directors of Engin in connection with or conditional upon the outcome of the proposed Capital Reduction.

18.5 Other material information

Other than as contained in this Explanatory Statement, there is no other information in relation to SGH or Network Investment that is material to the decision whether or not to vote in favour of the Capital Reduction that is information that is known to the directors of SGH or Network Investment (other than information known to any of the directors in their capacity as directors of Engin) and has not previously been disclosed to Shareholders.

Definitions

Definitions

Term	Meaning
ASIC	the Australian Securities and Investments Commission.
Associate	has the meaning given by sections 10 to 17 of the Corporations Act.
ASX	the stock exchange conducted by ASX Limited.
Board	the board of directors of Engin from time to time.
Business Day	a day on which banks are generally open for business in New South Wales, excluding Saturdays, Sundays and public holidays.
Capital Reduction	the cancellation of all Shares held by the Minority Shareholders in consideration for the payment to each Minority Shareholder of \$0.70 for each Share cancelled.
Complying Superannuation Entity	a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust for the purposes of the Australian taxation legislation.
Corporations Act	the Corporations Act 2001 (Cth).
Engin	Engin Limited ACN 063 582 990, a company incorporated in the Australian Capital Territory, whose registered office is at Level 2, 38 – 42 Pirrama Road, Pymont NSW 2009.
Entitlement Time	means: - for General Meeting: 11.00am Saturday 29 January 2011 - for Special Meeting of Minority Shareholders: 11.45am Saturday 29 January 2011
Explanatory Statement	the explanatory statement accompanying the Notice of Meeting and Notice of Meeting of Minority Shareholders contained in this

Term	Meaning
	document.
General Meeting	the proposed general meeting of the Shareholders at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 commencing at 11.00 am to consider and, if thought fit, pass the resolutions set out in the Notice of Meeting.
Independent Chairman	Mr Ian Smith.
Independent Expert	Loneragan Edwards & Associates Limited
Independent Expert's Report	the report by the Independent Expert, a copy of which is included in this document.
Independent Tax Expert	Ernst & Young
Independent Tax Opinion	the opinion by the Independent Tax Expert, a copy of which is included in this document.
Meetings	the General Meeting and the Special Meeting.
Minority Shareholders	all holders of Shares except for Network Investment (in respect of the shareholding of SGH in Engin).
Network Investment	Network Investment Holdings Pty Limited ACN 078 448 512, a company incorporated in the Australian Capital Territory, whose registered office is at Level 2, 38 – 42 Pirrama Road, Pyrmont NSW 2009.
Notice of Meeting	the notice of General Meeting of Engin set out on page 18 of this document.
Notice of Meeting of Minority Shareholders	the notice of Special Meeting of Minority Shareholders of Engin set out on page 22 of this document.

Term	Meaning
Option	an option to subscribe for a fully paid ordinary share in Engin issued under Engin's Executive Share Ownership Plan.
Proposal	subject to the approval of the Capital Reduction at the Meetings, the implementation of the Capital Reduction as described in this document.
Record Date	22 February 2011*
Register	the register of members of Engin.
SGH	Seven Group Holdings Limited ACN 142 003 469, a company incorporated in the Australian Capital Territory whose registered office is at Level 2, 38 – 42 Pirrama Road, Pymont NSW 2009 and where the context requires, Network Investment.
Share Registry	Registries Limited, Level 7, 207 Kent Street, Sydney NSW 2000.
Shareholder	each person who is registered in the Register as the holder of Shares from time to time.
Share	a fully paid ordinary share in Engin.
Special Meeting	the proposed special meeting of the Minority Shareholders at Room 7, 38-42 Pirrama Road, Pymont, NSW, 2009 on Monday, 31st January 2011 commencing at 11.45 am (or as soon as the General Meeting has concluded or been adjourned, whichever is earlier) to consider and, if thought fit, pass the resolution set out in the Notice of Meeting of Minority Shareholders.
Trading Day	has the same meaning as in the Listing Rules issued by the ASX

Dates marked with an asterisk (*) are indicative only and may be sooner or later than these indicative dates. Any change to these indicative dates will be announced to the Australian Stock Exchange (ASX).

APPENDIX A: Independent Expert's Report

LONERGAN EDWARDS & ASSOCIATES LIMITED

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Mr Ian Smith
Chairman
Engin Limited
Wharf 17
38 Pirrama Road
Pyrmont NSW 2009

20 December 2010

Subject: Engin Limited – Selective Capital Reduction

Dear Mr Smith

Introduction

- 1 On 2 December 2010 Engin Limited (Engin or the Company) announced that it had received from Network Investment Holdings Pty Limited (Network Investment)¹, two member's requests under s249D of the *Corporations Act 2001 (Cth)* (Corporations Act) to call a general meeting of the shareholders of Engin, and a general meeting of the shareholders of Engin other than Network Investment (Engin Minority Shareholders), at which shareholders will be asked to consider a proposed selective capital reduction (the Proposal). Under the Proposal, all shares in Engin other than those owned by Network Investment (i.e. those shares held by the Engin Minority Shareholders) will be cancelled in return for a cash payment of 70 cents per Engin share (Proposal Consideration).
- 2 The Proposal values the total equity in Engin at approximately \$9.1 million and is subject to a number of conditions which are outlined in Section I.

Engin

- 3 Engin is an Australian internet telephony company delivering Voice over Internet Protocol (VoIP) telephony services. Engin allows any broadband user to make and receive calls over the internet using their existing telephone or an Engin internet phone.

Purpose of report

- 4 While there is no statutory requirement for Engin to obtain an independent expert's report (IER), the Independent Chairman of Engin has requested that Lonergan Edwards & Associates Limited (LEA) prepare an IER stating whether, in LEA's opinion, the Proposal is "fair and reasonable".
- 5 LEA is independent of Engin and Network Investment and has no other involvement or interest in the outcome of the Proposal, other than the preparation of this report.

¹ Network Investment is a related company of Seven Group Holdings Limited (SGH).

Summary of opinion

- 6 LEA has concluded that the Proposal is fair and reasonable.
- 7 We have arrived at this conclusion for the reasons set out below.

Valuation of Engin

- 8 LEA has valued 100% of the ordinary shares in Engin at between \$0.67 and \$0.77 per share, as summarised below:

Valuation of Engin ⁽¹⁾	Low \$000	High \$000
Enterprise Value (excluding the value of carry forward tax losses)	4,800	5,800
Carry forward tax losses	1,300	1,600
Surplus cash	3,432	3,432
Surplus liability – adopted value ⁽²⁾	(408)	(408)
Net debt	(273)	(273)
100% of equity value – controlling interest basis	8,851	10,151
Number of shares on issue (millions) ⁽³⁾	13.2	13.2
Engin value per share – controlling interest basis (cents per share)	67.0	76.8

Note:

- 1 Rounding differences exist.
- 2 The nature of this liability has not been disclosed due to commercial sensitivity.
- 3 Assuming the exercise of all outstanding options for nil consideration.

Assessment of fairness

- 9 Pursuant to Australian Securities & Investments Commission (ASIC) Regulatory Guideline 111 – *Content of expert reports* (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.”

- 10 We have assessed the value of ordinary shares in Engin at 67 cents to 77 cents per share. As the Proposal Consideration of 70 cents is within the range of our assessed value of 100% of the ordinary shares in Engin, in our opinion, the Proposal is fair.

Assessment of reasonableness

- 11 Pursuant to RG 111, an offer is reasonable if it is fair. Consequently we have concluded that the Proposal is both fair and reasonable.
- 12 Pursuant to RG 111, an offer may be reasonable if, despite not being fair but after considering other significant factors, shareholders should accept the offer in the absence of a higher bid before the close of the offer.

- 13 In our opinion, the Proposal is also reasonable. We are of this opinion because:
- (a) the Proposal Consideration of 70 cents per share contains an implied premium which is well above the range of control premiums paid in takeovers generally
 - (b) given Network Investment's 57.33% holding in Engin, it is unlikely that an alternate offer or proposal will be made
 - (c) if the Proposal does not proceed, the price of Engin shares is likely to trade at a significant discount to our valuation and the Proposal Consideration
 - (d) given the illiquidity of the Engin shares, the Proposal provides Engin Minority Shareholders with a means of realising immediate value for their investment.
- 14 We note that if the surplus liability of \$408,000 is excluded the low end of our assessed value range increases to 70.1 cents per share. Under this scenario, the Proposal is also fair as the Proposal Consideration is at the low end of our assessed range. Consequently, under this scenario, we would conclude that the Proposal is also fair and reasonable.

General

- 15 In preparing this report we have considered the interests of Engin's shareholders as a whole². Accordingly, this report only contains general financial advice and does not consider the personal objectives, financial situations or requirements of individual shareholders.
- 16 As a result of the payment of some \$350,000³ of untainting tax by Engin, the Proposal Consideration will be treated as a capital payment (as opposed to a dividend) for tax purposes. The taxation consequences of accepting the Proposal depend on the individual circumstances of each investor. Engin Minority Shareholders should read the taxation advice set out in Section 16 of the Explanatory Statement and should consult their own professional adviser if in doubt as to the taxation consequences of the Proposal.
- 17 The ultimate decision whether to accept the Proposal should be based on each Engin Minority Shareholder's assessment of their own circumstances, including their risk profile, liquidity preference, tax position and expectations as to value and future market conditions. Engin Minority Shareholders considering their response to the Proposal should be aware that our assessed value of Engin shares has been determined having regard to their medium / longer term prospects. Given the current market conditions individual shareholders may have a different time horizon.
- 18 If shareholders are in doubt about the action they should take in relation to the Proposal or matters dealt with in this report, shareholders should seek independent professional advice.

² In accordance with s256B.

³ The payment of this amount is excluded from our valuation assessment on the basis that Engin Minority Shareholders should not be affected by the costs of implementing the Proposal.

19 For our full opinion on the Proposal, and the reasoning behind our opinion, we recommend that Engin shareholders read the remainder of our report.

Yours sincerely



Julie Planinic
Authorised Representative



Grant Kepler
Authorised Representative

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I Outline of the Proposal

- 20 On 2 December 2010 Engin announced that it had received from Network Investment, two member's requests under s249D of the Corporations Act to call a general meeting of the shareholders of Engin, and a general meeting of the shareholders of Engin other than Network Investment, at which shareholders will be asked to consider a proposed selective capital reduction. Under the Proposal, all shares in Engin other than those owned by Network (i.e. those shares held by the Engin Minority Shareholders) will be cancelled in return for a cash payment of 70 cents per Engin share.
- 21 The capital reduction involves the reduction of Engin's share capital from 12,960,145 shares to 7,429,945 shares. This will be effected by the cancellation of 5,530,200 shares held by Engin Minority Shareholders in consideration for a cash payment of 70 cents for every share cancelled. After the capital reduction is completed, all shares on issue will be held by Network Investment.

Conditions

- 22 The Proposal is subject to:
- (a) the independent expert concluding in its report that the Proposal is fair and reasonable to Engin's shareholders
 - (b) tax advice on the Proposal confirming the treatment of distributions under the Proposal as capital for tax purposes
 - (c) necessary Engin shareholder approvals.
- 23 The Proposal requires approval of two special resolutions of shareholders:
- (a) **Special Resolution – General Meeting**

The first special resolution will be voted on at the General Meeting. The terms of this special resolution are set out in the Notice of Meeting. No votes may be cast in favour of the resolution by any person who is to receive consideration as part of the capital reduction or whose liability to pay amounts unpaid on shares is to be reduced, or by their associates.

Under the Proposal, Engin Minority Shareholders will receive consideration for the cancellation of their Shares. Accordingly, Engin will disregard any votes cast in favour on this resolution by Engin Minority Shareholders. That is, only Network Investment will be entitled to cast votes in favour on this special resolution. As a special resolution, the resolution must be passed by at least 75% of the votes cast by shareholders who are present and entitled to vote on the resolution.

This special resolution is conditional upon the special resolution to be considered at the Special Meeting also being passed.

(b) Special Resolution – Special Meeting

The second special resolution will be voted on at a meeting of the shareholders whose shares are to be cancelled, being the Special Meeting. The terms of the special resolution are set out in the Notice of Meeting of Minority Shareholders. As the shares held by Network Investment will not be cancelled, Network Investment will not be entitled to vote on this resolution. Again, this special resolution needs to be passed by at least 75% of the votes cast by Engin Minority Shareholders present and entitled to vote on the resolution.

This special resolution is conditional upon the special resolution to be considered at the General Meeting also being passed.

- 24 If the proposed capital reduction is approved, Engin will return capital of \$3,871,140 to the Engin Minority Shareholders. Engin will fund the entire amount of the Proposal Consideration of \$3,871,140 from cash reserves. Network Investment's related company, SGH, has committed to Engin to provide such funding as Engin requires in order to repay its current creditors and meet its debts as and when they fall due, to the extent that Engin does not have sufficient cash available to make the payment at the relevant time.
- 25 More detail on the above conditions is set out in the Explanatory Statement dated 20 December 2010.
- 26 Engin currently has 250,000 options on issue. SGH is aware that the board of Engin intends, if the Proposal is implemented, to negotiate with the holders of the Options to procure the cancellation of the Options by Engin for consideration to be agreed with the Optionholders. If such negotiations are not concluded satisfactorily with all the holders of the Options within a short period after the implementation of the Proposal, SGH intends to exercise its rights to compulsorily acquire the Options pursuant to the Corporations Act within the six month period after implementation as permitted by the Corporations Act.

II Scope of our report

Purpose

- 27 While there is no statutory requirement for Engin to obtain an IER, the Independent Chairman of Engin has requested that LEA prepare an IER stating whether, in LEA's opinion, the Proposal is "fair and reasonable".
- 28 This report has been prepared to assist the Independent Chairman of Engin in making a recommendation to Engin shareholders in relation to the Proposal and to assist the Engin Minority Shareholders to assess the merits of the Proposal. The sole purpose of this report is to set out LEA's opinion as to whether the Proposal is fair and reasonable. This report should not be used for any other purpose.
- 29 The ultimate decision whether to accept the Proposal should be based on each Engin Minority 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 in doubt about the Proposal or matters dealt with in this report, Engin Minority Shareholders should seek independent professional advice.

Basis of assessment

- 30 Our report has been prepared to assist the Independent Chairman and Engin Minority Shareholders in assessing whether the selective capital reduction is fair and reasonable as required under s256B and s256C(4) of the Corporations Act. Consequently, in preparing our report we have given due consideration to the Regulatory Guides issued by ASIC, particularly RG 1114.
- 31 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" but after considering other significant factors, shareholders should accept the offer in the absence of any higher bid before the close of the offer.
- 32 Based on our understanding of ASIC's policy intent, it should also be noted that:
- (a) when assessing the fairness of a transaction the expert must determine the full underlying value of the company's shares without applying any discount due to company specific factors (such as excess gearing or the need to undertake a significant equity raising) which may impair the company's ability to realise full underlying value
 - (b) company specific factors which may impair a company's ability to realise full underlying value should only be taken into account when assessing the reasonableness of a transaction.

⁴ RG111 states that a selective capital reduction is a control transaction.

33 Our report therefore considers:

Fairness

- (a) the market value of 100% of the shares in Engin
- (b) the value of the Proposal Consideration
- (c) the extent to which (a) and (b) differ (in order to assess whether the Proposal is fair under RG 111)

Reasonableness

- (d) the extent to which a control premium is being paid to Engin Minority Shareholders
- (e) the extent to which a share of the synergies likely to arise upon an acquisition of Engin are being shared with Engin Minority Shareholders
- (f) the listed market price of Engin shares both prior to and subsequent to the announcement of the Proposal
- (g) the likely market price of Engin shares if the Proposal is not successful
- (h) Network Investment's current shareholding in Engin
- (i) the value of Engin to an alternative offeror and the likelihood of an alternative offer emerging, either prior to the close of the Proposal, or sometime in the future
- (j) other risks, advantages and disadvantages.

Limitations and reliance on information

- 34 Our opinion is based on the economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time.
- 35 Our report is also based upon financial and other information provided by or on behalf of Engin. 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. The information provided was evaluated through analysis, enquiry and review for the purpose of forming an opinion as to whether the Proposal is fair and reasonable. However, in assignments such as this, time is limited and 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. None of these additional tasks have been undertaken.
- 36 We understand the accounting and other financial information that was provided to us has been prepared in accordance with the Australian equivalent to International Financial Reporting Standards (AIFRS).
- 37 An important part of the information base used in forming an opinion of the kind expressed in this report is the opinions and judgement of management of the relevant companies. 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.

- 38 We in no way guarantee the achievability of budgets or forecasts of future profits. Budgets and forecasts are inherently uncertain. They are predictions by management 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.
- 39 We have assumed that the forecasts have been prepared fairly and honestly, based on reasonable grounds and the information available to management at the time and within the practical constraints and limitations of such forecasts. We have assumed that management have reasonable grounds for the forecasts and the forecasts do not reflect any material bias. We have no reason to believe that these assumptions are inappropriate.

III Profile of Engin

Engin

- 40 Engin, formerly Mobile Innovations Limited, is an Australian broadband telephone company that provides new and innovative broadband telephony services, including VoIP (Voice over Internet Protocol) technology. Engin allows any broadband user to make and receive calls using their existing telephone at a very low price. The Company provides VoIP and broadband services to residential and business customers in Australia.
- 41 The Company was granted a telecommunications licence in March 2004 and began building a broadband telephone network that included 11 points of presence in most major capital cities and selected regional centres⁵. Engin relinquished its telecommunications licence in 2008. Engin commercially launched its services in September 2004 and now markets and sells a range of telephony products and services. The Company changed its name to Engin in 2005.
- 42 Engin's broadband telephony services are a type of service generally referred to as VoIP. In general terms, VoIP services carry voice telephony services over internet protocol broadband networks rather than through the traditional public switched telephone network (PSTN). VoIP services provide an alternative to regular fixed line phone services with the principal benefit of using VoIP being the potential for cost savings by the customer.

Service offerings and customer base

- 43 Historically, VoIP technology had only been used by large corporations that could afford to invest in this cost saving technology. Since 2004 Engin has been offering this same technology directly to residential and small business customers.
- 44 Engin was the first broadband phone service to be widely available to Australian consumers and businesses.
- 45 Today Engin provides VoIP, PSTN and ADSL⁶ internet services to residential, business and wholesale customers. Engin's growth in customer base is set out below:

Product mix	Year ended 30 June			
	2008 000	2009 000	2010 000	Nov 10 000
VoIP SIOs ⁽¹⁾	62.8	64.0	62.5	65.3
VoIP and broadband SIOs	-	0.9	2.4	3.9
VoIP, broadband and PSTN SIOs	-	0.3	0.7	0.7
Broadband and PSTN SIOs	-	-	0.3	0.5
All VoIP SIOs	62.8	65.2	65.9	70.4
Total SIOs	62.8	66.7	70.0	76.2

Note:

1 Services in operation.

2 2007 data not available in a format consistent with data from 2008 onwards.

Source: Engin management.

⁵ The network has since been written off and Engin has outsourced this function to a third party.

⁶ Asymmetric Digital Subscriber Line.

- 46 Although still a predominantly residential customer base, recent changes in marketing and product offering by Engin has facilitated a gradual increase in business and wholesale customers:

VoIP customer mix – total				
	Year ended 30 June			
	2008	2009	2010	Nov 10
	%	%	%	%
Residential	72	73	67	61
Business	24	23	28	32
Wholesale	4	4	6	7

Note: Based on services in operation.

Source: Engin management.

VoIP

- 47 Engin allows any broadband user to make and receive calls over the internet whilst using their existing telephone or Engin internet phone. The service potentially reduces customers' phone bills, whilst offering a range of free included features enabling users to actively control their own calls.
- 48 Engin provides VoIP services to customers by means of voice box hardware that connects to a customer's broadband modem router. The voice capacity used by Engin to facilitate the calls is principally provided by Optus Networks, supplemented by capacity provided by other carriers. Carriers are paid on a usage basis for this capacity.
- 49 Engin offers a variety of billing plans with varying monthly service fees and call rates for local / national calls, calls to mobiles and international calls with calls between Engin subscribers generally being free. There are three main attractions for customers to take up the Engin plans:
- (a) **line rental** – signing up for one of Engin's naked ADSL plans, customers no longer need to pay for a landline simply making and receiving calls using their Engin broadband phone
 - (b) **call costs** – with Engin, there are no connection fees. Local and national calls are either a flat 10 cents per call, or included in a flat fee. Overseas rates are much cheaper than traditional telecommunication company rates
 - (c) **features** – every Engin broadband phone plan comes with features that traditional telecommunication companies generally charge for (Caller ID, Call Waiting, Call Forwarding, Voicemail, V-Mail (voicemail to email)).

50 Engin has recently launched Engin2go⁷ for iPhones.

ADSL

51 In October 2008, Engin launched a naked ADSL2+ product offering⁸. ADSL is offered to customers bundled with VoIP. Engin's principal rationale for entering into the ADSL market was to protect its VoIP customer base from churning away from Engin to other internet service providers (ISPs) that were able to offer both VoIP and adequate internet connectivity to facilitate VoIP services. In simple terms, although the margins on ADSL services are not as attractive as those of VoIP, the provision of ADSL services aids Engin in retaining their VoIP customer base.

52 ADSL2+ services are provided by Engin by reselling bandwidth capacity purchased from Optus and another provider re-selling capacity purchased from Telstra.

Financial performance

53 A summary of Engin's recent financial performance is set out as follows:

Financial performance					
	2007	Year ended 30 June			5 months
	Audited	2008	2009	2010	to Nov 10
	\$000	Audited	Audited	Audited	Unaudited
		\$000	\$000	\$000	\$000 ⁽¹⁾
Revenue from ordinary activities ⁽²⁾	16,690	19,755	20,200	20,927	9,209
Communication expenses		(7,455)	(7,023)	(6,780)	(3,284)
Cost of hardware sold		(2,194)	(1,519)	(1,260)	(556)
Consumables used and network costs	(11,690)	-	-	-	-
Gross profit	5,000	10,106	11,658	12,887	5,369
Operating expenses ⁽³⁾	(17,472)	(18,481)	(13,139)	(12,186)	(5,186)
EBITDA	(12,472)	(8,375)	(1,481)	701	183
Depreciation, amortisation and impairment ⁽⁴⁾	(1,872)	(3,385)	(5,439)	(3,248)	(184)
EBIT	(14,344)	(11,760)	(6,920)	(2,547)	(1)
Net finance income / (expense)	540	(409)	160	135	80
Profit / (loss) before tax	(13,804)	(12,169)	(6,760)	(2,412)	79

Note:

1 As per Engin management accounts.

2 Operating revenue comprises:

Rendering of services	14,910	19,119	19,912	20,383	8,972
Sale of goods	1,780	636	288	544	237
Total	16,690	19,755	20,200	20,927	9,209

3 Net of "other income".

4 Depreciation, amortisation and impairment expenses comprise:

Depreciation and amortisation

Billing system	-	1,100	1,254	2,713	-
Other plant and equipment	1,354	1,556	1,277	335	106
Equipment under finance lease	518	729	1,277	200	78

⁷ Engin2go is an iPhone application.

⁸ Naked ADSL enables a subscriber to access the internet via ADSL without the requirement to subscribe to a fixed line phone service.

Financial performance					
	2007	Year ended 30 June			5 months
	Audited	2008	2009	2010	to Nov 10
	\$000	Audited	Audited	Audited	Unaudited
		\$000	\$000	\$000	\$000⁽¹⁾
Impairment					
Impairment of plant and equipment and equipment under finance lease	-	-	1,631	-	-
Total	1,872	3,385	5,439	3,248	184

Note:

Rounding differences exist.

Normalised EBITDA

54 Engin's financial results include a number of non-recurring items of revenue and expense. We have calculated the adjusted earnings before interest, tax, depreciation and amortisation (EBITDA) of Engin as follows:

Normalised EBITDA					
	2007	Year ended 30 June			5 months
	\$000	2008	2009	2010	to Nov 10
		\$000	\$000	\$000	\$000
EBITDA	(12,472)	(8,375)	(1,481)	701	183
Net non-recurring items ⁽¹⁾	-	(2,502)	196	-	-
Adjusted EBITDA⁽²⁾	(12,472)	(10,877)	(1,285)	701	183

Note:

1 Non-recurring items:

Profit on sale of investment	-	3,712	-	-	-
Loss on disposal of property, plant and equipment	-	(86)	-	-	-
Write-off of inventory	-	(430)	-	-	-
Executive and director termination benefits	-	(694)	(196)	-	-
	-	2,502	(196)	-	-

2 Before impairment loss of \$1,632,000 on equipment under finance lease.

Comments on earnings

Customer acquisition costs, ARPU and churn

55 Customer acquisitions costs, average revenue per user (ARPU) and churn are frequently used metrics within the telecommunications industry. In essence, customer acquisition costs, ARPU and churn are inextricably linked and significantly impact upon the high level financial performance of an industry participant. This can be illustrated as follows:

Lower profitability	Greater profitability
High customer churn	Low customer churn
High customer acquisition costs	Low customer acquisition costs
Low ARPU	High ARPU

- 56 Engin’s current churn rate is in the region of 2.2% per month. The churn rate for VoIP customers is anecdotally higher than for broadband customers, in part due to the circumstance of VoIP customer contracts generally being for a shorter duration than broadband / ISP contracts⁹.
- 57 Customer acquisition costs, including activation incentives and promotional subsidies, for residential customers are approximately \$170 to \$200 per customer for externally generated customers, and approximately \$50 to \$70 per subscriber for directly generated customers¹⁰.
- 58 The recent ARPU experience of Engin is as follows:

ARPU per end user⁽¹⁾	Year ended 30 June			5 months
	2008	2009	2010	to Nov 10
	\$/month	\$/month	\$/month	\$/month⁽²⁾
VoIP customers (blended)	29.71	29.36	29.80	28.91
- VoIP customers – residential	n/a	n/a	24.96	23.23
- VoIP customers – business	n/a	n/a	60.88	63.90
- VoIP customers – wholesale	n/a	n/a	15.39	17.36
ADSL2+ customers	-	-	59.45	62.49

Note:

1 An end user may have multiple SIOs.

2 Average.

n/a – not available. Data not available on a consistent basis prior to 2010.

Source: Engin management.

- 59 The Australian VoIP market is highly competitive. The competition for fixed line communications from “traditional” PSTN providers, and the still increasing trend towards mobile telephony and communications has also impacted the level of overall ARPU. Further, voice telecommunications is effectively a commoditised market in which, participants may seek to differentiate themselves based on service as well as price however price is likely to be the key issue for consumers. The gradual decline in voice prices generally (including PSTN and mobile, given the caps now offered by providers) has partly mitigated the cost advantage that VoIP initially enjoyed.

⁹ By way of example, Engin’s residential contract terms are 12 months for VoIP and 24 months for ADSL2+.

¹⁰ Externally generated customers are those acquired through external channels including cold calling and on-line advertising. In contrast, directly generated customers are acquired where the customer approaches Engin directly via website or call centre. The current mix for residential customers is approximately 50:50 direct vs external.

60 In light of this, we believe it is commercially reasonable to expect that due to the high existing price competition and with providers competing for increasingly lower value customers, that ARPU would tend to further decline in the short-term, reflecting a continuing highly competitive environment with significant margin pressure, particularly for non-facilities based market participants.

Revenue

61 Notwithstanding the increase in customer numbers over the three years to June 2010, revenues from ordinary activities have not increased significantly, reflecting a decline in ARPU. A decline in ARPU can be generally attributed to:

- (a) reductions in pricing for plans
- (b) change in product mix including more inclusions to meet market demand
- (c) deterioration in quality of new residential customers acquired in comparison to existing customers (we note that the size and quality of business customers has strengthened).

62 In relation to this, we note that Engin has experienced both a shift in customer mix towards DSL, and relatively flat voice ARPU.

Gross profit

63 The gross profit margin has increased from some 51%¹¹ in 2008 to some 62%¹² in 2010.

64 The increase in gross margin is principally attributable to:

- (a) the result of efforts to reduce the cost of voice capacity
- (b) the increase in ADSL customers as a proportion of total customers, and an increase in the margins of Engin's ADSL services. The increase in margins earned from Engin's ADSL services is a function of the increase in number of ADSL customers leading to increased capacity efficiencies, and as a result of efforts to decrease the cost of capacity.

Operating expenses

65 Operating expenses principally comprise employee, marketing and occupancy expenses.

66 Management have undertaken a series of measures to decrease the overhead costs of Engin over the last few years, in particular, reducing:

- (a) the cost of the sales team
- (b) information technology and technology development
- (c) marketing spend
- (d) the size of the call centre (due to improvements in the efficiency of operating this service).

¹¹ \$10.1 million gross profit divided by \$19.8 million revenue.

¹² \$12.9 million gross profit divided by \$20.9 million revenue.

Financial position

67 Engin's statement of financial position is summarised below:

Financial position	Jun 10 Audited \$000	Nov 10 ⁽¹⁾ Unaudited \$000
Cash and cash equivalents	4,644	4,182
Trade and other receivables	1,371	1,525
Inventory	241	229
Other	156	285
Total current assets	6,412	6,222
Property, plant and equipment	814	773
Total non-current assets	814	773
Total assets	7,226	6,995
Trade and other payables	3,598	3,207
Borrowings – finance lease liability	60	91
Provisions	244	239
Total current liabilities	3,902	3,537
Borrowings – finance lease liability	192	181
Other	278	345
Total non-current liabilities	470	526
Total liabilities	4,373	4,063
Net assets	2,853	2,932

Note:

- 1 As per management accounts.
- 2 Rounding differences exist.

Comments on balance sheet

Cash

68 We note that there is a deficiency of trade and other receivables and inventory in comparison to trade and other payables as at 30 June 2010¹³. As a result, we do not consider the whole of the cash and cash equivalents to be “surplus” to normal operating requirements. Based on our analysis and discussions with management, an amount of \$750,000¹⁴ is considered necessary to fund the working capital requirements of the business.

¹³ A part of this deficiency arises due to a provision of some \$816,000 which has been held for many years as a current liability.

¹⁴ Based on our review of historic and forecast working capital requirements.

Customer management and billing system

69 The useful life of the customer management and billing system was revised from five years to 2.5 years during the year ended 30 June 2010 bringing the carrying value down to zero as at 30 June 2010. This asset was carried at \$2.7 million in the 30 June 2009 financial statements.

Plant and equipment

70 Plant and equipment with a carrying value of some \$0.4 million (net of accumulated depreciation) is subject to finance leases, with a present value of minimum lease payments of some \$0.3 million as at June 2010.

Share capital

71 As at 2 December 2010, Engin had 12,960,145 fully paid ordinary shares on issue. During the financial year ended 30 June 2010, Engin conducted a 50:1 share consolidation.

Options

72 As at 2 December 2010, Engin had 250,000 options on issue. These options were issued in four tranches, all of which carried an expiry date of 30 June 2015 and were exercisable on achievement of performance targets established¹⁵.

Top 10 shareholders

73 As at 16 December 2010, the top 10 shareholders of Engin were as follows:

Top 10 shareholders		
	No of Shares	%
Network Investment Holdings Pty Limited	7,429,945	57.33
Direct Group Pty Limited	726,011	5.60
Avondale Management Limited	562,001	4.34
Interfine Investments Pty Limited	355,438	2.74
JP Morgan Nominees Australia Limited	233,635	1.80
Mrs Jean Susanna Gamble	143,207	1.11
Rotherleigh Properties Pty Limited	114,285	0.88
Mr Angus Stuart Martin	100,001	0.77
Mr John McIntyre Waterman	87,130	0.67
Henley Group Holdings Ltd	85,714	0.66
Total shares attributable to top 10 shareholders	9,837,367	75.90
Total issued capital	12,960,145	

¹⁵ Options convert to one ordinary share upon exercise for nil consideration.

Security price performance

74 The price of Engin shares from 1 December 2009 to 2 December 2010¹⁶ is summarised in the table below:

Engin – share price performance table				
	High	Low	Close	Monthly
	\$	\$	\$	Volume⁽¹⁾
Quarter ended				
March 2010	0.77	0.46	0.50	24,546
June 2010	0.66	0.30	0.40	70,409
September 2010	0.50	0.35	0.39	51,019
December 2010 ⁽²⁾	0.46	0.35	0.46	70,097
Month ended				
December 2009	0.82	0.62	0.72	49,705
January 2010	0.77	0.75	0.77	13,319
February 2010	0.69	0.61	0.65	52,300
March 2010	0.50	0.46	0.50	8,019
April 2010	0.66	0.55	0.55	53,070
May 2010	0.55	0.50	0.50	49,637
June 2010	0.44	0.30	0.40	108,520
July 2010	0.41	0.35	0.36	85,449
August 2010	0.50	0.40	0.41	42,034
September 2010	0.40	0.36	0.39	25,574
October 2010	0.41	0.35	0.36	104,740
November 2010	0.41	0.35	0.40	81,230
December 2010 ⁽²⁾	0.46	0.41	0.46	24,320

Note:

1 Monthly volumes for the quarter ended represent average monthly volumes.

2 Up to and including 2 December 2010.

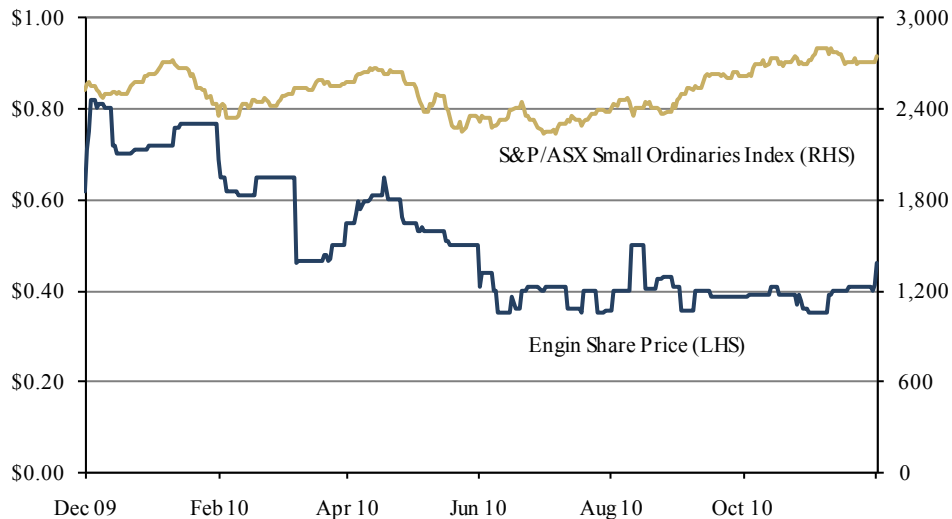
Source: Bloomberg.

¹⁶ Being the last day of trading before the proposal by Network Investment was announced.

75 The following graph illustrates the movement in the Engin share price compared to the A&P/ASX Small Ordinaries Index from 1 December 2009 to 2 December 2010:

Engin – share price history⁽¹⁾

1 December 2009 to 2 December 2010



Note:

1 Engin's share consolidation was completed on 30 November 2009, hence prices from 1 December 2009 to 2 December 2010 require no adjustment.

Source: Bloomberg.

76 As shown above the share price of Engin has under-performed the S&P/ASX Small Ordinaries Index over the majority of the period reviewed.

Liquidity in Engin shares

77 The liquidity in Engin shares based on trading on the ASX over the 12 month period to 2 December 2010 is set out below:

Engin – liquidity of securities

Period	Start date	End date	Value \$	Volume	As a % of issued capital
3 months	3 Sep 10	2 Dec 10	92,056	235,864	1.83
6 months	3 Jun 10	2 Dec 10	182,989	471,513	3.69
1 year	3 Dec 09	2 Dec 10	311,501	680,754	5.34

78 In the 12 month period prior to the announcement of 2 December 2010, total share turnover equalled 5.34% of the issued shares in Engin, indicating a very low level of market liquidity. The level of liquidity in more recent periods still remains low, with 1.83% of Engin shares traded in the three months prior to the announcement of 2 December 2010.

Current period performance and future prospects

Year to date

79 In the five months to November 2011, Engin has generated EBITDA of some \$183,000, in comparison to a budget of some \$300,000. The adverse variance to budget is principally due to higher than budgeted marketing costs. Total gross margin is materially consistent with budget. Both margin and EBITDA are lower than that for the corresponding period in 2009.

FY11 forecast

80 Engin is forecast to generate revenues of some \$22.1 million¹⁷ in FY11, up some 6% on FY10. This increase reflects the net effect of a forecast 4% decline in voice revenue, offset by a forecast 133% increase in revenue from data, which is estimated to increase from some \$1.5 million in FY10 to some \$3.5 million in FY11. Operating expenses in FY11 are forecast to be broadly in line with FY10, resulting in forecast FY11 EBITDA of some \$0.75 million.

81 Cash flows from operations for FY11 are forecast to be some 25% higher than FY10, increasing from some \$0.7 million to \$0.9 million. Cash out-flows from investing activities (acquisition of property, plant and equipment) in FY11 are forecast to be broadly in line with that incurred in FY10 of some \$0.36 million.

Opportunities

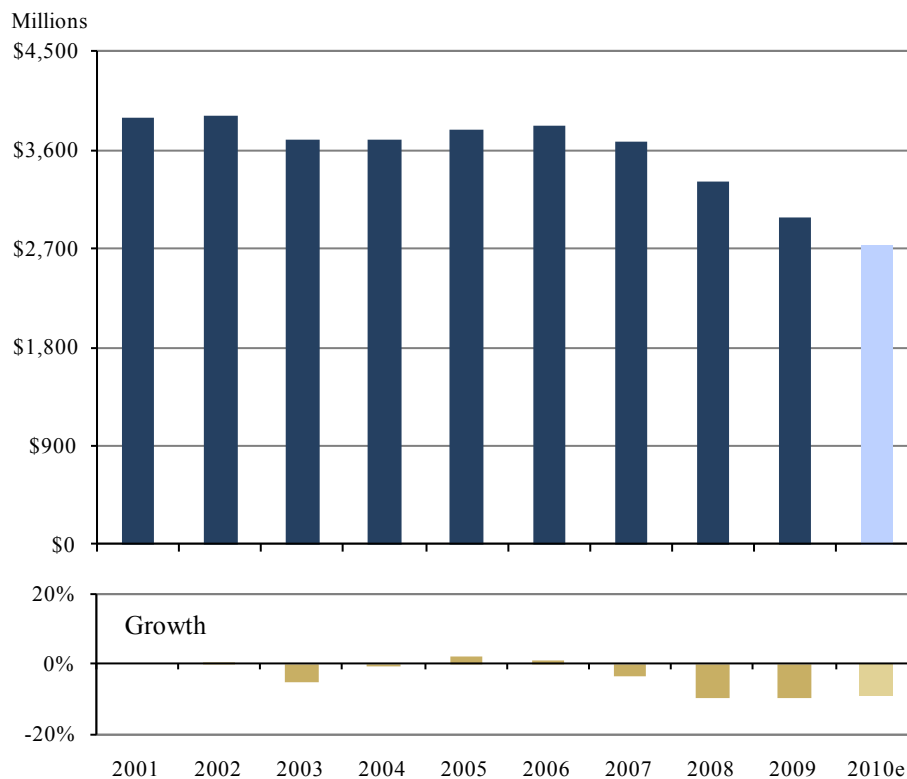
Mobile

82 The Company is to launch a mobile phone re-seller service, re-selling wholesale airtime provided by Optus.

83 If and when Engin does enter this market, they will enter an already crowded and competitive market place that yields margins that are generally poor, and have recently been decreasing.

¹⁷ Based on five months actual results and seven months budget results.

Telecommunication reseller industry revenue
Year ended 30 June



Source: IBISWorld, Telecommunications Resellers in Australia, June 2010.

84 However, the principal rationale of Engin in this regard is to leverage off its existing residential and business customer base to provide mobile services to these customers as a defensive measure to protect the existing VoIP/fixed line customer base. Although the margins may be low in reselling mobile services, a move into the mobile market will enable Engin to offer customers, particularly Engin's business customers, a more complete suite of telecommunications services, thus protecting Engin's higher margin VoIP business.

NBN

85 We note that Engin has made public statements to the effect that the proposed national broadband network (NBN) will create opportunities for service providers. However, it should be noted that:

- (a) the final structure of the NBN is still unknown
- (b) the potential exists for the removal of significant levels of competition from segments of the wholesale telecommunications industry, and the replacement thereof by a government-run monopoly.

86 In our view, any apparent benefits to service providers that may arise from the NBN are speculative at this stage.

- 87 In our view, irrespective of the final structure of the NBN, certain fundamental business principles particular to the telecommunications industry will remain, such as:
- (a) industry segments with relatively low barriers to entry, such as ISPs and VoIP providers, will be subject to significant competition
 - (b) industries of relatively commoditised products or services, particularly those with low barriers to entry, will generally not be able to achieve significant earnings margins
 - (c) government monopolies have not historically, on the whole, provided greater opportunities and/or low cost provision of goods or services
 - (d) although small operators may be able to develop niche markets, large economies of scale are generally only achieved by large fully integrated service providers.

Summary

- 88 Although Engin is forecast to achieve revenue growth by expanding its ADSL customer base, and may achieve some growth by implementing a strategy of entering the mobile telephony market, voice revenues and margins, which generate relatively higher margins than those derived on other services, are forecast to remain flat into the future.
- 89 Further in relation to ADSL and mobile reselling:
- (a) as Engin is not a facilities based provider, Engin is unlikely to be able to achieve the same scalability benefits as available to an ISP that owns its own infrastructure (such as iiNet and TPG)
 - (b) as Engin's move into mobile telephony is as a reseller only and not a facilities based participant, again, margins are low and the absence of an owned network means that the benefits of scalability are limited.
- 90 However, these developments need to be considered in light of the strategy adopted. The initial move by Engin into ADSL and the planned move to enter the mobile reselling market is primarily a defensive strategy to limit the losses of churn away from the higher margin voice business (i.e. not a strategy to generate significant growth). For these reasons, it is our view that Engin will not be expected to generate significant growth in revenues or margins in the near future under the current strategy and with the current capital available. There may be opportunities to pursue the acquisition of smaller telephony services providers which may result in improved economies of scale and margins over time with a moderate implementation risk.
- 91 Any move towards a high growth strategy is unlikely to be achieved without the assumption of significant risk, and without a significant capital contribution to exploit any new business directions.

IV Industry outlook

VoIP

Overview

- 92 VoIP is a telecommunications service for the provision of voice telephony. Unlike voice telephony over the “traditional” PSTN, VoIP calls are coded into digital format and transmitted in packets of data and routed over the Internet. The data is reassembled as voice / sound at the receiving end.
- 93 The principal advantages of VoIP in comparison to PSTN switched telephony are:
- (a) because the communications are transmitted digitally, the data can be compressed and sent in packets, thus using less capacity in comparison to a traditional PSTN carried call, in which dedicated lines are formed / switched between the callers, and then the entire capacity of those lines utilised by that call (even in periods of silence)
 - (b) telecommunications providers have historically developed their networks to carry voice traffic, and priced such traffic to generate economic returns, and have treated data as an incremental service, and have accordingly priced data at the margin.
- 94 As a result of the above and the technical advantage that a VoIP provider does not require access to the PSTN, numerous participants have been able to, and have, entered the Australian market to provide VoIP services. Reflecting this level of competition and the technical advantages, VoIP providers have competed aggressively on price, with, by way of example, product offerings that include:
- (a) free VoIP calls between subscribers of the same provider
 - (b) additional features such as voicemail, video calls and messaging either for free or at low cost.
- 95 Because VoIP is fundamentally¹⁸ a voice telephony service, Engin competes not only with other VoIP providers, but all other fixed line and mobile telecommunications providers.

Service types

- 96 VoIP services can be categorised into the following four service types:
- (a) **on-net services** – which enable customers of the same service provider to make and receive calls on that VoIP network only, isolated from the PSTN
 - (b) **outbound only** – which enables users to make outbound calls, including to the PSTN but do not enable the user to receive calls from the PSTN
 - (c) **inbound only** – which enables users to receive calls from the PSTN, but do not enable users to make calls to the PSTN

¹⁸ Notwithstanding the capacity of VoIP based technologies for video calling.

- (d) **inbound and outbound** – which enables users to make and receive calls from the PSTN¹⁹.

97 Although VoIP calls are capable of being of a quality equal to, or exceeding that of the PSTN or mobile networks, calls may be subject to more variation in call quality, due to general congestion on the internet or high demand at the user’s terminal (e.g. if the user is simultaneously downloading or uploading large files).

VoIP provider business models

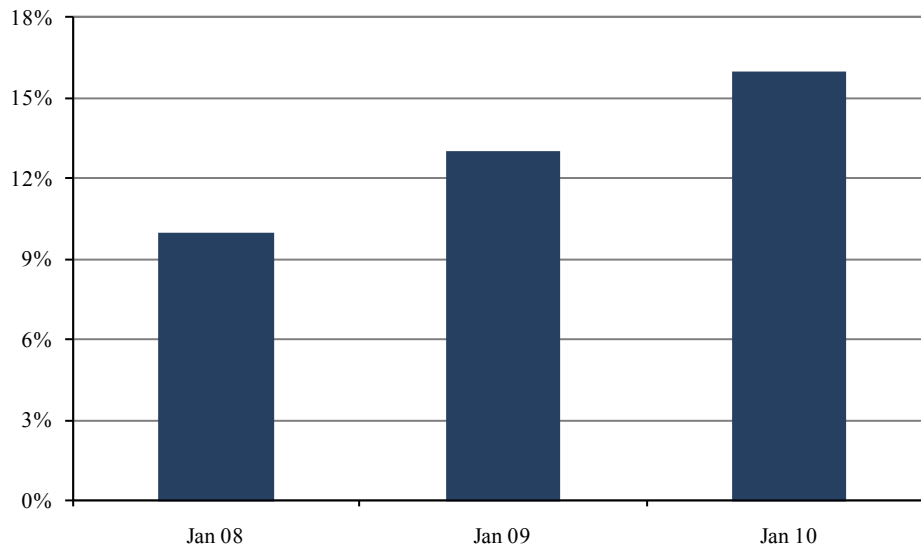
98 VoIP providers typically employ one of the following operating models:

- (a) **ISP – Independent** – such providers require customers to source their own broadband access
- (b) **VoIP and broadband bundle** – such providers provide VoIP services to their existing broadband customer base
- (c) **Hybrid** – such providers offer VoIP services to their own broadband customers as well as to customers of other broadband services.

VoIP market

99 At June 2010, some 16%²⁰ of Australians used VoIP in the home, up from 13% to June 2009.

Household consumers using VoIP at home



Source: ACMA

100 Although this take-up would generally be considered low, it is apparently not for lack of awareness of VoIP. By way of example, the same research indicates that notwithstanding that

¹⁹ Source: Australian Government – Australian Communications and Media Authority – The Australian VoIP Market, The Supply and take-up of VoIP in Australia, April 2008.

²⁰ Source: Australian Government – Australian Communications and Media Authority, Communications report 2009-10 services, Report 2 – Take-up and use of voice services by Australian consumers, 18 November 2010, citing Roy Morgan research.

80% of Australian broadband users²¹ were aware of VoIP as at June 2010, only 23% had taken up VoIP, suggesting the existence of significant barriers, other than awareness, to VoIP providers in obtaining customers.

VoIP providers

- 101 Indicative of the low barriers to entry, it is currently estimated that there are over 300²² VoIP providers operating in Australia at present, the majority of which are ISPs offering VoIP and broadband as a bundle²³, with over 160 providing internet based residential VoIP, and over 200 providing internet based business VoIP²⁴.
- 102 It is our view, consistent with some market commentary, that ISP-only businesses are at a disadvantage to ISPs offering bundled VoIP and broadband and ISPs offering a hybrid offering. This arguably reflects customer preference for VoIP to be one of the services offered by an ISP, as opposed to VoIP being a standalone offering²⁵.

Broadband

- 103 Although Engin provides broadband services employing ADSL2+ technology only, Engin competes not only just with other ADSL2+ providers, but with all Australian ISPs.

Internet service providers

- 104 The Australian ISP sector is the fastest growing of the telecommunications industry. Internet services can be provided by fixed lines via broadband or the antiquated dial-up process. Dial-up services provide slower connections and require the user to dial into the network for the cost of a local call. Broadband services can be accessed via a range of technologies, which are listed below:
- (a) ADSL is the most commonly used broadband technology and allows users to access the internet over a copper wire network, with speeds reducing as the distance from the exchange increases. The maximum speed is around 8 megabits per second (Mbps)
 - (b) ADSL2 also operates over copper wire networks, however it provides faster internet access than ADSL with speeds up to 20 Mbps. In order to use this technology, ISPs must install digital subscriber line access multipliers into Telstra-owned exchanges
 - (c) HFC cable (hybrid optical fibre and coaxial cable) provides broadband internet and other services to around 2.7 million premises in major cities. HFC typically offers speeds of 17 Mbps, but in Brisbane, Melbourne and Sydney speeds are generally 20 to 30 Mbps
 - (d) Satellite broadband provides 100% coverage over Australia's land mass, thus predominantly providing internet access to rural and remote customers at speeds similar to ADSL

²¹ Aged 14 and over.

²² Source: Market Clarity.

²³ Australian Government – Australian Communications and Media Authority, Changes in the Australian VoIP market, December 2009.

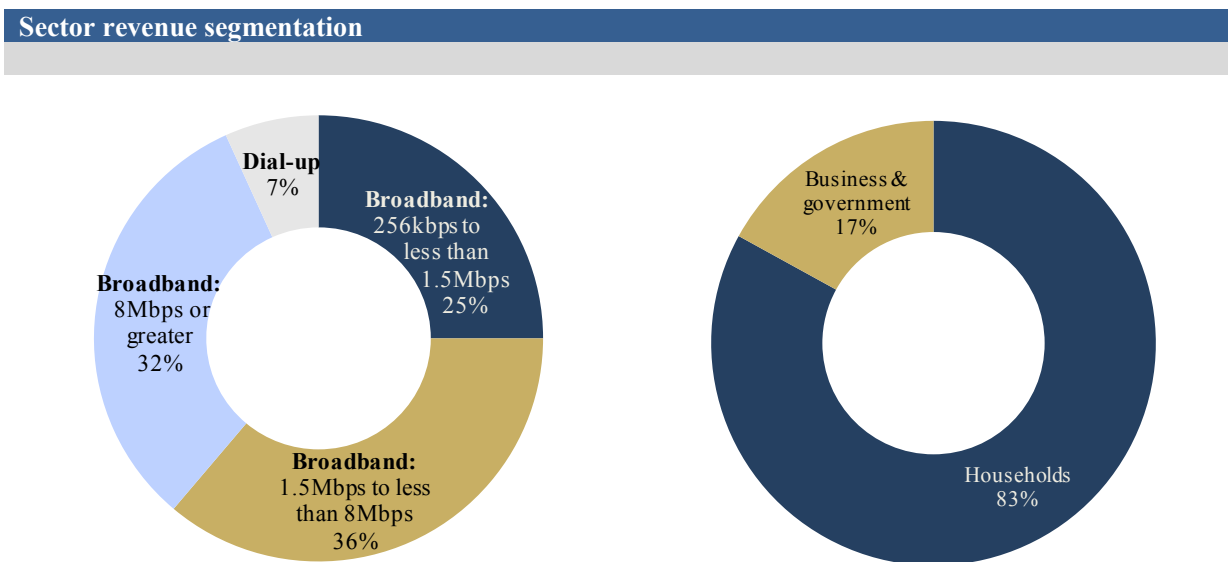
²⁴ With numerous providers servicing both residential and business / markets.

²⁵ Customer convenience such as a single bill for all internet related services is an example of a contributing factor.

- (e) Broadband over power lines (BPL) is an emerging technology that provides broadband internet over existing electricity power lines. Issues still to be addressed include potential interference with other radio communications services. BPL can allow broadband internet access at speeds up to 25 Mbps
- (f) 3G network access available via Australia’s 3G providers – Telstra, Optus and A3GA²⁶. Current 3G broadband speeds are up to a maximum of 14.4 Mbps however, Telstra’s NextG network (which is often referred to as 3.5G) offers internet access at speeds up to a maximum of 21 Mbps by February 2009 and were planned to reach 42 Mbps later in 2009.

Market segmentation

105 Broadband currently represents 93% of sector revenue, with the largest product segment being internet speeds of 1.5 Mbps to less than 8 Mbps. The sector’s largest source of revenue is households, representing 83% of revenue. The following chart provides a break-down of sector revenue:



Source: IBISWorld, Internet Service Providers in Australia, June 2010.

²⁶ A joint venture between Vodafone Group Plc and Hutchinson Telecommunications (Australia) Limited.

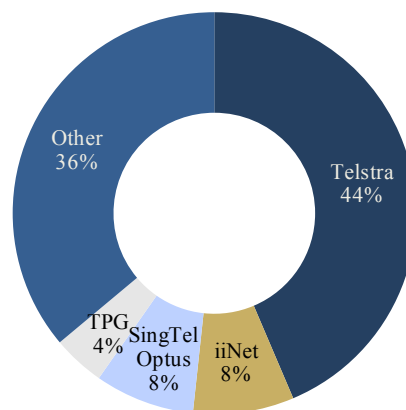
Competition

- 106 Competition in the ISP industry is driven by price, quality and level of service, product range and branding. Price is the major basis of competition, with other factors such as download volumes and speeds being generally comparable. For the smaller ISPs retail prices are a function of the wholesale price that Telstra or other infrastructure owners charge. Help desk and support services can be a differentiating factor, particularly for new internet users. Many ISPs do not report service outages so comparing technical services can be difficult.
- 107 The ability to offer the latest value-added features is important in differentiating the various providers. As prices fall users tend to migrate to faster services. In addition, some ISPs now offer VoIP and internet protocol television (IPTV).

Major market participants

- 108 The Australian fixed line ISP industry is highly fragmented with over 400 ISPs operating, most of which are small businesses²⁷. However, a few large fixed line ISPs dominate the market, with the top four providers forecast to account for 63% of total revenue for the year ended 30 June 2010²⁸. The following chart provides an overview of market share:

Market share by revenue – fixed line ISP



Source: IBISWorld, Internet Service Providers in Australia, June 2010.

Historical performance

- 109 As of December 2009 there were over 9 million internet subscribers in Australia. The majority of these (over 6 million accounts) are currently on fixed line services, with the remainder wireless. Wireless broadband technologies have vastly improved growth of the overall internet market in recent times, largely at the expense of the fixed line broadband sector which has been reflected in the take-up rates of telephony and broadband services, for which mobility is increasingly important.

²⁷ This excludes wireless operators.

²⁸ IBISWorld, Internet Service Providers in Australia, June 2010.

- 110 By way of example, as at 30 June 2010, Telstra had some 4 million wholesale and retail fixed line broadband services in operation, an increase of 0.7% on June 2009, whereas it also had 1.7 million wireless broadband services in operation at June 2010, an increase of over 58% on the previous year²⁹. The introduction of new mobile technologies such as Apple's iPad and other 'tablet' devices should compound this.
- 111 The growth in mobile broadband can be attributed to the considerable upgrading of 3G networks and comparable priced mobile internet connections.

²⁹ Source: Telstra 2010 Annual Report.

V Valuation approach

- 112 ASIC Regulatory Guideline 111 – *Content of expert reports* (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 discounted cash flow (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.
- 113 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.
- 114 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.
- 115 Capitalisation multiples can be applied to either estimates of future maintainable operating cash flow, earnings before interest, tax, depreciation and amortisation (EBITDA), earnings before interest, tax and amortisation (EBITA), earnings before interest and tax (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.

- 116 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.

Methodology selected

- 117 The valuation of Engin has been made on the basis of assessing the market value business as a going concern. Given the fact that the DCF methodology is the superior valuation methodology from a technical perspective and the availability of cash flow projections to 30 June 2014 (which we have reviewed in detail and adjusted for the purposes of our valuation) the primary valuation methodology used to value Engin is the DCF methodology incorporating a terminal value at the end of the forecast period.
- 118 The value of Engin has then been cross-checked by reference to the capitalisation of earnings methodologies.

VI Valuation of 100% of Engin

Valuation methodology

- 119 As stated in Section V we have adopted the DCF method as our primary valuation approach.
- 120 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.
- 121 The resulting value (in this case Enterprise Value) has been cross-checked by reference to the capitalisation of earnings methodologies.

Cash flow projections

- 122 Our DCF valuation is based on the free cash flow projections prepared by Engin management, which we have adjusted where considered necessary³⁰.
- 123 It should be noted that in respect of these projections:
- (a) the major assumptions underlying the projections were formulated in the context of current economic, financial and other conditions
 - (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) the achievability of these projections is not warranted or guaranteed by Engin or LEA, as they are predictions by Engin management of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of Engin and its management; and
 - (e) actual results may be significantly more or less favourable.
- 124 Free cash flow represents the operating cash flows of the business on an ungeared basis (i.e. before interest) less taxation payments³¹, capital expenditure and working capital requirements. The free cash flow on an ungeared basis is adopted to enable the value of the business (i.e. Enterprise Value) to be determined irrespective of the level of debt funding employed.
- 125 Engin management's free cash flow projections cover the period 1 December 2010 to 30 June 2014. A terminal value has been adopted at the end of the forecast period.

³⁰ We have excluded management's high level cash flow projections for the proposed mobile business on the basis that the business is yet to commence operations, is subject to implementation risk and competitive reaction and success therefore remains inherently uncertain.

³¹ Also calculated on an ungeared basis. Whilst the Company has significant carried forward losses, we have assessed the value of these losses separately.

126 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

Subscriber numbers

127 The DCF adopts the following forecast subscriber and product mix:

Forecast subscribers and product mix	30 Nov 10	30 Jun 14
	000s	000s
Unique end-users	53.5	62.2
VoIP SIOs only	65.8	105.7
VoIP and broadband SIOs	4.7	9.4
VoIP, broadband and PSTN SIOs	1.2	2.1

Source: Engin management.

- 128 Growth in the number of unique end-user accounts is expected to be driven by the wholesale segment and partly offset by a decline in residential (the number of business customers is largely expected to remain flat). This reflects a continuation of existing trends.
- 129 The considerable forecast growth in the total number of VoIP services in operation stems predominantly from an assumed increase in the number of services used by Engin’s business customer base (services in operation are expected to grow from a current average of 2.7 VoIP services per business user to 6.9 by the end of the forecast period³²). We note that the average number of VoIP SIOs per business customer has grown by some 45% during the year to 30 November 2010. Growth in the number of VoIP services in operation is also derived from the net increase in the number of wholesale and residential end users (each of these categories are modelled on the basis that they use approximately 1.0 VoIP per end user³³).
- 130 Churn rates are forecast to moderately increase in the residential customer base and decline in the business and wholesale customer bases.

³² This reflects the increasing size of the businesses in the customer base.

³³ The number of services used by end-users of the wholesalers to whom Engin provides its services is not known by the Company. Engin assume for the purposes of managing their business that each wholesale end-user has one SIO.

- 131 As a consequence the mix of VoIP services in operation is expected to continue to shift away from the historically residential focussed nature of the business. The following table compares the current and forecast position:

VoIP customer mix based upon SIOs		
	30 Nov 10	30 Jun 14
	%	%
Residential	61	29
Business	32	53
Wholesale	7	18

Source: Engin management.

- 132 Based upon recent take-up rates, the Company expects to continue to expand the number of broadband services in operation.

ARPU

- 133 Engin's overall ARPU is forecast to moderately decline (in nominal terms) over the forecast period.

ARPU per end user⁽¹⁾		
	5 month to	Year ended
	30 Nov 10	30 Jun 14
	\$/month⁽²⁾	\$/month⁽²⁾
VoIP customers (blended)	28.91	25.27
VoIP customers – residential	23.23	19.89
VoIP customers – business	63.90	66.12
VoIP customers – wholesale	17.36	16.24
ADSL2+ customers	62.49	57.81

Note:

1 An end-user may have multiple SIOs.

2 Average.

Source: Engin management.

Gross margin

- 134 Engin's overall gross profit margin is expected to moderately decline over the forecast period:

- (a) VoIP margins are expected to remain flat (but the weighted gross profit contribution decreases as the contribution from broadband increases)
- (b) broadband margins (which are less than those achieved by the VoIP business) are forecast to improve as that business grows (reaching some 23% by FY14)
- (c) the gross loss incurred by Engin in FY10 on hardware sales (being some \$720,000) is expected to reduced by some 10% over the forecast period.

Operating expenses (excluding depreciation and amortisation)

- 135 The Company is not expecting any material reduction in the operating expense base (when expressed as a percentage of gross profit). Employee costs, which represent approximately half the operating expense base, are expected to increase at between 3.0% per and 3.5% per annum (the forecast growth in the business is expected to be serviced by its existing employee base).
- 136 We have adjusted the forecast operating expenses (from 1 February 2011) to allow for some \$310,000 per annum in cost savings that would arise as a result of delisting the Company (these comprise savings in Independent Chairman fees, audit fees and other miscellaneous public company related costs).

Company tax

- 137 The DCF adopts the current corporate tax rate of 30%.
- 138 However, it should be noted that the Company has significant carry forward tax losses, some \$19.4 million as at 30 June 2010³⁴. We have valued the benefit of these tax losses separately to the business by:
- (a) extrapolating the forecast EBIT of the business from FY14 to FY25 based upon an assumed long term growth rate of 3.5%
 - (b) determining the period over which the current carry forward tax losses will be recouped
 - (c) discounting the tax benefits back to 30 November 2010 using a discount rate of 20% to 25%³⁵.
- 139 On the basis of the above, we have, for the purposes of this report, valued the carry forward tax losses at between \$1.3 million and \$1.6 million. This value represents 7 cents to 8 cents in the dollar of the gross tax losses, which we consider to be reasonable.

Working capital

- 140 There is no significant year-on-year increase in working capital requirements.

Capital expenditure

- 141 Maintenance capital expenditure is assumed to be approximately 1.0% of revenue. The Company has no planned investment capital expenditure (other than a small amount relating to the mobile business opportunity).

³⁴ Representing accumulated prior year tax losses which are available to the Company with a resulting tax benefit of \$5.8 million. This amount differs from the benefit attributed to revenue tax losses in the 2010 financial statements as the Company has received tax advice that indicates that a portion of these losses may not be available and will need to meet the continuity of ownership and/or continuity of business tests.

³⁵ In our opinion, a potential purchaser would consider the risks associated with the realisation of the benefit of the tax losses to be higher than the risks associated with the Company's operations as a result of the tax benefit being dependent not only upon the Company's ability to generate taxable profits but also upon there being compliance with all the current legislative requirements for recoupment and no future changes to taxation legislation.

Discount rate

142 As set out in Appendix C we have applied a discount rate of 15% to 16% per annum (after tax). This discount rate reflects:

- (a) a risk-free rate of 5.6 % per annum, equivalent to the yield to maturity currently prevailing on 10 year Australian Government bonds (as at 9 December 2010)
- (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 on a diversified portfolio of shares
- (c) a beta of range of 1.2 to 1.3, which we believe reflects the risks associated with Engin’s business operations
- (d) a specific risk premium to allow for the fact that, on average, investors require higher rates of return from smaller companies (such as that of Engin)
- (e) an assumed gearing level of 0% (i.e. no debt on the basis that Engin has only minimal tangible assets, the Company’s historic earnings have been volatile (and loss making) and that it had been required to provide cash backed bank guarantees for its finance lease facilities). Accordingly, our adopted discount rate is equal to the cost of equity.

143 Based on the above our adopted discount rate is derived as follows:

Parameters	Low	High
Beta	1.2	1.3
Market risk premium (%)	6.0	6.0
Risk free rate (%)	5.6	5.6
Cost of equity (%)	12.8	13.4
Additional risk premium (%)	2.0	3.0
Adjusted cost of equity (%)	14.8	16.4
Say	15%	16%

Note:

1 The assessed discount rate has been applied to cash flows on a mid-pointed basis.

Terminal value

144 We have estimated the terminal value of Engin as at 30 June 2014 based on the free cash flow projected in the year ending 30 June 2015.

145 Growth in perpetuity of 3.0% and 3.5% per annum has been assumed after 30 June 2014. The selection of these growth rates has been based on our review of:

- (a) the historical growth in revenue achieved by Engin to date
- (b) the growth in Engin’s revenue projected over the period to 30 June 2014
- (c) the trend in earnings of small Australian VoIP providers
- (d) the level of competition in ISP industry

(e) long-term inflation rates and gross domestic product (GDP) forecasts.

146 On this basis the terminal value of Engin as at 30 June 2014 represents a multiple of 4.9 to 5.7 times projected EBITDA in the year ending 30 June 2014 (which we consider reasonable for this sector of the Australian telecommunications industry).

Enterprise Value

147 Based on the above, the Enterprise Value of Engin (on an ungeared basis) ranges from \$4.8 million to \$5.8 million. This represents the value of the business on a 100% controlling interest basis and excludes our assessment of the value of the carry forward tax losses.

Cross-check for reasonableness

148 Our assessed value range represents an EBITDA multiple of 6.8 to 8.3 times Engin's reported EBITDA for the year ended 30 June 2010 and 4.5 to 5.5 times forecast EBITDA for the year ended 30 June 2011³⁶:

Implied EBITDA multiples	Low \$000	High \$000
Enterprise Value (excluding the value of carry forward tax losses)	4,800	5,800
FY10 EBITDA (actual)	701	701
EBITDA multiple – historic (times)	6.8	8.3
FY11 EBITDA (forecast) ⁽¹⁾	1,063	1,063
EBITDA multiple – forecast (times)	4.5	5.5

Note:

1 FY11 forecast adjusted to include a full year (rather than a part year) of public company cost savings, being \$312,000.

149 A summary of the implied EBITDA multiples for the Australian telecommunications transactions (Appendix D) as well as the implied EBITDA multiples for the small to medium sized listed Australian telecommunications companies³⁷ (Appendix E) are set out below:

³⁶ Adjusted to include a full year (rather than a part year) of public company cost savings.

³⁷ Primus Telecommunications Group is foreign based and listed but also provides telecommunications services to the Australian market.

EBITDA multiples – transaction and trading		
	EBITDA multiples	
	Historical	Forecast
Telecommunications transactions		
Range	3.0 – 10.9	3.0 – 5.8
Average	8.7	4.5
Median	5.0	4.7
Telecommunications listed companies⁽¹⁾		
Range	3.7 – 10.7	5.1 – 6.8
Average	7.1	5.9
Median	6.8	5.9

Note:

1 Based on their listed market prices (prior to reflecting a premium for control).

150 With respect to the above we note that:

- (a) the multiples implied by our valuation are within the range of those observed in Australian telecommunications transactions (and are broadly consistent with the average and median multiple on both an historic and forecast basis. As these transactions in most cases reflect the acquisition of a controlling interest, the transaction multiples set out above implicitly incorporate a premium for control (albeit the extent of the premium will vary on a case by case basis)
- (b) the listed telecommunications company multiples are based on the listed market price of each company's shares (and therefore exclude a premium for control). Empirical evidence undertaken by us 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 already 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
- (c) many of the listed companies are much larger than Engin and, all other things being equal, should therefore attract a higher multiple. The discount necessary to remove the size premium in this case, particularly in respect of the observed forecast multiples (which are based upon TPG Telecom and iiNet³⁸), would, in our opinion, largely offset the control premium (as mentioned above)
- (d) whilst My Net Fone Limited (the most comparable listed company) is currently trading at an historic EBITDA multiple of 9.1 times, the multiple reflects the market's perception of the company's growth prospects after the announcement of the FY10 results as follows:
 - (i) increase in revenue of 23.6%
 - (ii) increase in EBITDA of 771%
 - (iii) increase in net profit after tax of 1,058.3%

³⁸ Both of which are considerably larger than Engin.

(iv) expectations of profit growth in FY11.

151 Having regard to the above, we consider the EBITDA multiples implied by our valuation range to be reasonable.

Net debt

152 As at 30 November 2010 Engin had lease liabilities of \$0.273 million.

Surplus assets / liabilities

153 As set out in Section III, we consider Engin has some \$3.4 million in surplus cash³⁹.

154 Engin has a surplus liability of \$816,000. However, there is significant uncertainty as to whether this amount will have to be paid (the liability has existed for a number of years)⁴⁰. For the purposes of this report we have adopted 50% of the amount as a surplus liability in determining the value of the equity.

Fully diluted shares on issue

155 Engin currently has 12.96 million shares on issue.

156 In addition there are 250,000 options on issue that are exercisable only upon the achievement of certain performance targets⁴¹. Engin will negotiate with the option holders to procure their cancellation.

157 For valuation purposes we have therefore assumed 13.2 million shares on issue.

Value of Engin

158 On this basis, the value of 100% of Engin on a controlling interest basis is as follows:

Valuation of Engin⁽¹⁾		
	Low	High
	\$000	\$000
Enterprise Value (excluding the value of carry forward tax losses)	4,800	5,800
Carry forward tax losses	1,300	1,600
Surplus cash	3,432	3,432
Surplus liability – adopted value	(408)	(408)
Net debt	(273)	(273)
100% of equity value – controlling interest basis	8,851	10,151
Number of shares on issue (millions) ⁽²⁾	13.2	13.2
Engin value per share – controlling interest basis (cents per share)	67.0	76.8

Note:

1 Rounding differences exist.

2 Assuming the exercise of all outstanding options for nil consideration.

³⁹ Being \$4.182 million less \$0.750 million.

⁴⁰ The nature of this liability cannot be disclosed as it is commercially sensitive.

⁴¹ Options covert to one ordinary share upon exercise for nil consideration.

VII Evaluation of the Proposal

Summary of opinion

159 LEA has concluded that the Proposal is fair and reasonable.

160 We have formed this opinion for the following reasons.

Assessment of fairness

161 Pursuant to Australian Securities & Investments Commission (ASIC) Regulatory Guideline 111 – *Content of expert reports* (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.”

162 We have assessed the value of ordinary shares in Engin at 67 cents to 77 cents per share. As the Proposal Consideration of 70 cents is within the range of our assessed value of 100% of the ordinary shares in Engin, in our opinion, the Proposal is fair.

Assessment of reasonableness

163 Pursuant to RG 111, an offer is reasonable if it is fair. Consequently we have concluded that the Proposal is both fair and reasonable.

164 Pursuant to RG 111, an offer may be reasonable if, despite not being fair but after considering other significant factors, shareholders should accept the offer in the absence of a higher bid before the close of the offer.

165 In assessing whether the Proposal is reasonable, LEA has also considered:

- (a) the extent to which a control premium is being paid to Engin shareholders
- (b) the extent to which a share of the synergies likely to arise upon Network Investment becoming a 100% shareholder are being shared with Engin Minority Shareholders
- (c) the listed market price of Engin shares both prior to and subsequent to the announcement of the Proposal
- (d) the likely market price of Engin shares if the Proposal is not successful
- (e) Network Investment’s current shareholding in Engin
- (f) the value of Engin to an alternative offeror and the likelihood of an alternative offer emerging, either prior to the close of the Proposal, or sometime in the future
- (g) other risks, advantages and disadvantages.

166 These issues are discussed in detail below.

Extent to which a control premium is being paid

167 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.

168 We have calculated the premium implied by the Proposal Consideration of 70 cents per share by reference to the market prices of Engin shares prior to the announcement of the Proposal, as shown below:

Implied offer premium relative to recent share prices		
	Engin share price	Implied control premium
	\$	%
2 December 2010 ⁽¹⁾	0.460	52.2
Closing price 1 month prior 3 November 2010	0.350	100.0
Closing price 3 months prior 3 September 2010	0.355	97.2
1 month VWAP ⁽²⁾ 2 December 2010	0.408	71.6
3 months VWAP 2 December 2010	0.390	79.4

Note:

- 1 Being the closing price on the last day of trading prior to the announcement of the Proposal.
- 2 Volume weighted average price.

169 Consequently, in our opinion, the Proposal provides Engin Minority Shareholders with a significant premium for control.

Extent to which shareholders are being paid a share of synergies

170 Engin’s management have estimated that costs savings will arise as a consequence of Engin no longer being a publically listed company.

171 As the Proposal Consideration is within our assessed valuation range⁴², in our opinion, Engin Minority Shareholders are being offered an appropriate share of these expected synergies.

⁴² Our valuation incorporates these cost savings.

Recent share prices subsequent to the Proposal

172 Engin Minority Shareholders should note that Engin shares have not traded on the Australian Securities Exchange (ASX) above the 70 cents per share offered by Network Investment since the Proposal was announced. On 17 December 2010 Engin shares last traded at 69.5 cents per share (having traded as high as 70 cents per share).

Likely price of Engin shares if the Proposal lapses

173 In our opinion, if the Proposal lapses and no higher offer or alternative proposal emerges, it is likely (at least in the short-term) that Engin shares will trade at a discount to our valuation (consistent with the difference between the value of Engin on a portfolio basis and the value on a 100% controlling interest basis) and will trade at a significant discount to the Proposal Consideration of 70 cents per share.

Network Investment's current shareholding in Engin

174 At the date of the Proposal, Network Investment had a relevant interest in 57.33% of the shares on issue in Engin. The Proposal will, if approved, result in 100% of the shares in Engin being owned by Network Investments.

Liquidity

175 Engin Minority Shareholders should note that in the year prior to the announcement of the Proposal 0.681 million Engin shares traded, representing some 5.34%⁴³ of the total Engin shares on issue as at 2 December 2010.

176 In the absence of the Proposal, shareholders may therefore find it difficult to sell large parcels of shares or may need to do so at a discount to the last traded price.

Likelihood of an alternative offer

177 We have been advised by the Independent Chairman of Engin that no formal alternative offers have been received subsequent to the announcement of the Proposal on 2 December 2010.

178 Furthermore, in our opinion, as Network Investments presently holds 57.33% of the Company, it is unlikely that there will be any alternative offer made for Engin if the Proposal is not approved by Engin's Minority Shareholders.

Conclusion

179 Based upon the above we have concluded that the Proposal is reasonable.

180 We note that if the surplus liability of \$408,000 is excluded the low end of our assessed value range increases to 70.1 cents per share. Under this scenario, the Proposal is also fair as the Proposal Consideration is at the low end of our assessed range. Consequently, under this scenario, we would conclude that the Proposal is also fair and reasonable.

⁴³ The shares traded represent some 12.3% of the free float.

Other matters

- 181 As a result of the payment of some \$350,000⁴⁴ of untainting tax by Engin, the Proposal Consideration will be treated as a capital payment (as opposed to a dividend) for tax purposes. The taxation consequences of accepting the Proposal depend on the individual circumstances of each investor. Engin Minority Shareholders should read the taxation advice set out in Section 16 of the Explanatory Statement and should consult their own professional adviser if in doubt as to the taxation consequences of the Proposal.
- 182 The ultimate decision whether to accept the Proposal should be based on each Engin Minority Shareholders' assessment of their own circumstances, including their risk profile, liquidity preference, tax position and expectations as to value and future market conditions. If Engin Minority Shareholders are in doubt about the action they should take in relation to the Proposal or matters dealt with in this report, shareholders should seek independent professional advice.

⁴⁴ The payment of this amount is excluded from our valuation assessment on the basis that Engin Minority Shareholders should not be affected by the costs of implementing the Proposal.

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 authorises LEA to provide this Financial Services Guide (FSG) in connection with its preparation of an IER to accompany the Target Statement to be sent to Engin shareholders in connection with the Proposal.
- 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 entity who engages us. In the preparation of this IER, LEA is entitled to receive a fee estimated at \$55,000 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.

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- 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 27
363 George 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 more than 100 independent expert's reports to shareholders.
- 2 This report was prepared by Mrs Planinic and Mr Grant Kepler, who are each authorised representatives of LEA. Mrs Planinic and Mr Kepler have over 12 years and 15 years experience respectively in the provision of valuation advice.

Declarations

- 3 This report has been prepared at the request of the Independent Director of Engin to accompany the Explanatory Statement to be sent to Engin 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 Proposal is fair and reasonable to the Engin Shareholders as a whole.

Interests

- 4 At the date of this report, neither LEA, Mrs Planinic nor Mr Kepler have any interest in the outcome of the Proposal. 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 LEA has had no prior business or professional relationship with Engin or Network Investment prior to the preparation of this report.

Indemnification

- 6 As a condition of LEA's agreement to prepare this report, Engin 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 Engin 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 Engin's Explanatory Statement.

Assessment of appropriate discount rate

- 1 The determination of the discount rate or cost of capital for an asset requires identification and consideration of the factors that affect the returns and risks of that asset, together with the application of widely accepted methodologies for determining the returns demanded by the debt and equity providers of the capital employed in the asset.
- 2 The discount rate applied to the projected cash flows from an asset represents the financial return that will be demanded before an investor would be prepared to acquire (or invest in) the asset.
- 3 Businesses are normally funded by a mix of debt and equity. The weighted average cost of capital (WACC) is a widely used and accepted basis to calculate the “representative” rate of returns required by debt and equity investors. The required rate of return for equity is frequently evaluated using the capital asset pricing model (CAPM) and the required rate of return for debt funding is determined having regard to various factors such as current borrowing costs and prevailing credit ratings. The cost of equity and the cost of debt are weighted by the respective proportions of equity and debt funding to arrive at the WACC.
- 4 Consequently, we set out below an explanation of:
 - (a) the WACC and its elements (including the CAPM, its application in determining the cost of equity, the cost of debt and debt equity mix)
 - (b) our assessment of the appropriate parameters to be used in determining the discount rate to apply.

Weighted average cost of capital

- 5 The generally accepted WACC formula is the post-tax WACC, without adjustment for imputation⁴⁵ as shown below:

WACC formula

$$WACC = R_e \frac{E}{V} + R_d (1-t) \frac{D}{V}$$

Where:

R_e	=	expected equity investment return or cost of equity in nominal terms
R_d	=	interest rate on debt (pre-tax)
t	=	corporate tax rate
E	=	market value of equity
D	=	market value of debt
V	=	market value of debt plus equity

⁴⁵ Given free capital flows between developed countries and the small size of the Australian stock market (as a percentage of global markets), the cost of capital of listed companies (other than perhaps regulated infrastructure assets) should be assessed in a global context ignoring Australian imputation. This is the approach generally adopted by independent experts.

CAPM and the cost of equity

- 6 The CAPM stems from the theory that a prudent investor would price an investment so that the expected return is equal to the risk-free rate of return plus an appropriate premium for risk. The CAPM assumes that there is a positive relationship between risk and return. That is, rational investors are risk adverse and demand higher returns for accepting higher levels of risk.
- 7 The CAPM is based on the concept of non-diversifiable risk and calculates the cost of equity as follows:

Cost of equity calculation

$$R_e = R_f + \beta_e [E(R_m) - R_f]$$

Where:

R_e	=	expected equity investment return or cost of equity in nominal terms
R_f	=	risk-free rate of return
$E(R_m)$	=	expected market return
$E(R_m) - R_f$	=	market risk premium
β_e	=	equity beta

- 8 The individual components of the CAPM are discussed below.

Risk-free rate

- 9 The risk-free rate is normally approximated by reference to a long-term government bond with a maturity equivalent to the timeframe over which the returns from the assets are expected to be received. Typically in the Australian context, the yield on 10-year Commonwealth Government Bonds is used as a proxy for the long-term risk-free rate. For the purpose of our report, we have adopted the prevailing yield on 10-year Commonwealth Government bonds as at 9 December 2010 being 5.64% per annum.

Market risk premium

- 10 The market risk premium (MRP), $[E(R_m) - R_f]$, represents the additional return above the risk-free rate that investors require in order to invest in a well diversified portfolio of equity securities, i.e. the equity market as a whole. Strictly speaking, the MRP is equal to the expected return from holding shares over and above the return from holding risk-free government securities. Since expected returns are generally not observable, a common method of estimating the MRP is based on average realised (ex-post) returns.
- 11 Because realised rates of return, especially for shares, are highly volatile over short periods, short-term average realised rates of return are unlikely to be a reliable estimate of the expected rate of return or MRP. Consequently the MRP is measured over a long period of time. It should also be noted that the standard error of the estimate of the mean for longer periods is typically lower than the standard error of the mean where a shorter period is used. This supports more reliance being placed on the average MRP calculated over the longer term.

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- 12 A number of studies on historical MRPs have been carried out using long periods of historical data from the Australian as well as overseas markets. The following table summarises the empirical evidence on the MRP in the United States:

Market risk premium – empirical evidence		
US studies	Period over which MRP measured	Market risk premium %
Siegel	1802 – 1992	5.0
Pastor and Stambaugh	1834 – 1999	5.8
Fama and French	1872 – 2000	5.6
Ibbotson Associates	1926 – 2000	7.7
Fama and French	1951 – 2000	7.4

Source:

Siegel J., 1992, The Equity Premium: Stock and Bond Returns Since 1802, Financial Analysts Journal, pp. 28-38.

Pastor L. and R. Stambaugh, 2001, The Equity Premium and Structural Breaks, Journal of Finance, 56(4), pp. 1207-1239.

Ibbotson Associates, 2001, Stocks, Bonds, Bills, and Inflation.

Fama E. and K. French, 2002, The Equity Premium, Journal of Finance, 57(2), pp. 637-659.

- 13 The most recent MRP study in Australia was by Brailsford, Handley and Maheswaran (2008) who analysed data for the period from 1883 to 2005 (inclusive). The following table reports the MRP in nominal terms as measured by this data set, for different time periods up to 2005:

Historical Australian market risk premium – 1883 to 2005						
Time period ⁽¹⁾		Years	Arithmetic mean %	Geometric mean %	Standard deviation %	
From	To					
Relative to bills⁽²⁾						
1883	–	2005	123	6.6	5.3	16.0
1937	–	2005	69	6.4	4.6	19.1
1958	–	2005	48	6.8	4.5	22.1
1980	–	2005	26	6.2	3.9	21.9
1988	–	2005	18	5.2	4.2	15.2
1883	–	1987	105	6.8	5.5	16.2
Relative to bonds⁽³⁾						
1883	–	2005	123	6.2	4.9	16.0
1937	–	2005	69	5.8	4.0	19.1
1958	–	2005	48	6.3	4.0	22.0
1980	–	2005	26	6.0	3.8	21.7
1988	–	2005	18	5.1	4.0	15.0
1883	–	1987	105	6.4	5.1	16.2

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Note:

- 1 The first four periods have increasing data quality but decreasing sample size. The fifth period begins from the introduction of the imputation tax system in Australia.
- 2 Various types of bill returns were used due to the lack of a continuous government bill issue covering the study period. The majority of the bill return data is yield on three month Commonwealth Government securities.
- 3 Historical bond returns were also collected from a number of sources. Most of the bond returns are Commonwealth Government bond yields with a maturity of 10 years or more.

Source:

Brailsford, T., J. Handley, and K. Maheswaran, 2008, Re-examination of the historical equity risk premium in Australia, *Accounting and Finance*, 48(1), pp. 73-97.

- 14 Various academic studies put the historical MRP of the Australian equity market in a wide range from 4% to 7% depending on the historical period chosen, whether the MRP is measured relative to bills or bonds, and whether arithmetic or geometric mean is used. However, the authors note the concern regarding the poor quality of the data prior to 1958. The arithmetic average MRPs relative to bonds and bills over the 1958 to 2005 period are 6.3% and 6.8% respectively. The corresponding geometric measures over the same period are significantly lower at 4% to 4.5%.
- 15 In summary, Australian and overseas empirical evidence shows (not surprisingly) that the historical MRPs vary across markets. Historical MRPs for the Australian market are generally in line with the overall range of the MRPs of developed countries, but are slightly higher than the world average.
- 16 The global financial crisis (GFC), originating from the sub-prime mortgage crisis in the US, had a significant impact on investors' perception of overall market risk. Associated with the crisis there was a very substantial increase in credit margins, significant equity market volatility and a substantial decrease in liquidity in capital markets. Although the economic fundamentals of the Australian economy remained strong, overseas market conditions had a substantial adverse impact on domestic financial markets. However, credit margins, equity market volatility and market conditions have since improved. Longer term, MRPs are expected to revert to the long-term historical level.
- 17 Prior to the GFC, independent experts in Australia generally adopted a MRP of around 6.0%. Following the GFC we adopted a MRP of 6.5%. This was consistent with many other independent experts and with the Australian Energy Regulator (AER) which also adopted a MRP of 6.5% in its Statement of Regulatory Intent (SORI) in May 2009. In the AER's most recent decision in October 2010 on Victorian electricity distribution network service providers (distribution determination 2011 to 2015) the AER continued to adopt a MRP of 6.5%. However, the AER noted that:
 - (a) *“commentary on financial markets indicates clear signs of stabilisation since the time of the AER's SORI and its decision to increase the MRP to 6.5%;*
 - (b) *an MRP of 6.5% may be considered conservative when accounting for improved financial conditions since the onset of the GFC, however, recovery in the global economy and conditions in global capital markets remains fragile.”*

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- 18 Since the issue of the SORI, the Queensland Competition Authority (QCA) has issued its final decision for the Dalrymple Bay Coal Terminal (DBCT) (in September 2010) adopting a MRP of 6.0% (being the same MRP they adopted in the prior regulatory decision five years earlier).
- 19 As the MRP is an estimate of the additional market return above the risk-free rate over the relevant investment horizon (i.e. the period over which cash flows have been forecast), it should be determined having regard primarily to the long-term historical MRP. However, short to medium term risk factors do have an impact on investors' perception of market risk and their demand for an appropriate MRP.
- 20 Having regard to all of the above and, in particular, the more stable equity market conditions and values currently prevailing in Australia, we have adopted a MRP of 6.0%.

Equity beta

Description

- 21 Beta is a measure of the expected volatility of the return on an investment relative to the market as a whole. The CAPM assumes that beta is the only reason expected returns on an asset differ from the expected return on the market as a whole. A beta greater than one suggests that an investment's returns are expected to be more volatile and risky than average (and accordingly a higher return than the market is required), whereas a beta less than one suggests that future returns will be less volatile and risky.
- 22 Similar to MRPs, expected equity betas are not observable. Historical betas are usually estimated and used as a reference to determine the appropriate forward-looking betas. In addition, factors such as betas of comparable companies and relevant industry sectors and a qualitative assessment of the systematic risks of the subject business are also considered. The determination of the appropriate beta to apply is, therefore, ultimately a matter of judgment.
- 23 In determining the appropriate equity beta for Engin we have considered:
 - (a) the risks faced by Australian VoIP and broadband companies generally
 - (b) the risks associated with Engin's operations; and
 - (c) the beta estimates for comparable VoIP and broadband services companies and the relevant sector.

Risk of VoIP and broadband operations in Australia

- 24 In assessing the appropriate beta attributable to companies with VoIP and broadband operations in Australia the following risks and factors are relevant:
 - (a) the VoIP market is a highly competitive, commoditised market with low barriers to entry where price is likely to be the key differentiating factor between providers
 - (b) the significant number of VoIP providers currently in the Australian market
 - (c) the gradual decline in voice prices generally has led to declines in ARPU in the short-term

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- (d) competition in the ISP industry is driven by price, quality and level of service, product range and branding, with price being the major driver of competition
- (e) the Australian ISP sector is the fastest growing of the telecommunications industry
- (f) the highly fragmented nature of the ISP industry
- (g) the uncertainty surrounding the final structure of the NBN and the potential impacts it will have on small operators
- (h) the defensive nature of telecommunication companies generally.

25 After consideration of the above, in our view, the level of systematic risk associated with consumer VoIP and ADSL operations in Australia approximates the level of systematic risk of the market as a whole.

Risk factors of Engin

26 In considering the risks associated with Engin it should be noted that:

- (a) the size of Engin's operations is relatively small
- (b) Engin has been experiencing a decline in overall ARPU as a result of a move in customer mix towards ADSL and a relatively flat voice ARPU
- (c) there has been an increase in the proportion of lower-margin ADSL customers as a proportion of total customers
- (d) in respect of its ADSL and proposed mobile reselling activities, as it is not a facilities based provider Engin is unlikely to be able to achieve the same scalability benefits as available to an ISP that owns its own infrastructure, thus resulting in lower margins
- (e) Engin's initial move into ADSL and the planned move to enter the mobile reselling market is principally a defensive strategy to limit the losses of churn away from the higher margin voice business, as opposed to a growth strategy
- (f) any move towards a high growth strategy is unlikely to be achieved without the assumption of significant risk and without significant capital contribution.

27 After consideration of the above, in our view, the risk (and therefore the beta) is greater for Engin's operations than the VoIP and ISP industry as a whole (principally due to its relatively small size and associated lack of scalability).

Betas of broadly comparable companies

28 In order to assess the appropriate equity beta for Engin, we have also had regard to the equity betas of broadly comparable companies listed on the ASX, as well as Primus Telecommunications Group which is listed on the over-the-counter securities market in the US⁴⁶, as shown below:

⁴⁶ Although foreign based Primus also provides telecommunications services to the Australian market. We note that the largest listed "pureplay" VoIP provider in the US, Vonage Holdings Group (Vonage) has an equity beta of 1.4 and an R-square of 0.04. Vonage does not provide VoIP services to the Australian market.

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Listed company betas						
Company name	Market cap ⁽¹⁾ A\$m	Gearing ⁽²⁾ %	Beta ⁽³⁾	AGSM R-square ⁽⁴⁾	Bloomberg Beta ⁽⁵⁾	Bloomberg R-square ⁽⁴⁾
Engin	6.0	(279.7)	1.12	0.12	0.87	0.07
TPG Telecom Ltd	1,178.8	20.0	1.71	0.17	1.85	0.15
iiNET Ltd	439.2	9.2	0.94	0.13	0.92	0.10
Primus Telecommunications GP	106.9	63.7	n/a	n/a	0.80	0.02
My Net Fone Ltd	11.0	(21.7)	1.23	0.12	0.88	0.24
Eftel Ltd	3.0	62.0	0.93	0.06	1.00	0.06
Min (excl. Engin)		(21.7)	0.93		0.80	
Max (excl. Engin)		63.7	1.71		1.85	
Average (excl. Engin)		26.6	1.20		1.09	
Median (excl. Engin)		20.0	1.09		0.92	

Note:

- 1 Market capitalisation as at 9 December 2010. All currencies have been converted to A\$ as at 9 December 2010.
 - 2 Gearing calculated as net debt (inclusive of net financial liabilities and net pension liabilities divided by Enterprise Value. Balance sheet items (such as debt) are as at the respective company's most recent reporting date. Negative gearing implies a net cash surplus.
 - 3 Australian Graduate School of Management (AGSM) betas are estimated as at 30 September 2010 using up to four years of monthly data.
 - 4 R-square is a statistical measure of how well the regression line approximates the real data points. It has a value between zero and 1. The closer R-square is to 1, the more reliable the beta estimate.
 - 5 Betas obtained from Bloomberg using up to four years of monthly data as at 30 November 2010.
- n/a – not available.

Source: Bloomberg, ASX Announcements, AGSM and LEA analysis.

- 29 The above comparable betas vary widely which reflects differences in size, leverage, stage of development and operational risks. None of the other listed companies are directly comparable to Engin. However, we note that the betas of these companies are generally around the average market beta of 1, indicating a similar level of systematic risk for Engin's operations generally.
- 30 It should be noted that as the equity beta is a function of both business risk and financial risk (being the level of financial leverage or gearing), the above equity betas are levered betas and theoretically would need to be adjusted to reflect the different levels of gearing. However, this adjustment is subject to considerable estimation error. For example, gearing ratios are normally calculated at a point in time and therefore may not reflect the target or optimal capital structures of comparable companies in the long run. In addition, gearing ratios typically change over time. Further, the practice of adjusting equity betas for the difference in financial leverage also gives a misleading impression that the process provides precise comparable beta estimates.

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- 31 Nevertheless, we have considered the following in determining the appropriate equity betas for Engin:
- (a) the difference in gearing levels of comparable companies where these levels differ significantly
 - (b) the current gearing levels of Engin and the long-term gearing levels that we consider appropriate.

Historical sector beta

- 32 The table below shows the historical beta estimates of the Australian Telecommunication Services sector:

Telecommunication Services sector		
Data period ended ⁽¹⁾	Beta	R-square
30 September 2010	0.42	0.19
30 June 2010	0.44	0.22
31 March 2010	0.48	0.24
31 December 2009	0.46	0.23
30 September 2009	0.43	0.20
30 June 2009	0.40	0.15
31 March 2009	0.38	0.15
31 December 2008	0.43	0.18

Note:

1 Using four years of monthly returns.

Source: AGSM

- 33 In having regard to the Australian Telecommunication Services beta we note that it is heavily weighted towards Telstra (accounting for approximately 80% of the sector by market capitalisation⁴⁷) which is a market leader within the industry. We have considered each of Engin's relative risks compared to Telstra's when determining the appropriate equity beta for Engin and note that Engin's operations are significantly different to Telstra's in respect of size, leverage, stage of development, diversification and operational risks. As such we have not had regard to the beta estimates of the Australian Telecommunication Services Sector when determining Engin's appropriate equity beta.

Conclusion

- 34 Having regard to the above we have adopted an equity beta in the range of 1.1 to 1.3 for Engin.

⁴⁷ Source: AGSM.

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Specific risk premium

- 35 Whilst specific company risks are not reflected in the CAPM, empirical studies demonstrate that investors do not ignore company specific risks. In particular, studies show that, on average, investors require higher rates of return from smaller companies (often referred to as the size premium).
- 36 A recent study by Ibbotson Associates provides evidence of the additional size premiums required for US companies based on return data (by size) from 1926 to 2008. They found that the size premium, calculated as the return on small company stocks in excess of that predicted by the CAPM, is in the range of -0.36% for the first (largest) decile⁴⁸ to 5.81% for the tenth decile (being the smallest 10% of the listed companies):

Size premium			
Decile	Market Capitalisation (US\$m) ⁽¹⁾		Size premium (return in excess of CAPM) ⁽²⁾
	Smallest	Largest	%
1	18,628	456,652	(0.36)
2	7,435	18,503	0.62
3	4,229	7,360	0.74
4	2,786	4,225	0.97
5	1,850	2,786	1.54
6	1,198	1,849	1.63
7	754	1,197	1.62
8	453	753	2.35
9	219	453	2.71
10	2	219	5.81

Note:

- 1 Market capitalisation was calculated as at 31 December 2008.
- 2 Size premium was calculated as the difference between the actual returns and the return calculated using the CAPM.
- 3 Ibbotson provided a further breakdown of the 10th decile, noting that the size premium for the upper half of the 10th decile (decile 10a) was 4.11%, whereas the size premium for the lower half of the 10th decile (decile 10b) was 9.53%.

Source: Market Results for Stocks, Bonds, Bills and Inflation 2009 Yearbook, Ibbotson SBBI.

- 37 We have not been able to find any empirical study which examines the relation between firm size and required rate of return using Australian data. However, when considering the appropriateness of the US size premium data in the Australian context it must be noted that:
- (a) US listed companies are generally significantly larger (in terms of market capitalisation) than Australian companies

⁴⁸ A decile is a proportion of a set of data that has been ranked and divided into 10 groups (or bands), where each group contains an equal number of data items.

Appendix C

- (b) the average 10-year Australian Commonwealth Government Bond yield is around 1% higher than the average 10-year US government bond yield⁴⁹
- (c) when valuing Australian companies, valuers generally apply a MRP of 6.0% which is around 1.0% (per annum) greater than that applied when valuing US companies
- (d) the result of (b) and (c) is that, on average, investors' required rate of return on Australian equities (measured by CAPM) is some 2% higher than for US equities⁵⁰, which in our opinion is likely to be principally due to the smaller size of Australian companies and the Australian market (and the related lower liquidity of its financial markets)
- (e) thus, in our opinion, a significant size premium is already reflected in the cost of equity derived for Australian companies relative to their US counterparts.

38 In summary, we are of the view that a size premium should be adopted in the current circumstances. Having regard to the size of Engin's operations, we have applied a size premium of 2.0% to 3.0% per annum when valuing the business.

Gearing

- 39 The gearing level adopted should represent the level of debt that the asset can reasonably sustain and is not necessarily equivalent to the gearing level of the entity owning the asset. The factors that affect the "optimum" level of gearing will differ between assets. Generally, the major issues to address in determining this optimum level will include:
- (a) the variability in earnings stream
 - (b) working capital requirements
 - (c) the level of investment in tangible assets
 - (d) the nature and risk profile of the tangible assets.
- 40 In general, the lower the expected volatility of cash flows (i.e. risk), the higher the debt levels which can be supported (and vice versa). Furthermore, as the equity beta is a function of both business risk and financial risk (being the level of financial leverage or gearing), it is important to adopt in the WACC calculation a level of gearing which is consistent with the gearing implied in the choice of equity beta.

⁴⁹ For example, the average 10-year US Treasury Bond yield over the period from 1883 to 2005 is 4.73% compared to the average 10-year Commonwealth Government Bond yield over the same period of 5.7% (estimated by Brailsford, Handley and Maheswaran, 2008).

⁵⁰ The average beta or market beta is 1, therefore, the average required rate of return for Australian companies is some 2% higher than that of the US companies.

Appendix C

- 41 There has historically been substantial variability in Engin’s earnings and the tangible assets of the company are minimal. As a result, we consider it unlikely that the Company could obtain any significant amount of debt finance⁵¹. We have therefore adopted a gearing level of 0% for Engin. Accordingly, the cost of capital (WACC) should be equal to the cost of equity.

Calculation of WACC

- 42 Based on the above we have adopted a discount rate in the range of 15% to 16% per annum (after tax) for Engin:

Engin - WACC		
Parameters	Low	High
Beta	1.2	1.3
Market risk premium (%)	6.0	6.0
Risk free rate (%)	5.6	5.6
Cost of equity (%)	12.8	13.4
Additional risk premium (%)	2.0	3.0
Adjusted cost of equity (%)	14.8	16.4
Say	15%	16%

⁵¹ We note that the Company’s lease finance arrangements have historically been secured by a cash backed bank guarantee (a condition of the facility).

Appendix D

Transaction multiples

- 1 There have been a number of transactions involving businesses operating in the Australian telecommunications industry which provide ISP and VoIP services. The implied multiples from these transactions at the date of acquisition are set out below:

VoIP and ISP transactions					
Date ⁽¹⁾	Target	Acquirer	Enterprise Value ⁽²⁾ \$m	EBITDA multiples	
				Historical x	Forecast x
Nov 10	Clever Communications ⁽³⁾	BigAir Group	2.8	3.0	n/a
Jul 10	AAPT Consumer Div.	iiNet	60.0	n/a	3.0
Mar 10	Netspace	iiNet	40.0	n/a	5.0
Dec 08	People Telecom	M2 Telecom.Group	13.2	4.3	n/a
May 08	Westnet Pty Ltd	iiNet	79.0	6.8	n/a
Feb 08	Chariot Limited ⁽⁴⁾	TPG Telecom	6.5	9.9	5.2 – 5.4
Feb 08	TPG Holdings ⁽⁴⁾	SP Telemedia	230.0	10.9	4.7
Sep 06	B Digital	SP Telemedia	127.0	4.4	5.8
Nov 04	Kooee Communications	B Digital	64.9	n/m	5.2
Mar 04	People Telecom	Swiftel Limited	39.2	6.1	n/a
Nov 03	DigiPlus	B Digital	62.1	3.4	n/a
Average				8.7	4.5
Median				5.0	4.7

Note:

- 1 Date of announcement.
- 2 Enterprise Value is inclusive of net debt (or net cash) and net off the value of any surplus assets.
- 3 The off-market takeover is not complete (however, Clever Communications' Directors have unanimously recommended that Clever Shareholders accept the offer).
- 4 The relatively high historic EBITDA multiples reflect the well above average expected EBITDA growth.

Source: LEA analysis using data from ASX announcements, IERs, analyst reports and company financial reports.

n/a – not available.

n/m – not meaningful.

- 2 An outline of the VoIP services provided by the target companies and a brief description of the company's activities at the date of the acquisition are set out below:

Appendix D

VoIP services offered							
	Internet-based residential VoIP	Internet-based business VoIP	Private network-based residential VoIP	Private network-based business VoIP	Internet-based IP Centrex / hosted Voice	Private network based IP Centrex / hosted Voice	Wholesale VoIP
Clever Communications				✓		✓	
AAPT Consumer Division				✓		✓	
Netspace	✓	✓					
People Telecom	✓						
Westnet	✓	✓		✓	✓	✓	✓
Chariot	✓	✓					
TPG Holdings	✓	✓		✓			✓
B Digital				✓			✓
Kooee Communications				✓			✓
DigiPlus				✓			✓

■ Services offered by Engin.

Source: Market Clarity "Aussie VoIP List".

Clever Communications Australia Limited

3 Clever Communications Australia is a telecommunications carrier company providing voice and data services to the business market throughout Australia. The company specialises in providing broadband internet, virtual private network and security and application services.

AAPT Consumer Division

4 AAPT is one of the three largest telecommunications companies in Australia and the consumer division, at the time of acquisition by iiNet, provided services to residential, small and home office users. These services include fixed line voice, broadband internet, mobile phone services and 2-in-1 bundles (broadband and phone bundles).

Netspace Limited

5 Netspace is a telecommunications service provider based in Melbourne. As of March 2010, when acquired by iiNet, Netspace operated in the business and consumer telecommunication markets, providing broadband, Ethernet and wireless internet access as well as fixed line telephony services. Netspace had over 105,000 subscribers including 70,000 broadband subscribers.

People Telecom Limited

6 People Telecom is a provider of a broad range of telecommunications products and services with offices in New South Wales and Victoria. At the date of the acquisition by M2 Telecommunications Group Limited (December 2008), the company provided all access voice services, mobile services and business solutions, broadband and Ethernet internet services and a complete suite of data and co-location solutions to some 42,000 customers.

Appendix D

Westnet Pty Limited

- 7 Westnet is a national telecommunications service provider based in Western Australia. As of May 2008, when it was acquired by iiNet, Westnet offered dial-up, ADSL, mobile and satellite broadband, telephony, web hosting, domain registration and business telecommunications solutions across Australia. Westnet was Australia's sixth largest internet service provider with over 200,000 customers, including some 140,000 broadband subscribers.

Chariot Limited

- 8 Chariot is an internet services provider, offering ISP services and products including dial-up, ADSL, VoIP, email, web hosting and co-location. The company also offers internet reseller incentives to those businesses that have clientele requiring internet access.

TPG Holdings Limited

- 9 TPG Holdings was a telecommunications company, retailing and wholesaling products and services to some 200,000 customers across Australia. When SP Telemedia Limited acquired TPG Holdings, the company offered dial-up and broadband internet solutions to consumers and small businesses, with a focus on the high speed, high volume segment of the broadband market.

B Digital Limited

- 10 B Digital was a provider of residential telecommunications services for mobile, home phone and internet. B Digital purchased access and air-time on the Optus network at wholesale rates and resold it together with standard mobile handsets. The company was acquired by SP Telemedia Limited in September 2006.

Kooe Communications

- 11 Koee Communications was a reseller of telecommunication services, offering products and services to the residential and corporate market segments. The company had been providing local, long distance, international and mobile telephony to consumers since October 2000, before being acquired by B Digital Limited in late 2004.

DigiPlus

- 12 DigiPlus was established in 1996 and provided some 150,000 residential customers with mobile, internet service provider, national, local and fixed to mobile telecommunication services prior to the acquisition by Swiftel Limited in 2004.

Appendix E

Listed company multiples

- 1 We have had regard to small to medium sized stock exchange listed companies that provide ISP and/or VoIP services in the Australian market. The EBITDA multiples for these companies and a brief description of their activities are set out below:

Listed company multiples ⁽¹⁾	Enterprise Value ⁽²⁾ A\$m	EBITDA	
		Historical ⁽³⁾ FY10 times	Forecast ⁽⁴⁾ FY11 times
TPG Telecom ⁽⁵⁾	1,474.3	6.8	6.8
iiNet ⁽⁶⁾⁽⁷⁾	483.7	5.1	5.1
Primus Telecommunications Group (Primus)	304.7	3.7	n/a
My Net Fone	9.3	9.1	n/a
Eftel	7.9	10.7	n/a
Average		7.1	5.9
Median		6.8	5.9

Note:

- 1 Enterprise value and earnings multiples calculated as at 9 December 2010, other than for Engin, which is calculated on the day prior to announcement of the Selective Capital Reduction (2 December 2010).
- 2 Enterprise Value includes net debt (interest bearing liabilities less non-restricted cash), market capitalisation adjusted for material option dilution, share placements and excludes surplus assets.
- 3 Historical earnings is based on latest statutory full year accounts and excludes non-recurring items, with the exception of Primus Communications, which is based on historical earnings for the 12 months to 30 September 2010.
- 4 Forecast earnings is based on Bloomberg broker average forecast (excluding outliers and outdated forecasts).
- 5 TPG Telecom's historical earnings have been adjusted to reflect a full year earnings contribution from Pipe Networks Limited (acquired on 31 March 2010).
- 6 iiNet's historical earnings have been adjusted to reflect full year earnings contributions of acquired company Netspace on 30 April 2010.
- 7 iiNet's forecast multiple is calculated based on Enterprise Value adjusted for the acquisition of the AAPT Consumer Division from Telecom Corporation of New Zealand on 30 September 2010.

Source: Bloomberg, latest full year statutory accounts, latest interim accounts, company announcements, LEA analysis.

n/a – not available.

Appendix E

- 2 An outline of the VoIP services provided by the broadly comparable companies and a brief description of the company's activities are set out below:

VoIP services offered by broadly comparable stock exchange listed companies							
	Internet-based residential VoIP	Internet-based business VoIP	Private network-based residential VoIP	Private network-based business VoIP	Internet-based IP Centrex / hosted Voice	Private network-based IP Centrex / hosted Voice	Wholesale VoIP
TPG Telecom	✓	✓		✓			✓
iiNet	✓	✓	✓	✓			
Primus	✓	✓					✓
My Net Fone	✓	✓		✓		✓	✓
Eftel ⁽¹⁾	n/a	n/a	n/a	n/a	✓	n/a	n/a

■ Services offered by Engin.

Note:

1 Break-down of VoIP services of Eftel not provided by the source.

Source: Market Clarity "Aussie VoIP List".

n/a – not available.

TPG Telecom Limited

- 3 TPG Telecom, formerly SP Telemedia Limited, is a multi-media full service telecommunications company providing voice, internet and data solutions to consumers, small medium enterprises, corporate and government sectors. After the merger with TPG Holdings Limited in 2008 subscriber numbers increased to over 700,000 customers, including some 460,000 broadband subscribers.

iiNet Limited

- 4 iiNet is an Australian based internet service provider supporting some 960,000 broadband, telephony and dial-up services across Australia. The company's products include internet access, phone, domains and hosting, telecommunication hardware and software, VoIP, and a wireless modem-and-phone-in-one, namely BoB. iiNet is, post the acquisition of Netspace and AAPT's Consumer Division, Australia's second largest internet service provider with some 650,000 broadband (DSL) subscribers.

Primus Telecommunications Group

- 5 Primus Telecommunications is an integrated telecommunications services provider offering international and domestic voice, wireless, internet, VoIP and data services to customers located primarily in Australia, Canada, United States, Brazil and the United Kingdom. The company provides retail and wholesale services over its VoIP network. Primus Telecommunications serves small and medium sized enterprises, multi-national companies, residential customers and other telecommunications carriers and resellers.

Appendix E

My Net Fone Limited

- 6 My Net Fone is a provider of internet protocol-based VoIP, data and video services, as well as enhanced service applications to residential and business enterprise customers. As of July 2010, the Company had over 83,000 residential customers throughout Australia, New Zealand and Asia. The company primarily derives its revenue from fees and call charges from residential and business markets, as well as from sales of customer premises equipment.

Eftel Limited

- 7 Eftel is engaged in the provision of telecommunications and supply of internet services to wholesale, business and retail customers. The company offers internet protocol, co-location, dial-up ports and DSL broadband. Eftel provides commercial wireless broadband and VoIP services under the Radiowan and Flatworld brands, respectively.

Glossary

Term	Meaning
ADSL	Asymmetric Digital Subscriber Line
AER	Australian Energy Regulator
AGSM	Australian Graduate School of Management
AIFRS	Australian equivalent to International Financial Reporting Standards
ARPU	Average revenue per user
ASIC	Australian Securities & Investments Commission
ASX	Australian Securities Exchange
BPL	Broadband over power lines
CAPM	Capital asset pricing model
Corporations Act	<i>Corporations Act 2001 (Cth)</i>
DBCT	Dalrymple Bay Coal Terminal
DCF	Discounted cash flow
DSL	
EBIT	Earnings before interest and tax
EBITA	Earnings before interest, tax and amortisation
EBITDA	Earnings before interest, tax depreciation and amortisation
Engin Minority Shareholders	All shares held by Engin shareholders other than Network Investment
Engin or the Company	Engin Limited
FOS	Financial Ombudsman Services Limited
FSG	Financial Services Guide
FY	Financial year
GDP	Gross domestic product
GFC	Global financial crisis
HFC	Hybrid optical fibre and coaxial cable
IER	Independent expert's report
IPTV	Internet protocol television
ISP	Internet service provider
LEA	LonerGAN Edwards & Associates Limited
Mbps	Megabits per second
MRP	Market risk premium
NBN	National broadband network
Network Investment	Network Investment Holdings Pty Limited
NPV	Net present value
PE	Price earnings
Proposal	Selective capital reduction of shares owned by Engin Minority Shareholders
Proposal Consideration	70 cents per Engin share
PSTN	Public switched telephone network
QCA	Queensland Competition Authority
RG 111	Regulatory Guideline 111 – <i>Content of expert reports</i>
SGH	Seven Group Holdings Limited
SIOs	Services in operation
SORI	Statement of Regulatory Intent
VoIP	Voice over Internet Protocol
Vonage	Vonage Holdings Group
VWAP	Volume weighted average price
WACC	Weighted average cost of capital

APPENDIX B: Independent Tax Opinion

20 December 2010

The Directors
Engin Limited
38-42 Pirrama Road
PYRMONT NSW 2009

Tax letter for ordinary shareholders

Dear Directors

This letter has been prepared at the request of Engin for inclusion in the Explanatory Statement accompanying the *Notice of Meeting and Notice of Meeting of Minority Shareholders* ("the Notice") to be dated **20 December 2010** in relation to the proposed selective capital reduction and share cancellation ("the Capital Reduction") of some of the Engin Limited shares pursuant to the Notice.

Defined terms used in this letter are consistent with those set out in the glossary section of the Notice.

This letter provides a summary of the general Australian income tax implications for an Australian resident (for income tax purposes) of the payment for the Capital Reduction.

This letter is concerned only with the taxation consequences for Australian resident investors that satisfy the following criteria (herein referred to as "the Minority Shareholders"):

- ▶ who are listed on the security registry as at the date of the Capital Reduction; and
- ▶ who held their shares in Engin on capital account; and
- ▶ are Australian resident entities who did not hold their shares as part of a business conducted through a permanent establishment in a foreign country; and
- ▶ were not subject to the taxation of financial arrangement rules in Division 230 in relation to gains and losses on their Engin shares.

The information contained in this letter is based on the *Income Tax Assessment Act 1936* ("ITAA 1936"), and the *Income Tax Assessment Act 1997* ("the ITAA 1997"), applicable case law and published Australian Taxation Office (ATO) rulings, determinations and administrative practice at the date of this letter. Any changes in the tax law or interpretation of the tax law subsequent to the date of this letter may alter the information contained in this tax letter.

Tax is a complex area of law and the tax implications for Minority Shareholders may differ from those detailed in this tax letter, depending on the Investor's particular circumstances. Accordingly, Shareholders should not rely on this tax letter as the information in this letter is only general in nature. Shareholders should obtain independent professional advice, specific to their circumstances, before deciding to participate in the Capital Reduction.

1. Capital Gains Tax ("CGT")

The Minority Shareholders to which this letter applies hold their shares on capital account and the shares were acquired after 20 September 1985. On this basis, the proposed Capital Reduction should trigger CGT event C2. The event should occur at the time when the shares are cancelled under the Capital Reduction.

The capital gain or loss that should arise to the Minority Shareholders on the cancellation of each share will broadly be calculated as the difference between the consideration received from Engin for the Capital Reduction of \$0.70 and each Minority Shareholder's original acquisition price for the share (plus any incidental costs of acquisition).

Some Minority Shareholders (commonly being individuals, complying superannuation entities or trustees) that have held Engin Shares for at least 12 months and do not choose to index the cost base of the Engin Shares may be entitled to discount the amount of the capital gain (after application of capital losses, if any, from this and other transactions). The amount of this discount is 50% in the case of individuals and trusts and 33 1/3% for complying superannuation entities. Alternatively, if the shares were acquired before 11.45am (by legal time in the ACT) on 21 September 1999 a shareholder may be able to use the indexation method to calculate their capital gain (but not a capital loss).

2. No part of the payment be a dividend

Broadly, a dividend for income tax purposes includes any distribution made by a company to any of its shareholders as well as any amount credited by a company to any of its shareholders as shareholders, except where the amount is debited against an amount standing to the credit of the share capital account of the company.

The accounting entries for the Capital Reduction will result in the total value of the payment being fully debited to Engin's share capital account. We understand that the share capital account will not be tainted when the Capital Reduction and the debit to the share capital account occur. Therefore, the Capital Reduction should be excluded from the definition of dividend for tax purposes. On this basis no part of the payment should be treated as a dividend in the hands of the Minority Shareholders.

3. No part of the payment be deemed a dividend

Despite our comments above, anti-avoidance provisions provide the Commissioner with discretionary powers to re-characterise some or all of a return of capital as an unfranked dividend. This would result in the amount received for the Capital Reduction being assessable income in the hands of the Minority Shareholders. The Commissioner is also empowered to debit the franking account of the company which has paid the deemed dividend.

In broad terms, the Commissioner has the capacity to make a determination to apply these anti-avoidance provisions if, based upon an analysis of certain relevant matters, it would be concluded that the distribution of capital has a purpose, other than an incidental purpose, of conferring a tax advantage on a taxpayer as compared to the payment of a dividend.

We have performed a review of the relevant matters and have concluded that it should not be concluded that the proposed Capital Reduction is being carried out for a purpose of conferring a tax advantage on a taxpayer.

Accordingly, we believe the Commissioner should not seek to apply these provisions to the proposal. However, because of the wide discretion contained in the provisions and the low threshold of purpose that can allow the provision to apply there must remain a residual risk that the Commissioner could seek to apply the provisions.

We disclaim all liability to any shareholder or other party for all costs, loss, damage and liability that the shareholder or other party may suffer or incur arising from or relating to or in any way connected with the contents of this letter or the provision of this letter to the shareholder or other party or the reliance on this letter by the shareholders or other party.

Ernst & Young has given its consent to the inclusion of this letter in the Notice. At the date of this letter, this consent has not been withdrawn.

Ernst & Young expresses no opinion and gives no assurance or guarantee in respect of the performance of the Capital Reduction and this letter's content should not be taken as an endorsement or as a recommendation thereof.

This advice is confined to taxation issues and is only one of the matters shareholders need to consider when making a decision about their investments. Under the Corporations Act, this advice is not required to be provided to investors by a holder of an Australian Financial Services Licence (AFSL). Before making a decision about their investments, investors should consider taking advice from a holder of an AFSL.

Yours faithfully

A handwritten signature in black ink that reads 'Ernst & Young' in a cursive style.

Ernst & Young

FOR ALL ENQUIRIES CALL:
(within Australia) 1300 737 760 (outside Australia) +61
2 9290 9600

FACSIMILE
+61 2 9290 9655

POSTAL ADDRESS:
Registries Limited
GPO Box 3993
Sydney NSW 2001
Australia

Name and Address

Your Address

This is your address as it appears on the company's share register. If this is incorrect, please mark the box with an "X" and make the correction on the form. Securityholders sponsored by a broker should advise your broker of any changes. **Please note, you cannot change ownership of your securities using this form.**

YOUR VOTE IS IMPORTANT

FOR YOUR VOTE TO BE EFFECTIVE IT MUST BE RECORDED BEFORE 11.00am
(Sydney Time) SATURDAY 29 JANUARY 2011

TO VOTE ONLINE

Reference Number: <HIN/SRN>



STEP 1 : VISIT www.registries.com.au/vote/engingm2011

STEP 2: Enter your holding/Investment type

STEP 3: Enter your Reference Number and VAC: <VAC NUMBER>

TO VOTE BY COMPLETING THE PROXY FORM

STEP 1 Appointment of Proxy

Indicate here who you want to appoint as your Proxy
If you wish to appoint the Chairman of the Meeting as your proxy, mark the box. If you wish to appoint someone other than the Chairman of the Meeting as your proxy please write the full name of that individual or body corporate. If you leave this section blank, or your named proxy does not attend the meeting, the Chairman of the Meeting will be your proxy. A proxy need not be a security holder of the company. Do not write the name of the issuer company or the registered securityholder in the space.

Proxy which is a Body Corporate

Where a body corporate is appointed as your proxy, the representative of that body corporate attending the meeting must have provided an "Appointment of Corporate Representative" prior to admission. An Appointment of Corporate Representative form can be obtained from the company's securities registry.

Appointment of a Second Proxy

You are entitled to appoint up to two proxies to attend the meeting and vote on a poll. If you wish to appoint a second proxy, an additional Proxy Form may be obtained by telephoning the company's securities registry or you may copy this form.

To appoint a second proxy you must:

- complete two Proxy Forms. On each Proxy Form state the percentage of your voting rights or the number of securities applicable to that form. If the appointments do not specify the percentage or number of votes that each proxy may exercise, each proxy may exercise half your votes. Fractions of votes will be disregarded.
- return both forms together in the same envelope.

STEP 2 Voting Directions to your Proxy

You can tell your Proxy how to vote

To direct your proxy how to vote, place a mark in one of the boxes opposite each item of business. All your securities will be voted in accordance with such a direction unless you indicate only a portion of voting rights are to be voted on any item by inserting the percentage or number of securities you wish to vote in the appropriate box or boxes. If you do not mark any of the boxes on a given item, your proxy may vote as he or she chooses. If you mark more than one box on an item your vote on that item will be invalid.

STEP 3 Sign the Form

The form **must** be signed as follows:

Individual: This form is to be signed by the securityholder.

Joint Holding: where the holding is in more than one name, all the securityholders must sign.

Power of Attorney: to sign under a Power of Attorney, you must have already lodged it with the registry. Alternatively, attach a certified photocopy of the Power of Attorney to this form when you return it.

Companies: this form must be signed by a Director jointly with either another Director or a Company Secretary. Where the company has a Sole Director who is also the Sole Company Secretary, this form must be signed by that person. **Please indicate the office held by signing in the appropriate place.**

STEP 4 Lodgement of a Proxy

This Proxy Form (and any Power of Attorney under which it is signed) must be received at an address given below not later than 48 hours before the commencement of the meeting at 11.00am (Sydney Time) on Monday, 31 January 2011. Any Proxy Form received after that time will not be valid for the scheduled meeting.

Proxies may be lodged using the reply paid envelope or:

BY MAIL - Share Registry – Registries Limited, GPO Box 3993,
Sydney NSW 2001 Australia

BY FAX - + 61 2 9290 9655

IN PERSON - Share Registry – Registries Limited,
Level 7, 207 Kent Street, Sydney NSW 2000 Australia

Vote online at:

www.registries.com.au/vote/engingm2011
or turnover to complete the Form →

Attending the Meeting

If you wish to attend the meeting please bring this form with you to assist registration.

PROXY FORM
General Meeting

<BARCODE>

STEP 1 - Appointment of Proxy

I/We being a member/s of Engin Limited and entitled to attend and vote hereby appoint

Form for appointing the Chairman of the Meeting, including a checkbox and a text box for the name.

If you are not appointing the Chairman of the Meeting as your proxy please write here the full name of the individual or body corporate (excluding the registered Securityholder) you are appointing as your proxy.

or failing the individual or body corporate named, or if no individual or body corporate is named, the Chairman of the Meeting, as my/our proxy at the General Meeting of Engin Limited to be held at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 at 11.00am and at any adjournment of that meeting, to act on my/our behalf and to vote in accordance with the following directions or if no directions have been given, as the proxy sees fit.

If the Chairman of the Meeting is appointed as your proxy or may be appointed by default, and you do not wish to direct your proxy how to vote in respect of a resolution, please mark this box. By marking this box, you acknowledge that the Chairman of the Meeting may vote as your proxy even if he has an interest in the outcome of the resolution and votes cast by the Chairman of the Meeting for those resolutions, other than as proxy holder, will be disregarded because of that interest.

STEP 2 - Voting directions to your Proxy - please mark [X] to indicate your directions

Table with 3 columns: Business, For, Against, Abstain*. Rows include 'To amend the Constitution of Engin Limited' and 'To approve the selective capital reduction'.

NOTE: The vote of any shareholder, other than Network Investment Holdings Pty Limited, who votes 'For' the resolution in Item 2 will be disregarded as set out in the Notice of Meeting.

- Therefore:
- if you wish to support the selective capital reduction, please mark [X] in the Abstain box for Item 2
- if you wish to oppose the selective capital reduction, please mark [X] in the Against box for Item 2

In addition to the intentions advised above. The Chairman of the Meeting intends to vote undirected proxies in favour of each of the items of business.
*If you mark the Abstain box for a particular item, you are directing your proxy not to vote on your behalf on a show of hands or on a poll and your votes will not be counted in computing the required majority on a poll.

STEP 3 - PLEASE SIGN HERE This section must be signed in accordance with the instructions overleaf to enable your directions to be implemented.

Three signature boxes labeled Individual or Securityholder 1, Securityholder 2, and Securityholder 3.

Sole Director and Sole Company Secretary, Director, Director/Company Secretary

Contact Name Contact Daytime Telephone Date / / 2011

FOR ALL ENQUIRIES CALL:
(within Australia) 1300 737 760 (outside Australia) +61
2 9290 9600

FACSIMILE
+61 2 9290 9655

POSTAL ADDRESS:
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Name and Address

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STEP 1 Appointment of Proxy

Indicate here who you want to appoint as your Proxy
If you wish to appoint the Chairman of the Meeting as your proxy, mark the box. If you wish to appoint someone other than the Chairman of the Meeting as your proxy please write the full name of that individual or body corporate. If you leave this section blank, or your named proxy does not attend the meeting, the Chairman of the Meeting will be your proxy. A proxy need not be a security holder of the company. Do not write the name of the issuer company or the registered securityholder in the space.

Proxy which is a Body Corporate

Where a body corporate is appointed as your proxy, the representative of that body corporate attending the meeting must have provided an "Appointment of Corporate Representative" prior to admission. An Appointment of Corporate Representative form can be obtained from the company's securities registry.

Appointment of a Second Proxy

You are entitled to appoint up to two proxies to attend the meeting and vote on a poll. If you wish to appoint a second proxy, an additional Proxy Form may be obtained by telephoning the company's securities registry or you may copy this form.

To appoint a second proxy you must:

- (a) complete two Proxy Forms. On each Proxy Form state the percentage of your voting rights or the number of securities applicable to that form. If the appointments do not specify the percentage or number of votes that each proxy may exercise, each proxy may exercise half your votes. Fractions of votes will be disregarded.
- (b) return both forms together in the same envelope.

STEP 2 Voting Directions to your Proxy

You can tell your Proxy how to vote

To direct your proxy how to vote, place a mark in one of the boxes opposite each item of business. All your securities will be voted in accordance with such a direction unless you indicate only a portion of voting rights are to be voted on any item by inserting the percentage or number of securities you wish to vote in the appropriate box or boxes. If you do not mark any of the boxes on a given item, your proxy may vote as he or she chooses. If you mark more than one box on an item your vote on that item will be invalid.

STEP 3 Sign the Form

The form **must** be signed as follows:

Individual: This form is to be signed by the securityholder.

Joint Holding: where the holding is in more than one name, all the securityholders must sign.

Power of Attorney: to sign under a Power of Attorney, you must have already lodged it with the registry. Alternatively, attach a certified photocopy of the Power of Attorney to this form when you return it.

Companies: this form must be signed by a Director jointly with either another Director or a Company Secretary. Where the company has a Sole Director who is also the Sole Company Secretary, this form must be signed by that person. **Please indicate the office held by signing in the appropriate place.**

STEP 4 Lodgement of a Proxy

This Proxy Form (and any Power of Attorney under which it is signed) must be received at an address given below not later than 48 hours before the commencement of the meeting at 11.45am (Sydney Time) on Monday, 31 January 2011. Any Proxy Form received after that time will not be valid for the scheduled meeting.

Proxies may be lodged using the reply paid envelope or:

BY MAIL - Share Registry – Registries Limited, GPO Box 3993,
Sydney NSW 2001 Australia

BY FAX - + 61 2 9290 9655

IN PERSON - Share Registry – Registries Limited,
Level 7, 207 Kent Street, Sydney NSW 2000 Australia

Vote online at:

www.registries.com.au/vote/engingm2011
or turnover to complete the Form →

Attending the Meeting

If you wish to attend the meeting please bring this form with you to assist registration.

<BARCODE>

Special Meeting of Minority Shareholders (all Shareholders other than Network Investment Holdings Pty Ltd)

STEP 1 - Appointment of Proxy

I/We being a member/s of Engin Limited and entitled to attend and vote hereby appoint

Form for appointing the Chairman of the Meeting, including a box for the name and an 'OR' separator.

If you are not appointing the Chairman of the Meeting as your proxy please write here the full name of the individual or body corporate (excluding the registered Securityholder) you are appointing as your proxy.

or failing the individual or body corporate named, or if no individual or body corporate is named, the Chairman of the Meeting, as my/our proxy at the Special Meeting of Minority Shareholders of Engin Limited (all Shareholders of Engin Limited other than Network Investment Holdings Pty Ltd) to be held at Room 7, 38-42 Pirrama Road, Pyrmont, NSW, 2009 on Monday, 31st January 2011 at 11.45 am and at any adjournment of that meeting, to act on my/our behalf and to vote in accordance with the following directions or if no directions have been given, as the proxy sees fit.

If the Chairman of the Meeting is appointed as your proxy or may be appointed by default, and you do not wish to direct your proxy how to vote in respect of a resolution, please mark this box. By marking this box, you acknowledge that the Chairman of the Meeting may vote as your proxy even if he has an interest in the outcome of the resolution and votes cast by the Chairman of the Meeting for those resolutions, other than as proxy holder, will be disregarded because of that interest.

STEP 2 - Voting directions to your Proxy - please mark [X] to indicate your directions

Table with columns: Business, For, Against, Abstain*. Row 1: Item 1 To approve the selective capital reduction.

In addition to the intentions advised above. The Chairman of the Meeting intends to vote undirected proxies in favour of each of the items of business. *If you mark the Abstain box for a particular item, you are directing your proxy not to vote on your behalf on a show of hands or on a poll and your votes will not be counted in computing the required majority on a poll.

STEP 3 - PLEASE SIGN HERE This section must be signed in accordance with the instructions overleaf to enable your directions to be implemented.

Signature lines for Individual or Securityholder 1, Securityholder 2, and Securityholder 3, with corresponding titles below.

Contact Name Contact Daytime Telephone Date / / 2011