

# ASX Announcement



## **LANTERN HOTEL GROUP (ASX:LTN)**

Tuesday, 12 May 2015

### Lantern Response to MAS' proposal to remove Lantern Directors

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**Russell Naylor**

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## Letter from the Chairman

Dear Shareholder,

You would have recently received a Notice of General Meeting and explanatory memorandum (**MAS Notice**) for a general meeting of security holders of Lantern Hotel Group Limited (**Company or Lantern**) to be held at 10 am on Wednesday 24 June 2015 (**Proposed Meeting**). The MAS notice proposes resolutions to remove current directors Bryan Mogridge, Russell Naylor and Deborah Cartwright and appoint Millinium Asset Services Pty Limited (**MAS**) nominees John Murphy and Graeme Campbell as new directors.

The MAS Notice was **NOT** issued by the Company. For the reasons set out in this letter, each Lantern Group director recommends that you **VOTE AGAINST** the resolutions set out in items 1 to 5 (other than the relevant Director in relation to his/her removal).

### Who has issued the MAS Notice?

The MAS Notice is **NOT** endorsed by the Lantern Board. It has been issued by Australian Executor Trustees Limited (custodian for the assets of the Borg Fund) (**Security Holder**) as holder of more than 5% of the securities in Lantern. While the Security Holder is calling the Proposed Meeting, it is MAS putting forward its views in the MAS Notice.

The Company has serious concerns about MAS' conduct in relation to the Lantern Group as outlined below. Lantern security holders may recall that MAS has a long history with the Lantern Group. This includes a failed attempt at last year's AGM to remove the entire Lantern Board and activity to derail the agreed binding buy-back arrangement with Lantern (**Proposed Buy-back**) by entering into conflicting transactions with CVC Limited (**CVC**) and Totem Holdings Pty Ltd (**Totem**) which led to costly litigation.

In the MAS Notice, MAS makes unsubstantiated statements that it has a claim for "significant damages" against the Lantern Group relating to the Settlement Deed entered into in relation to the Proposed Buy-back. MAS is offering not to pursue this unsubstantiated claim (which has not been brought) in return for Lantern security holders replacing the current Lantern board with MAS' own nominees and the MAS nominees (acting as the new Lantern Board) abandoning the Proposed Buy-back by 30 June 2015. Even if MAS was to waive whatever rights MAS claims to have under the Settlement Deed (which rights the Lantern Board denies MAS has) if Lantern determines not to proceed with the Proposed Buy-back, it is not clear if MAS proposes to indemnify the Lantern Group in respect of any subsequent claims by CVC and Totem under the Settlement Deed that might result (any liability for which Lantern denies).

This "ultimatum" to Lantern security holders is particularly concerning given Macquarie Investment Management Limited (as responsible entity of a number of managed investment schemes) (**Macquarie**) and Bond Street Custodians Limited (**Bond Street**) commenced a proceeding in the New South Wales Supreme Court on 22 December 2014 (**Macquarie Litigation**) against MAS alleging that, amongst other things, MAS informed Macquarie that it had entered into the option deeds with



Totem and CVC in respect of the Lantern Group securities held by MAS for the purpose of provoking litigation with Lantern Group in order to escape or improve the terms of the Proposed Buy-back, which allegation has been admitted by MAS.

It appears that MAS is merely seeking to provoke further disruption by removing the current Lantern Board. Further detail about the Macquarie Litigation is set out below.

The Board considers **MAS' interests are not aligned** with the long-term performance and success of the Group and the interest of **all security holders are not served by removing incumbent Directors and appointing the MAS nominee directors**.

Mr Julian Davidson, as the only independent director MAS is not seeking to remove, urges all security holders to **vote AGAINST all resolutions proposed by MAS** and will be writing separately to all security holders outlining his views.

While it is frustrating that the same security holder is again taking action which is so disruptive to the Lantern Group's business, the Lantern Board continues to be focused on the future success of the Lantern Group, including continuing to implement the growth strategy which is already bringing benefits to the Lantern Group.

#### **Summary of reasons to vote AGAINST ALL resolutions in the MAS Notice**

The Company has attached a detailed response to the comments and allegations set out in the MAS Notice. Here are some of the reasons Lantern security holders should vote **AGAINST ALL** resolutions in the MAS Notice:

- |   |  |
|---|--|
| <b>Strong Financial and Operating Performance</b> | <ul style="list-style-type: none"><li>➤ MAS commentary about Lantern Group financial and operating performance is skewed and selective and, in the Board's view, presents a misleading view of Lantern Group performance while continuing to misrepresent matters already refuted by the Lantern Board.</li><li>➤ Since the acquisition of the operating assets in June 2012 the current Board has been instrumental in a 112% increase in the price of Lantern securities. This is almost three times the performance of the ASX200 during that period.</li><li>➤ Performance for the 9 months ending March 2015 (on a same hotel basis) has seen an increase of 19.1% in EBITDA and a 6.5% increase in revenue when compared to the results to March 2014.</li><li>➤ The resolutions proposed will remove the current strong performing Board and replace them with two MAS selected non-executives who have no familiarity with the operations of the Lantern Group and appear to be aligned with MAS and its agenda.</li></ul> |
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**Risks to Lantern Group if resolutions are passed**

- MAS has not disclosed any actual strategy for the Lantern Group. It simply proposes a review of the Lantern Group operations by MAS nominees. This approach will leave Lantern Group in a holding pattern for at least 6 months and will see Lantern Group move from a clear, defined path and strategy to a period of uncertainty that the Board considers will be devastating to the current strategy and financial performance of the Lantern Group.

**Independence of proposed candidates from MAS is unknown**

- The nominees being put forward have been selected by MAS and appear to have agreed to implement a proposal determined by MAS. It is not clear what arrangements MAS has entered into with its proposed directors or MAS' intended future input.

**MAS' unknown agenda**

- The MAS notice discloses that the MAS nominees intend to review the Proposed Buy-back. MAS has undertaken to waive its rights under an unsubstantiated claim against Lantern Group for "significant damages" relating to the Proposed Buy-back without actually detailing the basis for such claim. Further, MAS' waiver will only occur if security holders vote in favour of the MAS resolutions and the new MAS nominees determine by 30 June 2015 (before their review of the Lantern business is even complete) not to proceed with the Proposed Buy-back. The Lantern Board considers this to simply be a vexatious threat by MAS which seeks to manipulate Lantern security holders into appointing MAS' nominees to allow MAS to implement its own agenda which may potentially expose Lantern Group to claims by CVC and Totem under the Settlement Deed.
- The Lantern Board is concerned that MAS proposed candidates will pursue strategies that are inconsistent with the current planned strategy and future direction for profit growth. Any such activities present a risk to security holders in respect of, amongst other things, returns, profitability and effectiveness.
- MAS conduct to date does not demonstrate alignment with the interests of all other security holders.

**Risk of withdrawal of support from Financiers**

- The Lantern Group is actively engaged in refinancing its existing debt, with one facility repayable by September 2015. It has been in active discussions in relation to this. When the MAS Notice was publicly announced by Lantern, one of those banks withdrew from discussions. The second bank has suspended discussions until the results of this meeting are known. The Lantern Board has very serious concerns about



the impacts the MAS actions are having on Lantern's relationship with its financiers.

**Risk of losing key experienced employees and directors**

➤ If the resolutions set out in items 1 to 5 are approved, there is a very real risk that Operational staff members may depart due to the change in composition of the Board. This would result in a loss of business know-how and may result in a loss of relationships with relevant customers and suppliers which would be detrimental to the Lantern Group's growth and returns for shareholders.

➤ The Managing Director has focused on building a quality team of experienced industry professionals who are likely to explore other opportunities if there is a change in Board or strategic direction of the Group.

**Experienced and Performance Focused Board with strong Corporate Governance practices**

➤ The Lantern Board is made up of an experienced and dedicated team of directors, including a Managing Director who has driven significant change in the performance of the Group during his tenure.

➤ MAS' allegations regarding the corporate governance of the Lantern Group **are without substance**. MAS has sought to "put a cloud" over the relationship between Managing Director Russell Naylor and Torchlight GP Limited (**Torchlight**), Lantern's 33.19% security holder, even though Mr Naylor's positions have been fully disclosed to security holders. It is not uncommon for a substantial security holder to have some connection to the board and Mr Naylor believes he has at all times acted in accordance with his duties to the Lantern Group. Mr Naylor's long-standing connection with Torchlight has been key to securing Torchlight support for key initiatives.

➤ Bryan Mogridge is considered to be independent by the Lantern Board and all of his relevant executive and non-executive positions outside of Lantern Group have been appropriately disclosed.

➤ Both Mr Naylor and Mr Mogridge hold securities in Lantern Group, equating to 1.14% and 2.3% of Lantern Group respectively, which they have purchased using their own funds. This not only signifies their belief in the future success of Lantern Group but also aligns their interest with its future performance.

➤ The current Board drove the 2012 transaction (underwritten by Torchlight and overwhelmingly supported by security holders) which saw the internalisation of management and the Lantern Group becoming owner of its own assets.



**MAS history with LTN and unknown agenda**

- In FY15 the Lantern Board is focused on ongoing growth works and performance improvement at venues where work has been completed.
- MAS' has a history of repeated attempts to cause significant disruption to the Lantern Group even though it has confirmed in its pleadings in the Macquarie Litigation that **it intends to divest itself of its Lantern investment**.
- It appears that MAS has not fully disclosed the true nature of the relationship between MAS, CVC and Totem, including the basis on which Totem has provided funding to MAS.
- MAS' has admitted in documents filed by it in the Supreme Court of New South Wales that in 2014 it has told Macquarie that it had entered call options with CVC and Totem for the purpose of provoking litigation with Lantern.
- MAS' standing and conduct as purported Trustee of the Borg Fund is being challenged by Macquarie in the Supreme Court of New South Wales **seeking MAS' removal as trustee**.
- MAS actions indicate it has little concern for the long term financial performance and strategic direction of the Lantern group and have caused Lantern to repeatedly incur costs and expenses and divert the attention of its management and executive away from running the Group, to the detriment of all Lantern Group security holders.



## VOTING OPTIONS AND PROXIES

### Validity of Proxies

Arising out of a concern about the validity of proxies forwarded to the Company via an intermediate party, the Company has facilitated Link Market Services (the Company's share registry) (**Registry**) to prepare a proxy form for the Proposed Meeting.

If you do not plan to attend the meeting in person, Lantern security holders are urged to vote using one of the methods set out on the enclosed blue proxy form (**Proxy Form**) by the proxy cut off time of **10 am Monday 22 June 2015 (Proxy Deadline)**.

### IF YOU HAVE ALREADY VOTED

Even if you have already returned the proxy form provided by MAS with the MAS Notice to Computershare, you can still vote (before Proxy Deadline) using one of the methods set out in the attached blue proxy form. Under the Corporations Act, a later proxy appointment revokes an earlier one.

### Voting by Proxy

A security holder who is entitled to attend and vote at this meeting is entitled to appoint not more than 2 proxies to attend and vote on the security holder's behalf. If the security holder appoints 2 proxies, the security holder may specify the proportion or number of votes each proxy is entitled to exercise. If no proportion or number of votes is specified, each proxy may exercise half of the security holder's votes. If the specified proportion or number of votes exceed that which the security holder is entitled to, each proxy may exercise half of the security holder's votes. Any fractions of votes brought about by the apportionment of votes to a proxy will be disregarded.

A proxy need not be a security holder of the Lantern Group. A body corporate appointed as a security holder's proxy may appoint a representative to exercise any of the powers the body may exercise as a proxy at the Proposed Meeting. The representative should bring to the meeting evidence of his or her appointment, including any authority under which the appointment is signed, unless it has previously been given to the Lantern Group.

Please note that:

- If a security holder has not directed their proxy how to vote, the proxy may vote as the proxy determines, and
- If a security holder appoints the Chairman of the Meeting as proxy and does not direct the Chairman how to vote on an item of business, the Chairman will vote in accordance with his voting intention as stated in this letter, namely AGAINST the resolutions in items 1 to 5 (inclusive) as set out in the MAS Notice.



## Proxy Voting by the Chairman

Where the Chairman is appointed as a security holder's proxy and that security holder has not specified the way in which the Chairman is to vote on the resolutions outlined in items 1 to 5 (inclusive), the security holder is directing the Chairman to vote in accordance with the Chairman's voting intentions as set out in this letter.

The Chairman intends to vote all undirected proxies **AGAINST** the five resolutions outlined in the MAS Notice.

## Proxy Forms

To be effective, the Proxy Form must be completed, signed and lodged (together with the relevant original power of attorney or a certified copy if the proxy is signed by an attorney) with the Lantern Group's Registry no later than the Proxy Deadline of **10.00 am on Monday 22 June 2015** (AET). Proxy forms may be submitted to the Registry in one of the following ways:

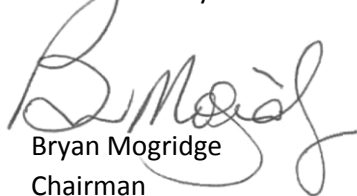
- (i) By mail to Link Market Services Pty Ltd using the reply paid envelope or Locked Bag A14, Sydney South NSW 1235. Please allow sufficient time so that it reaches the Registry by the Proxy Deadline;
- (ii) By fax to Link Market Services Pty Ltd on +61 2 9287 0309;
- (iii) Online via the Registry website at [www.linkmarketservices.com.au](http://www.linkmarketservices.com.au). Please refer to the Proxy Form for more information; or
- (iv) By hand delivery to Link Market Services Pty Ltd at Level 12, 680 George Street, Sydney NSW 2000.

Proxy Forms and Powers of Attorney must be received by the Proxy Deadline.

We thank you for your past and current support and look forward to continuing to create value for all security holders without the distraction of unwarranted and value destroying agitation from an entity whose interests do not appear to be aligned with all security holders.

Please contact Freddy Davison, Strategy & Implementation Manager on +61 2 8223 3602 for any questions in relation to this letter or the Proposed Meeting.

Yours faithfully

  
Bryan Mogridge  
Chairman





## **1 MAS is driving its own agenda and has already caused Lantern Group to incur significant costs and management diversion**

The Lantern Board has serious concerns about MAS' conduct in relation to the Company including:

### **Provoking Litigation**

As disclosed to ASX through various announcements, on 4 February 2014 the Borg Fund (of which MAS represented and represents itself as trustee) made a binding offer to the Lantern Group pursuant to which the Lantern Group was to buy-back all of the Lantern securities held by MAS. Despite the binding offer, on 28 February 2014 and 5 March 2014 MAS entered into inconsistent call option agreements with Totem and CVC, respectively, in relation to the same Lantern securities.

In its defence in a proceeding brought by Macquarie against MAS in the Macquarie Litigation, MAS has admitted that it had told Macquarie that:

- MAS had entered into the Totem and CVC call option agreements for the purpose of provoking litigation and thereby providing a platform to either escape or improve the terms of the binding buy-back offer with Lantern;
- MAS considered it was in the best interests of unit holders of the Borg Fund to escape the buy-back agreement or, if that was not possible, pressure Lantern to improve the terms of that agreement.

The Proposed Buy-back, which the Company entered into in good faith, had and has the potential to be a very favourable transaction for its security holders, a view supported by the Independent Expert, BDO Corporate Finance. This Proposed buy-back was supported by 98.3% of security holders entitled to vote on the resolution at the EGM held on 31 July 2014. Under the Corporations Act, MAS was not entitled to vote on that resolution.

The earlier Supreme Court litigation brought by Lantern (which MAS has admitted it provoked) (**Buy-back Litigation**) seeking to enforce the Proposed Buy-back transaction has come at a significant monetary and management time cost to the Lantern Group. This Buy-back Litigation is discussed further below.

### **Buy-Back Litigation**

On 7 March 2014, the Lantern Group commenced the Buy-back Litigation against MAS to enforce its rights under the binding offer to effect the Proposed Buy-back and agreed a settlement which, as previously disclosed, resulted in a Settlement Deed being entered into. Under the Settlement Deed, MAS received a \$1.4 million payment, of which its related entity (Millinium Capital Management) was paid \$600,000 and CVC and Totem received \$400,000 each. It is not clear the basis on which Millinium Capital Management received the \$600,000 payment and this payment is also the subject of the Macquarie Litigation.



This payment did facilitate a revised agreement between all parties to allow the Proposed Buy-back to proceed as the Group's Board continued to consider the Proposed Buy-back to be in the best interests of all Lantern Group security holders. Lantern has and continues to perform its obligations under the Settlement Deed. MAS has continued to act in a way which is inconsistent with the revised agreement.

The Company denies that MAS has any meritorious claim under the Settlement Deed (and accordingly any possible entitlement to damages) and notes that no such claim has been brought. Lantern Group has had independent legal advice in relation to the Settlement Deed and throughout the Proposed Buy-back transaction process.

As outlined above, the Lantern Board is surprised that MAS nominee directors are being referred to as "independent" when the MAS Notice discloses their intention to undertake actions so clearly aligned with MAS' agenda.

#### **MAS Payments to related entities and financing arrangements with Totem**

The pleadings filed by MAS in the Macquarie Litigation also confirm that on 7 and 13 October 2014 MAS informed Macquarie that the assets of the Borg Fund are **subject to lending arrangements with Totem** pursuant to which Totem has a first ranking security over the assets of the Borg Fund and which could affect the transfer of the assets. **No further detail about the Totem arrangements have been disclosed in the MAS Notice or otherwise, raising further questions about MAS' true agenda.**

#### **Macquarie Litigation**

Macquarie is the responsible entity of a number of managed investment schemes. Bond Street is a custodian that holds assets on behalf of Macquarie as responsible entity of those schemes, including units in the Borg Fund. In the Macquarie Litigation, Macquarie and Bond Street allege that MAS has **not** been duly appointed as trustee of the Borg Fund.

Macquarie and Bond Street further allege that MAS informed them that MAS had entered into option deeds with Totem Holdings Pty Limited and CVC Limited in respect of the Lantern securities held by MAS for the purpose of provoking litigation with Lantern in order to escape or improve the terms of the buy-back agreement MAS had already made with Lantern. MAS admits this allegation in the defence it filed in the Macquarie Proceeding on 20 February 2015.

Macquarie and Bond Street say that **MAS has not acted in their best interests or in the best interests of the beneficiaries of the Borg Fund and has breached its duties to the beneficiaries**, including that MAS breached its duty not to deal with the property of the Borg Fund for its personal benefit (including by the payment of fees to itself and related entities of MAS).

MAS has denied these allegations and as noted above the Macquarie Litigation is ongoing.

Macquarie and Bond Street are seeking declarations that MAS is not the trustee of the Borg Fund and if it is, that it be removed.



MAS has confirmed in its pleading in the Macquarie Litigation that as at 11 August 2014 its strategy for the Borg Funds was to liquidate the Fund's investment in Lantern by selling the securities it held in Lantern and that it would pursue any other options available to liquidate its holding in Lantern at the earliest possible opportunity and that as at 19 February 2015, MAS continued to take steps to liquidate the assets of the Borg Fund. If MAS continues to be one who is seeking to divest of its interest in Lantern in the short term, MAS' interests are not aligned with the long-term performance and success of the Group.

## 2 Specific Responses to MAS' Allegations

### 2.1 Historical Background

As noted above, the Lantern Group is performing strongly and the long-term growth strategy implemented by the Lantern Board in 2012 is already starting to deliver strong positive outcomes. The standalone data MAS refers to in the MAS Notice must be considered in the context of the significant restructure undertaken by the Lantern Board since 2012 and historical costs which have impacted certain current financial indicia.

The current Lantern Board was appointed in 2011 and immediately recognised the need to restructure the Group (then named the "ING Real Estate Entertainment Fund") to allow it rebuild value by repositioning the business from a passive landlord to an integrated operating model. There had been no investment in the underlying asset base for an extended period and value was continuing to deteriorate.

The Lantern Board proposed a restructure where Lantern Group would own the operating assets of its freehold properties allowing a stable platform to grow the business. Shareholders voted overwhelmingly in favour of this strategy.

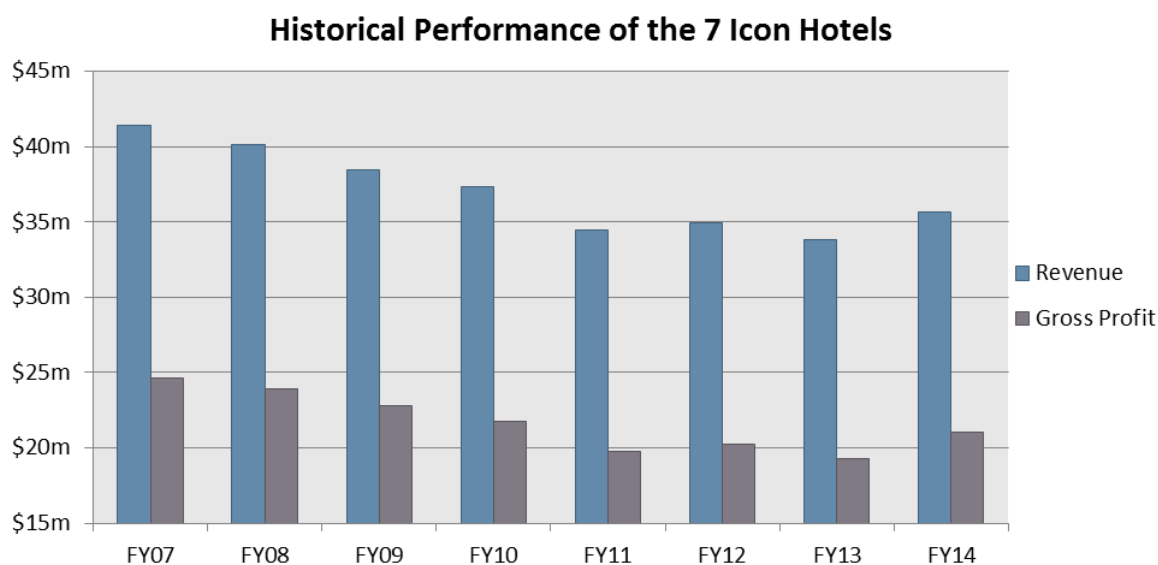
By June 2012, the restructure was implemented which included the stapling of the shares to the units in the Lantern Real Estate Trust and a rights issue (underwritten by Torchlight) to raise \$15 million to allow Lantern Group to acquire the seven tenant positions of its largest tenant (the **Seven Icon Hotels**).

Our journey to date has been set out in our prior announcements, but in summary –

- In FY13 the current Lantern Board stabilised the balance sheet, commenced reinvestment in the business and implemented a number of operating systems;
- In FY14 the current Lantern Board completed a wave of growth focussed capital works;
- In FY15 the current Lantern Board has focussed on ongoing growth works and performance improvement at venues where works have been completed.

A key step in turning around the Lantern Group has been a significant capital expenditure investment in the Seven Icon Hotels' operating assets, which had been neglected and were in receivership resulting in significant loss of clientele and a deteriorating performance.





(Financial information prior to June 2012 is based on records from previous owners).

The significant capital works program undertaken to date is starting to translate into the Lantern Group's operating performance.

Since June 2012 (when the group purchased the leasehold position of the Seven Icon Hotels) the current Board has:

- Invested in building a solid platform to support growth over the medium term;
- Commenced refreshing the gaming offering (including installation of ticket-in ticket-out);
- Commenced capital works in varying degrees stabilising the portfolio;
- Commenced growth capital works;
- Diversified the group's revenue base installing kitchens in all but one venue;
- Launched loyalty program; and
- Improved the staff culture.



## 2.2 Financial and Operating Performance

The Lantern Board considers the information provided by MAS in relation to the financial and operational performance of Lantern Group misleading.

- MAS fail to point out that since the acquisition of the operating assets in June 2012, the security price has increased by 112%. Almost three times the performance of the ASX200.



- Following from our February results presentation, momentum continues to build. Updated same-hotels performance to the end of March 2015 is outlined below:

Performance for the 9 months ending March 2015	Mar-15	Mar-14
Same hotels Revenue	36,571	34,325
Same hotels GP	60.3%	59.6%
Same hotels EBITDA	7,355	6,178

(Same-Hotels excludes Crown, Waterworks, and Exchange Hotels, head office expenses, fund administration expenses, rental income and discontinued assets).



## 2.3 Financial Results

MAS claims that Lantern has “delivered poor financial results over the past two years”. MAS seeks to rely on a loss of \$2.15m for the 2014 financial year as support for their claim. However, as outlined below, the loss is largely attributable to the inevitable disruption of operations resulting from major capital works and is not an indicator of the future financial performance of the assets.

While MAS correctly notes, as per the accounts, that the Net Profit After Tax was a loss of \$2.15m in FY14 and an adjusted profit of \$673k in FY13 (MAS exclude the \$3.1m benefit of the sale of one of the Panthers assets from the profit figures it presents), it fails to disclose that the FY14 loss is attributable to the following:

- Depreciation and amortisation expense \$3.2m;
- Write down of goodwill \$2.8m (negative impact of disruption flowing from completion of capital works programme being reflected in fair value adjustment);
- \$2.7m higher than otherwise interest expense due to the inherited out-of-the-money swap position.

Aside from the above factors, the performance relates to a period of material disruption during which significant capital works were being completed.

To better assist shareholder understanding of trading results a ‘Earnings Before Interest Taxes, Depreciation and Amortisation’ (“EBITDA”) performance summary was included in our half year results presentation.

This showed emerging trend of improved operational performance, which has continued through the March quarter.

## 2.4 MAS claimed high Administration Expenses

MAS misrepresents administration expenses as being Head Office costs, fails to adjust for Depreciation/Amortisation charges and inappropriately seeks to bench mark against passive non trading real estate rental businesses.

This is the second time MAS makes such representations, the first being at the Lantern 2014 AGM where MAS claims were refuted and MAS representatives were informed that the administration expenses included \$1.8 m of depreciation and amortisation charges. MAS’ omission of this information is misleading.

The Directors do not consider benchmarking Administration expenses against non-trading real estate business models with no operational platform to be either relevant or appropriate.



The administration expenses included in the Lantern FY14 accounts is a far broader definition than ALE and HPI comparatives and is made up of:

Depreciation of buildings	\$0.9m
Amortisation of borrowing costs	\$0.9m
Centralised head office costs related to operating the venues including hotel management costs, marketing, promotion and entertainment staff, operations finance (excluding fund accounting), IT expenses, hotel license compliance and risk management, centralised kitchen management, inventory control systems and centralised purchasing, POS systems, loyalty and customer management systems, centralised gaming machine management, audit costs associated with the operating companies and capital works project management	\$2.1m
Investment property expenses	\$0.7m
Of the FY14 head office and administrative costs, those that would have been incurred had Lantern been a landlord and not an operator, (including director fees, share registry and custody fees, responsible manager fees, valuation fees, other professional fees and audit fees for the fund)	\$1.7m
<b>Total administration expenses</b>	<b>\$6.3m</b>

Whilst we do not consider comparison to these entities relevant or appropriate, we nonetheless provide below like-for-like estimates:

	Annual Administration Expense	Number of Venues	Cost per Venue (\$000s)
ALE	\$4.8m	85.5	56
HPI	\$3.6m	41	88
LTN FY14	\$1.7m	19	89

The table shows that Lantern has less than half the annual administration expenses of HPI. The expense is comparable on a per venue basis despite significantly less economies of scale.

**We note that these expenses have reduced from approximately \$2.3m (whilst ING Management Ltd was the responsible entity of the Fund) to \$1.7m under the current Board post stapling and internalisation.**

**Lantern Directors consider Administration expenses to be well managed and controlled and reflect efficient management of the stapled structure.**



## 2.5 Operating Performance

MAS claim it is impossible to determine the underlying performance of the Hotel Portfolio. **The Lantern Board disagrees.** The results commentary released in conjunction with the half-year results included same hotels commentary to provide investors with an indication of core portfolio performance.

MAS have chosen to focus on one aspect of Group performance, with the sole measurement being state gaming rankings. The Directors do not consider gaming rankings to be an appropriate measure of success or otherwise of this aspect of the Group's operational activities. Quarterly ranking data is inherently volatile with large fluctuations common place.

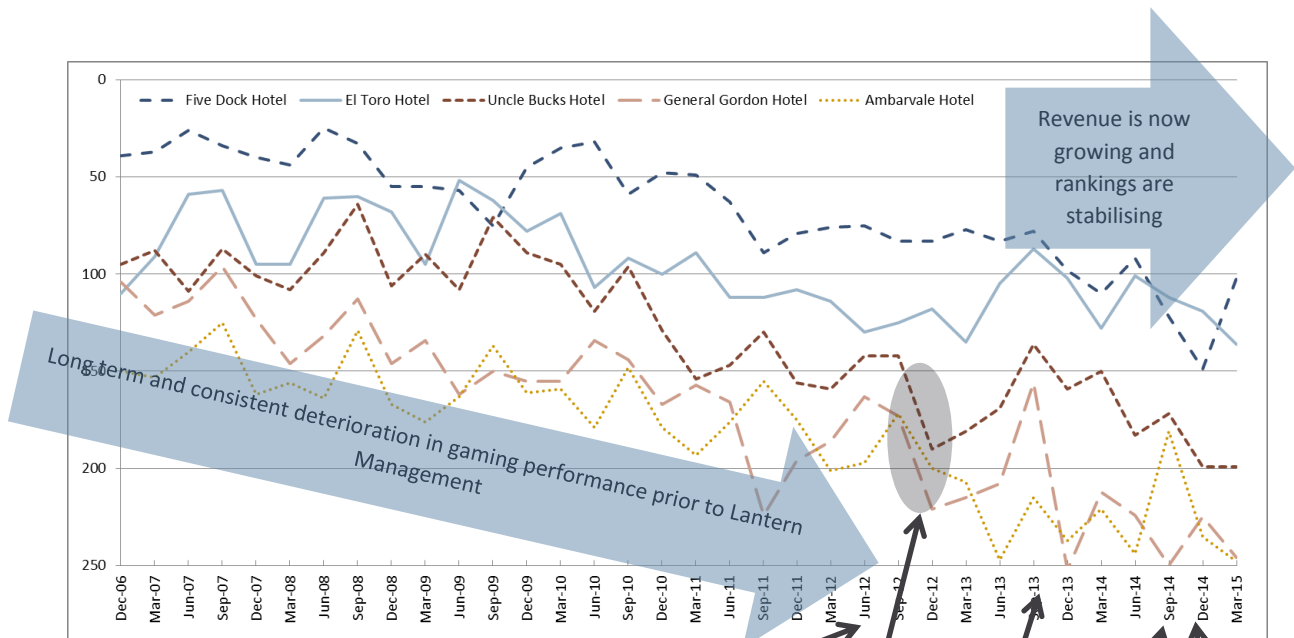
Consistent with all of our past announcements and commentary, the Lantern Board has focussed on rebuilding value via a holistic and balanced approach to all aspects of business operations. Commentary in respect of the quarterly ranking commentary included by MAS in the information they have circulated follows.





## 2.6 Ranking Data for the 5 Largest Icon Gaming Hotels

Below is the chart provided by MAS with additional detail extending back to 2006 rather than 2010 and inclusive of March 2015 data. It shows the continued and longer term decline of the 5 Icon gaming hotels' gaming performance together with commentary around the various events. We have removed the Crown Hotel as we acquired that hotel at a later date.



- June 2012, – commencement of Lantern operation.
  - Soon after the Icon acquisition Lantern discovers that the Uncle Bucks, General Gordon and Ambarvale Hotels gaming smoking solutions were non-compliant and were forced to rectify. Lantern also discovered there had been a history of undesirable activities at the venues.
  - October 2012, compliance based rectification and other minor refurbishment works commenced. Investment in machine upgrades commences.
    - October 2013, Second wave of new machine purchases commences, installation of the Aristocrat S7000 centralised gaming system, and upgrade to Ticket-In Ticket-Out rollout starts.
    - Loyalty program rolled out throughout calendar 2014
    - Both Five Dock and Uncle Bucks have recently come under increasing competition as nearby hotels complete refurbishments.



The financial information provided by the vendor of the 5 gaming venues which form part of the Seven Icon Hotels shows that gaming revenue had **consistently decreased every year since the start of the data in 2007**. The total decrease in gaming revenue over the 5 year period to June 2012 was approximately 17% by the time Lantern commenced operating the venues.

Lantern Group stopped this trend in FY13 and in FY14 increased gaming revenue by approximately 6%, or to approximately **5% higher than the FY12 level**.

**This represents the first positive movement in gaming revenue since 2007** and supports the Lantern Board's view that the ongoing (and balanced) progressive investment in this aspect of the business is starting to flow through into improved outcomes.

Since December 2012, Lantern has achieved the following:

- Installed Ticket-In Ticket-Out
- Developed and launched a loyalty program and centralised gaming system
- Renovated every hotel's gaming rooms to various degrees.
- Improved the average age of the gaming machines
- Invested in an ongoing basis in progressively refreshing the gaming product (this investment is continuing)

Ongoing investment in refreshing / upgrading gaming product and use of Loyalty program to support marketing initiatives is expected to result in continued growth in this aspect of the business.

### **3 Corporate Governance Concerns**

The Lantern Board is made up of an experienced and dedicated team of directors, including a Managing Director who has driven significant change in the performance of the Group during his tenure. MAS' allegations regarding the corporate governance of the Lantern Group are without substance.

#### **3.1 Russell Naylor**

The Lantern Board disagrees that Mr Russell Naylor lacks the requisite skill set to manage the Group. During Mr Naylor's tenure as Managing Director he capably and competently led the Lantern Group, including having stabilised the balance sheet by restructuring the Panthers asset, extended and restructured Lantern Group funding, progressively divested non-core assets and built an operational team and platform to ensure sustained performance.

Mr Naylor's association with Torchlight is well known and has been fully disclosed in all relevant material. Mr Naylor is an Executive Director and Investment Committee Member of Torchlight and is a Director of NZX listed company Pyne Gould Corporation Limited (ultimate holding company of Torchlight) (PGC). Mr Naylor's position at Torchlight facilitates a stronger relationship between the Lantern Group and its key security holder, which has been demonstrated by the previous support Torchlight has offered to the Lantern Group, including in relation to the 2012 \$15 million rights issue which was fully underwritten by Torchlight and without which the restructure could not proceed.



As part of this restructure Torchlight enabled stapling with **NO consideration being paid to Torchlight** as the owner of the Responsible Entity who at the time was entitled to (and absent stapling would have continued) to receive Management Fees, Property Management Fees and Transaction Fees.

Mr Naylor holds 12,450,086 (or approximately 1.14% of all Lantern securities) as at the date of this letter and has purchased all of those securities on market using his own funds. This demonstrates clear alignment of Mr Naylor with all security holders and personal commitment to the performance of Lantern Hotel Group.

### **3.2 Bryan Mogridge**

As announced to ASX on 6 January 2015, Mr Mogridge's directorships with PGC have been disclosed by Lantern on many occasions (including in its most recent Annual Report). As stated in the 2014 Annual Report, the Board (excluding Mr Mogridge) considers Mr Mogridge to be an independent Director. Mr Mogridge also considers himself to be independent.

Mr Mogridge is independent as he is not directly associated with a substantial shareholder of the Lantern Group. Torchlight's investment in Lantern Group is managed through an investment committee of which Mr Mogridge is not a member. Mr Mogridge has no involvement in Torchlight's investment activities.

Mr Mogridge is a security holder of Lantern Group and holds 20,294,072 stapled securities (or approximately 2.3% of all Lantern securities) at the date of this letter. Like Mr Naylor, Mr Mogridge has acquired all of his investment in Lantern using his own funds. Mr Mogridge's personal holding in Lantern aligns his personal interest with that of the Group and show his commitment to the Group. As with Mr Naylor, Mr Mogridge sees significant value in the current price and looks forward to continuing to serve on the Lantern Board to see the future growth strategy implemented and brought to fruition.

### **3.3 Deborah Cartwright**

Deborah Cartwright has over 30 years' experience as a Chartered Accountant with Pitcher Partners Sydney and has extensive experience working with the hospitality industry.

Ms Cartwright is currently experiencing personal health issues and the Board intends to appoint a new independent board member as Chair of Audit and Risk. The Lantern Board does not intend to remove Ms Cartwright at this time as we believe she should be able to seek appropriate medical advice and make her own decision whether she is able to continue as a Director.

In Ms Cartwright's role with Pitcher Partners she has provided professional services advice to entities associated with Mr George Kerr, a director of and (through associated entities) substantial shareholder of PGC. The Board is aware of these services and understands that this advice generates fee income for Pitcher Partners and Ms Cartwright which is immaterial in quantum and as a percentage of the size of her practice. As such, the provision of these services is not viewed by the Board (excluding Ms Cartwright) as impacting Ms Cartwright's independence, and therefore Lantern



confirms that she is considered an independent director. Ms Cartwright considers herself to be independent.

#### **4 Proposed Buy-Back**

The Company has fully complied with all obligations under the Settlement Deed and continues to do so. The Lantern Board denies that MAS has any meritorious claim against the Lantern Group in relation to the Settlement Deed and notes that no proceeding has been brought to date to agitate any such claim. Lantern has taken independent legal advice throughout.

Even if MAS was to waive whatever rights MAS claims to have under the Settlement Deed (which rights the Lantern Board denies it has), it is not clear if MAS proposed to indemnify the Lantern Group in respect of any subsequent claims by CVC and Totem under the Settlement Deed that might result (any liability for which Lantern denies).

Please contact Freddy Davison, Strategy & Implementation Manager on +61 2 8223 3602 for any questions in relation to this letter or the Proposed Meeting.

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