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16 September 2013

BY ELECTRONIC LODGEMENT

Company Announcements Office
Australian Securities Exchange Limited

Dear Sir/Madam

Australian Power and Gas Company Limited (ASX: APK) target's statement (options offer) – takeover bid by AGL APG Holdings Pty Limited (a wholly owned subsidiary of AGL Energy Limited (ASX: AGK))

We act for Australian Power and Gas Company Limited ACN 077 206 583 (**APG**) in relation to the takeover bid by AGL APG Holdings Pty Limited ACN 081 834 826 (**AGL Bidder**) for all of the options to acquire ordinary shares in APG.

On behalf of APG we **attach**, in accordance with section 633(1) (item 14) of the *Corporations Act 2001* (Cth), a copy of the target's statement (including an independent expert's report by Grant Thornton Corporate Finance Pty Limited) prepared by APG in connection with the takeover bid.

The target's statement will be lodged with the Australian Securities and Investments Commission and sent to AGL Bidder today.

Yours faithfully
Corrs Chambers Westgarth

pp Elizabeth Knight

Andrew Lumsden

APG Optionholder Information Line

Australian callers:	1800 705 748
International callers:	+61 2 8256 3386

9563071/1

AUSTRALIAN POWER & GAS COMPANY LIMITED

ACN 077 206 583

Australian Power & Gas

This document is important and requires your immediate attention. You should read this document in its entirety. If you are in any doubt as to how to deal with this document you should consult your legal, financial or other professional advisers as soon as possible.

TARGET'S STATEMENT

This Target's Statement has been issued in response to the off-market takeover bid made by AGL APG Holdings Pty Limited (ABN 72 834 826), a wholly owned subsidiary of AGL Energy Limited (ABN 74 115 061 375), for all the options to acquire ordinary shares in Australian Power and Gas Company Limited.

The Independent Directors of Australian Power and Gas Company Limited recommend that, in the absence of a Superior Proposal, you accept the Offer. Optionholders should read this Target's Statement in full before deciding whether to accept the Offer.

The Independent Expert has concluded that the Offer for each Option is fair and reasonable to Optionholders, in the absence of a Superior Proposal.

Optionholders can call the Australian Power and Gas Company Limited Optionholder Information Line on 1800 705 748 (within Australia) or +61 2 8256 3386 (outside Australia) at any time between 8:30am and 5:30pm (Sydney time) on Monday to Friday if they require assistance.

Financial advisers

arthurphillip

Finflex

Legal adviser

CORRS CHAMBERS WESTGARTH lawyers

INFORMATION ABOUT THIS TARGET'S STATEMENT

Optionholder information

Australian Power and Gas has established an Optionholder Information Line which Optionholders may call if they have any queries in relation to the Offer. The telephone number for the Optionholder Information Line is 1800 705 748 (for calls made from within Australia), or +61 2 8256 3386 (for calls made from outside Australia).

Further information relating to the Offer can be obtained from Australian Power and Gas' website at www.australianpowerandgas.com.au/investorandmediacentre/asxandmediareleases.

Important information

This document is a Target's Statement issued by Australian Power and Gas under Part 6.5 of Division 3 of the Corporations Act in response to AGL's Bidder's Statement and Offer.

A copy of this Target's Statement was lodged with ASIC and given to ASX on 16 September 2013. Neither ASIC, ASX nor any of their respective officers take any responsibility for the content of this Target's Statement.

Investment advice

This Target's Statement does not take into account your individual investment objectives, financial situation or particular needs. It does not contain personal advice. The Australian Power and Gas Directors encourage you to seek independent financial and taxation advice before making a decision as to whether or not to accept the Offer.

Forward-looking statements

This Target's Statement may contain forward-looking statements, including statements of current intention or expectation. As such forward-looking statements relate to future matters, they are subject to known and unknown risks, uncertainties, assumptions and other factors that may cause actual results, performance or achievements to differ materially from the anticipated results, performance or achievements expressed, projected or implied by such forward-looking statements. These risks and uncertainties include factors and risks specific to the industries in which Australian Power and Gas, AGL and AGL Bidder operate as well as matters such as general economic conditions, many of which are outside the control of Australian Power and Gas, AGL and AGL Bidder and their respective directors. These factors may cause the actual results, performance or achievements of Australian Power and Gas, AGL and AGL Bidder to differ, perhaps materially, from the results, performance or achievements expressed or implied by those forecasts or forward-looking statements. Australian Power and Gas and its Directors, officers and advisers give no representation, assurance or guarantee to Optionholders or any other person that any forward-looking statements will actually occur or be achieved.

Disclaimer as to information

The information on AGL and AGL Bidder contained in this Target's Statement has been prepared by Australian Power and Gas using publicly available information (including information contained in the Bidder's Statement) and has not been independently verified by Australian Power and Gas. Accordingly, subject to the Corporations Act, Australian Power and Gas does not make any representation or warranty (express or implied) as to the accuracy or completeness of such information.

The Independent Expert's Report has been prepared by the Independent Expert for the purposes of this Target's Statement and the Independent Expert is responsible for that report. Neither Australian Power and Gas nor any of its officers, employees or advisers assumes any responsibility for the accuracy or completeness of the Independent Expert's Report, except, in the case of Australian Power and Gas, in relation to information which it has provided to the Independent Expert.

INFORMATION

Diagrams

Diagrams appearing in this Target's Statement are illustrative only and may not be drawn to scale. Unless stated otherwise, all data contained in charts, graphs and tables is based on information available at the date of this Target's Statement.

Rounding

A number of figures, amounts, percentages, prices, estimates, calculations of value and fractions in this Target's Statement are subject to the effect of rounding. Accordingly, the actual calculation of these figures may differ from the figures set out in this Target's Statement.

Foreign jurisdictions

The distribution of this Target's Statement may, in some jurisdictions outside Australia, be restricted by law or regulation. Accordingly, persons outside Australia who come into possession of this Target's Statement should inform themselves of, and observe, those restrictions. Any failure to comply with such restrictions may constitute a violation of applicable laws or regulations.

This Target's Statement has been prepared in accordance with Australian law and the information contained in this Target's Statement may not be the same as that which would have been disclosed if this Target's Statement had been prepared in accordance with laws and regulations outside Australia.

Privacy

Australian Power and Gas has collected your information from the Register for the purpose of providing you with this Target's Statement. The type of information Australian Power and Gas has collected about you includes your name, contact details and information on details of your shareholding or optionholding in Australian Power and Gas. Your information may be disclosed on a confidential basis to Australian Power and Gas' related bodies corporate and external service providers (such as the share registry of Australian Power and Gas and print and mail providers) and may be required to be disclosed to regulators such as ASIC and ASX.

Internet

Australian Power and Gas maintains an internet site. The Australian Power and Gas internet site is www.australianpowerandgas.com.au. Information contained in, or otherwise accessible through, this internet site does not form part of this Target's Statement. All references in this Target's Statement to the Australian Power and Gas internet site are inactive textual references and are for your information only.

Defined terms

A number of defined terms are used in this Target's Statement. Unless the contrary intention appears, the context requires otherwise or words are defined in section 13 of this Target's Statement, words and phrases in this Target's Statement have the same meaning and interpretation as in the Corporations Act.

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Dear Optionholders

Takeover Bid by AGL

On 15 July 2013, Australian Power and Gas announced that it had entered into a bid implementation agreement with AGL Energy Limited (**AGL**), pursuant to which AGL, acting through its wholly owned subsidiary, AGL APG Holdings Pty Limited (**AGL Bidder**), would, subject to various conditions, make offers for all Options on issue to acquire ordinary shares in Australian Power and Gas (**Offer**).

AGL Bidder also announced that it would make a separate offer of $0.52 cash per Share for all of the Shares on issue not already owned by it (**Share Offer**). The Offer is conditional on, among other things, the Share Offer becoming unconditional.

Independent Board Committee

Australian Power and Gas has taken steps to ensure the independence of Australian Power and Gas' response to the Offer and has formed an Independent Board Committee to consider and assess the Offer. The Independent Board Committee comprises the Directors of Australian Power and Gas who are independent of Australian Power and Gas' major Shareholders (at the date on which the Offer was announced), Nippon Gas and the Cobra Group, being Mr Ian McGregor and Mr James Myatt (**Independent Directors**).

Independent Expert

The Independent Board Committee appointed Grant Thornton Corporate Finance Pty Limited (**Independent Expert**) to opine on whether the Offer is fair and reasonable to Optionholders and to prepare a report for Optionholders (**Independent Expert's Report**). A copy of the Independent Expert's Report is set out in Annexure B of this Target's Statement.

The Independent Expert has concluded that the Offer is fair and reasonable to Optionholders.

Independent Directors recommend you accept the Offer

The Independent Directors have carefully considered the advantages and disadvantages of the Offer. Each of the Independent Directors recommends that Optionholders **accept** the Offer, in the absence of a Superior Proposal.

In making their recommendations, the Independent Directors have carefully considered the following matters:

- the Offer is based on a valuation of the Options undertaken by the Independent Valuer using the Black-Scholes option valuation formula which, in most cases (but not necessarily for deep 'in the money' Options), results in a higher price for the Options than the intrinsic value of the Options (that is, spot price less strike price). As a result, AGL Bidder is paying cash to acquire Options even if they are 'out of the money' at the price offered under the Share Offer;
- the Offer is made at the following prices for each class of Options on issue:

Expiry date	Number on issue	Exercise price	Offer Consideration
22/12/2014	2,500,000	$0.40 (minimum of 40 cents or 30 day VWAP at time of exercise)	$0.1479
31/12/2013	5,000,000	$0.55	$0.0440
31/03/2014	250,000	$0.35	$0.1772
1/10/2013	513,031	$0.35	$0.1647
30/10/2014	2,035,000	$0.40	$0.1592
30/10/2014	1,500,000	$0.45	$0.1303
30/10/2014	125,000	$0.50	$0.1060
1/10/2014	500,000	$0.50	$0.1028
30/10/2014	125,000	$0.55	$0.0859
1/10/2014	500,000	$0.55	$0.0826
30/10/2015	1,519,243	$0.55	$0.0928
31/12/2013	18,900,000	$0.60	$0.0289
30/10/2015	925,000	$0.60	$0.0757
01/07/2015	500,000	$0.70	$0.0421
30/10/2013	500,000	$0.70	$0.0052
30/10/2013	500,000	$0.80	$0.0013
1/7/2014	1,000,000	$0.20	$0.3174

- the Independent Expert has concluded that the Offer is fair and reasonable to Optionholders;
- the Independent Directors who hold or control Options (and who are the only Directors to hold or control Options) intend to accept the Offer;
- there is major Optionholder support for the Offer;
- the Offer enables a number of Optionholders to monetise a value for Options at a premium (subject to the Conditions of the Offer being fulfilled or freed);
- the Offer provides Optionholders with certainty of cash;
- there may be adverse consequences associated with not accepting the Offer;
- the Independent Directors have recommended that, in the absence of a Superior Share Proposal, Shareholders accept the Share Offer; and
- as at the date of this Target's Statement, no Superior Proposal for Australian Power and Gas has emerged.

Each Director of Australian Power and Gas who holds or controls Shares or Options has informed Australian Power and Gas that they intend to accept the Share Offer and the Offer (if relevant) in respect of the Shares or Options that they hold or control by no later than the next Business Day after the date on which the applicable offer is or becomes unconditional, in the absence of a Superior Proposal in respect of either the Share Offer or the Offer, as the case may be.

Major Optionholder support

The Cobra Group and the Poole Interests, who hold or control 4.5 million and 5 million Options respectively, have each informed Australian Power and Gas that they intend to accept the Offer in respect of all Options they hold or control by no later than the next Business Day after the date on which the Offer becomes free of the Conditions, in the absence of a Superior Proposal. This, along with the optionholdings of Australian Power and Gas' Directors, collectively accounts for approximately 41.7% of the total number of Options on issue as at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement).

Accepting the Offer and next steps

The Offer is scheduled to close at 7:00pm (AEST) on 11 October 2013, unless extended or withdrawn. If you wish to accept the Offer you should follow the instructions in the Bidder's Statement and on the Acceptance Form which each Optionholder has been sent. To be valid your acceptance must be received before the close of the Offer Period. Optionholders who accept the Offer will not be able to trade their Options and may only withdraw their acceptance in the circumstances described in section 9.9 of this Target's Statement.

Before making your decision in relation to the Offer, the Australian Power and Gas Directors encourage you to:

- read this Target's Statement (including the Independent Expert's Report contained in Annexure B) in its entirety and in conjunction with the Bidder's Statement you have received from AGL Bidder or which can be accessed at www.australianpowerandgas.com.au/investorandmediacentre/asxandmediareleases;
- read the Share Target's Statement in its entirety and in conjunction with the Share Bidder's Statement you received from AGL Bidder or which can be accessed at www.australianpowerandgas.com.au/investorandmediacentre/asxandmediareleases; and
- have regard to your individual investment objectives, financial situation and tax position and consult your independent legal, financial or other professional adviser on the effect of accepting the Offer.

Australian Power and Gas will keep Optionholders informed of any material developments in relation to the Offer through releases to ASX (which will also be published on Australian Power and Gas' website at www.australianpowerandgas.com.au/investorandmediacentre/asxandmediareleases).

I encourage you to read this document carefully. If you need any more information I recommend that you seek professional advice or call the Optionholder Information Line between 8:30 am and 5:30 pm (AEST) on Monday to Friday.

Yours sincerely

Ian McGregor
Chairman, Independent Board Committee
Australian Power and Gas Company Limited

1. FREQUENTLY ASKED QUESTIONS

This section answers some commonly asked questions about the Offer. This section should be read together with all other parts of this Target's Statement.

Question	Answer	Further information
Who are AGL and AGL Bidder?	AGL is a company listed on ASX and is the ultimate holding company of AGL Bidder (formerly AGL Utility Services Pty Ltd). AGL Bidder is the entity making the Offer to acquire all your Options.	Section 6 of this Target's Statement and section 2 of the Bidder's Statement.
What is the Target's Statement?	This document is a Target's Statement issued by Australian Power and Gas under Part 6.5 of Division 3 of the Corporations Act in response to the Bidder's Statement from AGL Bidder. It contains information that is relevant to your decision whether or not to accept the Offer, including the recommendation of the Independent Directors in respect of the Offer.	
What is the Bidder's Statement?	The Bidder's Statement is a statement prepared by AGL Bidder and was dispatched to Optionholders on 4 September 2013. The Bidder's Statement describes the terms of the Offer for your Options and information relevant to your decision whether or not to accept the Offer.	
What is the Offer for my Options?	AGL Bidder is offering to acquire all Options on issue by way of an off-market takeover bid. If you accept the Offer, you will have agreed to transfer your Options to AGL Bidder. Full details of the Offer and the Optionholders entitled to participate in the Offer are contained in the Bidder's Statement from AGL Bidder. AGL Bidder is also making a separate offer to all Shareholders in respect of all Shares on issue not already owned by it. The Share Offer extends to Shares that come into existence during the Offer Period through the exercise of Options. A copy of the Share Bidder's Statement is publicly available at www.australianpowerandgas.com.au/investorandmediacentre/asxandmediareleases.	Section 9 of this Target's Statement and section 9 of the Bidder's Statement.
What if I hold Non-transferable Options?	If you are the holder of Non-transferable Options your acceptance of the Offer is subject to, among other things, the satisfaction of the Rule 6.23.4 Waiver Conditions. Details of the circumstances in which Non-transferable Options will become transferable are set out in section 9.2 of this Target's Statement. Alternatively, you can exercise your Non-transferable Options (subject to their terms) and accept the Share Offer.	Section 9.2 of this Target's Statement.
What is the Offer Consideration?	The Offer Consideration is a cash sum being offered for each class of Options under the Offer. The Offer Consideration has been based on a valuation of the Options undertaken by the Independent Valuer.	Section 3.1 of this Target's Statement and section 9.2 of the Bidder's Statement.

1. FREQUENTLY ASKED QUESTIONS CONT'D

Question	Answer	Further information
What is the Independent Board Committee?	A committee of the Australian Power and Gas Board formed to consider the Offer. It comprises Mr Ian McGregor and Mr James Myatt. The remainder of the Board who are not members of the Independent Board Committee, being Mr Michael Hogg and Mr Shinji Wada, have determined that they do not consider it is appropriate to give a recommendation to Optionholders in connection with the Offer on the following basis: • Mr Hogg was nominated to the Australian Power and Gas Board by the Cobra Group which held a relevant interest in 13.44% of the total number of Shares on issue as at the Announcement Date. • Mr Wada was nominated to the Australian Power and Gas Board by Nippon Gas which held a relevant interest in 17.23% of the total number of Shares on issue as at the Announcement Date.	Section 2.1 of this Target's Statement.
What is the Independent Board Committee recommending?	The Independent Board Committee unanimously recommends that you accept the Offer, in the absence of a Superior Proposal.	Section 2.2 of this Target's Statement.
Is there an Independent Expert's Report?	Australian Power and Gas has engaged Grant Thornton Corporate Finance Pty Limited to opine on whether the Offer and the Share Offer are fair and reasonable and to prepare a report for inclusion into this Target's Statement. The Independent Expert's Report can be found in Annexure B. The Independent Expert has concluded that the Offer is fair and reasonable to Optionholders.	Section 3.2 of this Target's Statement.
What do the Directors of Australian Power and Gas intend to do with their Options?	Each Australian Power and Gas Director has advised Australian Power and Gas that they intend to accept the Offer in respect of any Options that they hold or control by no later than the next Business Day after the date on which the Offer becomes free of the Conditions, in the absence of a Superior Proposal. Further, each Australian Power and Gas Director has advised that they intend to accept the Share Offer in respect of any Shares that they hold or control by no later than the next Business Day after the date on which the Share Offer becomes free of the Share Conditions, in the absence of a Superior Share Proposal.	Section 2.3 of this Target's Statement.

1. FREQUENTLY ASKED QUESTIONS CONT'D

Question	Answer	Further information
What do the major Optionholders intend to do with their Options?	The Cobra Group and the Poole Interests, who control 4.5 million and 5 million Options respectively, have informed Australian Power and Gas of their intentions to accept the Offer in respect of all Options they hold or control by no later than the next Business Day after the date on which the Offer becomes free of the Conditions, in the absence of a Superior Proposal. This, together with the holdings of Australian Power and Gas' Directors, collectively accounts for 41.7% of the total number of Options on issue.	Section 3.5 of this Target's Statement and section 5.1 of the Share Bidder's Statement.
What choices do I have as an Optionholder?	As an Optionholder, you have the following choices in respect of your Options: • accept the Offer for all of your Options; • sell your Options (subject to any restrictions on their transfer); • exercise your Options (subject to their terms) and accept the Share Offer; • exercise your Options (subject to their terms) and sell some or all of your Shares on ASX (unless you have previously accepted the Offer and you have not validly withdrawn your acceptance); • exercise the Options (subject to their terms) and reject the Share Offer; or • do nothing.	A summary of the implications for each of these choices is set out in section 7 of this Target's Statement.
How do I accept the Offer?	Details of how to accept the Offer are set out in section 8 of this Target's Statement and section 1.2 of the Bidder's Statement.	Section 8 of this Target's Statement and section 1.2 of the Bidder's Statement.
Where can I find my Acceptance Form?	You will have been sent an Acceptance Form with the Bidder's Statement. If you have any questions regarding how to accept the Offer, please contact the Optionholder Information Line on 1800 705 748 (within Australia), or +61 2 8256 3386 (outside Australia) between 8:30am and 5:30pm (AEST) on Monday to Friday.	
What are the consequences of accepting the Offer now?	If you accept the Offer, unless withdrawal rights are available (see below), you will give up your right to sell your Options (if they are transferable under their terms) or otherwise deal with your Options while the Offer remains open.	Section 7.1 of this Target's Statement.
If I accept the Offer, can I withdraw my acceptance?	You may only withdraw your acceptance of the Offer if: • AGL Bidder varies the Offer in a way that postpones, for more than one month, the time when AGL Bidder needs to meet its obligations under the Offer. This will occur if AGL Bidder extends the Offer Period by more than one month and the Offer is still subject to the Conditions; and • the Conditions have not been satisfied or waived at the time of your purported withdrawal.	Section 9.12 of this Target's Statement.

Question	Answer	Further information
What if my Options expire during the period before the Offer becomes unconditional?	If your Options expire after you have accepted the Offer, but before all of the Conditions are satisfied or waived, you will still receive the applicable consideration for the Options if the Conditions are satisfied or waived by the end of the Offer Period. If either your Options expire before you accept the Offer, or the Conditions are not satisfied or waived by the end of the Offer Period, you will not receive any consideration for your Options.	Section 9.13 of this Target's Statement.
Do I have to pay any fees?	No brokerage, charges or stamp duty will be payable by you on the acceptance of the Offer.	
What are the consequences of doing nothing/ not accepting the Offer?	If you do not accept the Offer, you do not sell or exercise your Options (subject to the terms of your Options) and your Options do not expire, you will remain an Optionholder and will not receive any cash consideration pursuant to the Offer. However, AGL Bidder has stated that if it becomes entitled to compulsorily acquire your Options and your Options have not expired, it intends to do so. This means that AGL Bidder may be able to acquire your Options even if you did not accept the Offer. If this occurs, you will still receive the cash consideration for your Options but at a later date than you would have received it if you had accepted the Offer.	Sections 7.6, 12.6 and 12.7 of this Target's Statement.
What are the taxation consequences of accepting the Offer?	The taxation consequences of accepting the Offer depend on a number of factors and will vary according to your particular circumstances. A general outline of the taxation consequences of accepting the Offer is set out in section 11 of this Target's Statement and section 7 of the Bidder's Statement. However, you are encouraged to seek your own professional advice as to the taxation implications applicable to your circumstances.	Section 11 of this Target's Statement and section 7 of the Bidder's Statement.
When does the Offer close?	The Offer is presently scheduled to close at 7:00 pm (AEST) on 11 October 2013.	Section 9.7 of this Target's Statement and section 1.1 of the Bidder's Statement.
Can the Offer be extended?	AGL Bidder may extend the Offer Period at any time before giving the Notice of Status of Conditions (referred to in section 9.6 of this Target's Statement) while the Offer is subject to the Conditions. However, if the Offer is unconditional, AGL Bidder may extend the Offer Period at any time before the end of the Offer Period. In addition, there will be an automatic extension of the Offer Period if, within the last seven days of the Offer Period: • AGL Bidder improves the consideration offered under the Offer; or • AGL Bidder's voting power in Australian Power and Gas increases to more than 50%. If either of these two events occurs, the Offer Period is automatically extended so that it ends 14 days after the relevant event occurs.	Section 9.8 of this Target's Statement.

Question	Answer	Further information
What are the Conditions to the Offer?	The Conditions of the Offer are set out in summary form in section 9.5 of this Target's Statement and in full in Annexure A.	Section 9.5 of this Target's Statement and section 9.8 of the Bidder's Statement.
What happens if the Conditions of the Offer are not satisfied or waived?	If the Conditions are not fulfilled or freed (that is, if any of the Conditions are not satisfied or waived) before the end of the Offer Period, the Offer will lapse. You would then be free to deal with your Options even if you had accepted the Offer.	Section 9.12 of this Target's Statement and section 9.8 of the Bidder's Statement.
When will I be paid if I accept the Offer?	If you accept the Offer and the Offer becomes unconditional, AGL Bidder will pay you the Offer Consideration by the earlier of: • 21 days after the end of the Offer Period; or • one month after the later of receipt of your valid acceptance and the date on which the Offer becomes unconditional.	Section 9.3 of this Target's Statement.
What interest does AGL Bidder currently have in Australian Power and Gas Shares?	As at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), AGL has a relevant interest over 83,316,356 Shares representing 44.30% of Shares on issue, comprising: • 38,113,795 Shares acquired outright pursuant to Pre-Bid Acquisition Agreements entered into on the Announcement Date (representing 19.9% of all Shares on issue at that point); and • 45,202,561 Shares which have been accepted into the Share Offer as at 12 September 2013 (representing 23.51% of all Shares on issue at that point).	Section 5.4 of this Target's Statement.
Can I participate in the Share Offer in respect of my Shares?	AGL Bidder is making an off-market takeover offer for all Australian Power and Gas Shares. Australian Power and Gas Shareholders have been sent a Share Bidder's Statement and Share Target's Statement containing information in respect of the Share Offer. If you are not a Shareholder and have not received a copy of the Share Bidder's Statement, a copy is publicly available at www.australianpowerandgas.com.au/investorandmediacentre/asxandmediareleases. This Offer is conditional on, among other things, the Share Offer becoming unconditional.	Section 12.4 of this Target's Statement, section 8.1 of the Bidder's Statement, section 9 of the Share Bidder's Statement and section 9 of the Share Target's Statement.

2. INDEPENDENT DIRECTORS' RECOMMENDATION

RECOMMENDATION

2.1 Directors of Australian Power and Gas

As at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), the Directors of Australian Power and Gas are:

Name	Position
Mr Ian McGregor	Chairman Non-executive Director
Mr James Myatt	Managing Director
Mr Michael Hogg	Non-executive Director
Mr Shinji Wada	Non-executive Director

An Independent Board Committee, comprising Mr Ian McGregor and Mr James Myatt was formed by Australian Power and Gas for the purpose of responding to the Offer (please see section 10.1 of this Target's Statement for further information regarding the Independent Board Committee and the protocols it followed in relation to the Offer).

The Australian Power and Gas Directors who are not Independent Directors, being Mr Michael Hogg and Mr Shinji Wada, have determined that they do not consider that it is appropriate to give a recommendation to the Optionholders in connection with the Offer on the following basis:

- Mr Hogg was nominated to the Australian Power and Gas Board by the Cobra Group which held a relevant interest in 13.44% of the total number of Shares on issue as at the date the Independent Board Committee was formed; and
- Mr Wada was nominated to the Australian Power and Gas Board by Nippon Gas which held a relevant interest in 17.23% of the total number of Shares on issue as at the date the Independent Board Committee was formed.

2.2 Independent Directors' recommendation

The Independent Directors have carefully considered the advantages and disadvantages of the Offer. Each Independent Director recommends that you **accept** the Offer, in the absence of a Superior Proposal.

The reasons why each Independent Director makes their recommendation is described in section 3 of this Target's Statement.

In considering whether to accept the Offer, the Independent Directors encourage you to:

- read the whole of this Target's Statement and the Bidder's Statement;
- read the whole of the Share Target's Statement and the Share Bidder's Statement;
- have regard to your individual risk profile, portfolio strategy, tax position and financial circumstances; and
- obtain financial advice from your broker or financial adviser on the Offer and obtain taxation advice on the effect of accepting the Offer.

2.3 Intentions of Australian Power and Gas Directors in relation to their own Options

The Independent Directors hold or control Options and have informed Australian Power and Gas that they intend to accept the Offer in respect of all Options that they hold or control by no later than the next Business Day after the date on which the Offer becomes free of the Conditions, in the absence of a Superior Proposal.

The other Directors do not hold or control Options.

Details of the relevant interests of each Director in the Options are set out in section 10.2 of this Target's Statement.

3. REASONS WHY YOU SHOULD ACCEPT THE OFFER

3.1 Offer is based on the Independent Valuer's Report

An Independent Valuer has valued the Options and prepared a valuation report, which is set out in Annexure A of the Bidder's Statement. The consideration being offered is based on the valuation the Independent Valuer attributed to each class of Options. The formula used by the Independent Valuer is based on the Black-Scholes option valuation formula, which in most cases (but not necessarily for 'deep in the money' Options) results in a higher price for the Options than the intrinsic value of the Options (that is, spot price less strike price). As a result, AGL Bidder is paying cash to acquire Options even if they are 'out of the money' at the price offered under the Share Offer.

Based on the Independent Valuer's valuation, the Offer is made at the following prices for each class of Options on issue:

Expiry date	Number on issue	Exercise price	Offer Consideration
22/12/2014	2,500,000	$0.40 (minimum of 40 cents or 30 day VWAP at time of exercise)	$0.1479
31/12/2013	5,000,000	$0.55	$0.0440
31/03/2014	250,000	$0.35	$0.1772
1/10/2013	513,031	$0.35	$0.1647
30/10/2014	2,035,000	$0.40	$0.1592
30/10/2014	1,500,000	$0.45	$0.1303
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1/10/2014	500,000	$0.55	$0.0826
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30/10/2015	925,000	$0.60	$0.0757
01/07/2015	500,000	$0.70	$0.0421
30/10/2013	500,000	$0.70	$0.0052
30/10/2013	500,000	$0.80	$0.0013
1/7/2014	1,000,000	$0.20	$0.3174

3.2 The Independent Expert has concluded that the Offer is fair and reasonable

The Independent Board Committee appointed the Independent Expert to opine on, among other things, whether the Offer is fair and reasonable to Optionholders and to prepare an Independent Expert's Report. A copy of the Independent Expert's Report is set out in Annexure B of this Target's Statement.

The Independent Expert has concluded that the Offer is fair and reasonable to Optionholders. For the information of Optionholders, the Independent Expert has estimated the full underlying value of Australian Power and Gas, including a control premium, to be in the range of $93,459,000 to $106,386,000.

3.3 The Independent Board Committee unanimously recommends that you accept the Offer

The Independent Directors have carefully considered the advantages and disadvantages of the Offer. Each of the Independent Directors recommends that you **accept** the Offer, in the absence of a Superior Proposal.

3.4 Directors who hold or control Options intend to accept

The Independent Directors who hold or control Options (and are the only Directors to hold or control Options) have informed Australian Power and Gas that they intend to accept the Offer in respect of all Options that they hold or control by no later than the next Business Day after the date on which the Offer becomes free of the Conditions, in the absence of a Superior Proposal.

The other Directors do not hold or control Options.

3. REASONS WHY YOU SHOULD ACCEPT THE OFFER CONT'D

3.5 Major Optionholder support

The Cobra Group and the Poole Interests, who hold or control 4.5 million and 5 million Options respectively, have informed Australian Power and Gas that they intend to accept the Offer in respect of all Options they hold or control by no later than the next Business Day after the date on which the Offer becomes free of the Conditions, in the absence of a Superior Proposal. This means that together with the Independent Directors, holders of approximately 41.7% of the Options have indicated their intention to accept the Offer, in the absence of a Superior Proposal.

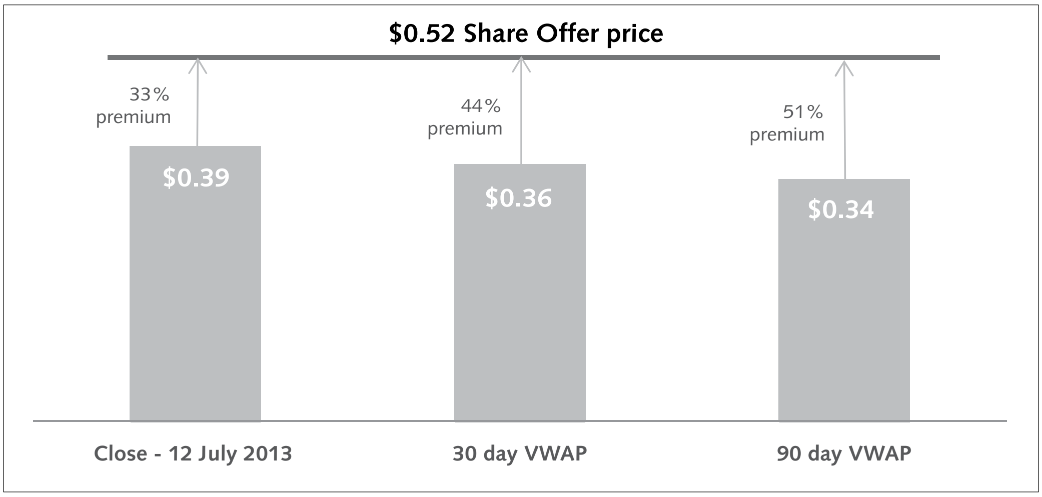
3.6 Cash consideration: certain and immediate value for your Options

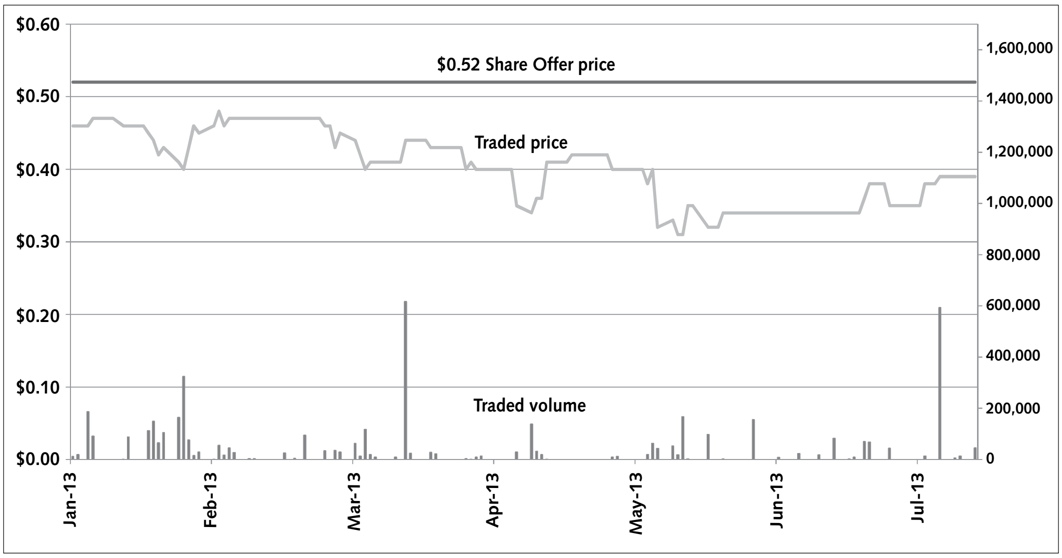
AGL Bidder is offering to acquire all of your Options for cash. This gives you certainty about the value of the consideration being offered (subject to the Conditions being satisfied). This may be particularly attractive for Optionholders given the risks associated with Australian Power and Gas' business and the risks associated with owning Options in a listed company (see section 4.4 of this Target's Statement).

3.7 The Share Offer represents a substantial premium to recent trading, which is reflected in the Offer

The price being offered for Options under the Offer is based on the valuation by the Independent Valuer. The Options, as a derivative of the Shares, derive value from the Shares themselves. Accordingly, the valuation of the Options also reflects the Share Offer price of $0.52 cents per Share, which is a substantial premium to Australian Power and Gas' Share trading prices prior to the Announcement Date, including:

- a 33.3% premium to the closing price of $0.390 per Share to the last trading day prior to the Announcement Date;
- a 44% premium to the 30 day VWAP of $0.361 per Share to the last trading day prior to the Announcement Date; and
- a 51.2% premium to the 90 day VWAP of $0.344 per Share to the last trading day prior to the Announcement Date.





3.8 No other alternatives to the Offer

At this stage, the Board has not received any Superior Proposal to the Offer.

4. OTHER MATTERS TO CONSIDER IN DECIDING WHETHER OR NOT TO ACCEPT THE OFFER

4.1 You may wish to participate in any potential upside that may result from remaining an Optionholder

If you accept the Offer and the Offer becomes unconditional, you will no longer be entitled to participate in Australian Power and Gas' future financial performance. This will mean that you will not retain any exposure to Australian Power and Gas' assets or have the potential to share in the value that could be generated by Australian Power and Gas in the future and you will not have the opportunity to receive future dividends from Australian Power and Gas if you exercised your Options.

4.2 There may be tax consequences from accepting the Offer

Disposal of your Options under the Offer may have tax consequences for you. A summary of the taxation implications of disposing of your Options under the Offer is set out in section 7 of the Bidder's Statement. That summary is based on Australian taxation law and administrative practice as at the date of the Bidder's Statement. The application of tax laws to Optionholders will be dependent on particular facts and circumstances and accordingly it is strongly encouraged that Optionholders obtain independent taxation advice.

4.3 There are risks associated with accepting the Offer

There are risks associated with accepting the Offer, including:

- you will only receive payment if the Conditions are satisfied or waived, the timing of which is uncertain. If you accept the Offer and any Condition is not satisfied or waived, AGL Bidder will not acquire your Options under the Offer and you will not receive the Offer Consideration for them;
- if your Options expire before you accept the Offer, or the Conditions are not satisfied or waived by the end of the Offer Period, you will not receive any consideration for your Options; and
- Optionholders who accept the Offer will only be able to withdraw their acceptance to accept a Superior Proposal (if any such proposal emerges) if:
    - the Conditions have not been satisfied or waived at the time of your purported withdrawal; and
    - AGL Bidder varies the Offer in a way that postpones, for more than one month, the time when AGL Bidder needs to meet its obligations under the Offer. This will occur if AGL Bidder extends the Offer Period by more than one month and the Offer is still subject to the Conditions.

However, you should note that, as at the date of this Target's Statement, Australian Power and Gas has not received a Superior Proposal and no assurance can be given that any such proposal will be received.

4.4 If you accept the Offer you will no longer be exposed to the risks and uncertainties associated with owning Options

The Offer is to acquire all your Options for cash. The Offer provides Optionholders with the ability to lock in an attractive price compared to the risks and uncertainties associated with remaining an Optionholder.

The Offer provides you with the opportunity to receive a certain cash return relative to retaining your Options. If you retain your Options and exercise those Options into Shares, you will continue to be exposed to the risks associated with, amongst other things:

- Share price volatility;
- regulatory and policy risk;
- electricity and gas price risk;
- funding risk; and
- industry challenges and operational risks.

Industry challenges

Australian Power and Gas announced to ASX on 9 May 2013 and 24 July 2013 that it has been adversely impacted by several factors affecting the energy retail market, which have significantly influenced the results for FY13.

4. OTHER MATTERS TO CONSIDER IN DECIDING WHETHER OR NOT TO ACCEPT THE OFFER CONT'D

These factors include:

- the implementation of the carbon tax coinciding with high network price rises which saw retail prices rise up to 30%;
- reduced margins resulting from unfavourable pricing determinations in New South Wales and Queensland and increased wholesale energy costs; and
- increased competition among retailers for mass market customers.

Funding risks

Several factors may impact Australian Power and Gas' current funding position:

- Australian Power and Gas announced to ASX on 9 May 2013 that recent developments have placed a strain on working capital, resulting in the Directors initiating a review of working capital requirements. Australian Power and Gas' provision for bad debt increased significantly in FY13;
- Australian Power and Gas has been required from time to time, to seek various waivers or indulgences under its financing arrangements based on technical non-compliance with certain financial and operational covenants related to those arrangements. There can be no assurance that, to the extent that the waivers or indulgences are required in the future, those waivers or indulgences will be forthcoming from Australian Power and Gas' financiers;
- Australian Power and Gas may need to secure additional equity and/or debt to fund ongoing operations and to achieve its stated objectives, and any equity raising may dilute existing Shareholders or the economic interests of Optionholders; and
- Australian Power and Gas' need for further funding may be exacerbated by the industry challenges described above.

As at 30 June 2013, Australian Power and Gas had a net debt (including amounts subject to a charge or held to secure bank guarantees) of $55.4 million.

Lack of scale

- Australian Power and Gas has significantly less customers than the major competitors in the sector; and
- Australian Power and Gas has also recently issued guidance on 9 May 2013 that its current customer numbers may decrease in FY14.

Share price risk

The Independent Directors believe that the market price of Shares may fall if the Share Offer is unsuccessful and that accepting the Offer and/or Share Offer is likely to be the best way for Shareholders and/or Optionholders to crystallise value for their Shares and/or Options as the case may be.

Minority Shareholder risk

If during, or at the end of, the Offer Period, AGL Bidder has relevant interests in at least 90% (by number) of the Options and the Offer becomes unconditional, AGL Bidder will be entitled to proceed to compulsorily acquire all outstanding Options. Optionholders who have their Options compulsorily acquired (provided those Options have not expired) will receive consideration for their Options later than those Optionholders who accept the Offer. For further information regarding compulsory acquisition, please refer to sections 12.6 and 12.7 of this Target's Statement.

If you do not accept the Offer by the end of the Offer Period and, at the end of the Share Offer Period, AGL Bidder has relevant interests in more than 50% but less than 90% of the Shares and AGL Bidder waives the minimum acceptance condition (which AGL Bidder, in its Bidder's Statement, has stated that it has no current intention to do, but it reserves the right to do so) and the Offer becomes unconditional, you will end up holding Options in a company with a single controlling Shareholder. This will have a number of possible implications, including:

- AGL Bidder may be in a position to cast the majority of votes at a general meeting of Australian Power and Gas. This will enable it to control the composition of the Australian Power and Gas Board and senior management, determine Australian Power and Gas' dividend policy and control the strategic direction of the business;

4. OTHER MATTERS TO CONSIDER IN DECIDING WHETHER OR NOT TO ACCEPT THE OFFER CONT'D

OTHER CONSIDERATIONS

- once AGL Bidder acquires a relevant interest in excess of 50% of the Shares and the Share Offer has become or is declared unconditional, Australian Power and Gas has agreed that the nominees of AGL Bidder are appointed as Directors of Australian Power and Gas and that those Australian Power and Gas Directors nominated by AGL Bidder resign such that AGL Bidder nominees represent a majority of the Australian Power and Gas Board;
- if AGL Bidder obtains effective control of Australian Power and Gas and there is limited spread or volume of Shareholders remaining at the end of the Share Offer Period, AGL Bidder has indicated that it may seek to procure the removal of Australian Power and Gas from the official list of ASX. Alternatively, if the number of Shareholders is less than that required by the ASX Listing Rules to maintain an ASX listing, then ASX may suspend and/or de-list Australian Power and Gas. If Australian Power and Gas is de-listed, any remaining Shareholders will not be able to sell their Shares on market and the corresponding impact on the liquidity of the Shares would be likely to have a commensurate effect not only on the value of the Shares but also on the underlying Options in respect of the Shares;
- if Australian Power and Gas remains listed, the liquidity of Shares may be lower than at present;
- there may be limited institutional support for Shares;
- if AGL Bidder acquires 75% or more of the Shares, AGL Bidder will be able to pass a special resolution of Australian Power and Gas. This will enable AGL Bidder to, among other things, change Australian Power and Gas' constitution;
- if AGL Bidder acquires a majority of the Shares, the Directors of Australian Power and Gas believe that it is unlikely that a subsequent takeover bid for Australian Power and Gas will emerge at a later date; and
- even if AGL Bidder is not entitled to proceed to compulsory acquisition of minority holdings after the end of the Offer Period under Part 6A.1 of the Corporations Act, it may subsequently become entitled to exercise rights of general compulsory acquisition under Part 6A.2 of the Corporations Act – for example, as a result of acquisitions of Shares in reliance on the "3% creep" exception in item 9 of section 611 of the Corporations Act. If so, AGL Bidder has indicated that it intends to exercise those rights, including in relation to outstanding Options where it is entitled to do so.

Optionholders should take all of these possible implications into account in considering whether or not to accept the Offer.

5. INFORMATION ABOUT AUSTRALIAN POWER AND GAS

5.1 Overview of Australian Power and Gas

Australian Power and Gas is an ASX listed energy retailer, with its principal activity being the sale of electricity and gas to households. Australian Power and Gas was founded in 2006 and was listed on ASX in January 2007. It holds gas and electricity retail licences in Victoria, New South Wales, ACT, South Australia and Queensland and has been approved to operate by AEMO, the Australian Energy Market Operator.

Australian Power and Gas' customers are in the residential and commercial sectors and are currently located in Victoria, New South Wales and Queensland. Approximately 61% of customer accounts are for electricity supply and 39% for gas. During FY13, customer accounts grew by 12,000.

For FY13, Australian Power and Gas experienced a growth in revenue, up 33% to $483.6 million from a rise in both customer account numbers and average revenue per account. However, the implementation of the carbon tax and the increase in network charges has increased costs to customers in the order of 30%. The increased costs associated with distribution and the carbon tax are passed through to customers and, as such, result in an increase in revenue rather than in Australian Power and Gas' underlying profitability. Australian Power and Gas' statutory loss increased by $4.7 million to $8.6 million. An underlying loss after tax of $11.0 million was reported compared to an underlying profit of $6.1 million in FY12.

During FY13, annualised average revenue per account increased to $1,391. Increased revenue was offset by declining average customer usage, higher levels of wholesale energy costs and higher levels of bad debts. An increased level of bad debt provision was required due to an unexpected growth in the number of customers on hardship programs.

5.2 Issued capital

As at the date of this Target's Statement, the issued capital of Australian Power and Gas consisted of:

- 192,246,334 fully paid ordinary Shares; and
- the following 36,892,274 Options on issue:

Expiry date	Number on issue	Exercise price	Offer Consideration	Type
22/12/2014	2,500,000	$0.40 (minimum of 40 cents or 30 day VWAP at time of exercise)	$0.1479	Transferable
31/12/2013	5,000,000	$0.55	$0.0440	Transferable
31/03/2014	250,000	$0.35	$0.1772	Transferable
1/10/2013	513,031	$0.35	$0.1647	Non-transferable
30/10/2014	2,035,000	$0.40	$0.1592	Non-transferable
30/10/2014	1,500,000	$0.45	$0.1303	Non-transferable
30/10/2014	125,000	$0.50	$0.1060	Non-transferable
1/10/2014	500,000	$0.50	$0.1028	Non-transferable
30/10/2014	125,000	$0.55	$0.0859	Non-transferable
1/10/2014	500,000	$0.55	$0.0826	Non-transferable
30/10/2015	1,519,243	$0.55	$0.0928	Non-transferable
31/12/2013	18,900,000	$0.60	$0.0289	Transferable
30/10/2015	925,000	$0.60	$0.0757	Non-transferable
01/07/2015	500,000	$0.70	$0.0421	Non-transferable
30/10/2013	500,000	$0.70	$0.0052	Non-transferable
30/10/2013	500,000	$0.80	$0.0013	Non-transferable
1/7/2014	1,000,000	$0.20	$0.3174	Non-transferable

5.3 Election Rights

Australian Power and Gas has granted Nippon Gas 6 million election rights (each, an **Election Right**) under the Nippon Gas Loan Agreement. A summary of those rights is provided below.

Each Election Right entitles Nippon Gas following exercise of that Election Right to receive the greater of:

- the 5 day VWAP of Shares ending on the day immediately before the date of an exercise notice in respect of that Election Right as noted on the Bloomberg page "SMR AU Equity VAP" (**Market Price**) less $0.50; or
- zero,

(the **Cash Settlement Amount**).

Following the exercise of an Election Right, Australian Power and Gas must pay Nippon Gas the Cash Settlement Amount for that Election Right on the date which is seven Business Days after receiving notice from Nippon Gas that it has exercised the Election Right (**Cash Settlement Payment Date**).

Alternatively, Australian Power and Gas may elect (subject to Nippon Gas' consent, which must not be unreasonably withheld) instead of paying the Cash Settlement Amount for Election Rights on a Cash Settlement Payment Date to issue to Nippon Gas the number of Australian Power and Gas Shares equal to the aggregate of all Cash Settlement Amounts that would have been payable on the Cash Settlement Payment Date if Australian Power and Gas had not elected to issue Shares, divided by the Market Price for the relevant Election Right.

The exercise period of the Election Rights expires on 11 April 2015.

Nippon Gas must not issue a notice to exercise the Election Rights in certain circumstances during the 14 Business Days immediately after Australian Power and Gas has publicly announced that it has entered into discussions which may result in a change of control transaction or makes any other announcement in respect of a potential or proposed change of control transaction.

Nippon Gas has agreed with Australian Power and Gas that it will not exercise the Election Rights during the period between the Announcement Date and the date that the payment is made to Australian Power and Gas in consideration for the cancellation of the Election Rights (see section 12.2(d) of this Target's Statement).

Australian Power and Gas has further agreed with Nippon Gas that, if the Share Offer becomes free of the Share Conditions, then on the date which is 10 Business Days after the close of the Share Offer Period the Election Rights will be cancelled in consideration of payment by Australian Power and Gas to Nippon Gas of $591,634 (exclusive of GST) in aggregate for the 6 million Election Rights held by Nippon Gas. See section 12.2(d) of this Target's Statement for further details.

5.4 Acquisition of Shares by AGL

On the Announcement Date, AGL Bidder entered into various Pre-Bid Acquisition Agreements with each of Australian Power and Gas' then three largest Shareholders, being Nippon Gas, the Cobra Group and the Poole Interests, to acquire, in aggregate, 38,113,795 Shares for $0.52 per Share giving AGL Bidder a relevant interest of 19.9% in Australian Power and Gas at that point. The price paid by AGL Bidder under those Pre-Bid Acquisition Agreements is the same price as the price offered for Shares under the Share Offer.

Further information in relation to these Pre-Bid Acquisition Agreements is set out in section 12.1 of this Target's Statement and section 8.2 of the Bidder's Statement.

As a result of acceptances under the Offer up to 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), AGL had a relevant interest over 83,316,356 Shares representing 44.30% of Shares on issue at that point.

As at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), the Share Offer remains subject to some or all of the Share Conditions.

5.5 Options

AGL Bidder has stated in section 5.4(c) of its Bidder's Statement that it has not agreed to provide any consideration for any Options during the four months before the date of the Offer.

5. INFORMATION ABOUT AUSTRALIAN POWER AND GAS CONT'D

5.6 Substantial Shareholder information

As at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), Australian Power and Gas has the following substantial Shareholders:

Shareholder	Number of Shares	% Voting power
AGL Bidder, AGL and AGL Group	83,316,356	44.30%
Nippon Gas (and its controlled entities)	33,000,370	17.17%
Poole Interests	15,807,728	8.22%

5.7 Controlled entities

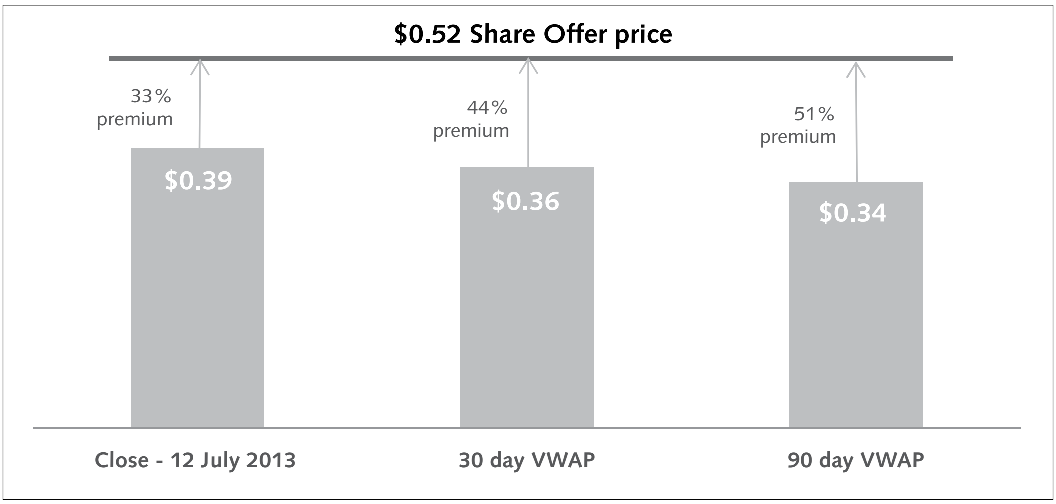
As at the date of this Target's Statement, Australian Power and Gas has the following subsidiaries:

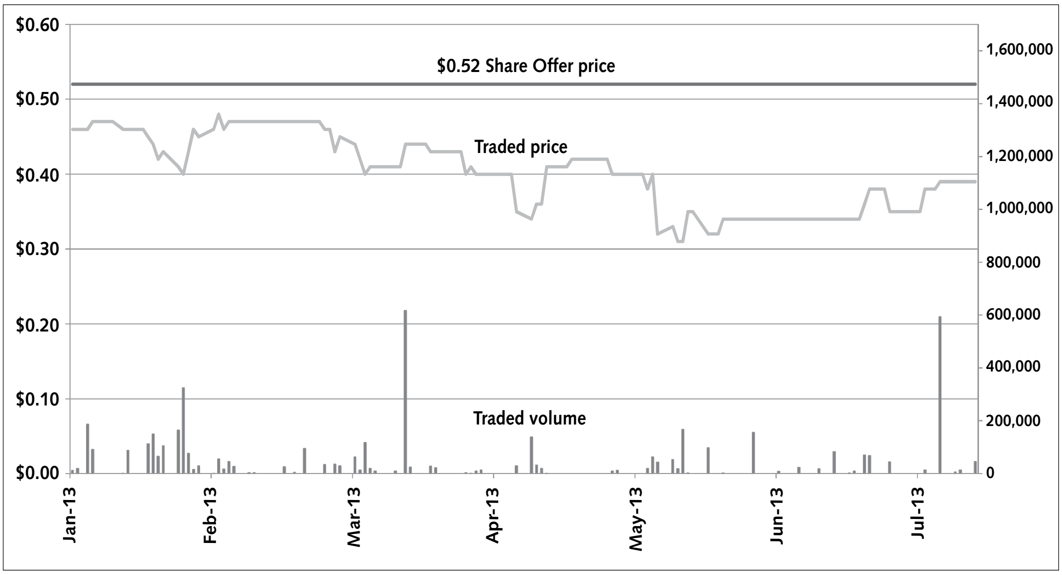
Company name	% interest
APG Operations Pty Ltd	100%
Australian Power and Gas (NSW) Pty Ltd	100%
Australian Power and Gas Pty Limited	100%
Greentricity Pty Limited	100%
Ignition Energy Pty Limited	100%
IQ Energy Services Pty Ltd	100%

5.8 Trading update – price history relative to Offer

The Offer price of $0.52 per Share represents a significant premium to Australian Power and Gas' trading prices prior to the Announcement Date, including:

- a 33.3% premium to the closing price of $0.390 per Share to the last trading day prior to the Announcement Date;
- a 44% premium to the 30 day VWAP of $0.361 per Share to the last trading day prior to the Announcement Date; and
- a 51.2% premium to the 90 day VWAP of $0.344 per Share to the last trading day prior to the Announcement Date.





5.9 Financial information and other relevant matters

Australian Power and Gas' last published audited financial statements are for the financial year ended 30 June 2012 and were lodged with ASX on 31 August 2012. Australian Power and Gas also released its auditor reviewed half year report in respect of the six months ended 31 December 2012 (first half FY13) to ASX on 28 February 2013 and its revised guidance for full FY13 results on 24 July 2013, detailing additional provisions for increasing levels of bad debt. This has also been taken into account in the FY14 guidance with increased provisioning. The unaudited results for the year ended 30 June 2013 were released to ASX on 21 August 2013.

Guidance for FY14 results was released to ASX on 9 May 2013. In that statement, Australian Power and Gas announced a FY13 and FY14 profit guidance downgrade with increased debt provisioning. At this time, full year FY13 net profit after tax was downgraded from a $1 - $3 million loss to a $3 - $5 million loss.

For FY13 Australian Power and Gas experienced revenue growth of 33%. This revenue growth was attributable to both increasing customer numbers and the average amount paid by customers. In addition, and as referred to in section 5.1 above, revenue growth resulted in part from the increase of distributor use of system charges and the carbon tax, which in each case are passed through directly to customers and do not affect the underlying profit of Australian Power and Gas. This rate of growth has placed a strain on Australian Power and Gas' working capital and, as mentioned, a review of working capital requirements has been initiated by the Board. The impact of the increased pricing on consumers also appears to have increased overdue debt ratios across the industry. While Australian Power and Gas has undertaken measures to improve the management of its customer debt, these changes won't be realised until FY14 and this has affected cash flow and will result in an increased provision affecting the FY13 results.

Australian Power and Gas has satisfactorily dealt with this year's issues but considers that, given the size of its operations and the market challenges, it will need to focus on increasing cash held. A number of initiatives intended to strengthen Australian Power and Gas' balance sheet and available liquidity over the forthcoming year will need to be effectively implemented before growth is resumed.

Australian Power and Gas as an independent gas and electricity retailer is subject to and regulated by a number of regulatory frameworks and regulatory bodies both at the State and Commonwealth levels. Technical non-compliance with and breaches of the regulatory framework is relatively common in the electricity and gas retail sectors in Victoria, New South Wales and Queensland. Australian Power and Gas is from time to time subject to discussions with one or more regulators regarding potential non-compliance or breaches of the relevant regulatory codes, legislation and rules. No assurance can be given that, in the future, fines or penalties will not be imposed on Australian Power and Gas for potential breaches of, or failures to comply with, relevant regulatory instruments.

5. INFORMATION ABOUT AUSTRALIAN POWER AND GAS CONT'D

In particular, Australian Power and Gas announced to ASX on 11 September 2013 that the ACCC has commenced Federal Court proceedings against Australian Power and Gas for alleged contraventions of Australian Consumer Law, particularly with respect to certain provisions regarding misleading and unconscionable conduct and door to door marketing activities. Shareholders and Optionholders will be aware that the Share Conditions include a defeating Condition to the effect that Australian Power and Gas has threatened or commenced against it any material claims or proceedings in any court or tribunal other than as fully, fairly and accurately disclosed by Australian Power and Gas or its advisers before the Announcement Date. Australian Power and Gas is of the view that this defeating Condition has not been triggered by the commencement of the Federal Court proceedings by the ACCC, a view which has been confirmed by AGL itself.

5.10 Funding position

Several factors may impact Australian Power and Gas' current funding position:

- Australian Power and Gas announced to ASX on 9 May 2013 that recent developments have placed a strain on working capital, resulting in the Directors initiating a review of working capital requirements. Australian Power and Gas' provision for overdue debt increased significantly in the first half of FY13 and for the full FY13. Whilst Australian Power and Gas has highlighted that it has undertaken measures to improve overdue debt levels these won't be realised until FY14 and this has affected cash flow and will result in an increased provision affecting the FY13 results;
- Australian Power and Gas may need to secure additional equity and/or debt to fund ongoing operations and to achieve its stated objectives and any equity raising may dilute existing Shareholders; and
- Australian Power and Gas' need for further funding may be exacerbated by the industry challenges described above.

Additionally, Australian Power and Gas has, from time to time, been required to seek various waivers or indulgences under its financing arrangements based upon technical non-compliance with certain financial and operational covenants related to those arrangements. There can be no assurance that, to the extent that waivers or indulgences are required in the future, those waivers or indulgences will be forthcoming from Australian Power and Gas' financiers.

6 INFORMATION ABOUT AGL AND AGL BIDDER

AGL is one of Australia's major integrated energy companies with a market capitalisation of approximately $8.3 billion as at the close of the last day that ASX was open for trading prior to the Announcement Date.

AGL Bidder is a wholly owned subsidiary of AGL.

AGL has offices and businesses in every Australian state (excluding Western Australia) and the Australian Capital Territory and as at the date of the Bidder's Statement has approximately 2,900 employees. AGL's head office is in Sydney.

AGL retails natural gas, electricity and energy related products and services to almost 3.5 million customers. AGL increased its customers by approximately 180,000 for the 2012 financial year. Its customer accounts grew by 56,700 (1.6%) for the six months ending 31 December 2012.

For the financial year ending 2012, AGL reported an underlying net profit of $482.0 million, an increase of 11.8% on the underlying net profit of $431.1 million reported in 2011. AGL's statutory net profit was $114.9 million, compared with $558.7 million last year due to significant items (most of which arise from the acquisition and funding of the Loy Yang A power station in Victoria) and fair value adjustments. For the six months ended 31 December 2012, AGL reported a statutory net profit after tax of $364.7 million and an underlying profit of $279.4 million, a 20% increase on the prior corresponding period.

Section 2 of the Bidder's Statement provides further background and information regarding AGL. In addition, you may also obtain information regarding AGL from its website at www.agl.com.au.

7 YOUR CHOICES AS AN OPTIONHOLDER

As an Optionholder you have six choices currently available to you:

7.1 Accept the Offer

You may elect to accept the Offer for all of your Options. If those Options are Non-transferable Options, you may elect to accept the Offer for those Non-transferable Options, subject to, among other things, them becoming transferable in accordance with the Rule 6.23.4 Waiver and upon satisfaction of the Rule 6.23.4 Waiver Conditions (see section 9.2 of this Target's Statement for more information).

Optionholders who accept the Offer will not incur any brokerage charge. Section 1.2 of the Bidder's Statement contains details of how to accept the Offer. Details of the consideration that will be received by Optionholders who accept the Offer are set out in section 9.3 of this Target's Statement.

If you accept the Offer:

- unless withdrawal rights are available (see section 9.12 of this Target's Statement) and you exercise those rights, you will be unable to sell your Options or otherwise deal with your Options (where such Options are Transferable Options, this will include transferring your Options), including by accepting any Superior Proposal (should any such proposal emerge);
- once the Conditions are satisfied or waived, you will be paid the Offer Consideration by AGL Bidder for each Option;
- you undertake to transfer to AGL Bidder not only the Options to which the Offer relates, but also all Rights attached to those Options; and
- you will be liable for CGT on the acquisition of your Options (see section 7 of the Bidder's Statement and section 11.1 of this Target's Statement).

7.2 Sell your Options

Optionholders who have not already accepted the Offer may sell some or all of their Options (subject to any applicable restrictions under their terms).

Optionholders who sell their Options will be liable for CGT on the sale (see section 7 of the Bidder's Statement and section 11.2 of this Target's Statement).

7.3 Exercise your Options and accept the Share Offer

You can exercise your Options (subject to any restrictions under their terms) and accept the Share Offer. Shareholders who accept the Share Offer will not incur any brokerage charge. Section 9.4 of the Share Bidder's Statement contains details of how to accept the Share Offer.

If you accept the Share Offer:

- unless withdrawal rights are available (see section 9.10 of the Share Target's Statement) and you exercise those rights, you will be unable to sell your Shares or otherwise deal with your Shares, including by accepting any Superior Share Proposal (should any such proposal emerge);
- once the Share Conditions are satisfied or waived, you will be paid $0.52 for each Share you own; and
- if you accept the Share Offer in respect of the Shares issued to you upon exercise of your Options you will be liable for CGT on the sale (see section 7 of the Bidder's Statement and section 11.3 of this Target's Statement).

7.4 Exercise your Options and sell your Shares

You may exercise your Options and sell some or all of your Shares, issued upon the exercise of your Options, on market for the market price at the time (unless you have already accepted the Share Offer in respect of those Shares and you have not validly withdrawn your acceptance). This may be at, above or below the Share Offer price of $0.52 per Share.

On 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), Australian Power and Gas' Share price closed at $0.515, which is lower than the Share Offer price of $0.52 per Share. The latest price for Shares may be obtained from ASX website www.asx.com.au.

If you sell any Shares issued to you upon the exercise of your Options you will be liable for CGT on the sale and may incur a brokerage charge (see section 7 of the Bidder's Statement and section 11.4 of this Target's Statement).

7 YOUR CHOICES AS AN OPTIONHOLDER

If you wish to sell your Shares on market you should contact your broker for information on how to effect the sale.

Shareholders that sell their Shares on market cannot subsequently accept the Share Offer or any Superior Share Proposal that may emerge.

7.5 Exercise your Options and reject the Share Offer

You can exercise your Options and reject the Share Offer by doing nothing.

Shareholders should note that if AGL Bidder satisfies the required thresholds in the Corporations Act, it will be entitled to compulsorily acquire the Options and the Shares that it and its associates do not already own (see sections 12.6 and 12.7 of this Target's Statement for further details). There will be CGT consequences at the time of the compulsory acquisition (see section 11.5 of this Target's Statement and section 7 of the Bidder's Statement).

If you exercise your Options and decide to retain those Shares issued upon the exercise of your Options, and AGL Bidder does not become entitled to compulsorily acquire those Shares, you should consider the risks associated with a continuing investment in Australian Power and Gas (see section 4.4 of the Share Target's Statement for further details on the consequences of retaining Shares and see section 4.4 of the Share Bidder's Statement for details of AGL Bidder's intentions if it acquires more than 50% but less than 90% of Shares).

7.6 Reject the Offer by doing nothing

If you do not wish to accept the Offer or exercise your Options you may do nothing.

If you decide to retain your Options, you should consider the risks associated with a continuing investment in Australian Power and Gas (see section 4.4 of this Target's Statement for further details on the consequences of retaining your Options).

If you do not accept the Offer, you will remain an Optionholder and will not receive any consideration for your Options. However, if AGL Bidder becomes entitled to compulsorily acquire your Options and your Options have not expired, it intends to do so. If this occurs, you will receive consideration for your Options but at a later date than you would have received it if you had accepted the Offer. There will be CGT consequences at the time of the compulsory acquisition (see section 7 of the Bidder's Statement and section 11.6 of this Target's Statement).

7.7 Employees and Optionholders

If you are an employee of Australian Power and Gas and are a participant in the ESOP, please refer to section 10.4(b) of this Target's Statement for information regarding the effect of the Takeover Bids on your interests in Options and Shares and section 11.7 of this Target's Statement for further details on the taxation consequences regarding your choices in respect of the Offer.

If you are a Shareholder you will have been sent a separate Share Bidder's Statement and Share Target's Statement with respect to the Share Offer, which sets out the alternatives available to you in respect of your Shares in connection with the Takeover Bids. The Directors encourage you to read the information regarding the Share Offer sent to you.

8 HOW TO ACCEPT THE OFFER

Please see section 9 of the Bidder's Statement for full information on how to accept the Offer.

You may only accept the Offer for all of your Options. Acceptances must be received before 7.00pm (AEST) on 11 October 2013 (unless the Offer Period is extended).

To accept the Offer, complete and return the Acceptance Form enclosed in the Bidder's Statement in accordance with the instructions on it to the address indicated in section 9 of the Bidder's Statement and on the Acceptance Form before the end of the Offer Period.

9 KEY FEATURES OF THE OFFER

9.1 The Offer

AGL Bidder is offering to acquire all Options on issue for the consideration relevant to each class of Option.

The Share Offer also extends to all Shares that are issued before the end of the Offer Period upon the exercise of Options.

Under the terms of the Offer, the amount of consideration you receive directly from AGL Bidder will be reduced by the amount or value of any Rights attaching to Options, on or after the Announcement Date, which AGL Bidder does not receive.

For full details of the terms of the Offer, please refer to section 9 of the Bidder's Statement.

9.2 The Offer and Non-transferable Options

When they were first issued, the terms of the following Non-transferable Options imposed restrictions which prevented them from being transferred:

Expiry date	Number on issue	Exercise price
1/10/2013	513,031	$0.35
30/10/2014	2,035,000	$0.40
30/10/2014	1,500,000	$0.45
30/10/2014	125,000	$0.50
1/10/2014	500,000	$0.50
30/10/2014	125,000	$0.55
1/10/2014	500,000	$0.55
30/10/2015	1,519,243	$0.55
30/10/2015	925,000	$0.60
1/07/2015	500,000	$0.70
30/10/2013	500,000	$0.70
30/10/2013	500,000	$0.80
1/7/2014	1,000,000	$0.20

Australian Power and Gas obtained the Rule 6.23.4 Waiver on 20 August 2013 which permitted Australian Power and Gas to amend, without Shareholder approval, the terms of the Non-transferable Options so as to allow, subject to the satisfaction of the Rule 6.23.4 Waiver Conditions, for the transfer of the Non-transferable Options to AGL Bidder in connection with the Offer (see section 12.9 of this Target's Statement for more information).

The Board has resolved to amend the terms of the Non-transferable Options to permit all Non-transferable Options to be transferred to AGL Bidder, subject to the Rule 6.23.4 Waiver Conditions being satisfied. You may therefore elect to accept the Offer for your Non-transferable Options subject to, among other things, them becoming transferable.

The Conditions themselves include a Condition that the Rule 6.23.4 Waiver Conditions are satisfied. Accordingly, if this Condition is satisfied, the Non-transferable Options will become transferable.

Alternatively, it is open to holders of Non-transferable Options to exercise their Non-transferable Options (subject to any restrictions under their terms) and accept the Share Offer.

9.3 Timing of payment to Optionholders who accept the Offer

If you accept the Offer and the Offer becomes unconditional, AGL Bidder will pay you the Offer Consideration by the earlier of:

- 21 days after the end of the Offer Period; or
- one month after the later of receipt of your valid acceptance and the date on which the Offer becomes unconditional.

Full details of when you will be issued the Offer Consideration are set out in section 1.1 of the Bidder's Statement.

KEY FEATURES

9.4 Effect of an improvement in consideration on Optionholders who have already accepted the Offer

If AGL Bidder improves the consideration offered under the Offer, all Optionholders, whether or not they have accepted the Offer before that improvement in consideration, will be entitled to the benefit of that improved consideration for Options accepted into the Offer.

9.5 Conditions to the Offer

The Offer is subject to a number of Conditions. The Conditions are set out in full in section 9.8 of the Bidder's Statement and in Annexure A of this Target's Statement.

In summary, the outstanding Conditions as at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement) are:

- (**Share Offer unconditional**) the Share Offer becomes unconditional;
- (**90% acceptances**) AGL Bidder obtains a relevant interest in more than 90% (by number) of the Options at the end of the Offer Period; and
- (**ASX waivers**) the Rule 6.23.4 Waiver Conditions being satisfied at the end of the Offer Period (for more information see section 12.9 of this Target's Statement)

(together, the **Conditions**).

The Conditions are conditions subsequent. The non-fulfilment of a condition subsequent does not, until the end of the Offer Period, prevent a contract to sell your Options from arising, but it does entitle AGL Bidder, by written notice to you, to rescind the contract resulting from acceptance of the Offer.

Subject to the Corporations Act, AGL Bidder may declare the Offer to be free from any Condition or Conditions at any time.

9.6 Notice of Status of Conditions

Section 9.8 of the Bidder's Statement indicates that AGL Bidder will give a Notice of Status of Conditions to ASX and Australian Power and Gas on 3 October 2013.

AGL Bidder is required to set out in its Notice of Status of Conditions:

- whether the Offer is free of any or all of the Conditions;
- whether, so far as AGL Bidder knows, any of the Conditions have been fulfilled; and
- AGL Bidder's voting power in Australian Power and Gas.

If the Offer Period is extended by a period before the time by which the Notice of Status of Conditions is to be given, the date for giving the Notice of Status of Conditions will be taken to be postponed for the same period. In the event of such an extension, AGL Bidder is required, as soon as practicable after the extension, to give a notice to ASX and Australian Power and Gas that states the new date for the giving of the Notice of Status of Conditions.

If a Condition is fulfilled (so that the Offer becomes free of that Condition) during the Offer Period but before the date on which the Notice of Status of Conditions is required to be given, AGL Bidder must, as soon as practicable, give ASX and Australian Power and Gas a notice that states that the particular Condition has been fulfilled.

9.7 Offer Period

The Offer is scheduled to close at 7:00pm (AEST) on 11 October 2013 (but it may be extended or withdrawn in accordance with the Corporations Act).

The circumstances in which AGL Bidder may extend or withdraw the Offer are set out in section 9.8 and section 9.9 respectively of this Target's Statement.

9.8 Extension of the Offer Period

AGL Bidder may extend the Offer Period at any time before giving the Notice of Status of Conditions (referred to in section 9.6 of this Target's Statement) while the Offer is subject to the Conditions. However, if the Offer is unconditional (that is, all the Conditions are fulfilled or freed), AGL Bidder may extend the Offer Period at any time before the end of the Offer Period.

Further, there will be an automatic extension of the Offer Period if, within the last seven days of the Offer Period:

- AGL Bidder increases the amount of the Offer Consideration (or otherwise improves the consideration offered under the Offer); or
- AGL Bidder's voting power in Australian Power and Gas increases to more than 50%.

In either of these circumstances, the Offer Period is automatically extended in accordance with section 624(2) of the Corporations Act so that it ends 14 days after the occurrence of the relevant event.

9.9 Withdrawal of Offer

AGL Bidder may withdraw the Offer at any time with the written consent of ASIC which consent may be given subject to such conditions (if any) as are specified in the consent. Notice of any withdrawal will be given to ASX and Australian Power and Gas will comply with any other conditions imposed by ASIC. If AGL Bidder withdraws the Offer, any contract resulting from its acceptance will automatically be void.

9.10 Entitlement to Offer

Details concerning the entitlement of Optionholders, or those to whom Options are transferred during the Offer Period, to receive the Offer are set out in section 9.6 of the Bidder's Statement. Optionholders should read these provisions in full to understand the operation of the Offer in these regards.

9.11 Effect of acceptance

The effect of acceptance of the Offer is set out in section 9.6 of the Bidder's Statement. Optionholders should read these provisions in full to understand the effect that acceptance will have on their ability to exercise the Rights attaching to their Options and the representations and warranties which they give by accepting the Offer.

9.12 Your ability to withdraw your acceptance

You only have limited rights to withdraw your acceptance of the Offer.

You may only withdraw your acceptance of the Offer if:

- AGL Bidder varies the Offer in a way that postpones, for more than one month, the time when AGL Bidder needs to meet its obligations to pay for Options under the Offer. This will occur if AGL Bidder extends the Offer Period by more than one month and the Offer is still subject to the Conditions; and
- the Conditions have not been satisfied or waived at the time of your purported withdrawal.

9.13 Acceptance and expiry of Options

If your Options expire after you have accepted the Offer, but before all of the Conditions are satisfied or waived, you will still receive the applicable consideration for those Options if the Conditions are satisfied or waived by the end of the Offer Period. However, if your Options expire before you accept the Offer, or the Conditions are not satisfied or waived by the end of the Offer Period, you will not receive any consideration for your Options (see section 9.7 of the Bidder's Statement for further details).

9.14 Lapse of Offer

The Offer will lapse if the Conditions are breached, or not fulfilled or freed (that is, the Conditions are not satisfied or waived), at the end of the Offer Period; in which case, all contracts resulting from acceptance of the Offer and all acceptances that have not resulted in binding contracts are void. In that situation, you will be free to deal with your Options as you see fit (subject to any restrictions in their terms).

10 DIRECTORS' INTERESTS

10.1 Independent Board Committee

As noted in section 2.1 of this Target's Statement, in accordance with its constitution, Australian Power and Gas established an Independent Board Committee for the purpose of responding to the Offer, comprising:

- Mr McGregor; and
- Mr Myatt.

To ensure that consideration of the Offer has been subject to appropriate controls and that any actual or potential conflicts of interest have been managed, the Independent Board Committee established a number of protocols. These included:

- the Independent Board Committee being exclusively responsible for all decisions connected to the Offer;
- each of the Directors who are not Independent Directors absenting himself from any deliberations with respect to any matters in relation to the Offer;
- the Directors who are not Independent Directors refraining from making a recommendation in respect of the Offer;
- the establishment of protocols for the Directors and managers of Australian Power and Gas in relation to the provision of information to and communications with AGL Bidder and the Independent Expert;
- the Independent Board Committee appointing Corrs Chambers Westgarth to act as its legal adviser in respect of the Offer; and
- the Independent Board Committee appointing the Independent Expert to prepare an Independent Expert's Report to evaluate the Offer.

10.2 Directors' interests and dealings in Australian Power and Gas securities

(a) Interests in Shares and Options

As at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), the Australian Power and Gas Directors had the following relevant interests in Shares and Options:

Director	Number of Shares	Number of Options
Mr Ian McGregor	2,758,668	1,750,000[1]
Mr James Myatt	4,918,026	4,142,857[2]
Mr Michael Hogg	1,059,734	Nil
Mr Shinji Wada	Nil	Nil
Total	**8,736,428**	**5,892,857**

[1] 1,000,000 Class Ian McGregor Options and 750,000 Class Unlisted Options. For further details, refer to section 5.2 of this Target's Statement.

[2] 1,000,000 Class James Myatt Options, 142,857 Class ESOP ($0.35) Options, 1,000,000 Class ESOP ($0.40) Options, 1,000,000 Class ESOP ($0.45) Options, 500,000 Class ESOP ($0.50) Options and 500,000 Class ESOP ($0.55) Options. For further details, refer to section 5.2 of this Target's Statement.

(b) Dealings in Shares and Options

No Director of Australian Power and Gas or any of their associates have acquired or disposed of a relevant interest in any Shares or Options in the four month period ending on the date immediately before the date of this Target's Statement.

DIRECTORS'

INTERESTS

10.3 Directors' interests and dealings in AGL or AGL Bidder's securities

(a) Interests in AGL or AGL Bidder's securities

As at the date immediately before the date of this Target's Statement, the following Australian Power and Gas Directors had a relevant interest in any AGL Group securities:

Director	Number of shares	Number of options
Mr James Myatt	177	Nil

(b) Dealings in AGL or AGL Bidder's securities

No Director of Australian Power and Gas has acquired or disposed of a relevant interest in any AGL Group securities in the four month period ending on the date immediately before the date of this Target's Statement.

10.4 Benefits and agreements

(a) Benefits in connection with retirement from office

Other than as described below, no person has been or will be given any benefit (other than a benefit which can be given without member approval under the Corporations Act) in connection with the retirement of that person, or someone else, from a board or managerial office of Australian Power and Gas or related body corporate of Australian Power and Gas.

In accordance with Listing Rule 10.19 (and under sections 200B and 200E of the Corporations Act where applicable) and as approved by Shareholders at the Annual General Meeting of Australian Power and Gas on 20 November 2012, under the terms of their respective employment contracts with APG Operations, each of Mr Warren Kember, Mr David Goadby, Mr Grant Long, Ms Shelley Reed, Mr Phillip Ridley and Ms Joanne Tseng (being, the **Executives**) and Mr James Myatt (who is employed by Australian Power and Gas) will be entitled to a termination payment (plus any payment in lieu of notice, or other entitlements under the contract) if an Early Termination Event occurs, being where the relevant contract is terminated by:

- Australian Power and Gas or APG Operations (without cause) prior to the end of the fixed period under the relevant employment contract; or
- in the case of an Executive, the Executive because of a material diminution in the Executive's role and responsibilities, other than as agreed, or in Mr Myatt's case, Mr Myatt because of a reduction in the duties or responsibilities of Mr Myatt following a change of control in Australian Power and Gas.

The potential termination benefits payable to the Executives and Mr Myatt are:

- termination payments under their respective employment contracts with Australian Power and Gas;
- short term incentive (bonus) payments; and
- the automatic or accelerated vesting of long term incentive payments (performance shares or options) issued to the Executive or Mr Myatt under Australian Power and Gas' ESOP (for further details see section 10.4(b) of this Target's Statement).

The value of the potential termination payments to the Executives and Mr Myatt may exceed 5% of Australian Power and Gas' equity interests set out in its latest financial accounts provided to ASX.

For full details of the potential payments to each Executive or Mr James Myatt, please refer to Australian Power and Gas' Notices of Annual General Meeting for each of the years 2011 and 2012 which, in each case, contain detailed summaries of the terms applicable to such termination payments.

(b) Agreements connected with or conditional on the Offer

Other than as described below, there are no agreements made between any Director of Australian Power and Gas and any other person in connection with, or conditional upon, the outcome of the Offer other than in their capacity as a holder of Shares or Options.

Certain participants in the ESOP currently have a number of unvested Options entitlements. These entitlements are subject to vesting conditions. Under clause 9.5 of the ESOP, where the Directors are of the opinion that a Change of Control has occurred, the Directors may determine that the relevant performance conditions applicable to any entitlement of a participant may be satisfied and that the Options granted to such a participant may be exercised (the **Waiver Power**). On 18 July 2013 the Directors passed a resolution delegating authority to Mr Ian McGregor to exercise the Waiver Power, subject to certain conditions being satisfied. One of the relevant conditions is that a takeover bid to acquire more than 50% of the voting shares in Australian Power and Gas has been made. As at the date of this Target's Statement, Mr McGregor has not sought to exercise the Waiver Power but may do so in the future if the relevant conditions are satisfied.

(c) Interests of Directors in contracts with AGL or AGL Bidder

No Director has any interests in any contracts with AGL or AGL Bidder (save as disclosed in section 10.4 of this Target's Statement).

11 TAXATION CONSEQUENCES

TAX CONSEQUENCES

The following is a general outline of the main Australian income tax consequences for an Australian resident individual Optionholder. The outline is not exhaustive of all income tax considerations which could apply in the circumstances of any given Optionholder and there are a number of limitations to the outline including that, unless otherwise stated in section 11.7:

- it applies only to Australian resident individual taxpayers who acquired their Options otherwise than in respect of employment with Australian Power and Gas or its associated companies. It does not cover the tax treatment for any other classes of taxpayers including individuals who are non-residents of Australia for tax purposes, companies, banks, insurance organisations, superannuation funds or trusts;
- it applies only where Optionholders hold their Options on capital account. It does not apply where the Options are held on revenue account (for example, Options held by Optionholders who trade in securities or hold securities as trading stock); and
- it is based on current Australian tax law as at the date of this Target's Statement. It does not take into account or anticipate any changes in the law (including changes to legislation, judicial authority or administrative practice).

This outline does not constitute, and should not be construed as, taxation advice. Australian Power and Gas and its Directors and advisers do not accept any liability or responsibility in respect of any statement concerning the taxation consequences of the Offer or in respect of the taxation consequences themselves.

All Optionholders, and particularly those Optionholders not specifically addressed by this outline, should consult their own independent professional taxation advisers regarding the Australian and, if applicable, foreign income tax consequences of disposing of Options given the particular circumstances which apply to them.

11.1 If you accept the Offer

If you accept the Offer, the acquisition of your Options under the Offer will constitute a CGT event and you could make a capital gain or loss. A general outline of the taxation consequences of accepting the Offer is set out in section 7 of the Bidder's Statement. The outline provided in the Bidder's Statement has been prepared by or on behalf of AGL and AGL Bidder (and not Australian Power and Gas or its Directors).

11.2 If you sell your Options

For Optionholders who sell some or all of their Options (subject to any applicable restrictions under their terms) in an arm's length transaction, the sale will constitute a CGT event and you will make a capital gain or loss in accordance with the principles described in section 7 of the Bidder's Statement. Your capital proceeds will be equal to the price for which you sell the Options (which may be above or below the Offer price applicable to your class of Options).

11.3 If you exercise your Options and accept the Share Offer

If you exercise your Options (subject to any restrictions under their terms) and accept the Share Offer, it may result in taxation consequences, including exposure to tax under the CGT rules. If you are a Shareholder that holds their Shares on capital account for income tax purposes, the sale of the Shares under the Share Offer will constitute a CGT event and you could make a capital gain or loss. A general outline of the taxation consequences of accepting the Share Offer is set out in section 7 of the Share Bidder's Statement. For the purposes of calculating your capital gain or loss on the sale of your Shares, your cost base will be equal to the consideration you paid to acquire your Options plus the exercise price paid to acquire your Shares. Your Shares will be acquired for CGT purposes at the time you exercise your Options.

11.4 If you exercise your Options and sell your Shares

If you exercise your Options and sell some or all of your Shares on ASX for the market price at the time, the sale will constitute a CGT event and you will make a capital gain or loss in accordance with the principles described in section 7 of the Share Bidder's Statement. Your capital proceeds will be equal to the price for which you sell the Shares (which may be above or below the Share Offer price of $0.52 per Share). Your cost base will be equal to the consideration you paid to acquire your Options plus the exercise price paid to acquire your Shares. Your Shares will be acquired for CGT purposes at the time you exercise your Options.

11.5 If you exercise your Options and reject the Share Offer by doing nothing

If you exercise your Options and do not wish to accept the Share Offer, then if AGL Bidder satisfies the required thresholds, it will be entitled to compulsorily acquire the Shares that it and its associates do not already own. At the time of compulsory acquisition, there will be CGT consequences in accordance with the principles described in section 7 of the Share Bidder's Statement. The CGT event will occur at the time the compulsory acquisition becomes effective. Your cost base will be equal to the consideration you paid to acquire your Options plus the exercise price paid to acquire your Shares. Your Shares will be acquired for CGT purposes at the time you exercise your Options.

11.6 If you reject the Offer by doing nothing

If you do not wish to accept the Offer or exercise your Options and instead you do nothing, then if AGL Bidder satisfies the required thresholds, it will be entitled to compulsorily acquire the Options that it does not already own.

At the time of compulsory acquisition, there will be CGT consequences in accordance with the principles described in section 7 of the Bidder's Statement. The CGT event will occur at the time the compulsory acquisition becomes effective.

11.7 Employee Optionholders under the ESOP

This section applies to Optionholders who are employees of Australian Power and Gas, are Australian residents for tax purposes and who acquired their Options on or after 1 July 2009. The summary assumes that your Options were ESS interests issued under an employee share scheme which qualified for deferral of taxation under Division 83A of the *Income Tax Assessment Act 1997* (Cth).

(a) If tax has been triggered under the ESS tax rules

If you have been subject to a tax event under the ESS tax rules since the time your Options were acquired, then you would have been taxed on your Options based on their value (determined in accordance with the tax rules) less any consideration you paid for the grant of the Options. This applies also to an Optionholder who becomes subject to a tax event after the date of this Target's Statement, but not if such an Optionholder then exercises their Options and sells the Shares within 30 Days of the tax event (see section 11.7(b) below).

Your Options are a CGT asset for tax purposes and you would have a cost base in your Options based on their value at the time of the tax event (generally, the difference between the value of the Share and the Option exercise price). Your Options will be acquired for CGT purposes at the time of the tax event.

The commentary at sections 11.1 to 11.6 above is applicable to you in respect of any dealings with your Options.

(b) If tax has not been triggered under the ESS tax rules

If you have not been subject to an ESS deferred taxing point under the ESS tax rules since the time your Options were acquired:

- if you sell your Options under the Offer, there will be an ESS deferred taxing point and the Offer Consideration will form part of your ordinary assessable income;
- if you do nothing and your Options are compulsorily acquired, there will be an ESS deferred taxing point and the Offer Consideration paid for the acquisition will form part of your ordinary assessable income;
- if you exercise your Options and sell the Shares (under the Share Offer or on ASX) within 30 days of the exercise date, there will be an ESS deferred taxing point and the consideration for the sale will form part of your ordinary assessable income; and
- if you exercise your Options and do not sell the Shares within 30 days of the exercise date, if there is an ESS deferred taxing point on exercise of the Options, an amount will form part of your ordinary assessable income equal to the value of the Shares on the exercise date less the Option exercise price paid by you. The commentary at sections 11.1 to 11.6 above will be applicable to you in respect of any dealings with your Options.

TAX CONSEQUENCES

12 OTHER MATERIAL INFORMATION

12.1 Pre-acceptance agreements

On the Announcement Date, AGL Bidder entered into separate pre-bid acquisition agreements (**Pre-Bid Acquisition Agreements**) with each of Australian Power and Gas' then three largest Shareholders, Nippon Gas, the Cobra Group and the Poole Interests. Under these Pre-Bid Acquisition Agreements AGL Bidder agreed to purchase a total of 38,113,795 Shares at $0.52 per Share. The Shares acquired comprised:

- Nippon Gas – 10,000,000 Shares;
- Cobra Group – 10,000,000 Shares; and
- Poole Interests – 18,113,795 Shares.

In total, the Shares acquired under the Pre-Bid Acquisition Agreements represented 19.9% of the total number of Shares on issue at that point. AGL Bidder is now the registered Shareholder of these Shares. Complete copies of these Pre-Bid Acquisition Agreements were attached to a substantial holder notice in respect of Australian Power and Gas lodged by AGL and AGL Bidder with ASX on 16 July 2013.

In addition, each of Nippon Gas, the Cobra Group and the Poole Interests have advised Australian Power and Gas of their intention to accept the Share Offer in respect of all Shares they hold or control by no later than the next Business Day after the date on which the Share Offer becomes free of the Share Conditions, in the absence of a Superior Share Proposal. Such acceptances would collectively account for approximately 38.76% of the total number of Shares on issue (in addition to the 19.9% already acquired from the three Shareholders named above by AGL Bidder). As at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), the Cobra Group had accepted the Share Offer in respect of 21,320,288 of the 25,736,627 Shares it holds.

12.2 Material contracts

(a) Australian Power and Gas' agreements in relation to Australian Power and Gas material contracts

Australian Power and Gas has entered into agreements to amend the terms of, and in some cases terminate, certain existing agreements between Australian Power and Gas and certain counterparties (**Termination Letters**). As a general matter, the Termination Letters relate to contractual arrangements that were in place as between Australian Power and Gas and the relevant counterparty prior to the commencement of discussions between AGL and Australian Power and Gas in relation to the Share Offer. The Termination Letters confer on Australian Power and Gas benefits in the nature of a non-compete commencing from the time at which the Share Offer becomes free of the Share Conditions. The letters also require payments to be made by Australian Power and Gas to the applicable counterparty in accordance with the requirements of the underlying arrangements or in consideration for their early termination.

(b) Agreement between Australian Power and Gas and its Financial Advisers

Arthur Phillip and Finflex (**Financial Advisers**) have each been appointed to act as advisers in relation to corporate finance and strategic matters, including mergers and acquisitions, and takeovers.

These arrangements were entered into by Australian Power and Gas and Arthur Phillip on 4 October 2006 and between Australian Power and Gas and Finflex on 23 April 2013.

Arthur Phillip is a Poole Interest. As at the date of this Target's Statement, the Poole Interests have a relevant interest in 8.25% of the total number of Australian Power and Gas Shares currently on issue.

Pursuant to the terms of engagement between Australian Power and Gas and Arthur Phillip, Arthur Phillip is entitled to a success fee on completion of a takeover offer for Australian Power and Gas. In addition, under the terms of engagement between Australian Power and Gas and Finflex, Finflex is entitled to a success fee in respect of a takeover offer for Australian Power and Gas.

Australian Power and Gas has clarified with each of the Financial Advisers that their entitlement to a success fee in respect of the Share Offer under their engagement letters will arise when the Share Offer becomes free of all Share Conditions and Australian Power and Gas will pay the success fees to each Financial Adviser within 10 Business Days after the end of the Share Offer Period.

Each of the Financial Advisers is also entitled to a monthly retainer fee. Australian Power and Gas has agreed with each Financial Adviser that their respective entitlements to receive a monthly retainer under their mandate will end:

- in the case of Arthur Phillip – in the month in which the Share Offer becomes free of the Share Conditions; and
- in the case of Finflex – as if the entitlement to a monthly retainer expires in April 2014 (the monthly retainer was otherwise due to expire in September 2014).

Australian Power and Gas has agreed with each of the Financial Advisers that the mandate with each Financial Adviser will terminate with effect from the date the applicable success fee in relation to the Offer is paid to that Financial Adviser.

During the two years from the date the Share Offer becomes free of the Share Conditions, each of the Financial Advisers and their related entities has agreed with Australian Power and Gas not to directly or indirectly hold an economic interest in any retail residential electricity or gas business in New South Wales, Victoria or Queensland (subject to some limited exceptions).

(c) Agreement between Australian Power and Gas and Appco

In September 2006, APG Operations entered into a Marketing Services Agreement (**MSA**) with Appco, a member of the Cobra Group. The MSA was novated to Australian Power and Gas on 5 October 2006 and amended on 19 November 2010. As at 12 September 2013 (being the latest practical date prior to the dispatch of this Target's Statement), the Cobra Group had accepted the Share Offer in respect of 21,320,288 of the Shares it holds, remaining the holder of 4,416,339 Shares (representing 2.30% of all Shares on issue at that point).

Pursuant to the MSA, Appco agreed to exclusively supply Australian Power and Gas with marketing and sales services to assist Australian Power and Gas to acquire customers.

The MSA has an initial term of 10 years and can be terminated by either party providing not less than 12 months' notice to the other party. Australian Power and Gas has agreed with Appco that despite the 12 months' notice period, if the Share Offer becomes free of the Share Conditions then Australian Power and Gas will terminate the MSA between Appco and Australian Power and Gas by:

- giving Appco not less than one month's written notice of the termination of the MSA; and
- paying to Appco $775,000 (exclusive of GST) on or before the date of termination of the MSA.

The payment referred to above was negotiated and agreed between Australian Power and Gas and Appco on arm's length terms.

During the two years from the date the Share Offer becomes free of the Share Conditions, Appco and its related entities have agreed with Australian Power and Gas not to directly or indirectly hold an economic interest in any retail residential electricity or gas business in New South Wales, Victoria or Queensland (subject to some limited exceptions).

(d) Agreement between Australian Power and Gas and Nippon Gas

Nippon Gas has entered into the Nippon Gas Loan Agreement with Australian Power and Gas which was announced to ASX by Australian Power and Gas on 5 April 2013. Under the Nippon Gas Loan Agreement, Nippon Gas:

- agreed to provide Australian Power and Gas with unsecured loans for an aggregate amount equal to $6 million, with each loan having a one year term; and
- was granted the Election Rights. Further details of the Election Rights are set out in section 5.4 of this Target's Statement.

Australian Power and Gas has agreed with Nippon Gas that if the Share Offer becomes free from the Share Conditions:

- then on the date which is 10 Business Days after the date on which the Share Offer Period closes, the Election Rights will be cancelled in consideration of a payment to Nippon Gas by Australian Power and Gas of an aggregate amount of $591,634 (exclusive of GST) for Nippon Gas' 6 million Election Rights (**Cancellation Payment**). The Cancellation Payment has been calculated on the same basis on which the consideration for the Options was calculated for the purposes of the Offer;

- if a loan is repaid or prepaid in whole or in part prior to the repayment date for that loan, Australian Power and Gas is liable under the terms of the Nippon Gas Loan Agreement to pay Nippon Gas interest that has accrued on the amount repaid or prepaid up to and including the date of repayment or prepayment plus interest that would have accrued up to the date which is 12 months after the loan is drawn down (**Make Whole Payment**). Australian Power and Gas has agreed with Nippon Gas that the interest rate applicable to the Make Whole Payment will be less than the amount originally agreed under the Nippon Gas Loan Agreement; and
- if AGL has acquired a relevant interest in at least 90% of the total number of Australian Power and Gas Shares on issue, Australian Power and Gas will, on the date which is 10 Business Days after the close of the Share Offer Period, repay to Nippon Gas the total amount of the loans outstanding and the agreed interest; Nippon Gas has also agreed with Australian Power and Gas that:
  - o it will not exercise the Election Rights during the period between the Announcement Date and date of payment of the Cancellation Payment for the Election Rights to Nippon Gas; and
  - o it will not exercise any acceleration rights which may arise under the Nippon Gas Loan Agreement as a result of the Offer.

During the two years from the date the Share Offer becomes free of the Share Conditions, Nippon Gas and its related entities have agreed with Australian Power and Gas not to directly or indirectly hold an economic interest in any retail residential electricity or gas business in New South Wales, Victoria or Queensland (subject to some limited exceptions).

(e) Agreement between Australian Power and Gas and James Myatt

Mr James Myatt is the Chief Executive Officer and Managing Director of Australian Power and Gas. Australian Power and Gas and Mr Myatt have an agreement in place whereby Australian Power and Gas has agreed to lend money to Mr Myatt to assist him to satisfy his payment obligations for the exercise of Options. Mr Myatt has agreed with Australian Power and Gas that he will not exercise any Options granted to him and will make no further requests for advances under the agreement. Mr Myatt has also agreed with Australian Power and Gas to direct the payment of consideration he receives under the Share Offer for Shares acquired upon the exercise of Mr Myatt's Options to the repayment of any amounts payable to Australian Power and Gas under the agreement.

Mr Myatt has also agreed with Australian Power and Gas that:

- during the 12 months from the date the Share Offer becomes free of the Share Conditions, Mr Myatt and his related entities have agreed not to directly or indirectly hold an economic interest in any retail residential electricity or gas business in New South Wales, Victoria or Queensland (subject to some limited exceptions); and
- he will accept the Offer on or before the next Business Day after the Offer becomes free of the Conditions, in the absence of a Superior Proposal.

(f) MBL deed of undertaking

MBL and Australian Power and Gas are parties to the MBL Facilities Agreement. AGL and MBL have entered into a deed of undertaking pursuant to which:

- AGL has agreed that if the Share Offer has become or is declared unconditional then it will procure that Australian Power and Gas repays the borrowings under the MBL Facilities Agreement in full on the earlier of:
  - o 31 December 2013; or
  - o the date which is five Business Days after the date that Australian Power and Gas provides a notice to MBL of its intention to prepay the borrowings in full;
- once the Share Offer has become or is declared unconditional, MBL has agreed to provide a waiver to Australian Power and Gas of any past breaches or defaults that have occurred under the MBL Facilities Agreement and confirmation to Australian Power and Gas that MBL will not allege that any potential event of default, event of default or breach has occurred under the MBL Facilities Agreement (in relation to the period prior to the date the Offer has become unconditional) on or before the date the borrowings are repaid in full. If the Share Offer has not become or been declared unconditional by the earlier to occur of:
  - o 31 December 2013; and
  - o the date of the close of the Share Offer Period,

  then the waiver will terminate on that date.

12.3 No agreements subject to change of control

Other than as described below, as far as the Directors are aware, no agreement which is material in the context of Australian Power and Gas' business contains a change of control clause which may be triggered if AGL Bidder is successful in acquiring control of Australian Power and Gas and which may result in that agreement being terminated or the business of Australian Power and Gas being materially adversely affected.

Under the terms of the electricity and gas licences for the Australian Capital Territory held by Australian Power and Gas Pty Limited, a subsidiary of Australian Power and Gas, any change in the shareholding resulting in at least 50% of the Shares in Australian Power and Gas is a deemed assignment under the terms of the licence, which requires the prior written consent of the Independent Competition and Regulatory Commission (**ICRC**) which must not be unreasonably withheld. ICRC will be satisfied of an assignment if the proposed assignee is a respectable, responsible and solvent person who is capable of performing all obligations in the licence. Australian Power and Gas does not provide any retail services to electricity or gas customers in the Australian Capital Territory and the Directors of Australian Power and Gas do not consider this to be a significant issue in the context of the Offer.

12.4 Share Offer

AGL Bidder has made an off-market takeover offer to Shareholders to acquire 100% of their Shares. The Share Offer consideration is $0.52 cash per Share. The Share Offer extends to Shares that come into existence as a result of Options being exercised during the Offer Period.

Further information about the Share Offer is set out in the Share Bidder's Statement and Share Target's Statement which contain detailed information regarding the alternatives available in respect of the Shares in connection with the Share Offer, including information on the tax consequences of those alternatives.

12.5 Bid Implementation Agreement

On 15 July 2013 Australian Power and Gas entered into an agreement with AGL in respect of the Offer and the Share Offer (**Bid Implementation Agreement**). A summary of certain key terms of that agreement is set out in section 8.5 of the Bidder's Statement. The summary does not purport to be exhaustive or constitute a definitive statement of the rights and liabilities of each of Australian Power and Gas and AGL under the agreement. The full terms of the agreement can be viewed in the announcement made by AGL on ASX in connection with the Offer on the Announcement Date and is available at www.asx.com.au.

12.6 Compulsory acquisition

AGL Bidder has indicated in section 4.3 of its Bidder's Statement that if it becomes entitled to do so, it intends to compulsorily acquire any outstanding Options in accordance with Part 6A.1 of the Corporations Act.

AGL Bidder will be entitled to compulsorily acquire any Options in respect of which it has not received an acceptance of its Offer on the same terms as the Offer if, during or at the end of the Offer Period:

- AGL Bidder and its associates have a relevant interest in at least 90% (by number) of the Options; and
- AGL Bidder and its associates have acquired at least 75% (by number) of the Options that AGL Bidder offered to acquire, provided that, for the purpose of its calculations, Options that are exercised during the Offer Period are excluded from the number of Options that AGL Bidder offered to acquire under the Offer (ASIC Class Order 13/522).

If this threshold is met, AGL Bidder will have one month after the end of the Offer Period within which to give compulsory acquisition notices to Optionholders who have not accepted the Offer. Optionholders have statutory rights to challenge the compulsory acquisition, but a successful challenge will require the relevant Optionholder to establish to the satisfaction of a court that the terms of the Offer do not represent 'fair value' for their Options.

If compulsory acquisition occurs, Optionholders who have their Options compulsorily acquired are likely to be paid their consideration later than Optionholders who accepted the Offer.

12 OTHER MATERIAL INFORMATION CONT'D

12.7 General compulsory acquisition

If, following closure of the Offer Period, AGL Bidder becomes the holder of full beneficial interests in at least 90% (by number) of the Options (for example, by subsequent acquisitions of Options), it will be entitled to compulsorily acquire any outstanding Options in accordance with Part 6A.2 of the Corporations Act.

12.8 ASIC modifications

AGL Bidder has stated in section 8.6 of its Bidder's Statement that it has obtained the following modifications from ASIC in respect of the Offer:

- section 605(2), to allow AGL Bidder to treat the different classes of Options as one class for the purpose of the Offer; and
- section 619(2), to allow AGL Bidder to offer different consideration to each class of Options under the Offer.

A copy of the relief instrument is attached at Annexure B of the Bidder's Statement.

12.9 ASX Listing Rule waivers

Australian Power and Gas obtained a waiver of ASX Listing Rule 6.23.4 from ASX on 20 August 2013 (**Rule 6.23.4 Waiver**). The Rule 6.23.4 Waiver was required in order to allow the Board of Australian Power and Gas to amend, without Shareholder approval, the terms affecting the Non-transferable Options so that AGL Bidder is able to acquire (rather than cancel) the Non-transferable Options in respect of which AGL Bidder receives valid acceptances under the Offer. The Rule 6.23.4 Waiver is subject to the satisfaction of the following conditions:

- the Share Conditions being fulfilled or freed; and
- AGL Bidder and its associates obtaining voting power over at least 50.1% of the Shares in Australian Power and Gas

(together, being the **Rule 6.23.4 Waiver Conditions**).

The Rule 6.23.4 Waiver also has the consequence that the waiver to ASX Listing Rule 6.23.2 (which was contemplated as a condition to the Offer in the Bid Implementation Agreement) is not required.

12.10 Share Offer extends to new Shares

For the purposes of section 633(2) of the Corporations Act, the date for determining the persons to whom information is to be sent in items 6 and 12 of section 633(1) of the Corporations Act is the Register Date being 7:00pm (AEST) on 27 August 2013.

The Share Offer extends to persons who become registered, or entitled to be registered, as the holder of Shares during the Share Offer Period due to the conversion of, or exercise of rights attached to, securities convertible into Shares (being Options) which are on issue on the Register Date.

12.11 Broker commissions

AGL Bidder has stated in section 8.10 of its Share Bidder's Statement that AGL Bidder may offer to pay a commission to brokers who solicit acceptances of the Share Offer from their clients, but it has made no final decision in relation to the matter at this stage.

Any commission payments will be paid only in respect of parcels of Shares held by retail Shareholders who accept the Share Offer.

If a commission is offered, commission payments will not exceed 0.75% of the value of the consideration payable to a retail Shareholder who accepts the Offer, and will be subject to minimum payments (not exceeding $50) and maximum payments (not exceeding $300) for each acceptance.

If a commission is offered, it will be payable only to brokers and will be subject to the condition that no part of the fee will be able to be passed on or paid to Shareholders.

It is AGL Bidder's intention that, if and when an offer of commission has been made to any broker by AGL Bidder, the commission arrangement will remain in place for the balance of the Offer Period and the amount of the commission offered will not be increased during the Offer Period.

12.12 Regulatory and legal matters

(a) Autonomous Sanctions Regulations 2011 (Cth)

The *Autonomous Sanctions Regulations 2011* (Cth) currently prohibits making an asset available to, or for the benefit of, a designated person or entity without authorisation from the Minister of Foreign Affairs or to use or deal with an asset owned or controlled by a designated person or entity without authorisation from the Minister for Foreign Affairs. Designated persons and entities include:

- specified individuals associated with the former government of the Federal Republic of Yugoslavia;
- specified ministers and senior officials of the Government of Zimbabwe;
- specified individuals and entities associated with the Democratic People's Republic of Korea (North Korea); and
- several entities and individuals who contribute to Iran's proliferation activities not already listed by the UN Security Council.

(b) Other Commonwealth legislation

The *Charter of the United Nations Act 1945* (Cth) prohibits:

- assets from being provided to prescribed persons or entities; and
- the use or dealing, and facilitation of such use or dealing, of certain assets owned or controlled by proscribed persons or entities,

in each case without the written consent of the Minister of Foreign Affairs.

Persons and entities from various countries have been proscribed under various Regulations made pursuant to the *Charter of the United Nations Act 1945* (Cth) including in relation to Côte d'Ivoire, Democratic Republic of the Congo, Iran, Iraq, Liberia, Sudan, Somalia and the Democratic People's Republic of Korea.

12.13 Consents

This Target's Statement contains statements made by, or statements based on statements made by, Arthur Phillip, Australian Power and Gas, BDO East Coast Partnership, Corrs Chambers Westgarth, Finflex and Grant Thornton. Each of Arthur Phillip, Australian Power and Gas, BDO East Coast Partnership, Corrs Chambers Westgarth, Finflex and Grant Thornton has given and has not, before lodgement of this Target's Statement with ASIC, withdrawn their consent:

- to be named in this Target's Statement in the form and context in which they are named;
- for the inclusion of their respective reports or statements (if any) noted next to their names and the references to those reports or statements in the form and context in which they are included in this Target's Statement; and
- the inclusion of other statements in this Target's Statement which are based on or referable to statements made in those reports or statements, or which are based on or referable to other statements made by those persons in the form and context in which they are included.

Each of Arthur Phillip, Australian Power and Gas, BDO East Coast Partnership, Corrs Chambers Westgarth, Finflex and Grant Thornton:

- does not make, or purport to make, any statement in this Target's Statement other than those statements referred to above and as consented to by that person; and
- to the maximum extent permitted by law, expressly disclaims and takes no responsibility for any part of this Target's Statement other than as described in this section with the person's consent.

As permitted by ASIC Class Order 13/521, this Target's Statement contains statements which are made, or based on statements made, in documents lodged by AGL or AGL Bidder with ASIC or given to ASX, or announced on ASX, by AGL. Pursuant to the Class Order, the consent of AGL or AGL Bidder is not required for the inclusion of such statements in this Target's Statement. Any Optionholder who would like to receive a copy of any of those documents may obtain a copy (free of charge and within two Business Days of the request being made) during the Offer Period by contacting the Optionholder Information Line on 1800 705 748 (for calls made from within Australia), or +61 2 8256 3386 (for calls made from outside Australia).

12 OTHER MATERIAL INFORMATION CONT'D

12.14 Continuous disclosure

Australian Power and Gas is a disclosing entity under the Corporations Act and subject to regular reporting and disclosure obligations under the Corporations Act and the ASX Listing Rules. These obligations require Australian Power and Gas to notify ASX of information about specified matters and events as they occur for the purpose of making that information available to the market. In particular, Australian Power and Gas has an obligation (subject to limited exceptions) to notify ASX immediately on becoming aware of any information which a reasonable person would expect to have a material effect on the price or value of Shares.

Copies of the documents filed with ASX may be obtained from ASX website at www.asx.com.au and Australian Power and Gas' website at www.australianpowerandgas.com.au/investorandmediacentre/asxandmediareleases.

Copies of documents lodged with ASIC in relation to Australian Power and Gas may be obtained from, or inspected at, an ASIC office.

12.15 No other material information

This Target's Statement is required to include all the information that Optionholders and their professional advisers would reasonably require to make an informed assessment whether to accept the Offer, but:

- only to the extent to which it is reasonable for investors and their professional advisers to expect to find this information in this Target's Statement; and
- only if the information is known to any of the Directors of Australian Power and Gas.

The Directors of Australian Power and Gas are of the opinion that the information that Optionholders and their professional advisers would reasonably require to make an informed assessment whether to accept the Offer is:

- the information contained in the Bidder's Statement (to the extent that the information is not inconsistent or superseded by information in this Target's Statement);
- the information contained in the Share Target's Statement and Share Bidder's Statement (to the extent that the information is not inconsistent or superseded by information in this Target's Statement);
- the information contained in Australian Power and Gas' releases to ASX, and in the documents lodged by Australian Power and Gas with ASIC before the date of this Target's Statement; and
- the information contained in this Target's Statement.

The Directors of Australian Power and Gas have assumed, for the purposes of preparing this Target's Statement, that the information in the Bidder's Statement is accurate. However, the Directors of Australian Power and Gas do not take any responsibility for the contents of the Bidder's Statement and are not to be taken as endorsing, in any way, any or all statements contained in it.

In deciding what information should be included in this Target's Statement, the Directors of Australian Power and Gas have had regard to:

- the nature of the Options;
- the matters that Optionholders may reasonably be expected to know;
- the fact that certain matters may reasonably be expected to be known to Optionholders' professional advisers; and
- the time available to Australian Power and Gas to prepare this Target's Statement.

13 GLOSSARY AND INTERPRETATION

13.1 Glossary

In this Target's Statement defined terms have the meanings set out below (with the exception of Annexure A which contains its own defined terms):

Term	Meaning
$, A$ or AUD	Australian dollar
ACCC	Australian Competition and Consumer Commission
Acceptance Form	the form of acceptance of the Offer enclosed with the Bidder's Statement or, as the context requires, any replacement or substitute acceptance form provided by or on behalf of AGL Bidder
AEST	Australian Eastern Standard Time
AGL	AGL Energy Limited (ACN 115 061 375)
AGL Bidder	AGL APG Holdings Pty Limited (ACN 081 834 826), a wholly owned subsidiary of AGL
AGL Group	AGL and each of its related bodies corporate
APG Operations	APG Operations Pty Ltd (ABN 41 120 076 379)
Announcement Date	15 July 2013
Appco	Appco Group Energy Pty Ltd (formerly known as Appco Energy Direct Pty Ltd) (ACN 095 538 248)
Arthur Phillip	Arthur Phillip Pty Ltd (ACN 100 908 101)
ASIC	Australian Securities and Investments Commission
ASX	ASX Limited (ABN 98 008 624 691) or, as the context requires, the financial market known as the "Australian Securities Exchange" operated by that entity
ASX Listing Rules	the official listing rules of ASX as amended or varied from time to time
Arthur Phillip	Arthur Phillip Pty Ltd (ACN 100 908 101)
Australian Power and Gas	Australian Power and Gas Company Limited (ACN 077 206 583)
Bidder's Statement	the statement of AGL Bidder under Part 6.5 of Division 2 of the Corporations Act issued in relation to the Offer dated 4 September 2013
Bid Implementation Agreement	the takeover bid implementation agreement dated 15 July 2013 between AGL and Australian Power and Gas
Board	the board of Directors of Australian Power and Gas

13 GLOSSARY AND INTERPRETATION CONT'D

Term	Meaning
Business Day	a day on which banks are open for business in Sydney, excluding a Saturday, Sunday or public holiday
Cancellation Payment	has the meaning given to that term in section 12.2 of this Target's Statement and section 8.3(c) of the Bidder's Statement
Cash Settlement Amount	has the meaning given to that term in section 5.3 of this Target's Statement and section 5.2 of the Bidder's Statement
Cash Settlement Payment Date	has the meaning given to that term in section 5.3 of this Target's Statement and section 5.2 of the Bidder's Statement
CGT	capital gains tax
Change of Control	has the meaning given to that term in the ESOP
Cobra Group	The Cobra Group Pty Limited (ACN 068 819 456), Cobra Investment BV and Barton Holdings Limited
Competing Proposal	any proposal, transaction, arrangement or offer (whether from a person with whom Australian Power and Gas has previously been in discussions or not) that: • would, if completed substantially in accordance with its terms, result in any person or persons other than AGL Bidder: o acquiring: • directly or indirectly, an interest in all or a substantial part of the assets of Australian Power and Gas; or • a relevant interest in more than 10% of the voting shares of Australian Power and Gas or otherwise acquire control of Australian Power and Gas within the meaning of section 50AA of the Corporations Act; or o otherwise acquiring or merging with Australian Power and Gas whether by way of takeover offer, scheme of arrangement, Shareholder approved acquisition, capital reduction, share buy back, sale or purchase of assets, joint venture, reverse takeover, dual listed company structure or other synthetic merger or any other transaction or arrangement; or • may materially reduce the likelihood of success of the Offer
Conditions	the conditions set out in section 9.8 of the Bidder's Statement and Annexure A of this Target's Statement
Corporations Act	the *Corporations Act 2001* (Cth) (as modified or varied by ASIC)
Directors	the directors of Australian Power and Gas
Early Termination Event	has the meaning given to that term in section 10.4 of this Target's Statement

Term	Meaning
Election Right	has the meaning given to that term in section 5.3 of this Target's Statement and section 5.2 of the Bidder's Statement
ESOP	the Australian Power and Gas Employee Share Option Plan adopted by the Board on 23 January 2007, as amended by the Board from time to time
ESS	Employee Share Scheme
Executives	has the meaning given to that term in section 10.4 of this Target's Statement
Financial Advisers	Arthur Phillip and Finflex
Finflex	Finflex Pty Ltd (ACN 162 975 466)
FY	financial year
GST	has the same meaning as in *A New Tax System (Goods and Services Tax) Act 1999* (Cth)
ICRC	Independent Competition and Regulatory Commission
Independent Board Committee	the committee formed by Australian Power and Gas comprising of the Independent Directors
Independent Directors	Mr Ian McGregor and Mr James Myatt
Independent Expert	Grant Thornton Corporate Finance Pty Limited (ABN 59 003 265 987)
Independent Expert's Report	the report of the Independent Expert included in Annexure B of this Target's Statement
Independent Valuer	BDO East Coast Partnership
Independent Valuer's Report	the report of the Independent Valuer referred to in section 3.1 of this Target's Statement
Make Whole Payment	has the meaning given to that term in section 12.2(d) of this Target's Statement and section 8.3(c)(ii) of the Bidder's Statement
Market Price	has the meaning given to that term in section 5.3 of this Target's Statement and section 5.2 of the Bidder's Statement
MBL	Macquarie Bank Limited (ACN 008 583 542)
MBL Facilities Agreement	the facilities agreement dated 30 August 2012 entered into between, among others, MBL and Australian Power and Gas
MSA	the marketing services agreement entered into between APG Operations and Appco

Term	Meaning
Nippon Gas	Nippon Gas Co., Ltd
Nippon Gas Loan Agreement	the Loan Facility Agreement dated 4 April 2013 between Nippon Gas and Australian Power and Gas
Non-transferable Options	those Australian Power and Gas Options set out in section 9.2 of this Target's Statement that are, or would be, non-transferable under their current terms without the benefit of the Rule 6.23.4 Waiver having been obtained or Shareholder approval to amend their terms being or having been obtained
Notice of Status of Conditions	AGL Bidder's notice disclosing the status of the Conditions which is required to be given by section 630(3) of the Corporations Act
Offer	the offer by AGL Bidder to acquire each Option in connection with the Takeover Bids, which offer is contained in section 9 of the Bidder's Statement
Offer Consideration	the consideration for each class of Options at which the Offer is made (based on the valuation the Independent Valuer attributes to each class of Options), which is contained in section 9.3 of this Target's Statement
Offer Period	the period during which the Offer will remain open for acceptance in accordance with section 9.3 of the Bidder's Statement
Optionholder	a person who is registered as the holder of one or more Options on the Register
Optionholder Information Line	the information line established by Australian Power and Gas to answer questions from Optionholders about the Offer
Options	any options to acquire Shares that have been granted by Australian Power and Gas
Poole Interests	Fontelina Pty Ltd (ACN 145 837 547), Richard Poole, Arthur Phillip, Arthur Phillip Nominees Pty Ltd (ACN 111 862 358), Amanda Poole and Haxby Pty Ltd (ACN 078 498 129)
Pre-Bid Acquisition Agreements	has the meaning given to that term in section 12.1 of this Target's Statement
Public Authority	any federal, provincial, state, regional, municipal, local or other government, governmental or public department, central bank, court, tribunal, administrative, statutory or judicial entity, arbitral body, commission, board, bureau or authority or agency
Register	the register of Shareholders and Optionholders (as the case may be) maintained by Australian Power and Gas in accordance with the Corporations Act
Register Date	means 7:00pm (AEST) on 27 August 2013, being the date set by AGL Bidder under section 633(2) of the Corporations Act

Term	Meaning
Rights	includes all accretions, rights or benefits of whatever kind attaching to or arising from or in respect of Options, whether directly or indirectly, including without limitation all rights to exercise the Options, to receive dividends (and any attaching franking credit), to receive or subscribe for shares, units, notes, options or other securities and to receive all other distributions or other entitlements declared, paid, made or issued by Australian Power and Gas or any subsidiary of Australian Power and Gas after the Announcement Date
Rule 6.23.4 Waiver	the waiver sought and subsequently obtained on 20 August 2013 by Australian Power and Gas from ASX in respect of ASX Listing Rule 6.23.4 and referred to in section 12.9 of this Target's Statement
Rule 6.23.4 Waiver Conditions	has the meaning given to that term in section 12.9 of this Target's Statement
Share Bidder's Statement	the statement of AGL Bidder under Part 6.5 of Division 2 of the Corporations Act issued in relation to the Share Offer dated 8 August 2013
Share Conditions	the conditions set out in section 9.8 of the Share Bidder's Statement and section 9.4 of the Share Target's Statement
Share Offer	the offer by AGL Bidder for the Shares, which offer is contained in section 9 of the Share Bidder's Statement
Share Offer Period	the period during which the Share Offer will remain open for acceptance in accordance with section 9.3 of the Share Bidder's Statement
Share Target's Statement	the statement of AGL Bidder under Part 6.5 of Division 2 of the Corporations Act issued in relation to the Share Offer dated 23 August 2013
Shareholder	a person who is registered as the holder of one or more Shares on the Register
Shares	fully paid ordinary shares in the capital of Australian Power and Gas
Superior Proposal	a bona fide, Competing Proposal received by Australian Power and Gas after the date of the Bid Implementation Agreement which the Australian Power and Gas Directors determine, acting both in good faith and reasonably: • is bona fide and in writing and, in the determination of the Independent Directors acting in good faith, is reasonably capable of being valued and completed, taking into account all aspects of the Competing Proposal (including its terms and conditions and the identity of the person or persons making it); and • in the determination of the Independent Directors acting in good faith and reasonably in order to satisfy what the Independent Directors consider to be their fiduciary or statutory duties (based on specific legal and any other appropriate advice), would, if substantially completed in accordance with its terms, be more favourable to Optionholders than the Offer, taking into account all aspects of the Competing Proposal

GLOSSARY AND

13 GLOSSARY AND INTERPRETATION CONT'D

Term	Meaning
Superior Share Proposal	a bona fide, Competing Proposal received by Australian Power and Gas after the date of the Bid Implementation Agreement which the Australian Power and Gas Directors determine, acting both in good faith and reasonably: • is bona fide and in writing and, in the determination of the Independent Directors acting in good faith, is reasonably capable of being valued and completed, taking into account all aspects of the Competing Proposal (including its terms and conditions and the identity of the person or persons making it); and • in the determination of the Independent Directors acting in good faith and reasonably in order to satisfy what the Independent Directors consider to be their fiduciary or statutory duties (based on specific legal and any other appropriate advice), would, if substantially completed in accordance with its terms, be more favourable to Shareholders than the Share Offer, taking into account all aspects of the Competing Proposal
Takeover Bids	the off-market takeover bids made by AGL Bidder for all the Shares and Options that AGL Bidder does not currently own or control and **Takeover Bid** means either bid, as appropriate
Target's Statement	this document (including its annexures), being the statement of Australian Power and Gas under Part 6.5 Division 3 of the Corporations Act
Termination Letters	has the meaning given to that term in section 12.2(a) of this Target's Statement
Transferable Options	Australian Power and Gas Options that are transferable to AGL Bidder under their terms
VWAP	volume-weighted average price
Waiver Power	has the meaning given to that term in section 10.4(b) of this Target's Statement

13.2 Interpretation

In this Target's Statement:

(a) Words and phrases have the same meaning (if any) given to them in the Corporations Act.

(b) Words of any gender include all genders.

(c) Words importing the singular include the plural and vice versa.

(d) An expression importing a person includes any company, partnership, joint venture, association, corporation or other body corporate and vice versa.

(e) A reference to a section, clause, annexure and schedule is a reference to a section of, clause of and an annexure and schedule to this Target's Statement as relevant.

(f) A reference to any legislation includes all delegated legislation made under it and amendments, consolidations, replacements or re-enactments of any of them.

(g) Headings and bold type are for convenience only and do not affect the interpretation of this Target's Statement.

(h) A reference to time is a reference to AEST.

14 AUTHORISATION

This Target's Statement has been approved by a resolution passed by the Directors of Australian Power and Gas. All Australian Power and Gas Directors voted in favour of that resolution.

Signed for and on behalf of Australian)
Power and Gas Company Limited:)

IAN McGREGOR

16 September 2013

AUTHORISATION

ANNEXURE A – CONDITIONS

1.1 Conditions

The Offer and any contract resulting from its acceptance, is subject to the Conditions set out below:

(a) Share Offer unconditional

At the end of the Offer Period, the Share Offer has become unconditional as a result of:

(i) all conditions of the Share Offer (as set out in section 9.8 of the Share Bidder's Statement) being fulfilled according to their terms; and

(ii) AGL Bidder declaring the Share Offer unconditional.

(b) Minimum acceptance condition

At the end of the Offer Period, AGL has a relevant interest in more than 90% (by number) of the Australian Power and Gas Options on issue at that time.

(c) ASX Waiver related conditions

At the end of the Offer Period, the Rule 6.23.4 Waiver Conditions being satisfied.

Grant Thornton
An instinct for growth™

Australian Power and Gas Company Limited

Independent Expert's Report and Financial Services Guide

13 August 2013

The Independent Directors
Australian Power and Gas Company Limited
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13 August 2013

Dear Sirs

Independent Expert's Report and Financial Services Guide

Introduction

Australian Power and Gas Company Limited ("APK", or the "Company") is listed on the Australian Securities Exchange ("ASX") and is primarily involved in the retailing of electricity and gas to residential households in Victoria, New South Wales and Queensland. As at 7 August 2013, APK's market capitalisation was approximately $96.7 million.

AGL Energy Limited ("AGL") is listed on the ASX and is one of Australia's largest energy retailers with over 3.5 million customers. AGL is also an owner, operator and developer of energy generation assets. As at 7 August 2013, AGL's market capitalisation was approximately $8.2 billion.

On 15 July 2013, APK announced that it had entered into a bid implementation agreement ("BIA") with AGL under which AGL, through a wholly owned subsidiary, agreed to make a takeover for the following:

- All shares of APK ("APK Shares") that AGL does not already own for a cash consideration of $0.52 per share (the "Share Offer").

- Subject to AGL and APK obtaining the required regulatory relief, all options currently on issue ("APK Options") at the option price as set out in the BIA ("Option Offer").

On 15 July 2013, AGL also announced that it had entered into separate pre-bid acquisition agreements ("Pre-Bid Acquisition Agreements") with APK's three largest shareholders to purchase a total of 38,113,795 APK shares (or 19.9% of the issued capital) at $0.52 cash per share.

If the Share Offer becomes unconditional and in the absence of a superior proposal, each of the three major shareholders intends to accept the Share Offer in respect to their entire shareholding.

This collectively accounts for an additional 38.92% of all APK Shares on issue (in addition to the 19.9% acquired by AGL under the Pre-Bid Acquisition Arrangements).

The Share Offer and the Option Offer are subject to separate conditions customary for a transaction of this type. Refer to sections 1.2 and 1.3 for further details.

Purpose of the report

Whilst there is not a legal requirement for the commissioning of an independent expert report in conjunction with the Share Offer and Option Offer, the Directors of APK have decided to commission an independent expert's report to assist APK Shareholders and APK Optionholders in assessing the merits of the Share Offer and Option Offer.

Grant Thornton Corporate Finance has been engaged to form a separate opinion on the Share Offer and Option Offer.

Summary of opinion – Share Offer

Grant Thornton Corporate Finance has concluded that the Share Offer is fair and reasonable to the APK Shareholders.

This summary of opinion should be read in conjunction with the detailed findings set out in the remainder of this report.

Fairness Assessment – Share Offer

In forming our opinion in relation to the fairness of the Share Offer, Grant Thornton Corporate Finance has compared our valuation assessment of the fair market value of APK on a control basis to the cash consideration of $0.52 per APK Share.

The following table summarises our assessment.

Fairness assessment	Section reference	Low A$	High A$
Fair value of APK Share on a controlling basis	7.1.10	0.488	0.555
Offer Price	1.1	0.520	0.520
Premium/(Discount)		**0.032**	**(0.035)**
Premium%/(Discount)%		**6.6%**	**(6.4)%**

Source: Calculations

The cash consideration of $0.52 per APK Share is within our assessed valuation range of APK Shares on a control basis. Accordingly, we conclude that the Share Offer is fair to the APK Shareholders.

APK Shareholders should be aware that our assessment of the value per APK Share does not reflect the price at which APK Shares will trade if the Share Offer lapses. The price at which APK Shares will ultimately trade depends on a range of factors including the liquidity of APK Shares, macroeconomic conditions, the underlying performance of the APK business and the supply and demand for APK Shares.

Reasonableness Assessment – Share Offer

RG111 establishes that an offer is reasonable if it is fair. It might also be reasonable if, despite being not fair, there are sufficient reasons for the security holders to accept the offer in the absence of any higher bid before the offer closes. In assessing the reasonableness of the Share Offer, we have considered the following advantages, disadvantages and other factors.

Advantages

Premium for control

A premium for control is applicable when the acquisition of control of a company or business would give rise to benefits such as:

- The ability to realise synergies and cost savings.
- Access to cash flows.
- Access to tax benefits.
- Control of the board of directors of the company.

Evidence from studies indicates that premiums for control on successful takeovers have frequently been in the range of 20% to 40% in Australia and that the premiums vary significantly from transaction to transaction.

The cash consideration of A$0.52 per share represents a premium of:

- 33% compared with the last trading day prior to the announcement of the Share Offer on 15 July 2013.
- 33% compared with the 1 week Volume Weighted Average Price ("VWAP") prior to 15 July 2013.
- 44% compared with the 30 day VWAP of APK prior to 15 July 2013.
- 51% compared with the 90 day VWAP of APK prior to 15 July 2013.

This premium for control is unlikely to be available to the APK Shareholders in the absence of the Share Offer.

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Remove exposure to refinancing and dilution risk

We note that the financial accounts for the half year ended 31 December 2012 ("H1 FY13) and FY12 included an emphasis of matter in relation to the ability of the Company to continue as a going concern. This was a result of APK being in breach of the covenants on its revolving facility, which have been waived by APK's current financier. Management has advised that the financial accounts for FY13 will likely contain an emphasis of matter.

APK has approximately A$55.3 million in external net debt as at 30 June 2013 under its existing debt facilities, which has been classified as current. The existing debt facilities may mature in the short to medium term as summarised below:

- Macquarie Bank facility expires in September 2015; however, it has been classified as a current liability .

- The Nippon Gas facility of A$6 million has a maturity date of April 2014.

- The repurchase agreements in respect of green certificates have maturities between July and October 2013.

APK has reported statutory losses for the last three financial years and at 30 June 2013, its current liabilities exceeded its total current assets.

In our opinion, the current debt level and maturity profile in conjunction with the uncertain regulatory environment, make APK more sensitive to further deterioration given the underlying economy and volatility in the financial markets.

Whilst, the lender of the revolving facility has indicated that it will continue to support the Company and have allowed temporary adjustments to the facility (including reduced covenant levels and conditional waivers), there can be no assurance that to the extent that the waivers are required in the future; these will be forthcoming from APK's current financier.

In addition, we note the following:

- Given the current status of the Macquarie facility, it is possible that refinancing discussions may commence immediately if the Share Offer lapses.

- As indicated in the Target's Statement, APK may be required to secure additional equity funding if the Share Offer lapses. In our opinion, potential future equity raisings may be dilutive for the existing shareholders.

In our opinion, the Share Offer removes any potential refinancing, financial and dilution risks for APK Shareholders.

Lack of liquidity of APK Securities

The APK Shares listed on the ASX have limited liquidity. If the Share Offer is accepted, it will provide an opportunity for APK Shareholders to exit their investment at a material premium to the APK Share price. In the absence of the Share Offer or alternative transactions, it is unlikely that APK Shareholders will be able to realise their investment at a value comparable or equivalent to the consideration offered.

Ability for APK Shareholders to realise their investment in APK

The Share Offer represents an opportunity for APK Shareholders to receive certain and immediate value for their investment in APK free of any realisation costs.

APK Shareholders will no longer be exposed to the on-going risks associated with holding an investment in APK which include the following:

- *Pricing volatility* – APK may be adversely impacted by volatility in retail and wholesale energy prices and electricity distribution costs. APK is a pure energy retailer without vertical integrated operations which typically allows other retailers integrated with generators to manage the risk of volatility in the wholesale markets without having to resort to potentially costly long term price contracts.

- *Bad debt* – APK has experienced a material spike in bad debt allowance in FY13 which has increased from 2.6% of revenue in FY12 to 5.1% of revenue in FY13. The high levels of bad debt were a key cause of the loss reported by APK in FY13 and puts a strain on the Company's working capital levels. The company has taken measures to improve collection procedures and protocols, with benefits expected to be realised over the next 12 months. However, there are no guarantees that future bad debt levels will reduce compared with FY13.

- *Carbon tax* – In FY13, the introduction of the carbon tax and renewable energy target have increased the cost of electricity generation which is mainly conducted through the burning of coal. This in turn has increased the wholesale and retail cost of electricity with the majority of the carbon tax costs and costs of purchasing renewable energy certificates passed to the end consumers. As a result, electricity prices have increased significantly over the last 5 years. These increases do not appear to be sustainable in the medium term and consumer organisations and the ACCC are pressuring for a more consumer-friendly energy environment. Furthermore, there is substantial political uncertainty relating to the upcoming Australian elections and the impact these elections could have on clean energy legislation, including carbon tax reform. There is a risk that changes to the regulatory environment and future electricity prices may have an adverse impact on APK going forward.

- *Door to door* – Door-to-door customer acquisition is the key marketing channel of APK. Over the last few years there have been a number of legal proceedings launched against leading energy retailers for misleading and deceptive door-to-door selling practices. This has resulted in sustained campaigning from consumer groups and the ACCC stating that it would investigate the method used by retailers using door-to-door selling. Major energy retailers including

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EnergyAustralia, AGL and Origin have recently decided to stop door-to-door selling practices[1]. We note that recently the big six gas and electricity companies in Great Britain have also decided to stop door-to-door selling practices after intense pressure from consumer groups, legal complaints and the energy regulator, the Office of Gas and Electricity Markets. There is no certainty that door-to-door selling will continue to be allowed in Australia going forward and this may have a material impact on APK, given this is its key sales channel.

APK Share price in the absence of the Share Offer

In the absence of the Share Offer or an alternative transaction, all other things being equal, it is likely that APK Shares will trade at prices below the value of the consideration offered and the prices achieved in the trading period since 15 July 2013.

In our opinion, the prospect of APK Shares trading above the offer price in the short term is remote in the absence of the Share Offer or alternative transactions.

Disadvantages

No participation in future potential upside of APK

If the Share Offer is accepted, APK Shareholders will give up the right to participate in the future potential upside and growth opportunity of APK. In this regard, we note that Management of APK have announced the implementation of Project Refresh to focus on identifying and implementing strategies to improve the management of cash in-flow and revenues, while reducing costs and cash outflows, and to assist with seasonal cash flow management. Management expect to be able to improve gross margins in the future. In the event, Management of APK are successful in delivering these projections, APK Shareholders will not be able to share in these benefits.

Other factors

Prospect of a superior offer

The Share Offer is the outcome of a funding and sale process that was undertaken to obtain proposals for consideration by the APK Board and Shareholders. As part of the process, a number of parties who were considered to be potentially interested in acquiring APK or its assets or providing funding, conducted due diligence on APK and its operations. Having undertaken this review of strategic initiatives, no superior value proposition that is realisable by APK Shareholders has emerged.

In our opinion, it is unlikely that APK will receive a superior alternative proposal given the sale and funding process undertaken by the Company and the Pre-Acquisitions Agreements entered into by AGL, whereby AGL has secured a 19.9% interest in the Company.

However, although APK has agreed to the typical no talk no shop and no due diligence provisions, there are no impediments to an alternative proposal being submitted by potential interested parties. The transaction process should act as a potential catalyst for potential interested parties and it will

[1] EnergyAustralia and AGL stopped door-to-door selling throughout Australia in March 2013, while Origin announced in June 2013 that it will stop in September 2013.

provide significant additional information in the Target's Statement and Independent Expert's Report to enable such potential acquirers to assess the merits of potential alternative transactions.

Alternative opportunities to the Proposed Offer – Trade-on

Another possible alternative available to APK Shareholders is to choose not to accept the Share Offer and continue to be shareholders of APK on a stand-alone basis. This should only be pursued if APK Shareholders believe they can get better value in continuing to hold APK Shares compared with the Share Offer.

After considering the strengths, weakness, opportunities and threats of APK, in Grant Thornton Corporate Finance's view, the risks and uncertainties of continuing to hold APK Shares outweigh the potential prospect of generating a higher return than the Share Offer.

Value of APK for AGL

If the Share Offer is completed, in our opinion AGL will be able to realise, among others, the following benefits/synergies which are available to a pool of hypothetical purchasers.

- If the Proposed Offer completes, APK will be delisted from the ASX and AGL will realise direct synergies in relation to cost savings on listing fees, ASX compliance costs and Directors' fees. We have incorporated these cost savings into our valuation assessment of APK on a 100% basis.
- AGL is one of the largest energy operators in the Australian market. As set out in section 4 of the Bidder's Statement, AGL intends to incorporate the functions, assets and core business of APK into AGL's existing businesses and functions rather than operate APK as an independent company.
- AGL claims that it will improve the products and services offered to APK customers by the application of AGL's scale, systems, experience and stronger financial position.
- The acquisition will provide AGL with the opportunity for its position in the retail gas and electricity markets to grow through the combination of APK's gas and electricity customers with its own customers.
- The ability to service APK's customers utilising AGL's lower cost to serve.

In our opinion, AGL is not receiving any material special value as a result of the Share Offer.

Implications if the Share Offer lapses

If the Share Offer lapses, all other things being equal, it is likely that APK Shares will trade at prices below the value of the consideration offered under the Share Offer and the prices achieved in the trading period after 15 July 2013.

If the Share Offer lapses, it would be the current Directors' intention to continue operating APK in line with its objectives as announced to the market on 9 May 2013 as part of Project Refresh. APK

Shareholders who retain their APK Shares would continue to share in any benefits and risks in relation to APK's ongoing business.

Directors' recommendations and intentions

In the absence of a superior proposal and subject to the Independent Expert opinion that the Share Offer is reasonable to APK Shareholders, the Recommending Directors[2] of APK unanimously recommend that all APK Shareholders accept the Share Offer.

All APK Directors intend to accept the Share Offer in respect of the APK Shares that they own or control if the Share Offer becomes free of the defeating conditions and in the absence of a superior offer.

APK Shareholders intentions

If the Share Offer becomes free of the defeating conditions as summarised in section 9.8 of the Bidder's Statement and in the absence of a superior proposal, each of Nippon Gas, the Cobra Group and the Poole Interests intend to accept the Share Offer in respect to their entire shareholding. This collectively accounts for an additional 38.92% of all APK Shares on issue (in addition to the 19.9% acquired by AGL under the Pre-Bid Acquisition Arrangements).

Transaction expenses and reimbursement fee

If the Share Offer lapses, APK will incur transaction expenses of approximately A$0.4 million[3]. Furthermore, under certain circumstances, APK may be required to pay a reimbursement fee of A$1 million to AGL. Based on the financial performance and financial position of APK, these potential funding requirements are not immaterial.

However, in our opinion, the quantum of the potential reimbursement fee payable by APK to AGL if an alternative proposal is completed should not act as deterrent to alternative proposals.

Compulsory acquisition

AGL has stated in section 4 of the Bidder's Statement that, if it acquires 90% or more of APK Shares and becomes entitled to do so under the Corporations Act, AGL intends to give notices to compulsorily acquire any outstanding APK Shares. As such, if the Share Offer is declared unconditional, remaining APK Shareholders may wish to consider accepting the Share Offer prior to the end of the offer period in order to expedite receipt of the cash consideration.

Tax implications

APK Shareholders may crystallise a capital gains tax expense if they accept the Share Offer, however, the taxation consequences for APK Shareholders will vary according to their individual circumstances. If appropriate or required, APK Shareholders should seek independent financial and tax advice on the implications of accepting the Share Offer.

[2] James Myatt and Ian McGregor. Michael Hogg and Shinji Wada have determined that they do not consider it appropriate to give a recommendation to APK Shareholders given they are nominees of the Cobra Group and Nippon Gas which have entered into Pre-Bid Acquisitions Agreements with APK.
[3] Excluding transaction expenses contingent on the successful completion of the Share Offer.

Reasonableness conclusion

Based on the qualitative factors identified above, it is our opinion that the Share Offer is reasonable to the APK Shareholders.

Overall conclusion

After considering the abovementioned quantitative and qualitative factors, Grant Thornton Corporate Finance has concluded that the Share Offer is fair and reasonable to the APK Shareholders.

Summary of opinion – Option Offer

Grant Thornton Corporate Finance has concluded that the Option Offer is fair and reasonable to the APK Optionholders.

Fairness Assessment – Option Offer

In forming our opinion in relation to the fairness of the Option Offer to the APK Optionholders, Grant Thornton Corporate Finance has compared our valuation assessment of the fair market value of APK Options to the cash consideration.

The following table summarises our assessment.

Fairness assessment	Exercise price	Expiry date	Consideration per Option	Assessed value per Option		Consideration premium	
of Option Offer	A$		A$	Low (A$)	High (A$)	Low (%)	High (%)
Fortess Options[1]	$0.40	22-Dec-14	0.1479	0.0594	0.0531	149.0%	178.5%
Fortess Options	$0.55	31-Dec-13	0.0440	0.0067	0.0062	556.3%	607.5%
David Franks	$0.35	31-Mar-14	0.1772	0.0756	0.0718	134.3%	146.9%
Employee options	$0.35	31-Oct-13	0.1647	0.0530	0.0518	210.5%	218.1%
Employee options	$0.40	30-Oct-14	0.1592	0.0714	0.0656	123.0%	142.8%
Employee options	$0.45	30-Oct-14	0.1303	0.0537	0.0489	142.5%	166.2%
Employee options	$0.50	30-Oct-14	0.0859	0.0402	0.0363	113.8%	136.7%
Employee options	$0.50	01-Oct-14	0.1028	0.0378	0.0342	172.3%	200.7%
Employee options	$0.55	30-Oct-14	0.1060	0.0300	0.0269	253.5%	294.6%
Employee options	$0.55	01-Oct-14	0.0826	0.0277	0.0249	198.0%	231.8%
Employee options	$0.55	30-Oct-15	0.0928	0.0347	0.0288	167.6%	222.7%
Unlisted options	$0.60	31-Dec-13	0.0289	0.0034	0.0032	743.2%	816.8%
Employee options	$0.60	30-Oct-15	0.0757	0.0264	0.0217	186.3%	249.6%
Employee options	$0.70	01-Jul-15	0.0421	0.0114	0.0092	270.1%	356.5%
James Myatt	$0.70	30-Oct-13	0.0052	0.0001	0.0001	3,976.1%	4,361.6%
James Myatt	$0.80	30-Oct-13	0.0013	0.0000	0.0000	8,712.1%	9,686.3%
Ian McGregor	$0.20	01-Jul-14	0.3174	0.1964	0.1892	61.6%	67.8%

1. The exercise price is the lower of A$0.40 or the 30 day VWAP of APK at the time of exercise.

Source: Calculations

The cash consideration for the APK Options is higher than our assessed valuation of the APK Options. Accordingly, we conclude that the Option Offer is fair to the APK Optionholders.

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Reasonableness Assessment – Option Offer

RG111 establishes that an offer is reasonable if it is fair. Given the Option Offer is fair, it is also reasonable.

Refer to the Share Offer reasonableness section for further discussion on the reasonableness considerations.

Other matters

Grant Thornton Corporate Finance has prepared a Financial Services Guide in accordance with the Corporations Act. The Financial Services Guide is set out in the following section.

The decision of whether or not to accept the Share Offer and the Option Offer is a matter for each APK Shareholder and APK Optionholder to decide based on their own views of value of APK and expectations about future market conditions, APK's performance, risk profile and investment strategy. If APK Shareholders and/or APK Optionholders are in doubt about the action they should take in relation to the Share Offer and Option Offer, they should seek their own professional advice.

Yours faithfully
GRANT THORNTON CORPORATE FINANCE PTY LTD

ANDREA DE CIAN	LIZ SMITH
Director	Director

13 August 2013

Financial Services Guide

1 Grant Thornton Corporate Finance Pty Ltd

Grant Thornton Corporate Finance Pty Ltd ("Grant Thornton Corporate Finance") carries on a business, and has a registered office, at Level 17, 383 Kent Street, Sydney NSW 2000. Grant Thornton Corporate Finance holds Australian Financial Services Licence No 247140 authorising it to provide financial product advice in relation to securities and superannuation funds to wholesale and retail clients.

Grant Thornton Corporate Finance has been engaged by APK to provide general financial product advice in the form of an independent expert's report in relation to the Share Offer and Option Offer. This report is included in the Company's Target Statement.

2 Financial Services Guide

This Financial Services Guide ("FSG") has been prepared in accordance with the Corporations Act, 2001 and provides important information to help retail clients make a decision as to their use of general financial product advice in a report, the services we offer, information about us, our dispute resolution process and how we are remunerated.

3 General financial product advice

In our report we provide general financial product advice. The advice in a report does not take into account your personal objectives, financial situation or needs.

Grant Thornton Corporate Finance does not accept instructions from retail clients. Grant Thornton Corporate Finance provides no financial services directly to retail clients and receives no remuneration from retail clients for financial services. Grant Thornton Corporate Finance does not provide any personal retail financial product advice directly to retail investors nor does it provide market-related advice directly to retail investors.

4 Remuneration

When providing the Report, Grant Thornton Corporate Finance's client is the Company. Grant Thornton Corporate Finance receives its remuneration from the Company. In respect of the Report, Grant Thornton Corporate Finance will receive from APK a fixed fee of approximately $90,000 plus GST, which is based on commercial rate plus reimbursement of out-of-pocket expenses for the preparation of the report. Our directors and employees providing financial services receive an annual salary, a performance bonus or profit share depending on their level of seniority.

Except for the fees referred to above, no related body corporate of Grant Thornton Corporate Finance, or any of the directors or employees of Grant Thornton Corporate Finance or any of those related bodies or any associate receives any other remuneration or other benefit attributable to the preparation of and provision of this report.

5 Independence

Grant Thornton Corporate Finance is required to be independent of APK in order to provide this report. The guidelines for independence in the preparation of independent expert's reports are set out in Regulatory Guide 112 *Independence of expert* issued by the Australian Securities and Investments Commission ("ASIC"). The following information in relation to the independence of Grant Thornton Corporate Finance is stated below.

"Grant Thornton Corporate Finance and its related entities do not have at the date of this report, and have not had within the previous two years, any shareholding in or other relationship with APK (and associated entities) that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation the Share Offer and Option Offer.

Grant Thornton Corporate Finance has no involvement with, or interest in the outcome of the transaction, other than the preparation of this report.

Grant Thornton Corporate Finance will receive a fee based on commercial rates for the preparation of this report. This fee is not contingent on the outcome of the transaction. Grant Thornton Corporate Finance's out of pocket expenses in relation to the preparation of the report will be reimbursed. Grant Thornton Corporate Finance will receive no other benefit for the preparation of this report.

Grant Thornton Corporate Finance considers itself to be independent in terms of Regulatory Guide 112 "Independence of expert" issued by the ASIC."

6 Complaints process

Grant Thornton Corporate Finance has an internal complaint handling mechanism and is a member of the Financial Ombudsman Service (membership no. 11800). All complaints must be in writing and addressed to the Chief Executive Officer at Grant Thornton Corporate Finance. We will endeavour to resolve all complaints within 30 days of receiving the complaint. If the complaint has not been satisfactorily dealt with, the complaint can be referred to the Financial Ombudsman Service who can be contacted at:

PO Box 579 – Collins Street West
Melbourne, VIC 8007
Telephone: 1800 335 405

Grant Thornton Corporate Finance is only responsible for this report and FSG. Complaints or questions about the General Meeting should not be directed to Grant Thornton Corporate Finance. Grant Thornton Corporate Finance will not respond in any way that might involve any provision of financial product advice to any retail investor.

Compensation arrangements

Grant Thornton Corporate Finance has professional indemnity insurance cover under its professional indemnity insurance policy. This policy meets the compensation arrangement requirements of section 912B of the Corporations Act, 2001.

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1 Overview of the Share Offer and Option Offer

1.1 Terms of the Share Offer

Australian Power and Gas Company Limited ("APK", or the "Company") is listed on the Australian Securities Exchange ("ASX") and is primarily involved in the retailing of electricity and gas to residential households in Victoria, New South Wales and Queensland. As at 7 August 2013, APK's market capitalisation was approximately $96.7million.

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On 15 July 2013, APK announced that it had entered into a bid implementation agreement with AGL ("BIA") under which AGL, through a wholly owned subsidiary, agreed to make a takeover for the following:

- All shares of APK ("APK Shares") that AGL does not already own for a cash consideration of $0.52 per share (the "Share Offer").
- Subject to AGL and APK obtaining the required regulatory relief, all options currently on issue ("APK Options") at the option price as set out in the BIA ("Option Offer").

On 15 July 2013, AGL also announced that it had entered into separate pre-bid acquisition agreements ("Pre-Bid Acquisition Agreements") with each of APK's three largest shareholders, Nippon Gas Co. Ltd, Cobra Group[4] and the Poole Interests[5]. Under the Pre-Bid Acquisition Agreements, AGL purchased a total of 38,113,795 shares in APK at $0.52 cash per share which represents 19.9% of the total number of APK Shares on issue.

If the Share Offer becomes free of defeating conditions ("Defeating Conditions") as summarised in section 9.8 of the Bidder's Statement and in the absence of a superior proposal, each of Nippon Gas, the Cobra Group and the Poole Interests intend to accept the Share Offer in respect to their entire shareholding. This collectively accounts for an additional 38.92% of all APK Shares on issue (in addition to the 19.9% acquired by AGL under the Pre-Bid Acquisition Arrangements).

In the absence of a superior proposal and subject to the Independent Expert opinion that the Share Offer is reasonable to APK shareholders ("APK Shareholders"), the Recommending Directors[6] of APK unanimously recommend that all APK Shareholders accept the Share Offer.

All APK Directors intend to accept the Share Offer in respect of the APK Shareholders that they own or control if the Share Offer becomes free of the Defeating Conditions and in the absence of a superior offer.

[4] The Cobra Group Pty Ltd, Cobra Investment BV and Barton Holdings Limited.
[5] Fontelina Pty Ltd, Richard Poole, Arthur Phillip, Arthur Phillip Nominees Pty Ltd, Amanda Poole and Haxby Pty Ltd.
[6] James Myatt and Ian McGregor. Michael Hogg and Shinji Wada have determined that they do not consider it appropriate to give a recommendation to APK Shareholders given they are nominees of the Cobra Group and Nippon Gas which have entered into Pre-Bid Acquisitions Agreements with APK.

Other key terms of the Share Offer are summarised below.

- *Exclusivity* – APG has agreed to a period of exclusivity ("Exclusivity Period") up to the date which is the earliest of:
  - 15 November 2013.
  - Termination of the BID.
  - End of the Share Offer period.
- *No shop, no talk, no due diligence* – During the exclusivity period, APK has agreed to customary no shop, no talk and no due diligence clauses typical for a transaction of this type (subject to Directors' fiduciary and statutory duties in conjunction with a superior proposal).
- *Matching right* – If during the Exclusivity Period a superior proposal emerges, AGL has two business days after receipt of the notification of the superior proposal to amend the terms of the Share Offer and to match the terms of the superior proposal.
- *Reimbursement fee* – Under certain circumstances, including if a superior proposal emerges during the Exclusivity Period and as consequence of the superior proposal the Recommending Directors change their recommendation in relation to the Share Offer, APK may be required to pay AGL a reimbursement fee of approximately A$1.0 million (refer to section 8 of the BIA for details).
- *Compulsory acquisition* – If it becomes entitled to do so under the Corporations Act, AGL intends to give notices to compulsorily acquire any outstanding APK Shares in accordance with section 661B of the Corporations Act. If it is required to do so under section 662A of the Corporations Act, AGL intends to give notices to APK Shareholders offering to acquire their APK Shares in accordance with section 662B of the Corporations Act.
- *Controlling shareholding* – As set out in section 1.2 below, one of the conditions of the Share Offer is 90% minimum acceptance of APK Shareholders. Section 4.4 of the Bidder's Statement summarises AGL's intentions if AGL was to waive the 90% minimum acceptance condition and acquire effective control of APK but not become entitled to compulsorily acquire the outstanding APK Shares. As set out in the Bidder's Statement, AGL has no present intention to waive the 90% minimum acceptance condition.

1.2 Conditions to the Share Offer

The Share Offer is subject to a number of Defeating Conditions. An abstract of those conditions is summarised below (refer to section 9.8 of the Bidder's Statement for further details).

- 90% minimum acceptance of APK Shareholders.
- AGL not receiving written communication before the end of the Share Offer period that the Australian Competition & Consumer Commission ("ACCC") objects the Share Offer.

- No material adverse change or prescribed occurrences in APK's business.
- The Target's Statement contains confirmation from APK that the number of APK's retail customer accounts is not less than 340,500 and this statement does not change during the Share Offer period.
- No restraining order, injunction or any other order issued by any legal or regulatory authority that prevents the making and completion of the Share Offer.

At the request of AGL, APK has entered into certain agreements to amend the terms/terminate certain existing agreements with APK's financial advisors, the Cobra Group, Nippon Gas and James Myatt. With the exception of the agreement with James Myatt, these agreements will become enforceable by AGL only if the Share Offer becomes free of Defeating Conditions. The agreement with James Myatt became enforceable by AGL on the announcement of the Share Offer and the Option Offer. APK is also required to make certain cash payments in conjunction with the amendment/termination of these agreements. Refer to section 8 of the Bidder's Statement.

1.3 Option Offer

AGL proposes to make a takeover offer to APK Optionholders to acquire 100% of their APK Options. The price which AGL proposes to offer to APK Optionholders under the Option Offer is in accordance with an independent valuation prepared for AGL by an independent party.

The Option Offer is subject to a number of conditions including:

- At the end of the offer period for the Option Offer, AGL has a relevant interest in more than 90% (by number) of the APK Options on issue at that time.
- Share Offer is declared unconditional.

All Directors of APK intend to accept the Option Offer in respect of any APK Options held or controlled by them by no later than the next business day after the Option Offer becomes free of any conditions, in the absence of a superior proposal.

The Recommending Directors of APK unanimously recommend that APK Optionholders accept the Option Offer in the absence of a superior proposal and subject to the independent expert appointed by APK concluding the Option Offer is reasonable. We note that if the independent expert does not conclude that the Option Offer is reasonable, this circumstance cannot be the basis for the Recommending Directors to withdraw, revise or revoke their recommendation in relation to the Share Offer.

Cobra Group and Richard Poole, who hold or control 4.5 million and 5.0 million APK Options respectively, have stated that they intend to accept the Option Offer in respect of all APK Options they hold or control by no later than the business day after the Option Offer becomes free of Defeating Conditions in the absence of a superior proposal.

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2 Scope of the report

2.1 Purpose of the report

2.1.1 Share Offer and Option Offer

Section 640 of the Corporations Act requires that a target statement made in response to a takeover offer for securities in an Australian publicly listed company must be accompanied by an independent expert's report if:

- the bidder's voting power in the target is 30% or more; and
- for a bidder who is, or includes, an individual – the bidder is a director of the target company; or
- for a bidder who is, or includes, a body corporate – a director of the bidder is a director of the target company.

The independent expert's report must state whether, in the opinion of the independent expert, the takeover offer is fair and reasonable to the target company's independent securityholders and provide the reasons for forming that opinion.

As at the date of this report, we note that AGL does not have more than 30% of the voting power in APK and there are no common directors between APK and AGL.

Whilst there is not a legal requirement for the commissioning of an independent expert report in conjunction with the Share Offer and Option Offer, the Directors of APK have decided to commission an independent expert's report in relation to the Share Offer and the Option Offer to assist APK Securityholders in assessing the merits of the proposed transaction.

We note that Grant Thornton Corporate Finance Pty Ltd has been engaged to form two separate opinions on the Share Offer and Option Offer.

2.2 Basis of assessment

The Corporations Act does not define the meaning of "fair and reasonable". In preparing this report, Grant Thornton Corporate Finance has had regard to Regulatory Guide 111 "Content of expert reports" ("RG 111"). RG 111 establishes certain guidelines in respect of independent expert's reports prepared for the purposes of the Corporations Act. RG 111 is framed largely in relation to reports prepared pursuant to Section 640 of the Corporations Act and comments on the meaning of "fair and reasonable" in the context of a takeover offer.

- An offer is considered fair if the value of the offer price or consideration is equal to or greater than the value of the securities that are subject to the offer. The comparison should be made assuming 100% ownership of the target company and irrespective of whether the consideration offered is script or cash and without consideration of the percentage holding of the offeror or its associates in the target company.

- An offer is considered reasonable if it is fair. If the offer is not fair it may still be reasonable after considering other significant factors which justify the acceptance of the offer in the absence of a higher bid. ASIC has identified the following factors which an expert might consider when determining whether an offer is reasonable:
  - The offeror's pre-existing entitlement, if any, in the shares of the target company.
  - Other significant shareholding blocks in the target company.
  - The liquidity of the market in the target company's securities.
  - Taxation losses, cash flow or other benefits through achieving 100% ownership of the target company.
  - Any special value of the target company to the offer, such as particular technology and the potential to write off outstanding loans from the target company.
  - The likely market price if the offer is unsuccessful.
  - The value to an alternative offeror and likelihood of an alternative offer being made.

Grant Thornton Corporate Finance has determined whether the Share Offer is fair to APK Shareholders by comparing the fair market value of APK on a 100% basis and inclusive of a premium for control with the cash consideration offered under the Share Offer.

In considering whether the Share Offer is reasonable to APK Securityholders, we have considered a number of factors, including:

- Whether the Share Offer is fair.
- The implications to APK Securityholders if the Share Offer lapses.
- Likelihood of alternative superior offers.
- Other likely advantages and disadvantages associated with the Share Offer as required by RG111.
- Other costs and risks associated with the Share Offer that could potentially affect the APK Securityholders.

In forming our opinion in relation to the Option Offer, we have compared the fair market value of the APK Options with the offer price and consider other qualitative factors in relation to the Option Offer.

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2.3 Independence

Prior to accepting this engagement, Grant Thornton Corporate Finance considered its independence with respect to the Share Offer and Option Offer with reference to the ASIC Regulatory Guide 112 "Independence of Expert's Reports" ("RG 112").

We note that Grant Thornton Corporate Finance was appointed as an independent expert by APK in August 2010 in relation to the conversion and exercise of convertible notes, which required approval of APK Shareholders.

In our opinion, the above engagement does not impact on our ability to provide an independent and unbiased opinion in the context of the Share Offer and Option Offer. In our opinion, Grant Thornton Corporate Finance is independent of APK, its Directors and all other parties involved in the Share Offer and Option Offer.

Grant Thornton Corporate Finance has no involvement with, or interest in, the outcome of the approval of the hare Offer and Option Offer other than that of independent expert. Grant Thornton Corporate Finance is entitled to receive a fee based on commercial rates and including reimbursement of out-of-pocket expenses for the preparation of this report.

Except for these fees, Grant Thornton Corporate Finance will not be entitled to any other pecuniary or other benefit, whether direct or indirect, in connection with the issuing of this report. The payment of this fee is in no way contingent upon the success or failure of the Share Offer and Option Offer

2.4 Consent and other matters

Our report is to be read in conjunction with the Target's Statement dated on or around 23 August 2013 in which this report is included, and is prepared for the exclusive purpose of assisting the APK Securityholders in their consideration of the Share Offer and Option Offer. This report should not be used for any other purpose.

Grant Thornton Corporate Finance consents to the issue of this report in its form and context and consents to its inclusion in the Target's Statement.

This report constitutes general financial product advice only and in undertaking our assessment, we have considered the likely impact of the Share Offer and Option Offer to the APK Securityholders as a whole. We have not considered the potential impact of the Share Offer and Option Offer on an individual securityholder. Individual securityholders have different financial circumstances and it is neither practicable nor possible to consider the implications of the Share Offer and Option Offer on an individual securityholder.

The decision of whether or not to accept the Share Offer and Option Offer is a matter for each APK Securityholder based on their own views of value of APK and expectations about future market conditions, APK's performance, risk profile and investment strategy. If APK Securityholders are in doubt about the action they should take in relation to the Share Offer and Option Offer, they should seek their own professional advice.

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3 Overview of the Australian energy industry[7]

3.1 Introduction

The energy industry in Australia is divided into four subsectors as set out below:

Energy industry sub-sector

Sub-sector	Electricity	Gas
Production	Electricity generation	Gas extraction and processing
Transmission	Delivery of high voltage electricity to substations	Delivery of gas via high pressure pipelines to distribution hubs
Distribution	Delivery of electricity to end-users via a low-voltage network	Delivery of gas to end-users via low pressure pipelines
Retail	Retail to commercial, industrial and residential end users	Retail to commercial, industrial and residential end users

Source: IBISWorld

Trends in the energy industry in recent years have seen integration between electricity and gas retailers and vertical integration between electricity retailers and generators. Vertical integration allows retailers and generators to manage the risk of volatility in the wholesale markets with reduced reliance on short and long term price contracts.

Total Australian energy consumption is forecast to grow by an average of 0.5% per annum to 2050, although growth rates vary significantly between the different states. Projected annual growth rates of energy consumption in the different states are set out below[8]:

Projected annual grow rate of energy consumption

Average Growth rate	rate (2013 - 2050)
Victoria	-0.5%
New South Wales & ACT	0.6%
Queensland	1.1%
South Australia	0.3%
Western Australia	0.8%
Tasmania	0.4%
Northern Territory	1.4%
Australia	**0.5%**

Source: BREE

The projected annual growth rate of energy consumption in Australia is forecast to be lower than the historical average mainly as a result of expected decline in energy intensive industries such as manufacturing, increased energy efficiency and increased use of renewable energy which require relatively less energy inputs to generate electricity than fossil fuels.

Given APK only operates in Victoria ("VIC"), New South Wales ("NSW") and Queensland ("QLD"), we have limited our industry overview to these states where applicable.

[7] All statistics and factual data are sourced from IBISWorld Industry Report D3613, Electricity Distribution in Australia, March 2013 and IBISWorld Industry Report D3620, Gas Supply in Australia, April 2013 unless otherwise referenced
[8] Australian Energy Projections to 2050, BREE, December 2012

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3.2 Electricity retailing in Australia

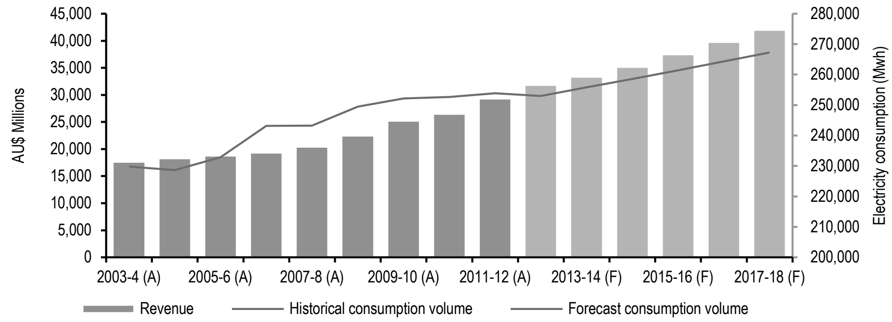
3.2.1 Overview

The electricity retail industry in Australia ("the Electricity Retail Industry") mainly engages in retailing of electricity.Many participants in the Electricity Retail Industry are vertically integrated and also generate electricity which they sell on a wholesale basis.

The volume of electricity consumed in Australia in 2012 is estimated at 253,851 gigawatt hours ("GWh"). Electricity consumption increased by 0.5% in 2012, with residential electricity usage remaining relatively flat, increasing approximately by 0.1% in the period.

Set out below is a chart of the historic and forecast revenue and electricity consumption volume for the Electricity Retail Industry to FY18:

Revenue and consumption volumes in the Electricity Retail Industry



Source: IBISWorld and BREE

The Electricity Retail Industry grew by an average of 8.7% per annum based on revenue between 2007 and 2012, with expected annual growth of 5.7% between 2013 and 2018. Historical revenue growth over the last 5 years has mainly been driven by increases in transport network costs which have been passed through to the end consumer in the form of price increases. Transport network costs consist of the operational cost of transporting electricity along poles and wires, and expansion and upgrade costs of the network infrastructure.

The price increases of the last few years have masked increasingly challenging conditions faced by operators, in particular, decreasing per capital growth in energy demand mostly due to:

- Economic slowdown caused by the global financial crisis ("GFC") and the European sovereign debt crisis.
- Significant increases in the price of electricity as a result of retailers passing through introduction of the carbon tax and the increased cost of transport network costs.
- Increased energy efficiency practices being adopted in response to introduction of the carbon tax and increased community awareness and importance placed on environmental protection.

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- Increased use of alternative renewable energy sources, in particular solar power which has been supported by government subsidies to households for installing solar panels.

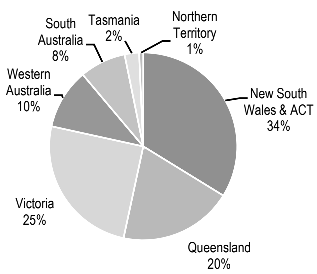
- A decline in energy-intensive industries such as manufacturing, however this has been mostly offset by strong growth in the Australian mining industry.

Revenue growth over the next 5 years between 2013 and 2018 is expected to be slightly higher than the last 5 years with total consumption forecast to increase at approximately 1.1% per annum to 2018. [9] This is mainly due to continual recovery of the economy and population growth supporting an increase in total consumption. BREE forecast an average population growth rate of approximately 1.3% and gross domestic product average growth rate of 2.5% for Australia from 2013-2050. However, consumption is expected to moderate in the long-term reflecting continual decline in energy-intensive industries and increased use of small-scale generation technology such as solar panels by residential customers.

3.2.2 Market segmentation

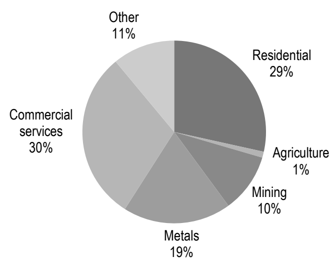
Demand for electricity varies between each state and is driven by population size, local climate and industry requirements. The following graphs sets out residential customer numbers by State and electricity consumption by segment as at 30 June 2012:

Number of residential customers by State



Source: Energy Supply Association of Australia ("ESAA")

Electricity consumption by segment



Source: BREE

APK's customer base is primarily represented by residential households. However, recently APK have commenced a trial of acquiring commercial business clients as a strategy to diversify its customer base.

3.2.3 Electricity usage

Average electricity usage varies by state and is impacted by the proportion of gas users (higher gas usage results in a lower requirement for electricity). In particular, in VIC a large population of residential households have connections to gas pipelines which are used for heating purposes.

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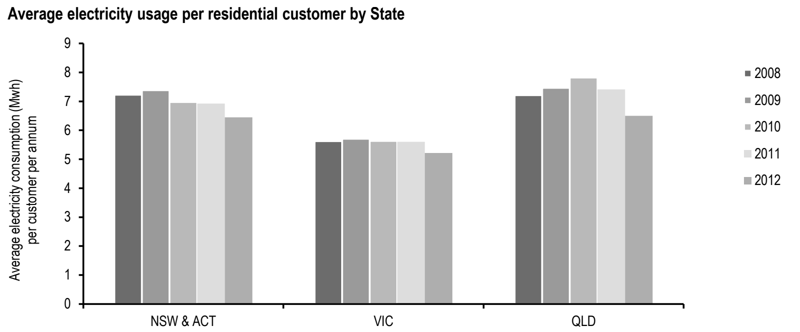
[9] Australian Energy Projections to 2050, BREE, December 2012

Accordingly, electricity usage is relatively lower in VIC. The average electricity usage per residential customer in NSW, QLD and VIC for the past 5 years is set out below[10].



Source: ESAA

Over the last few years, average electricity usage per residential customer has decreased mainly due to increased energy efficiency use and conservatism driven by higher electricity prices, introduction of renewable energy incentives and increase use of solar power, relatively mild weather seasonal demand and the global economic slowdown.

3.2.4 Competition

Competition in the Electricity Retail Industry is considered to be high and steady in particular in those states like VIC, where the market deregulation is high.

The overall market shares of the industry's key participants are set out below:

Electricity Retailing Industry market share

Company	Market share	
Origin Energy	27%	Publicly listed electricity retailer, selling principally in VIC, South Australia, QLD and NSW. Origin also supplies natural gas and LPG.
Energy Australia	25%	Owned by the Hong Kong-based CLP Holdings Limited and is mainly engaged in the retail and generation of fossil fuel-fired electricity in QLD, VIC, Australian Capital Territory, NSW, and South Australia
AGL	14%	Listed on the ASX, AGL operates a distribution network in VIC as well as retailing electricity in VIC, NSW, South Australia and QLD
Synergy	10%	It is owned by the Government of Western Australia. And it is Western Australia's largest energy retailer[11]
Other	24%	

Source: IBISWorld

[10] We have limited the analysis only to the states where APK currently operates.
[11] WA is not included in the NEM

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Set out below is a brief summary of the active retailers and level of competition on the eastern seaboard of Australia as at August 2012[12]:

- QLD - had 22 licensed retailers out of which 11 are active in the small business and residential customer market. Origin Energy, AGL Energy and the state owned Ergon Energy held approximately 90% of the market share in QLD. Ergon Energy is not permitted to compete for new customers and supplies electricity to mainly rural and regional QLD.

- NSW - had 23 licensed retailers out of which 11 are active in the small business and residential customer market. The retail market in NSW was dominated by state-owned entities until 2011, when Origin and EnergyAustralia acquired a number of retailers and generation contracts from the state. Origin and EnergyAustralia together have approximately 75% retail market share and 39% electricity production capacity in NSW.

- VIC - had 24 licensed retailers out of which 16 are active in the small business and residential customer market. The established retailers, AGL, Origin and EnergyAustralia held 72% of the VIC domestic energy retail market share with smaller retailers accounting for the remaining 28% (up from 8% in 2005).

The Australian electricity market experiences some of the highest residential customer retailer switching rates (customer churn) in the world. In June 2013, the small customer churn rate was approximately 28% in VIC, 10% in QLD and 18% in NSW[13]. The customer churn rate in VIC has been consistently higher than the churn rate for other states since VIC removed all price caps on retail electricity and gas rates in 2009. The retail electricity prices in NSW and QLD still remain under regulation (Refer to section 3.2.6 for more details on electricity regulation).

Recent developments in door-to-door marketing

Door-to-door customer acquisition is regarded as one of the most effective channels for customer acquisition and has historically been a key marketing method for energy retailers in Australia. It also represents the main sales channel for APK. In 2011, the ACCC commissioned a report on the door-to-door sales industry and found that the energy industry were the largest users of door-to-door sales and estimated that the energy industry made approximately 55% of its residential sales through door-to-door sellers. It was also estimated that door-to-door sales accounted for approximately 61% of small customer account switches made during the year. However, this may overstate the relevance of door-to-door selling, as a proportion of customers cancel contracts signed at the door before the end of the cooling-off period due to win-back offers made by their original retailer.

Over the last few years there have been a number of legal proceedings launched by ACCC against leading energy retailers for misleading and deceptive door-to-door selling practices. This has resulted in sustained campaigning from consumer groups and the ACCC stating that it would investigate the method used by retailers using door-to-door selling.

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[12] AER, State of the energy market, 2012
[13] National Electricity Retail Transfer Statistics, June 2013

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In response, new regulation[14] was introduced in 2010 to limit the permitted hours for door-to-door visits to potential consumers without appointment as below:

- Monday to Friday from 9am to 6pm (in FY10, almost 50% of the door to door new customers were signed-off between 6pm and 8pm).
- Saturday from 9am to 5pm.
- Dealers are prohibited from calling on a consumer on a Sunday or a public holiday.

Furthermore, in 2012 the retail energy industry (member firms including AGL and APK) launched a Code of Practice ("Code") to set standards and monitor door-to-door energy sales in an effort to provide self-regulation and reduce consumer complaints. The Code aims to:

- Ensure sales agents are recruited, trained and assessed in a consistent manner.
- Monitor sales agent behaviour and ensure any breach of standards result in suitable disciplinary measures.
- Impose sanctions on energy retailers or marketing companies who fail to comply with the Code.

Whilst the number of customer complaints due to door-to-door selling has seen some reduction due to the above initiatives, pressure from consumer groups and ACCC to cease door-to-door selling and increasing compliance scrutiny by ACCC persisted. Also recently there have been a number of legal proceedings brought and fines ordered against major energy companies over misleading and deceptive door-to-door selling practices including:

- In September 2012, Neighbourhood Energy Pty Ltd (subsidiary of Alinta Energy Holdings Pty Limited) was fined A$1.0 million.
- In March 2013, ACCC launched legal proceedings against EnergyAustralia.
- In May 2013, AGL Sales Pty Ltd and AGL South Australia Pty Ltd (subsidiary of AGL) was fined A$1.55 million.
- In July 2013, Lumo Energy Australia Pty Ltd provided a three year court enforceable undertaking following an ACCC investigation into the conduct of its door-to-door sales agents.

As a result, major energy retailers including EnergyAustralia, AGL and Origin decided to stop door-to-door selling practices. EnergyAustralia and AGL stopped door-to-door selling throughout Australia in March 2013, while Origin announced in June 2013 that it will stop in September 2013.

The big six gas and electricity companies in Great Britain have also recently decided to stop door-to-door selling after intense pressure from consumer groups, legal complaints and the energy

[14] Australian Consumer Law, A guide to provisions, April 2010

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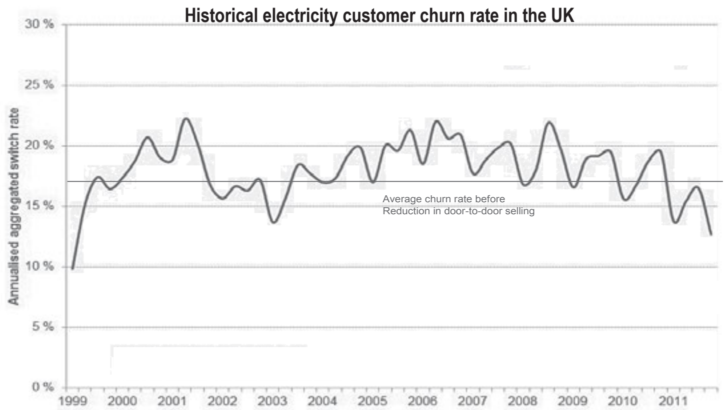
regulator, the Office of Gas and Electricity Markets. In July 2012, E.ON SE[15] was the last of the big six energy companies to announce that it will stop door-to-door selling. Subsequent to the mutual ban on door-to-door selling by the big six energy companies, the UK customer churn/switching rate decreased significantly from approximately 20% in 2011 to 13% in 2012, as illustrated in the graph on the following page.



Source: UCSRP by VaasaETT Ltd.

The ceasing of door-to-door selling by major energy retailers in Australia and the continuous pressure from consumer groups and the ACCC may have a material impact on the customer churn rates in the Electricity Retail Industry and on the business model of APK, if the Share Offer does not become unconditional.

3.2.5 Pricing

Price Regulation

State and territory governments are currently responsible for the regulation of electricity retail markets with some non-price regulatory functions transferred to a national framework administered by the Australian Energy Market Commission ("AEMC") and the Australian Energy Regulator ("AER"). The largest electricity market is the National Electricity Market ("NEM") which connects generators to retailers across the Eastern seaboard of Australia, Tasmania ("TAS") and South Australia ("SA"). The NEM operates as a wholesale spot market managed by the Australian Energy Market Operator ("AEMO"). Given APK operates only in NSW, QLD and VIC, our review of the regulatory environment is mainly focused on the states that are a part of the NEM ("NEM Jurisdictions").

Australian Governments have introduced various levels of retail contestability since the 1990s, whereby all customers are permitted to enter into a supply contract with a retailer of their choice. Full retail contestability was introduced in January 2002 in NSW and VIC, and July 2007 in QLD.

Despite the introduction of full retail contestability, the only states currently without a price cap regulation in place are VIC and SA. Pricing is regulated by the Independent Pricing and Regulatory

[15] E.ON SE operates as a power and gas company. The company generates electricity through coal, natural gas and oil, nuclear, water, wind, solar, and bio energy; and is involved in the exploration and production of oil and gas in the United Kingdom, Norway, Algeria, and Russia.

Tribunal ("IPART") in NSW and the QLD Competition Authority ("QCA") in QLD. These authorities set default tariffs or caps in consideration of wholesale costs, distribution expenses, retailer operating costs and retail margin. Transmission and distribution prices are heavily regulated by the AER via revenue caps set for periods of five years and upwards.

The AEMC is currently reviewing the competitiveness of the NSW energy market for the purpose of determining whether the price cap for gas and electricity should be removed. A recent draft report issued by the AEMC has advised that there is sufficient competition in the NSW market for the removal of price caps to be beneficial to consumers. The AEMC will provide its final report and advice to the NSW Government in September 2013, and the NSW Government will decide on the future regulation of electricity and gas prices in NSW.

We also note that QLD announced in June 2013 that electricity price regulation will be removed in south-east QLD by 1 July 2015.

Retail Pricing

As discussed above, the retail price in the NEM Jurisdiction are mostly regulated by respective state governments except in VIC and SA. The table below provides a summary of the average regulated retail electricity price increase per annum from 2010 to 2013.

Average regulated retail electricity price increase

NEM jurisdiction	Regulator	Distribution network	Average price increase 2009-10	2010-11	2011-12	2012-13
Queensland	QCA	Energex and Ergon	15.5%	13.3%	6.6%	10.6%
New South Wales	IPART	AusGrid	21.7%	10.0%	17.9%	20.6%
		Endeavour Energy	21.1%	7.0%	15.5%	11.8%
		Essential Energy	17.9%	13.0%	18.1%	19.7%
Victoria	Unregulated	Citipower	5.7%	14.6%	3.7%	19.9%
		Powercor	5.2%	15.4%	7.7%	23.1%
		SP AusNet	6.0%	11.3%	23.6%	19.7%
		Jemena	7.7%	17.7%	10.5%	23.2%
		United Energy	7.0%	11.4%	9.7%	25.2%
South Australia	Unregulated	SA Power Networks	3.1%	18.3%	17.4%	18.0%
Tasmania	OTTER	Aurora Energy	6.2%	15.3%	11.0%	10.6%
ACT	ICRC	ActewAGL	6.4%	2.3%	6.5%	17.7%

Source: AER

Retail prices of electricity have been increasing significantly in recent years mainly due to the increase in network costs and introduction and expansion of environmental schemes such as the carbon tax. The increase in network costs is mainly due to increased investment in distribution and transmission networks to meet increased peak demand from the wide spread adoption of energy intensive devices such as air conditioners. Some networks have also been investing in smart meter technology to manage customer energy needs, which has also increased fixed costs.

The price setting mechanism of electricity regulators enable the majority of the increased capital investment expenditure to be passed through to the end consumer in the form of higher prices. Electricity prices in Australia increased by an average of 66% (real basis) over the past 5 years to 2012.

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The following table summarises the composition of a typical small customer (small business and residential) bill in 2012:

Composition of a small customer bill

State	Wholesale electricity costs	Network costs	Carbon costs	Other environmental	Retail costs
Queensland	34%	44%	10%	4%	8%
New South Wales	26%	52%	8%	5%	10%
South Australia	36%	44%	4%	4%	12%
Tasmania	35%	48%	5%	4%	8%
ACT	29%	43%	11%	7%	10%

Source: AER

As discussed in section 3.2.3, price cap regulation is still in place in NSW and QLD, while the VIC authorities rely on competition to restrict unfair pricing practices. Summarised below is a brief discussion of the latest pricing developments in QLD and NSW:

- The QLD Competition Authority ("QCA") imposed a price freeze on the regulated peak tariff for residential customers with exception to increases in relation to the carbon tax in 2012. The 10.6% allowed price increase for FY13 as set out in the table above is therefore solely attributable to the carbon tax. For FY14, the QCA has determined an average retail price increase of 22.6%[16] reflecting increased energy purchase costs, retail costs and lower average consumption by residential customers.

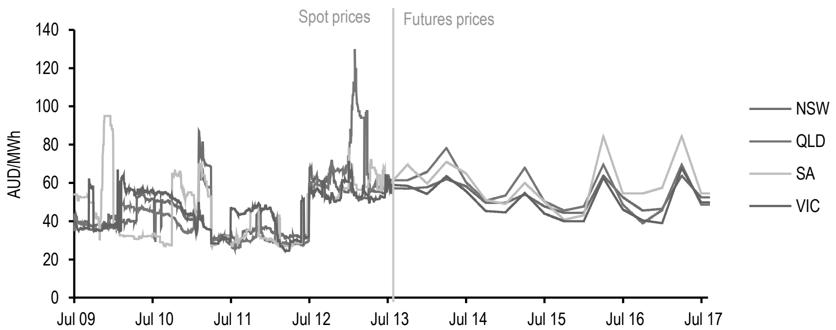
- NSW regulated retail prices have been set to increase by 1.7% and 1.8% for FY14 and FY15 respectively by IPART[17]. The average regulated price increase is significantly lower than in previous years mainly due to lower changes to network costs and relatively more stable environmental scheme costs. IPART has also indicated the regulated price to decrease by 6.9% in FY16 based on the current Clean Energy Plan[18], reflecting expected reduced costs of the carbon scheme which is set to move from the current fixed-price-basis to a market-price-basis linked to international carbon markets.

Wholesale Pricing

The NEM operates as a wholesale spot market for the eastern region of Australia, managed by AEMO. NEM allows electricity generators and retailers to trade electricity through a gross pool. Set out in the following chart are the historical spot and futures base prices for NSW, VIC, QLD and SA electricity:

16 Queensland Competition Authority, Notified Electricity Prices, 2013-2014
17 IPART, Review of regulated retail prices and charges for electricity for 1 July 2013 to 30 June 2016
18 However as discussed in section 3.2.6 below, the carbon tax may be subject to material changes after the 2013 Federal Election.

Hisotrical spot price and futures prices of electricity on NEM



Source: CaptialIQ

The wholesale price is influenced by a number of factors including short term changes in demand, supply disruptions, and weather. Recent record breaking high temperatures in early 2011 and 2013 resulted in significant increases in prices.

3.2.6 Carbon tax

Over the last 5 years environmental regulation changes have been at the forefront of issues faced by the energy industry as a whole. The carbon pricing scheme or 'carbon tax' was introduced by the Gillard Government in July 2012 as a part of the Clean Energy Plan, which aims to reduce greenhouse gas emissions in Australia to 80% of 2000 levels by 2050 and ensure at least 20% of Australia's electricity generation comes from renewables by 2020. The plan provides incentives for increased energy efficiency and investment into sustainable energy. It requires businesses emitting over 25,000 tonnes of carbon dioxide equivalent emissions annually to purchase emissions permits and electricity wholesalers to purchase renewable energy certificates under the Renewable Energy Target ("RET") if they are unable to meet their renewable energy targets.

Unlimited carbon emission permits were made available from the Government at a fixed price of A$23 per one tonne of carbon in the 2012–13 financial year. Based on the current Clean Energy Plan, the fixed price will then be escalated by 2.5% per year until transition into an emissions trading scheme in 2015–16, where the available number of permits will be reduced in line with a pollution cap. Similarly, the number of RET certificates available for sale will be reduced in line with the renewable energy target.

Introduction of the carbon tax and RET have increased the cost of electricity generation which is mainly conducted through the burning of coal. This in turn has increased the wholesale and retail cost of electricity with majority of the carbon tax costs and costs of purchasing renewable energy certificates to comply with legislation passed to the end consumers.

We note that there is political uncertainty with a Federal election scheduled on 7 September 2013. In particular, we note that the two main political parties, the Labour Party and Liberal Coalition have divergent policies in relation to the carbon tax. The Liberal Coalition has promised to fully abolish the carbon tax while the Labour Party has promised to shift the current fixed carbon tax to the emissions traded scheme in 2014 (from a fixed carbon price of $24.15/tonne to a floating price of estimated $6/ tonne), 2 years ahead of schedule. The outcome of the election is likely to be decisive in terms of environmental regulation policies for the Australian energy market.

3.3 Gas supply in Australia

3.3.1 Introduction

Natural gas is a colourless and odourless fossil fuel. Natural gas is a combustible mixture of hydrocarbon gases and is formed primarily of methane (CH4). Other categories of gas include ethane (chemical feedstock), propane (LPG) and butane (LPG).

There are three main sources of natural gas:

- Conventional natural gas - which is found in underground onshore and offshore reservoirs. The methane is often associated with oil reserves.
- Coal seam gas ("CSG") - which is formed as a by-product during the natural process of "coalification" whereby organic matter is turned into coal. The methane is trapped in the structure of the coal molecules due to the fact that coal has a large and complex internal surface area that is able to attract and hold the methane molecules.
- Shale gas – which is found trapped within shale (a fine-grained sedimentary rock) formations. Shale gas is becoming an increasingly important source of unconventional natural gas for the United States.

Natural gas, when used to produce electricity, is a relatively environmentally friendly energy source that emits approximately 50% less greenhouse gas than conventional coal fired electricity generation.

Natural gas is mainly used in the transport, industrial and mining sectors and for the generation of electricity. Natural gas is usually transported by pipelines unless it needs to be transported for long distances, in which case natural gas is liquefied.

3.3.2 Overview

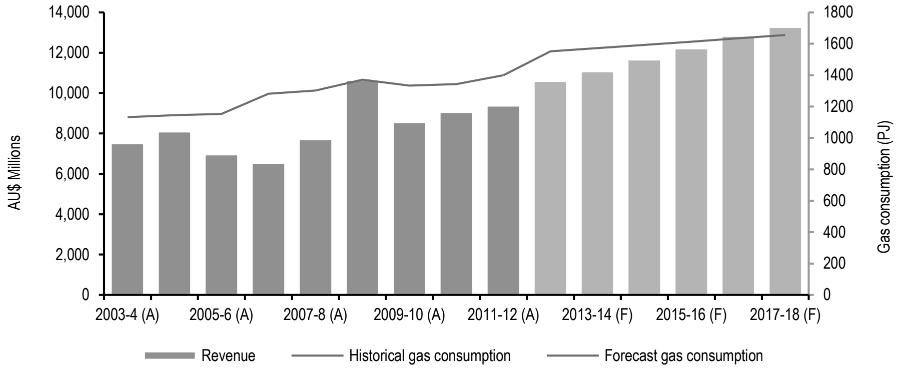
The Australian domestic gas market consists of 3 distinct regional markets:

- Eastern Market consisting of ACT, NSW, VIC, QLD, SA and TAS.
- Western Market consisting of WA.
- Northern Market consisting of NT.

The gas supply industry, defined as distribution and retail of natural gas via Australia's system of gas reticulation pipelines, generated revenue of approximately $10.6 billion in Australia in 2012. The volume of gas consumed domestically in 2012 was 1,399 petajoules (PJ)[19].

Set out below is a chart of the historic and forecast revenue and gas consumption volume for the gas supply industry to FY18:

Revenue and consumption volumes in the gas supply industry in Australia



Source: IBISWorld and BREE

Major restructuring, disaggregation and regulatory change impacted revenue and costs in the industry in the early part of the 2000s, masking underlying trends in growth, which is normally expected to follow broad trends in the availability of gas and gas prices.

The industry experienced significant volatility from 2008 to 2010. From 2008 to 2009, industry revenue increased by approximately 38% reflecting strong gas consumption levels and higher prices as a result of increased gas exports and gas-fired electricity generation. From 2009 to 2010, growth in revenue decreased by approximately 20% as slower economic activity due to the global financial crisis limited growth in consumption volumes and lowered prices.

Since 2010, the industry has experienced steady improvement in revenue growth reflecting gradual recovery from the global financial crisis and is expected to stabilise at around 5% annual growth to FY18. Revenue growth is expected to remain elevated above long term economic growth over the next 5 years mainly due to expected increase in price. The increase in the domestic price of gas will mainly be due to continual recovery of the economy, measures to reduce emissions such as the carbon tax, and increased demand for gas as a relatively cleaner fuel.

Australia's domestic gas consumption is expected to increase to approximately 2,400 PJ by 2050 representing a CAGR of 1.3% from 1,399 PJ in 2012[19]. Growth in domestic consumption will likely be constrained by continual development and growth in Australia's liquefied natural gas ("LNG") production capacity. Virtually all LNG produced in Australia is exported which means domestic customers must compete with overseas markets for gas. Due to the strong forecast demand of overseas markets such as China and India, the growth in domestic price for gas is expected to be higher than the growth in domestic consumption of gas. Also, in the longer term it is expected that

[19] Bureau of Resources and Energy Economics statistics (BREE)

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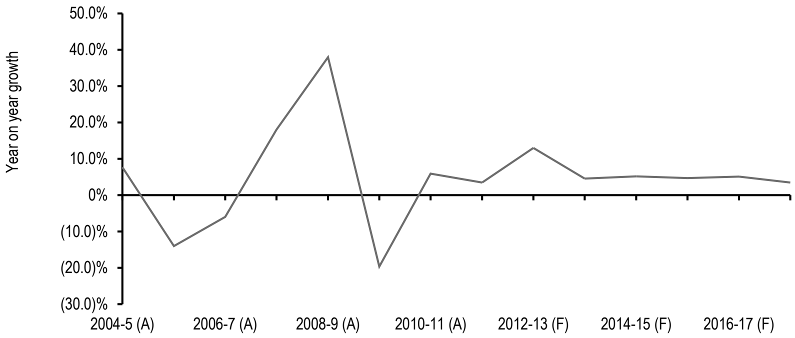
the increased use of renewable energy such as solar and wind, will also act to limit the consumption growth of gas.

Historic and forecast revenue growth in the gas supply sector in Australia is set out below:

Revenue growth rates in the gas supply sector in Australia



Source: IBISWorld

Average annual revenue growth between FY13 and FY18 is expected to be 4.6%. Price increases are expected beyond FY13 as a result of moderate increase in the volume of gas consumed, and higher gas prices partly reflecting the introduction of the carbon tax in mid-2012.

Domestic gas consumption volumes are also expected to increase in the five years to FY18 as other less environmentally friendly fuels suffer relative to the comparatively low-carbon natural gas, and continual recovery of the economy support increased demand.

BREE have projected an annual growth rate in primary domestic gas consumption of 1.3% from 2013 to 2050.

Market segmentation

Demand for gas varies between the States and is linked not only to population size and economic growth, but also to the availability of supply infrastructure. The following graph sets out estimated consumption by state and by segment for 2012:

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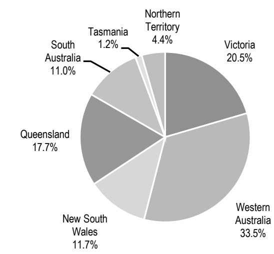
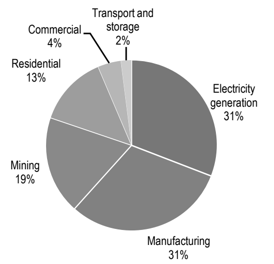
Gas consumption by State



Source: IBISWorld

Gas consumption by segment



Source: IBISWorld

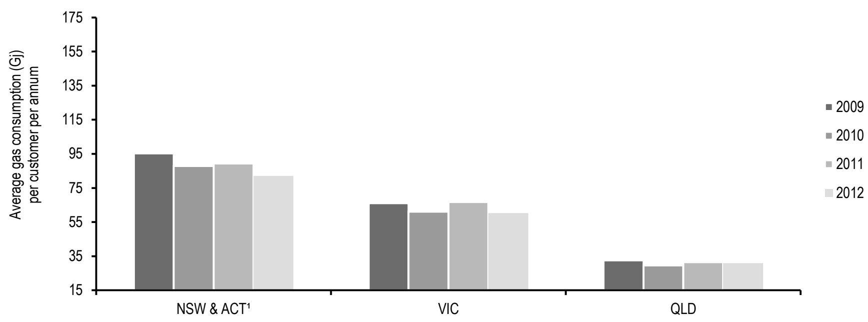
VIC is the second largest user of natural gas accounting for 20.5% of total demand with approximately one-third of natural gas demand in VIC coming from residential households. The gas supply network is well established in VIC and has ready access to gas.

Usage in other states tends to be more heavily weighted towards commercial businesses. In particular, Western Australia, QLD, South Australia and the Northern Territory rely on gas for electricity generation.

3.3.3 Gas usage

Total customer consumption and customer numbers are key revenue drivers for the gas supply industry. Average gas consumption per customer connection for the past 4 years is set out below:

Average gas consumption per residential customer by State



Source: ESAA

Note (1): Gas consumption for NSW&ACT includes commercial customers as consumption by customer classification was unavailable in NSW.

As with electricity demand, over the last few years average gas consumption per customer connection has decreased mainly due to weaker industrial demand and increased energy efficiency use by both commercial and residential customers driven by higher gas prices, relatively milder weather (particularly in VIC with unusually warmer winters and cooler summers), and the global economic slowdown.

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3.3.4 Competition

Competition in the industry is considered moderate. Barriers to entry include Regulator approval and the synergies experienced by existing participants who tend to retail electricity alongside their gas retail offering. The gas supply industry's key participants are set out below:

Gas supply industry market share

Company	Market share	
AGL	20%	AGL supplies gas to customers in QLD, VIC and SA as well as being a retail supplier of electricity.
Origin Energy	13%	Origin retails gas in VIC, NSW, SA and QLD. Origin also operates in exploration and production, power generation and electricity retail.
Envestra	5%	Envestra owns gas distribution assets, primarily in VIC and SA, for which it charges a volume-based rent for transmitting gas. It is not involved directly in gas retail and it is currently subject to a takeover offer.
Jemena	5%	Jemena, owns and operates the Jemena Gas Network in NSW which consist of approximately 24,000 km of gas distribution pipe network and supplies over 1.1 million customers.
Other	57%	

Source: IBISWorld

Set out below is a brief summary of the level of competition across the eastern seaboard of Australia as at August 2012[20]:

- NSW - had 11 licensed retailers out of which 6 are active in the small customer market comprising 3 established retailers (AGL, Origin, and ActewAGL Retail) and the 3 relatively newer entrants (EnergyAustralia, APG and Lumo Energy).
- VIC - had 12 licensed retailers out of which 7 are active in the small customer market. The established retailers in VIC, EnergyAustralia, Origin and AGL, collectively had a market share of approximately 85% of the gas retail market.
- QLD – had 7 licensed retailers out which 2 are active in the small customer market, AGL Energy and Origin Energy.

The gas retail market experiences a high rate of customer churn, with the percentage of small customers that changed retailer in June 2013 being 28% in VIC, 12% in QLD and 18% in NSW/ACT. [21]

3.3.5 Regulatory environment

State and territory governments are currently responsible for the regulation of gas retail markets with some non-price regulatory functions devolved to a national framework administered by the AEMC and the AER.

[20] AER, State of the energy market, 2012
[21] National Electricity Retail Transfer Statistics, June 2013

Historically, gas retailers and distributors were integrated, often being state owned entities. Throughout the 1990s the sector was restructured towards privatisation and the introduction of competition.

As at July 2013, NSW is the only state that still applies some form of retail gas price regulation. Price regulation in QLD, VIC and SA were removed on 1 July 2007, 1 January 2009 and 1 February 2013 respectively.

The National Gas Law and the National Gas Rules provide the regulatory framework under which transmission and distribution pipelines operate. Transmission and distribution pipelines are open to variable levels of regulation. The AER is the gas transmission and distribution pipeline regulator except in Western Australia. For those pipelines subject to full regulation, the National Gas Rules require tariffs to cover for costs and a return on capital.

3.3.6 Pricing

Wholesale Pricing

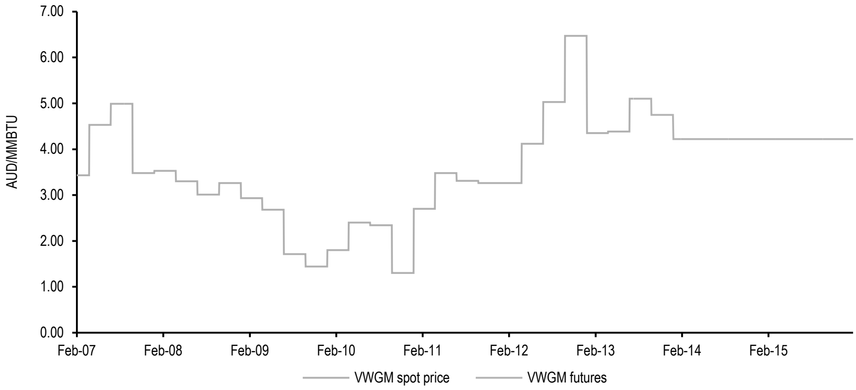
The price of gas is affected by a number of factors including overall economic conditions, demand and supply, pipeline capacity, weather conditions, government regulations and movement in foreign exchange rates.

Historically, wholesale gas was mainly priced and sold under confidential, long-term contracts. However, recently there has been a shift towards shorter-contracts and the use of spot market. The Victorian Wholesale Gas Market ("VWGM") was established in 1999, and Sydney, Adelaide and Brisbane hubs of the Short Term Trading Market ("STTM") in 2010 and 2011. For VIC, QLD and NSW, the STTM and VWGM mainly acts to provide a spot mechanism for parties to manage contractual imbalances and its participants include retailers, power generators and other large scale gas users.

BREE estimates that approximately 10% to 20% of wholesale gas volumes in VIC are traded at the VWGM spot price.

Set out below are the historical spot and futures prices for VWGM natural gas:

Historical spot prices and futures prices for natrual gas



Source: AEMO and Grant Thornton Corporate Finance calculations

Note: Henry Hub prices are daily close spot prices while VWGM prices are weighted average quarterly spot prices.

Prior to 2012, the VWGM price typically traded at prices below world gas spot prices (such as Henry Hub natural gas price) due to the relatively abundance of the natural gas in the region. However, with steady increases in exports of natural gas in the form of liquefied natural gas ("LNG") at an average of 9% per annum since 2008, Australia began experiencing a domestic shortage of gas which has driven up domestic natural gas prices. In particular, in 2012 LNG export prices increased significantly reflecting higher crude oil prices in Asia and stronger demand from Japan as a result of the nuclear disaster reducing supply of nuclear electricity to the nation. Introduction of the carbon tax has also been partly responsible for the increase in domestic gas prices. Domestic futures prices are expected to remain at current levels or possibly increase further depending on the outcome of the above events. This may be moderated by a reduction of the carbon tax and increase in gas supply from gas projects currently under development.

Retail Pricing

As discussed in section 3.3.5, NSW is the only state in the NEM Jurisdiction that still applies retail price regulation. The table below provides a summary of the average historical regulated retail gas price increase per annum from 2010 to 2013 for NSW as determined by IPART.

Average regulated retail gas price increase

State	Regulator	Distribution network	Average price increase 2009-10	2010-11	2011-12	2012-13	2013-14
New South Wales	IPART	Jemena	4.4%	5.2%	4.0%	14.8%	8.5%

Source: AER

Similar to retail electricity prices, retail prices of gas have been increasing significantly in recent years mainly due to the increase in network costs and introduction of the carbon tax in 2012 which is also reflected in IPART's recent final regulated price determination for 2013-14.

The following table summarises the composition of a typical small customer (small business and residential) bill in 2012:

Composition of a typical small customer bill

State	Wholesale energy costs	Network costs	Carbon costs	Other environmental costs	Retail costs
New South Wales	32%	45%	5%	0%	18%

Source: AER

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4 Profile of Australian Power and Gas

4.1 Corporate overview

APK is an electricity and gas retailer operating in NSW, VIC and QLD. Whilst the Company operates across the eastern seaboard, 65% of its customers are located in VIC.

Key milestones in the Company's history are set out below:

Date	Comments
September 2006	APK acquired a licence to supply electricity in NSW through the acquisition of an existing NSW licence holder.
November 2006	APK was granted licences to sell electricity and gas in VIC.
January 2007	Electricity and gas licences granted by the QLD Government's department of Mines and Energy.
February 2007	APK commenced signing customers in VIC.
March 2007	Licence to supply gas in NSW granted by IPART to complement its electricity licence in that state.
August 2007	APK successfully completed the acquisition of 50,000 customer accounts from a Victorian retailer.
November 2007	APK's application for a licence to supply electricity and gas in South Australia was approved by the Essential Services Commission of South Australia.
June 2008	Electricity and gas licences granted by the ACT's Independent Competition & Regulatory Commission.
July 2009	APK achieved 100,000 customer accounts which represented an increase of approximately 185% from FY08.
June 2010	APK announced a series of significant developments for expansion of the company into QLD and NSW markets which included a proposed $18.75 million convertible note facility, extension of existing $50.0 million receivables financing facility until December 2012, and signing of a wholesale electricity supply contract with a major QLD generator.
December 2010	APK secures new 3-year wholesale gas supply contract with Esso Australia and BHP Billiton and a new 4-year 8-month contract with a major wholesale participant for NSW and VIC.
June 2011	APK announced that Nippon Gas Co. Ltd.("Nippon") agreed to acquire a significant strategic stake in APK via a direct placement of 10 million shares and an off-market purchase of a further 10 million shares at $0.50 per share. After the transaction, Nippon held 11.4% interest in APK.
August 2011	APK announced its first dividend of $0.05 per share.
September 2011	APK achieved 300,000 customer accounts. APK announced that it has agreed on electricity derivatives and 'reallocation' contracts with Macquarie Bank Limited.
February 2013	APK signed with global payment company, PayPal which will enable APK customers to pay bills online.
July 2013	APK entered into the BIA with AGL.

Source: ASX announcements

As at 30 June 2013, APK had approximately 354,000 active customer accounts which were primarily residential customers. We have been advised by Management that APK recently commenced a trial of acquiring commercial business clients as a strategy to diversify its customer base.

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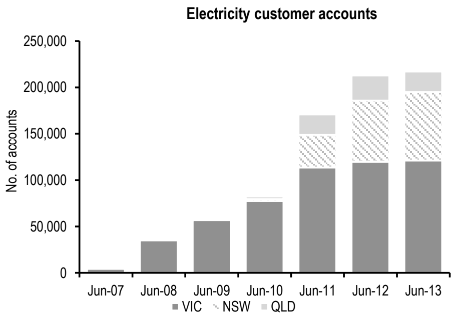
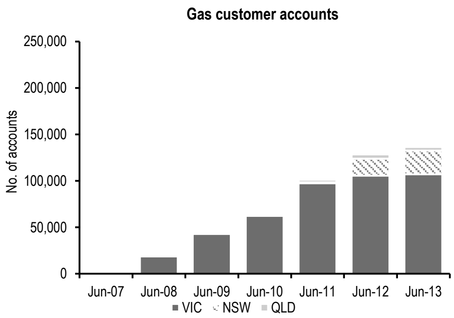
The breakdown of the active customer accounts by state is set out in the table below.

APK customers as at 30 June 2013		
State	Number of customer accounts	% of total APK customers
VIC	228,000	64%
NSW	100,000	28%
QLD	26,000	7%
Total	**354,000**	**100%**

Source: APK

The graph below sets out growth in the total number of active customers of APK from 2007 onwards segmented by geography and energy type:





Source: APK Annual Reports

Note: Consistent with industry practice the number of customer accounts does not reflect the number of customers as some customers have both gas and electricity accounts.

We note that the number of active customer accounts set out above does not reflect the number of APK customers. APK provides to a number of customers "dual fuel packages" which offers both electricity and gas supply. We understand that APK is continually focusing on increasing the number of dual fuel customers.

It is estimated that APK's market share of the Victorian residential electricity and gas market is approximately 5.4% as at 30 June 2013. In the financial year ended 30 June 2013 revenue derived from VIC contributed approximately 62.2% of total revenue.

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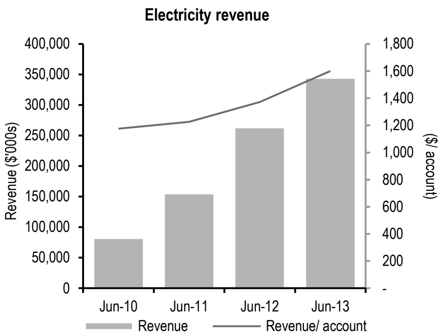
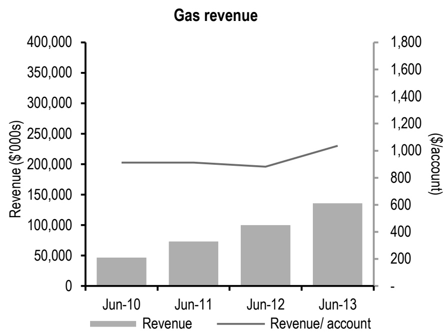
The graph below sets out growth in the revenue from 2010 onwards segmented by energy type:





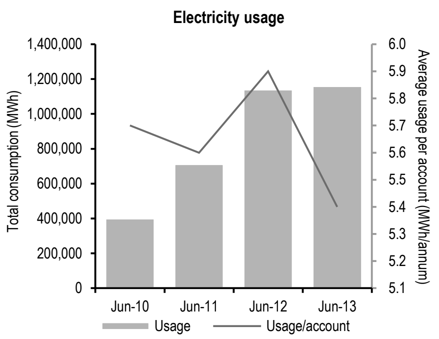
Source: APK Annual Reports

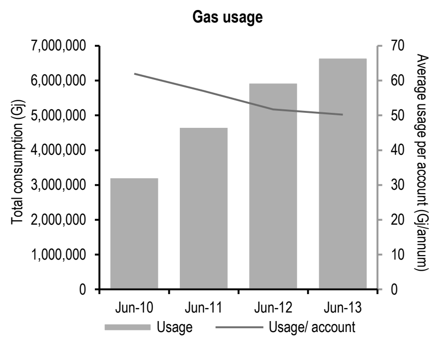
Total revenue attributable to electricity and gas retail has increased by a CAGR of approximately 61% and 42% respectively from FY10 to FY13. The increase has been mainly attributable to:

- *Increase in number of customers* – as set out previously, the number of electricity and gas customers has increased by an average annual growth rate of 45% and 35% respectively, particularly with APK's expansion into NSW and QLD markets in FY10.

- *Increase in retail price* – the sale price of gas and electricity have both increased significantly year-on-year as evidenced by increasing revenue per customer account despite significant increases in customer numbers and decreases in energy usage per customer. The increase in sale prices has been driven by increases in distribution network costs and introduction of the carbon tax which have been passed through to the customer.

Growth in total revenue has been partially offset by decreases in energy use per customer account. The graph below sets out growth in energy usage by APK customers from 2010 onwards segmented by energy type:





Source: APK Annual Reports

The decrease in energy usage per customer has been mainly due to relatively mild weather in recent years, increased use of solar energy as a substitute for electricity, and increasing gas prices.

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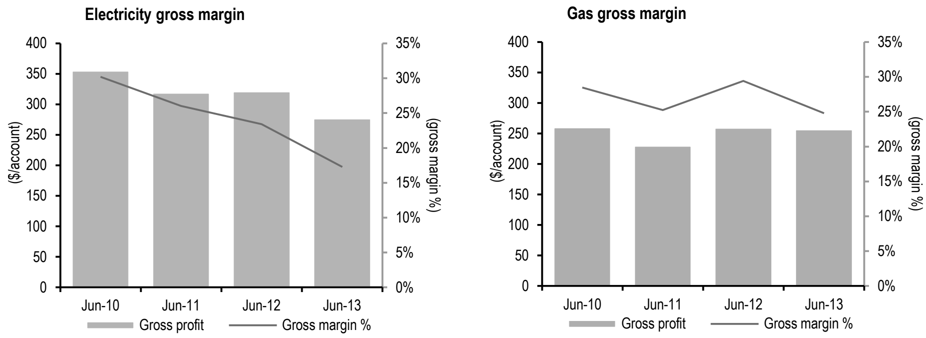
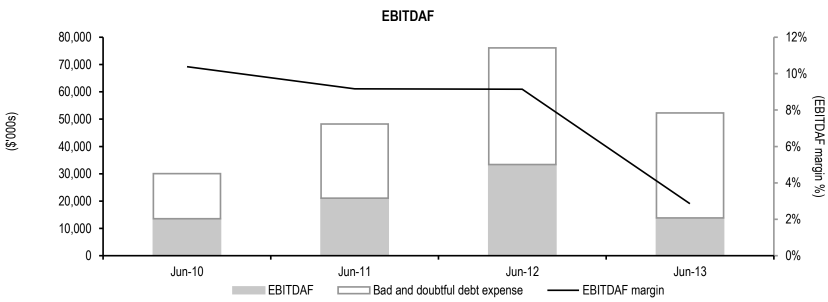
These factors have impacted gross margin which has been in decline over the last few years. The graph below sets out growth in the gross profit per average customer accounts, and gross margin from 2010 onwards segmented by energy type:



Source: APK Annual Reports

As a result of declines in gross margin for both of APK's product segments, APK's total earnings before interest, tax expense, depreciation and amortisation, and changes in the fair valuation of financial instruments and other assets ("EBITDAF") has declined from FY12 to FY13 as set out below:



Source: APK Annual Reports

The decrease in EBITDAF in FY13 was particularly significant due to a substantial increase in the level of bad and doubtful debt expense. Increase in bad debt allowance was a result of collection problems being experienced by approximately 10,000 customers in an environment of large price increases and general economic slowdown. (For further details on bad debt expense please refer to section 4.4.1).

The financial performance of APK is affected by a relatively high customer churn rate which requires the Company to invest heavily in customer acquisitions to grow/ maintain customer numbers. The high churn rate is partially driven by APK's target customer base which consists of a number of 'deal seekers' who check prices frequently and switch retailers proactively or reactively to take advantage of promotions or discounts, and to save money. Accordingly, customer acquisitions to replace loss of customers or to increase the customer base are a key area of focus for APK. APK's churn rates have been higher than market average over the past 3 financial years.

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4.2 Business model

APK buys energy at wholesale prices (spot and fixed) on the NEM, pays network owners to transport the energy and bills customers at retail rates. Given the uncertainty and volatility in electricity wholesale prices and the regulation of retail rates in QLD and NSW, in APK's view, it is essential to hedge appropriately against wholesale price movements. Accordingly, the Company enters into fixed price energy supply and reallocation agreements.

APK's business model also involves the outsourcing of certain functions, including sales channels, customer transfer administration, billing, customer service and payments. Funding, wholesale energy purchasing, retail pricing some sales channels and product development functions are retained internally.

Historically, APK has implemented different pricing strategies for each state which are largely driven by the regulatory environment.

A summary of the key agreements of APK are set out in the sections below.

4.2.1 Electricity wholesale agreements

In order to mitigate wholesale pricing risks and volatility on the NEM, APK has entered into fixed forward commodity contracts with energy market participants in NSW, VIC and QLD ("Electricity Forward Contracts"). The Electricity Forward Contracts are fixed price hedges for agreed volumes and effectively allow APK to supply electricity at predetermined fixed prices and/or prices within its desired range to customers in NSW, VIC and QLD.

Under theses electricity forward contracts, credit support, the provision of security for amounts owing, is required by counterparties. Credit support is normally provided in the form of bank guarantees.

The Electricity Forward Contracts also provides for "reallocation". The reallocation arrangements enable APK and the counterparty to reallocate electricity volumes between themselves to reduce prudential requirements required by AEMO.

APK put in place electricity derivatives and reallocation facilities with Macquarie Bank Limited ("Macquarie") that has significantly reduced the cash required by the Company to meet its prudential obligations to AEMO. The reallocation agreement reduces the likelihood of call notices or the need for security deposits under the national energy regulators prudential control requirements.

4.2.2 Gas wholesale agreements

In May 2008, APK entered into a sale and purchase agreement for the sale and purchase of gas in Victoria. The agreement was initially set to run until 31 December 2011 but was later extended to 31 December 2014. APK has entered into other similar gas supply agreements in VIC, NSW and QLD with other suppliers including AGL (together referred to as "Gas Supply Agreements").

The terms of the Gas Supply Agreements include a fixed base price (subject to inflationary adjustments), minimum take or pay requirements and maximum usage limitations. Due to the minimum take or pay requirements, APK has occasionally experienced excess gas supply due to lack of customer demand and been required to sell it on the spot market.

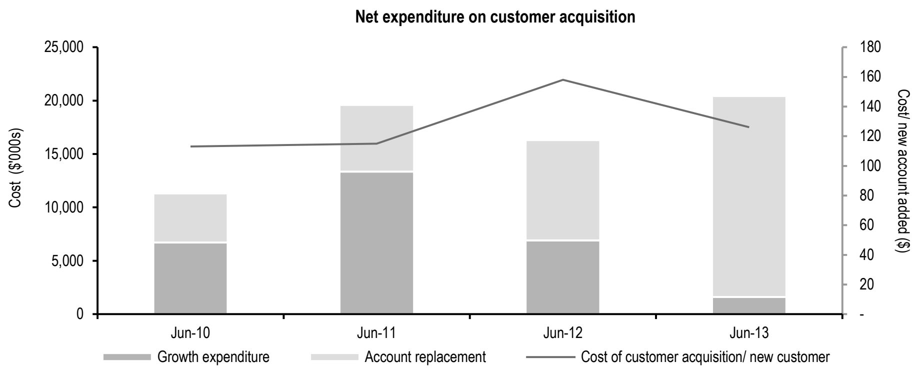
To mitigate pricing and volumetric risk resulting from the mismatching of forecast demand and supply under the Gas Supply Agreements, APK has gas storage contracts to store gas for use during peak demand where demand is in excess of supply. APK also actively purchases gas at the wholesale spot price for storage when prices are considered to be relatively low.

4.2.3 Customer acquisitions

APK acquires customers primarily through door-to-door sales channels. APK have engaged the Appco Group to operate a door-to-door sales channel via a marketing services agreement. The Appco Group is a global market leader in this sector having acquired several million customers for energy companies in deregulating markets in Australia, New Zealand and Europe since their commencement in the industry in 1996. The door-to-door customer acquisition channel has historically been very successful for APK and it represents the main sales channel of the Company.

In FY12 APK expanded its acquisition capability by entering into new agreements in order to diversify sales channels and reduce channel risk. This included new telemarketing and web switching channels with APK operating up to 12 sales channels at any point in time.

The graph below illustrates APK's net expenditure on customer acquisitions from 2010 to 2013.



Source: APK Annual Reports

APK's net expenditure on customer acquisition increased by approximately 73.3% from FY10 to FY11 mainly due to expansion of operations into QLD and NSW. In FY12, customer acquisitions in QLD and NSW were reduced mainly due to unfavourable regulatory price settings and to preserve cash. In FY13, the majority of expenditure on customer acquisition was for replacing existing accounts with the cessation of direct customer acquisitions in July 2012 for QLD as a result of further adverse price determinations by QCA.

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4.2.4 Other outsourcing

Other outsourced functions such as customer management, billing, collections and other back office activities are carried out by specialist providers such as Serviceworks, a subsidiary of Computershare, and are predominately based on a fixed rate per customer account.

In FY13, APK also signed an agreement with global payment company, PayPal to provide electronic billing and online account management to customers.

4.3 Future strategy

On 9 May 2013, APK announced the implementation of Project Refresh to focus on identifying and implementing strategies to improve the management of cash in-flow and revenues, while reducing costs and cash outflows particularly to assist with seasonable cash flow management. Set out below are the objectives of Project Refresh:

- Ensure the company is a profitable business with significant positive cash flows.
- Strengthening the company balance sheet organically through the generation of cash profits and reductions in expenditures as well as various working capital initiatives.
- Prepare and position the company for its next stage of growth.

As a result of implementing the first stage of Project Refresh, the Company provided guidance to the ASX in relation to FY14 as set out below:

- Number of customer accounts in the range of 330,000 to 350,000.
- Revenue in the range of $510 million to $530 million.
- Underlying EBITDA in the range of $40 million to $44 million.
- Underlying NPAT in the range of $13 million to $16 million.

4.4 Financial information

4.4.1 Financial performance

The following table summarises the consolidated statement of comprehensive income of APK for financial years ended 30 June 2011 ("FY11"), 30 June 2012 ("FY12") and 30 June 2013 ("FY13"):

APK - consolidated statement of comprehensive income	FY11 Audited A$'000	FY12 Audited A$'000	FY13 Unaudited A$'000
Revenue	230,122	364,798	483,643
Other Income	223	467	616
Expenses	(209,239)	(331,891)	(470,461)
EBITDAF	**21,106**	**33,374**	**13,798**
EBITDAF margin	*9.2%*	*9.1%*	*2.9%*
Changes in fair valuation of finanial instruments and other assets	(15,790)	(14,232)	3,423
EBITDA	**5,316**	**19,142**	**17,221**
EBITDA margin	*2.3%*	*5.2%*	*3.6%*
Depreciation and amortisation	(11,458)	(19,321)	(22,003)
EBIT	**(6,142)**	**(179)**	**(4,782)**
EBIT margin	*-2.7%*	*0.0%*	*-1.0%*
Net finance costs	(6,857)	(5,544)	(7,501)
Income tax benefit/(expense)	3,464	1,833	3,666
Statutory NPAT	**(9,535)**	**(3,892)**	**(8,618)**
Statutory NPAT margin	*-4.1%*	*-1.1%*	*-1.8%*
Adjustments for reconciliation of statutory profit to the underlying profit[1]			
Finance costs	2,219	-	-
Changes in fair value of other assets	-	155	4,847
Changes in fair value of financial instruments	11,053	9,806	(7,241)
Underlying NPAT	**3,737**	**6,072**	**(11,012)**
Underlying NPAT margin	*1.6%*	*1.7%*	*-2.3%*

Source: Financial Reports and Management

Note (1): The statutory NPAT includes changes in value of hedges or certificates (other assets and financial instruments) at each reporting period. However, Management believe that this does not accurately reflect the operating results of APK as the retail prices are set with reference to expected costs under fixed price hedges and operating margins are forecast accordingly to recover the expected costs under contracted agreements. Accordingly, the underlying NPAT excludes the movement in value for hedges or certificates.

We note the following in relation to APK's income statements:

FY12

- Revenue increased by approximately 58.5% to $364.8 million in FY12 mainly due to:
  - Increase in electricity and gas prices as a result of passing through increased transmission costs and change in customer base to include a higher percentage of NSW and QLD customers. The average revenue per customer account increased by approximately 7.8% to $1,188 per account.
  - APK also experience a large increase in the number of customer accounts going into financial hardship within 12 months of acquisition.
  - Increase in the number of active accounts from approximately 272,443 in FY11 to 341,619 in FY12.

- Whilst the total consumption of electricity and gas increased, there was a decline in the average annual usage of electricity and gas per customer from 5.7 MWh and 62.0 Gj in FY12 to 5.6 MWh and 57.0 Gj in FY12 respectively. This was mainly as a result of mild weather conditions in all three states and increased usage of solar panels for electricity generation.

- Expenses increased by approximately 53.8% to $346.1 million predominately due to the increase in total number of active accounts and total consumption of electricity and gas. Expenses also consist of $13.4 million (pre-tax) in fair value losses on other assets and financial instruments which are excluded from the calculation of the underlying NPAT.

- Increase in bad debt allowance by $3.3 million (55.0%) to $9.3 million in FY12.

- Depreciation and amortisation mainly relate to the expensing of customer acquisition and recording costs which are capitalised and amortised over the estimated life of the contract (between 1 and 3 years).

- Net financing costs decreased by approximately 19.1% to $5.5 million in FY12 mainly due to decrease in facility fees. In FY11, APK incurred facility fees of approximately $1.6 million (nil in FY12) in relation to share options issued with convertible notes.

- The underlying NPAT margin has increased slightly from 1.6% in FY11 to 1.7% in FY12 mainly due to the improvement in total revenue.

FY13

- Revenue increased by approximately 32.6% to $483.6 million in FY13 mainly due to:

  – Increase in electricity and gas prices as a result of passing through the carbon tax and increased transmission costs. The average revenue per customer account increased by approximately 17.1% to $1,391 per account.

  – Increase in the number of active accounts from approximately 341,619 in FY12 to 353,990 in FY13.

- The total consumption of electricity and gas increased, however, there was a further decline in the average annual usage of electricity and gas per customer from 5.6 MWh and 57.0 Gj in FY12 to 5.4 MWh and 50.2 Gj in FY13 respectively.

- Increase in expenses of approximately $120.9 million (34.9%) to $467.0 million FY13 mainly consists of the following:

  – Increase in wholesale costs by $108.6 million, operational expenses by $6.6 million, employee expenses by $5.8 million and administration expenses by $3.0 million predominately due to the increase in total number of active accounts and total consumption of electricity and gas.

  – Increase in bad debt allowance by $15.3 million (163.9%) from 2.6% of revenue in FY12 to 5.1% of revenue in FY13 due to collection problems being experienced by a significantly larger number of customers mainly as a result of:

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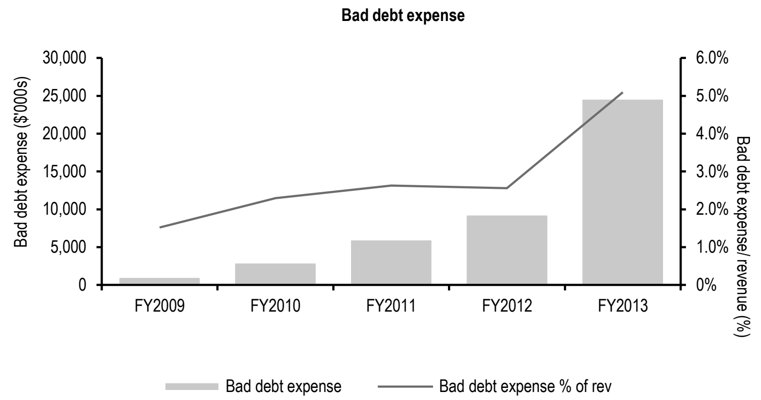
i) Large increases in retail prices of up to 30% due to the pass through of the carbon tax and strong increases in network distribution costs, which led to an increased number of customers struggling to pay bills on time especially over the Christmas period.

ii) Large increases in the collection base with the total number of APK customer accounts increasing by a CAGR of approximately 34.6% from FY10 to FY13.

The graph below illustrates the allowance for bad debt for APK from FY09 to FY13.



Source: Financial Reports and GTCG calculations

In early 2013, APK commissioned a review by Ernst & Young in relation to its customer debt management processes. APK and its customer management outsourced provider have since implemented the review's recommendations with the changes expected to be realised over the next 12 months.

- Net financing costs increased by approximately 35.3% to $7.5 million in FY13 mainly due to increase in facility fees by approximately $2.8 million paid to Macquarie Bank Limited ("Macquarie") in relation to the renegotiation of debt facilities. In August 2012, APK entered into an $85.0 million multi option facility with Macquarie which comprised a $55.0 million receivables financing facility which was used to refinance APK's then existing $50 million debt facility and related $4 million convertible note.

- The underlying NPAT margin has decreased from 1.7% in FY12 to (2.3)% in FY13 despite the material improvement in total revenue as the average revenue per customer account has decreased and the signification increase in bad debt allowance due to a challenging collection environment.

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4.4.2 Financial position

The consolidated statement of financial position of APK as at 30 June 2012 and 30 June 2013 are set out below:

APK - consolidated statement of finanical position	30-Jun-12 Audited A$'000	30-Jun-13 Unaudited A$'000
Current assets		
Cash and cash equivalents	18,319	22,609
Trade and other receivables	95,101	112,065
Inventories	1,580	1,180
Intangible assets	10,881	11,645
Other	11,988	12,936
Total current assets	**137,869**	**160,435**
Non-current assets		
Property, plant and equipment	414	994
Deferred tax assets	18,763	22,429
Intangible assets	41,030	41,986
Total non-current assets	**60,207**	**65,409**
Total assets	**198,076**	**225,844**
Current liabilities		
Trade and other payables	57,228	84,229
Borrowings	54,000	77,962
Other financial liabilities	36,924	21,362
Provisions	551	1,658
Total current liabilities	**148,703**	**185,212**
Non-current liabilities		
Borrowings	-	19
Total non-current liabilities	**-**	**19**
Total liabilities	**148,703**	**185,231**
Net assets	**49,373**	**40,613**
Equity		
Share capital	105,262	106,879
Reserves	8,138	7,896
Accumulated losses	(64,027)	(74,161)
Total equity	**49,373**	**40,613**

Source: Financial Reports and Management

We note the following in relation to APK's balance sheets:

- Cash and cash equivalents of $22.6 million as at 30 June 2013 consist of $20.3 million in restricted cash deposits requirements pursuant to the Macquarie Bank facility.
- Trade and other receivables of $112.1 million consist of mainly $60.0 million in trade receivables, $75.3 million in unbilled revenue and $25.4 million in allowance for doubtful debts. We note, the bad debt allowance decreased by approximately $13.1 million in FY13 in relation to amounts written off during the year as uncollectible.
- Inventories consist of gas held in storage for resale. As at 30 June 2013, APK held approximately 236,000 Gj of gas in storage.

- Current and non-current intangible assets of $53.6 million are made up of goodwill ($35.4 million), capitalised customer acquisition costs ($14.3 million), and capitalised systems development costs ($4.0 million). Capitalised customer acquisition costs are amortised over the expected life of the customer contract and capitalised development costs are amortised over a 3 year period.

- Other current assets of $12.9 million consist mainly of amounts advanced to counterparties as credit support ($8.1 million) and green commodity scheme certificates ($1.9 million).

- Deferred tax assets increased by approximately 19.5% to $22.4 million in FY13 mainly due to tax losses and timing differences which was partially offset by an increase in unbilled revenue.

- Trade and other payables of $84.2 million as at 30 June 2013 consist of $29.1 million in trade payables and $55.1 million in accruals mainly for amounts owing for wholesale energy and distribution costs.

- As at 30 June 2013, the Company had approximately $78.0 million in current borrowings. Refer to section 4.4.2.1 below for further details.

- Other financial liabilities decreased by approximately 42.1% to $21.4 million in FY13 predominately as a result of decrease in derivatives liabilities by $13.1 million and facility fee by $2.5 million which were paid in FY13.

- The total number of fully paid ordinary shares increased from 189,416,160 as at 30 June 2012 to 191,526,610 as at 30 June 2013 mainly as a result of:

  - Exercise of circa 235,000 employee share options at nil exercise price per option in December 2012.

  - Exercise of 715,586 fortress share options at nil exercise price per option on 29 October 2012.

  - Exercise of 500,000 director share options at exercise price of $0.50 per option and 500,000 director share options at exercise price of $0.60 per option on 30 October 2012.

  - Issue of 162,000 APK Shares under the employee share plan in December 2012.

- As at 30 June 2013, APK had contingent liabilities of approximately $10.3 million which included:

  - Bank guarantees of $9.6 million in relation to bank guarantees issued on behalf of APK and secured against monies held in deposit.

  - Director loan of $0.7 million in relation to APK agreeing to provide a loan for the payment of the exercise price of issued options in the event the options are exercised.

- In addition, we note that the financial accounts for the half year ended 31 December 2012 ("H1 FY13) and FY13 included an emphasis of matter in relation to the ability of the Company to continue as a going concern. This was a result of APK being in breach of the covenants of its revolving facility (that were waived by the Company's lender) which is the primary source of the Company's working capital. Management are of the opinion that the use of the going concern basis of accounting is appropriate as the lender of the revolving facility has indicated that it will continue to support the Company and have allowed temporary adjustments to the facility including reduced covenant levels and conditional waivers. These circumstances have continued through to the present time.

4.4.2.1 Debt financing

The debt facilities of the Company as at 30 June 2013 are summarised below.

Facility	Type of Facility	Max amount	Drawdown	Terms and description of facility
Revolving Loan Facility	Secured	$55.0 million	$49.6 million (The amount that can be drawn is limited to the level of receivables subject to certain adjustments)	Variable interest rate based on the bank bill swap yield plus a margin (6.45% as at 30 June 2013). Daily proceeds from customer payments are offset against the outstanding amount. The Revolving Loan Facility expires in November 2014 with arrangements to extend for a further year provided certain covenants are met. As at 30 June 2013, APK was in breach of certain covenants (that were waived by the Company's lender and discussed in further detail below). Daily proceeds from customer payments are offset against the outstanding amount.
Restricted Cash Facility	Secured	$30.0 million	$15.0 million	Interest rate of 4.45% per annum. Funds from the facility are placed in deposit with the lenders as security for bank guarantees and wholesale hedging facilities. The Restricted Cash Facility expires in November 2014. As at 30 June 2013, APK was in breach of certain covenants of the Restricted Cash Facility (that were waived by the Company's lender) and as a result, the Facility was reclassified as a current liability (discussed in further detail below).
Other Loans	Unsecured	$7.0 million	$7.0 million	Effective interest rate of 11.0% per annum. Other Loans relate to financial commitments for the acquisition of green certificates and have maturity dates between July and October 2013.
Nippon Gas Loan	Unsecured	$6.0 million	$6.2 million	Interest of 18.0% plus any applicable withholding taxes is payable on $6.0 million even if loan is partially or wholly repaid prior to maturity in April 2014. The Nippon Gas Loan also provides Nippon an election right until 11 April 2015 to receive an amount equal to the greater of: – difference between 5 day VWAP of APK Shares and $0.50; and – nil. For further details on the election rights refer to section 4.5.4. APK has the right to offer payment in the form of APK Shares instead of cash payment.

Source: Financial Reports, June 2013

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In August 2012, APK refinanced its then existing $50 million debt facility and related $4 million convertible note with an $85.0 million multi-option facility agreement with Macquarie which includes of a $55.0 million receivables financing facility and guarantees, hedging and restricted cash facilities ("Macquarie Facility").

In FY12, APK breached certain operational and financial covenants under the Macquarie Facility and Restricted Cash Facility and as a result, the lender has the ability to call for repayment of the facilities. APK has secured waivers from the lender with respect to the covenant breaches and the lender has indicated that it will continue to support APK and have provided temporary adjustments to the facilities including reduced covenant levels and continual waivers on the condition that APK is able to adhere to financial covenants in future periods (among other conditions). The aforementioned circumstances prevail to the present date.

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4.4.3 Cash flows

The following table summarises the consolidated statement of cash flows of APK for FY12 and FY13:

APK - consolidated statement of cash flows	FY12 Audited A$'000	FY13 Unaudited A$'000
Cash flows from operating activities		
Receipts from customers	342,767	448,504
Payments to suppliers and employees	(320,450)	(432,046)
Net receipts from sales	22,317	16,458
Prepayments to counter parties (credit support)	(242)	786
Payments for customer acquisition	(16,291)	(20,424)
Interest received	1,340	646
Borrowing costs paid	(8,706)	(5,473)
Fees paid on termination of facility	-	(2,500)
Fees paid on commencement of facility	-	(3,519)
Net cash used in operating activities	**(1,582)**	**(14,026)**
Cash flows from investing activities		
Payments for property, plant and equipment	(150)	(1,689)
Payments for intangibles	(1,775)	(1,749)
Payments for restricted cash (credit support)	(5,275)	(6,539)
Net cash used in investing activities	**(7,200)**	**(9,977)**
Cash flows from financing activities		
Proceeds from issue of ordinary shares	2,750	-
Dividends paid	(925)	(1,515)
Proceeds from drawdown of new working capital facility	-	55,000
Proceeds from drawdown of new restricted cash facility	-	15,000
Repayment of expiring facility	-	(50,000)
Repayment of convertible notes	-	(4,000)
Proceeds from drawdowns of working capital facility	-	355,930
Repayments of working capital facility	2,800	(359,258)
Proceeds from other loans	(2,700)	10,596
Net cash provided by financing activities	**1,925**	**21,754**
Net increase in cash and cash equivalents	**(6,857)**	**(2,249)**
Cash and cash equivalents at the beginning of the financial year	11,416	4,559
Cash and cash equivalents at the end of the financial year	**4,559**	**2,310**

Source: Financial Reports and Management

We note the following in relation to APK's cash flows:

- Cash and cash equivalents at the end of the financial year exclude cash deposits subject to charge/ restriction in relation to bank guarantees/ credit support. At the end of FY13 approximately $20.3 million out of $22.6 million in cash and cash equivalents was subject to a charge ($13.8 million out of $18.3 million in FY12 subject to charge).

- Decrease in net cash used in operating activities has mainly been due to:

  – Decrease in net receipts from sales by circa $5.9 million (26.3%) mostly as a result of a challenging collection environment and increase in wholesale costs.

– Increase in cash payments for customer acquisition in FY13 by circa $4.1 million.

– Termination and commencement fees of $6.0 million paid in relation to the refinancing of APK's $50.0 million debt facility and related $4 million convertible note in August 2012.

4.5 Capital Structure

As at 15 July 2013, APK has on issue:

- 191,526,610 fully paid ordinary shares ("APK Shares").
- 36,892,274 Options ("APK Options").
- 6,000,000 election rights granted to Nippon ("Election Rights").

4.5.1 APK share ownership

The top 10 shareholders of APK as at 1 August 2013 on an undiluted basis are set out below:

Shareholder	No of shares	% of issued shares
AGL APG HOLDINGS PTY LTD	38,113,795	19.9%
NIPPON GAS CO LTD	33,000,370	17.2%
THE COBRA GROUP PTY LIMITED	21,320,288	11.1%
ARTHUR PHILLIP NOMINEES PTY LTD	17,126,259	8.9%
NATIONAL NOMINEES LIMITED	9,260,924	4.8%
COBRA INVESTMENTS BV	4,416,339	2.3%
BNP PARIBAS NOMS PTY LTD <DRP>	4,392,000	2.3%
PCF GROUP PTY LTD <BLANE FAMILY A/C>	3,486,125	1.8%
COMMUNICATIONS POWER INCORPORATED (AUST) PTY LTD	3,000,000	1.6%
MR JAMES MYATT	3,000,000	1.6%
Total Top Ten Shareholders	**137,116,100**	**71.6%**
Other Shareholders	54,410,510	28.4%
Total	**191,526,610**	**100.0%**

Source: Management

Source: APK

We note that the total number of ordinary shares of 191,526,610 includes the following 212,960 ordinary shares in voluntary escrow:

- 62,000 shares in escrow until 14 March 2014 or ceasing as employee.
- 150,960 shares in escrow until 19 December 2015 or ceasing as employee.

APK has the ability to release the shares from escrow in the event of a change of control or the likelihood of one occurring.

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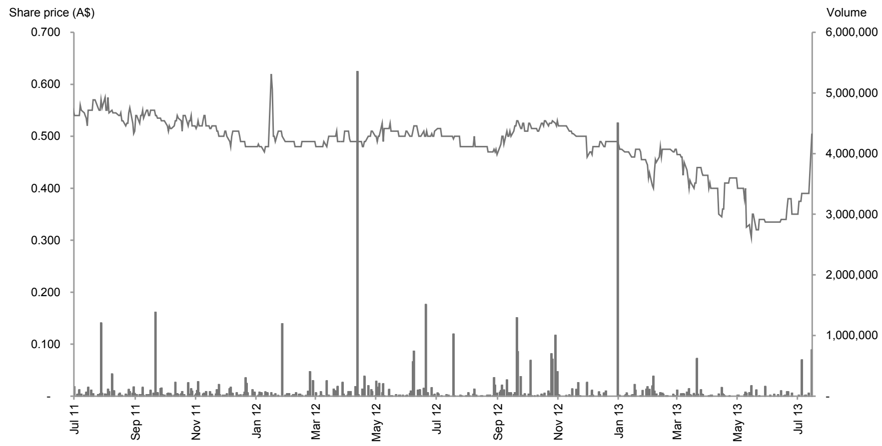
4.5.2 APK Share price

The daily movements in APK's share price and trading volumes for the period from 1 July 2012 to 15 July 2013 is set out below:



Source: CapitalIQ

We note the following with regard to the share price history shown above:

Date	Comments
15 Jul 2013	APK announced that it has entered into a Bid Implementation Agreement with AGL, under which AGL has agreed to make a recommended cash offer for all APK Shares it does not already own at A$0.52 per share and all options currently on issue. APK Share price closed at $0.505.
9 May 2013	APK announced FY13 and FY14 profit guidance downgrade with increased debt provisioning. Full year FY13 NPAT was downgraded from $1 - $3 million loss to $3- $5 million loss. APK Share price closed at $0.400.
5 Apr 2013	APK announced that it had secured $6.0 million of funding from Nippon Gas Co. Ltd. ("Nippon Gas") for the funding of working capital. The loan is unsecured and a 1-year term. APK Share price closed at $0.400.
4 Feb 2013	APK announced that it had entered into an agreement with PayPal to enable APK customers to pay bills online. APK Share price closed at $0.405.
31 Dec 2012	Nippon Gas purchased 4.5 million APK Shares through off-market transfer at $0.49 per APK Share. Nippon Gas's interest in APK increased from 19.67%to 22.12%. APK Share price closed at $0.490.
10 Sep 2012	Nippon Gas purchased 0.6 million APK Shares through off-market transfer at $0.50513 per APK Share. APK Share price closed at $0.510.

Source: ASX

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Date	Comments
30 Aug 2012	APK announced that it has signed an $85 million financing agreement with Macquarie Bank Limited which comprises of $55 million receivables financing facility, bank guarantee facility and a reallocation facility. The new facilities will be used to refinance APK's existing $50 million debt facility and related $4 million convertible note. APK Share price closed at $0.475.
31 Jul 2012	APK announced that is cash receipts from customers in FY12 increased by approximately 41.5% to $340.9 million and net underlying operating cash flow increased from $1.3 million in FY11 to $23.4 million in FY12. APK Share price closed at $0.480.
21 Dec 2011	APK restated profit guidance for FY12 following unseasonably warm weather in VIC. APK Share price closed at $0.480.
22 Sep 2011	APK announced that it had achieved 300,000 net customers. APK Share price closed at $0.540.
26 Aug 2011	APK announced first dividend of $0.05 per share. APK Share price closed at $0.550.
28 Jul 2011	APK announced that it had received the top customer satisfaction award in VIC from ratings agency, Canstar Blue. APK Share price closed at $0.570.

Set out below is the share performance of APK since June 2012:

Australian Power and Gas Company Limited	Share Price High $	Share Price Low $	Share Price Close $	Average weekly volume 000'
Month ended				
Jun 2012	0.52	0.50	0.51	873
Jul 2012	0.52	0.48	0.48	263
Aug 2012	0.50	0.47	0.47	171
Sep 2012	0.53	0.48	0.51	822
Oct 2012	0.53	0.51	0.53	778
Nov 2012	0.52	0.46	0.46	168
Dec 2012	0.49	0.47	0.49	1,147
Jan 2013	0.48	0.42	0.42	184
Feb 2013	0.48	0.40	0.48	226
Mar 2013	0.48	0.38	0.43	301
Apr 2013	0.42	0.31	0.42	57
May 2013	0.40	0.31	0.34	141
Jun 2013	0.40	0.31	0.35	83
Week ended				
29 Mar 2013	0.44	0.43	0.43	151
5 Apr 2013	0.42	0.40	0.40	29
12 Apr 2013	0.37	0.35	0.35	30
19 Apr 2013	0.41	0.31	0.41	192
26 Apr 2013	0.42	0.42	0.42	0
3 May 2013	0.40	0.40	0.40	23
10 May 2013	0.40	0.33	0.33	127
17 May 2013	0.35	0.31	0.35	243
24 May 2013	0.34	0.32	0.34	100
31 May 2013	0.34	0.34	0.34	156
7 Jun 2013	0.34	0.31	0.34	34
14 Jun 2013	0.34	0.32	0.34	102
21 Jun 2013	0.38	0.32	0.38	151
28 Jun 2013	0.40	0.35	0.35	45
5 Jul 2013	0.39	0.34	0.39	608
12 Jul 2013	0.39	0.39	0.39	66

Source: CapitalIQ

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4.5.3 APK Options

APK has 36,892,274 existing Options on issue as summarised in the table below:

Class of option	Exercise price	Expiry date	Number of options
Employee options	$0.35	01-Oct-13	513,031
Employee options	$0.40	30-Oct-14	2,035,000
Employee options	$0.45	30-Oct-14	1,500,000
Employee options	$0.50	01-Oct-14	500,000
Employee options	$0.50	30-Oct-14	125,000
Employee options	$0.55	01-Oct-14	500,000
Employee options	$0.55	30-Oct-14	125,000
Employee options	$0.55	30-Oct-15	1,519,243
Employee options	$0.60	30-Oct-15	925,000
Employee options	$0.70	01-Jul-15	500,000
Unlisted options	$0.60	31-Dec-13	18,900,000
Fortess Options	Lower of $0.40 and 30 day VWAP at the time of exercise	22-Dec-14	2,500,000
Fortess Options	$0.55	31-Dec-13	5,000,000
Ian McGregor	$0.20	01-Jul-14	1,000,000
James Myatt	$0.70	30-Oct-13	500,000
James Myatt	$0.80	30-Oct-13	500,000
David Franks	$0.35	31-Mar-14	250,000
Total number of options			**36,892,274**

Source: APK

4.5.4 Election Rights

APK issued 6,000,000 Election Rights to Nippon in April 2013 under the Nippon Gas Loan agreement. (Refer to section 4.4.2 for details on the Nippon Gas Loan).

Key terms of the Election Rights are summarised in the table below:

Number of Election Rights	Expiry date	Exercise price	Settlement amount post exercise of Election Rights	Other
6,000,000	11-Apr-15	N/A	The greater of: - difference between 5 day VWAP of APK Shares and $0.50 - nil. In cash, or (subject to Nippon's consent) in APK Shares.	Nippon must not issue a notice to exercise the Election Rights 14 business days immediately after APK has publicly announced that it has entered into discussions which may result in a change of control transaction or makes any other announcement in respect of a potential or proposed change of control transaction.

Source: APK

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5 Valuation methodologies

5.1 Introduction

In accordance with our adopted valuation approach as set out in section 2.1, our fairness assessment involves comparing the fair market value of APK Shares on a control basis to the cash consideration of $0.52 per APK Share.

Grant Thornton Corporate Finance has assessed the value of APK Shares using the concept of fair market value. Fair market value is commonly defined as:

"the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length."

Fair market value excludes any special value. Special value is the value that may accrue to a particular purchaser. In a competitive bidding situation, potential purchasers may be prepared to pay part, or all, of the special value that they expect to realise from the acquisition to the seller.

5.2 Valuation methodologies

RG 111 outlines the appropriate methodologies that a valuer should generally 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:

- Discounted cash flow ("DCF") method and the estimated realisable value of any surplus assets.
- Application of earnings multiples to the estimated future maintainable earnings or cash flows of the entity, added to the estimated realisable value of any surplus assets.
- Amount available for distribution to security holders on an orderly realisation of assets.
- Quoted price for listed securities, when there is a liquid and active market.
- 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.

Further details on these methodologies are set out in Appendix A to this report. Each of these methodologies is appropriate in certain circumstances.

RG111 does not prescribe the above methodologies as the method(s) that an expert should use in preparing their report. The decision as to which methodology to use lies with the expert based on the expert's skill and judgement and after considering the unique circumstances of the entity or asset being valued. In general, an expert would have regard to valuation theory, the accepted and most common market practice in valuing the entity or asset in question and the availability of relevant information.

5.3 Selected valuation methods

5.3.1 APK Shares

Grant Thornton Corporate Finance has selected the DCF method as the primary approach to assess the equity value of APK.

We consider the DCF method to be appropriate for the following reasons:

- Management have prepared long-term forecast financial information for the business which was made available to interested parties during the sale process.
- The DCF is expected to yield a more accurate valuation assessment of APK given the material customer acquisition costs (capex) and working capital requirements.

We have been provided access to the underlying financial model and with the assistance of APK's Management, we have tested the underlying assumptions to industry benchmarks and historic financial information

In conjunction with our DCF analysis, we have also undertaken a sensitivity analysis of the key variables underlying the projections including energy usage, price of electricity and gas, customer churn and bad debts recovery.

As a crosscheck we have referred to the quoted price of listed securities and empirical evidence in relation to the offer price per customer.

5.3.2 APK Options

There are a number of accepted valuation methodologies available to value options over shares in a company. The two most commonly used of these models are the Black-Scholes option valuation model and the Binomial option pricing model. Both these approaches value an option based upon assuming a log-normal distribution of future share prices. The value of an option is then calculated as an output of the following fundamental determinants of option value:

- The current market value of the underlying asset (share).
- The exercise price of the option.
- The time to expiry of the option.
- The prevailing level of the risk-free interest rate.
- The expected volatility of the value of the underlying asset (share) over the period until the expiry of the option
- The level of dividends expected to be paid on the asset (share) in the period until the expiry of the option and their timing.

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6 The APK Projections

6.1 Background

Management of APK have prepared a detailed monthly cash flow model for APK for the period from 1 July 2013 to 30 June 2017 ("APK Projections"). The APK Projections include three different scenarios (Base Case, Mid Case and High Case) to consider and sensitise the current uncertainty in relation to future retail prices and gross margins. The three scenarios mainly diverge in relation to the assumptions on the level of discounts offered to consumers from FY15 onwards.

The APK Projections adopted for the purpose of our valuation have been updated for the actual financial position as at 30 June 2013 and they are otherwise consistent with the projections approved by the Board in April 2013.

The forecast financial performance for FY14 included in each of the Base Case, Mid Case and High Case scenarios in the APK Projections is consistent with the guidance provided by APK to the market on 9 May 2013.

The major differences between the Base Case, Mid Case and High Case APK Projections are as follows:

- *Base case* – Management have assumed that gross margins will revert to FY13 levels after FY14. The key reason is Management's expectations in relation to the competitive landscape in VIC. Management have advised that its competitors in VIC may seek to engage in aggressive marketing strategies such as offering significant discounts to attract potential new customers. The big energy retailers have recently ceased door to door selling practices and therefore may engage in more aggressive price discounting to win market share. These pricing strategies may have a material impact on APK's ability to retain its relatively small customer base in the absence of price discounting. In addition to the competitive landscape, there is also uncertainty and volatility in relation to wholesale costs. Accordingly, under the Base Case, APK is expected to increase the level of discount offered to its customers after FY15 in order to remain competitive and preserve its customer base.

- *Mid case* – Management have assumed that its large competitors in VIC will engage in moderate marketing strategies and accordingly there will be a marginal decrease in gross margin compared with those forecast for FY14, but higher margins compared with FY13.

- *High case* – Management have assumed that the gross margin in FY15 and beyond will remain steady at forecast FY14 levels. Management consider the High Case to be an aspiration target and not the most likely outcome.

6.2 Our review of Base Case, Mid Case and High Case APK Projections

In accordance with the requirement of RG 111, we have undertaken a critical analysis of the APK Projections including the hypothetical assumptions before relying on them for the purpose of our valuation assessment. Specifically, we have performed the following analysis:

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- Conducted high level checks of the APK Projections, including limited procedures in relation to the mathematical accuracy.
- Performed a broad review, critical analysis and benchmarking of each of the three cases with the historical performance of APK and current trends in the energy market.
- We have held several meetings with the Management of the Company to discuss the APK Projections.

In order to test the reasonableness of APK's forecast, we have, among other things, reviewed and benchmarked revenue growth rates and EBIT margins as summarised below.

Revenue benchmark

We have set out in the table below the projected revenue increases of APK's main competitors (AGL, EnergyAustralia and Origin)[22] based on consensus forecasts. Whilst this provides an indication of investment analysts' views in relation to the revenue growth of some of the largest players in the Australian electricity market, this data should be considered with caution given the diversified operations of AGL, EnergyAustralia and Origin compared with APK. In addition, future revenue growth is driven by several assumptions in relation to the number of customers, average usage per customer, type of customer (retails, commercial, industrial) and retail price forecast.

Forecast revenue growth	FY14	FY15	FY16
	%	%	%
APK	3.1%	5.3%	8.3%
Origin Energy Limited[1]	4.2%	2.9%	NA
AGL Energy Limited[2]	1.5%	2.3%	NA
Origin Energy Limited (based on total company revenue growth)	3.1%	3.2%	8.6%
AGL Energy Limited (based on total company revenue growth)	3.8%	2.7%	4.4%

1. Based on the consensus forecast revenue growth for the Energy Markets and Contact Energy segments.
2. Based on the consensus forecast revenue growth for the Retail and Trading segment.

Source: APK Financial Model, Capital IQ, Broker reports

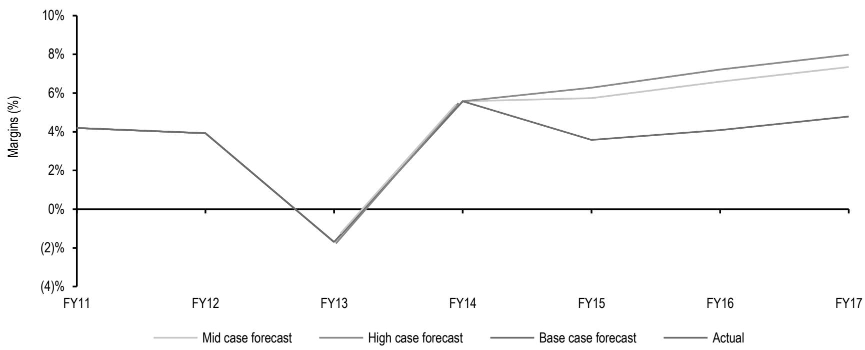
As illustrated in the table above, APK's FY14 revenue growth assumptions are in line with consensus forecast assumptions for its bigger competitors. However, APK's FY15 and FY16 revenue growth assumption are materially above AGL and Origin.

Whilst APK's revenue growth rates are consistent between the 3 cases in the APK Projections, the discount offered to retail prices is higher in the Base Case after FY14. The higher discount offered results in a lower gross margin. In our opinion, the above benchmark analysis provides an indication that the gross margins targeted by the Company after FY14 under the Mid Case and the High Case may be more challenging to achieve.

[22] Given that EnergyAustralia is not a listed company, forecast financial information is not publicly available.

EBIT margin

Set out below is the historical and forecast EBIT margin included in the APK Projections.



As outlined in the graph above, the EBIT margin is expected to increase materially in the APK Projections in all the three cases compared with FY13 (negative 1% EBIT margin). However, the EBIT margin under the Base Case is consistent with the historical performance before FY13.

In our opinion, there is a greater degree of risk in the achievement of the EBIT margin under the Mid Case and High Case due to the following:

- Nature of APK operations as a pure energy retailer.
- The lack of vertical integration of the Company which causes APK margins to be more volatile than some of its major competitors.
- There is a risk that demand for electricity will continue to decrease. This may have significant impacts on APK's ability to achieve the projected EBIT margins given that APK has a large base of fixed costs.
- The risk that APK may not necessarily be able to pass to the end consumers the full future potential increases in the transmission and network costs.
- APK has a higher churn rate and bad debts provisions compared to its competitors (who report such information publicly). APK is required to devote considerable time and financial resources in managing these aspects of its business. As a result APK's "cost to serve" is higher than its competitors (where comparable information is publicly available).

6.3 Selected case

In our valuation assessment of the fair market value of APK, we have adopted the Base Case due to the following:

- In our opinion, a pool of potential purchasers will not be prepared to pay for the EBIT growth estimated in the Mid Case and High Case. The EBIT growth in the Base Case over the forecast period is more consistent with the historical financial performance prior to FY13.

- The NPAT margin in the Base Case at the end of the APK Projections is slightly higher but overall consistent with the FY14 guidance released by the Board to the market.

- Historically APK has not generated positive free cash flows. Whilst this was mainly due to the capital expenditure required to fund customer acquisitions and the strong growth pursued and achieved by the Company in the past, in our opinion, there are material challenges for APK to generate the free cash flows estimated in the Mid Case and High Case and in our opinion, a potential purchaser will not be prepared to pay for them given the inherent uncertainty.

- The YTD financial performance of APK indicates that the winter so far has been milder than in previous years and accordingly, the current electricity and gas usage per customer are slightly below the historical average and the assumptions adopted in the APK Projections.

6.4 Key assumptions of Base Case APK Projections

Set out below are the key assumptions underlying the Base Case APK Projections.

6.4.1 Customer numbers

In June 2013, APK had approximately 354,000 net active customers. In relation to the APK Projections, we note the following:

- Net active customers in FY14 are expected to slightly decline in accordance with the guidance provided to the market as part of Project Refresh.

- At the end of the APK Projections, net active customers are expected to remain substantially unchanged compared with 30 June 2013, although a higher proportion of customers are forecast to be in Victoria. The net active customers located in VIC are expected to increase from 65% of the total customers in FY13 to 73% in FY17.

6.4.2 Pricing and volume

The price increases adopted in the APK Projections are commercial sensitive information and accordingly, we have not disclosed them for the purpose of this report. We have summarised below the principles adopted by Management to estimate future price increases:

- Retail prices are largely driven by the increase in wholesale energy costs. Management expect to be able to continue passing through wholesale energy costs to customers.

- There will be no material change in APK's pricing strategy.

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In relation to average usage rates for gas and electricity, they are estimated based on the Company's most recent rolling 12 months of observed averages. We have summarised in the following table, the assumptions adopted in the APK Projections.

APK Customer Usage	FY2009 Actual	FY2010 Actual	FY2011 Actual	FY2012 Actual	FY2013 Actual	FY2014 Projections	FY2015 Projections	FY2016 Projections	FY2017 Projections
VICTORIA									
Average usage per account - Electricity (mwh/year)	6.0	5.8	5.6	5.3	4.8	4.8	4.8	4.8	4.8
Average usage per account - Gas (gj/year)	66.8	64.2	59.9	55.5	57.7	57.7	57.7	57.7	57.7
NSW									
Average usage per account - Electricity (mwh/year)	-	-	-	7.1	6.2	6.3	6.3	6.3	6.3
Average usage per account - Gas (gj/year)	-	-	-	21.3	21.3	21.3	21.3	21.3	21.3
QUEENSLAND									
Average usage per account - Electricity (mwh/year)	-	-	-	6.8	5.8	5.8	5.8	5.8	5.8
Average usage per account - Gas (gj/year)	-	-	-	11.2	10.1	10.1	10.1	10.1	10.1

Source: APK Management and APK Financial Model

As indicated in the table above, electricity usage per customer has been declining in VIC since FY09. A notable risk of the APK Projections is the assumption that electricity usage going forward will stabilise around the FY13 level. Based on discussions with Management, we understand that the average electricity usage in Victoria has continued to decline over the historical period primarily as a result of increased competition from solar energy and a higher reliance on gas for heating purposes.

6.4.3 Wholesale costs

One of the most significant risks for pure energy retailers is a potential mismatch between changes in wholesale costs and retail prices. Accordingly, the Company has historically sought to mitigate this risk through the use of fixed long term contracts for energy supply or price hedging.

The electricity wholesale costs in the APK Projections are based on the following assumptions:

- *VIC* – based on the current agreement with the Victorian generator until 31 December 2014. Afterwards, the wholesale costs are estimated based on the current discussions with the generator and the current forward electricity curve. Management have assumed that APK will be able to renew electricity contracts over the period of the APK Projections.

- *QLD* – based on the current agreement with the QLD generator until 31 December 2013. Management have assumed that APK will be able to renew its contract over the period of the APK Projections.

- *NSW* – based on electricity derivatives and reallocation contracts with Macquarie. Additionally, APK has entered into forward electricity hedging agreements that include over-the-counter electricity swaps that fix supply costs in NSW. Management have assumed that APK will be able to renew its contracts over the period of the APK Projections.

Gas wholesale costs in the APK Projections are based on the current agreements with the suppliers that extend until December 2014 (refer to section 4.2.2 for further detail). Management expects a significant increase in wholesale gas costs in 2014 and 2015. Management have assumed that these costs will be passed on to customers in full in the APK Projections.

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6.4.4 Other costs assumptions

Other key assumptions are summarised below:

- *Network costs* - are made up primarily of two elements: a daily charge based on the number of customers and distribution charges based on total usage. Management has estimated forecast network price increases for each state over the projection period. Network costs in VIC are expected to increase at a rate higher than inflation as a result of some structural changes in the gas market. In QLD and NSW, network costs are expected to increase in line with inflation or slightly above inflation.

- *Employment costs* - Employment costs are estimated based on existing staff, required new staff take-on and inflation.

- *Operations costs* - Operations costs are largely made up of service fees payable to Serviceworks, a company that provides back office support services. The costs are based on contracted fees payable per customer and are subject to an agreement that expires in two years.

- *Bad debt provision* – as discussed in section 4.4.1, APK experienced a material increase in the bad debt allowance in FY13 from 2.6% of revenue in FY12 to 5.1% of revenue in FY13. The APK Projections assume that the bad debt provision as a percentage of total revenue will stabilise at 3.5% going forward. Based on discussions with Management, we understand that the spike in the bad debt provision in FY13 was partially due to the limited sophistication of certain internal systems and procedures of APK. Recently, APK commissioned an independent review of its customer debt management processes. APK and its customer management outsourced provider have since implemented the review's recommendations with the changes expected to be realised over the next 12 months. Whilst there is uncertainty whether or not the bad debt provision will reduce from the level experienced in FY13, Management is confident of achieving the assumptions adopted in the APK Projections. We note that the FY13 bad debts as a percentage of revenue incurred by APK was materially higher than the major players in the market.[23]

6.4.5 Other assumptions

- *Tax* – tax is calculated based on a corporate tax rate of 30%. We have considered the fair market value of the existing tax losses separately for the purpose of our valuation assessment.

- *Customer acquisition costs* – The customer acquisition costs are projected in accordance with historical information and in line with the agreement with the Cobra Group.

- *Working capital* – creditor days, debtors days and inventory days are projected to consistent with historic trends.

- *Capital expenditure* – mainly relates to the expenditure on IT equipment and IT systems which is projected to be consistent with historic spend.

[23] We note in for the 6-month period ending 31 December 2012, APK's bad debts expense as a percentage of revenue was approximately 4.8%, whilst AGL's was approximately 0.7%. Similarly, Origin's bad debts expense as a percentage of revenue for FY12 was approximately 0.5%.

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6.5 Limitations of Projections

Whilst we have relied on the Base Case APK Projections for the purpose of our valuation assessment, the APK Projections still involve significant elements of subjective judgement that may or may not be correct. There is no guarantee that the future performance will be consistent with the historical performance. The APK Projections do not satisfy the requirements for presentation in a disclosure document and they should be treated with caution. Actual results are likely to be different from those projected as events and circumstances often do not occur as expected and those differences may be material. In particular, we note that there is significant volatility and uncertainty in the Australian electricity market going forward driven by the following:

- Uncertainty in relation to the future of the Carbon Tax and its impact on the electricity market.
- Different regulations and pricing in the states where APK operates. Furthermore, we note that NSW is investigating a full deregulation of the gas and electricity markets (similarly to VIC) and a decision is expected in the second half of 2013.
- Electricity price increases have been material in the last two years due to the introduction of the Carbon Tax and the significant investment in the transmission networks which have been passed to the final consumers. Whilst future price increases are expected to be lower than recent history, future prices are difficult to predict and subject to inherent volatility.
- Uncertainty in relation to the price that APK will pay for wholesale electricity at the end of the current hedging.
- Door to door selling is under increased scrutiny by ACCC and consumers organisation. In addition, the major electricity players have recently agreed to stop door to door practices.

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7 Valuation assessment of APK Shares

7.1 Valuation assessment of APK

As discussed in section 5, we have selected the DCF methodology as our primary valuation methodology to assess the fair market value of APK in relation to the Share Offer.

The DCF method is based on the net present value of future free cash flows and it requires an assessment of the following:

- Future cash flows under the Base Case.
- Discount rate.
- Terminal value.
- Other surplus assets and liabilities.
- Net debt.

7.1.1 Future cash flows

The future cash flows have been assessed having regard to the Base Case in the APK Projections prepared by the Management. Refer to section 6 for details regarding the APK Projections.

7.1.2 Discount rate

The discount rate is based on the weighted average cost of capital ("WACC") which represents the average of the rates of return required by providers of debt and equity capital to compensate for the time value of money and the perceived risk of the business and the uncertainty of the cash flows, weighted in proportion to the market value of the debt and equity capital provided.

Our assessment of the discount rate under the Base Case takes into account the following:

- The nature and purpose of the cash flow projections and our view of the risk inherent in achieving the projections.
- Political uncertainty relating to the upcoming Australian election and the impact the election could have on clean energy legislation including carbon tax reform.
- The uncertainty in relation to the ability of the Company to continue door to door selling practices.
- The breach of financial covenants which have been waived by the Company's lender.
- The financial accounts for the half year ended 31 December 2012 included an emphasis of in relation to the ability of the Company to continue as a going concern.

- High churn rates and bad debt expenses historically incurred by APK.

We have assessed the net present value of the future cash flows using a discount rate between 14.2% and 14.6%. This is based on a cost of equity between 16.5% and 16.8%. A detailed assessment of the derivation of the discount rate is set out in Appendix B.

7.1.3 Terminal value

The terminal value assesses the value of the business after the discrete forecast period (i.e., beyond FY17). The terminal value has been calculated based on a normalised FY17 free cash flow. In our assessment of the terminal value, we have assumed growth of 2.5% per annum based on the following:

- Discussions with Management.
- Level of competition in the electricity and gas markets.
- Level of active customers remaining steady throughout the APK Projections.
- General level of inflation in Australia.
- General growth in population in Australia.

7.1.4 Net present value of public company cost savings

When considering the fair market value of APK on a 100% basis, we have excluded expenses associated with being a publicly listed company, which can be eliminated by a hypothetical purchaser. For APK, these costs include annual report printing, share register reporting costs, investor relations costs, and additional costs associated with the Board and non-executive Directors. We have assessed the net present value of future savings on public company between A$3.8 million and A$3.9 million.

7.1.5 Tax losses

Based on the draft 30 June 2013 financial statements, APK has approximately A$74.8 million in gross accumulated tax losses. For valuation purposes, unutilised tax losses may have a value as the hypothetical purchaser of a company can use the tax losses to offset against future taxable income, subject to satisfying certain taxation rules.

With respect to the potential utilisation of tax losses of APK, Grant Thornton Corporate Finance notes the following:

- The future utilisation of these tax losses is dependent on the ability of APK to meet the requirements of the Australian Tax Office ("ATO") in respect of the "continuity of ownership" or "same business" tests. We have been advised by the Company that following the acquisition of the 19.9% interest in APK by AGL, the Company is expected to fail the continuity of ownership test in relation to the existing tax losses.

- According to a tax ruling (which is strictly and interpretative decision) released by the ATO[24], income tax may be payable upon the supply of energy to the customers rather than when it is billed. Energy retailers have historically recognised the income tax liability upon billing customers. The ATO's view on unbilled revenue may potentially bring forward the timing of tax payments and also the utilisation of tax losses[25]. Whilst it may be difficult for the Company to pursue this avenue on a stand-alone basis given the required working capital funding, a potential purchaser like AGL may decide to pursue this upfront tax payment to crystallise the benefits of the existing tax losses.

- There are uncertainties in relation to the ability of a potential purchaser to utilise the tax losses. In particular, if APK is included in the consolidated tax group of AGL and if AGL can utilise existing APK tax losses under the same business test, those losses may only be utilised based on an available fraction[26]. This may materially delay the timing over which existing tax losses will be utilised and hence, reducing their current value.

Based on the above, Grant Thornton Corporate Finance has assessed the net present value of the existing tax losses with a utilisation rate in the range of 50% and 100% for the purpose of our valuation assessment.

7.1.6 Net debt

The net debt of the Company as at 30 June 2013 is summarised in the table below:

Net debt of APK as at 30 June 2013	Note	30-Jun-13 A$'000
Cash assets		
Cash and cash equivalents		**22,609**
Interest bearing debt		
Revolving loan		(49,568)
Restricted cash facility		(15,000)
Financial commitments - green certificates		(7,018)
Related party loans	1	(6,242)
Other loans		(122)
Finance leases		(32)
Total		**(77,982)**
Net debt as at 30 June 2013		**(55,373)**

Source: APK's FY13 draft financial accounts

Note 1: The related party loan has a maturity date of April 2014 and an effective interest rate of 18%. The loan also provides the lender an Election Rights until 11 April 2015 (refer to section 4.5.4 for further detail on the Election Rights). We have valued the Election Rights separately.

7.1.7 Other assets and liabilities

Other assets and liabilities as at 30 June 2013 comprise the following:

[24] AGL Energy 2012 Annual Report
[25] We note that this is dependent on the whether the company is able to generate a profit in the future and whether the closing deferred revenue for an amended year exceeds the closing deferred revenue by a sufficient amount to be in an overall taxable position.
[26] Based on the relative profit generated by APK compared with AGL.

- A director loan of approximately $0.59 million that was provided by the Company to settle the exercise price of share options.

- An accrued facility fee of $1.0 million related to the loan provided by Macquarie Bank.

The net book value of these other assets and liabilities are assumed to reflect their fair market values.

7.1.8 APK Options and Election Rights

APK currently has 36.9 million APK Options and 6.0 million Election Rights on issue as set out in section 4.5 with different exercise prices and expiry dates. The values of the APK Options and Election Rights have been determined using the Binomial Model, and having regard to the following key assumptions:

- Underlying share price of A$0.39 before the announcement of the Share Offer.

- Risk free rate of 2.5% being the yield on 2 year Australian Commonwealth Government Bond. The maturity of the Government Bond is broadly in line with the maturity of the APK Options.

- Assessed volatility over the life of the APK Options ranging from 31% to 40%[27].

- Dividend yield between nil and 2%.

Based on the above, we have assessed the total value of APK Options and Election Rights to be in the range of $1.0 million and $0.9 million. Refer to section 8 for further detail.

7.1.9 Costs associated with the Share Offer

Management of APK has advised that the estimated transaction costs to be incurred by APK irrespective of whether or not the Share Offer is completed are in the range of A$0.4 million to A$0.45 million.

[27] Based on the historical volatility of the shares of APK observed over a period similar to the life of the Options.

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7.1.10 Valuation of APK shares

Based on the above analysis, we have set out below our valuation assessment of APK Share on a control basis under the Base Case.

Valuation summary - Market value of net assets	Low	High
	A$'000	A$'000
APK enterprise value (control basis)	**150,328**	**163,105**
Net debt	(55,373)	(55,373)
APK Options	(1,046)	(947)
Transaction costs	(450)	(400)
APK equity value (control basis)	**93,459**	**106,386**
Number of APK Shares on issue	191,526,610	191,526,610
Assessed equity value per APK Share (A$) (control basis)	**0.488**	**0.555**

Source: Calculations

7.1.11 Sensitivity analysis

The APK projections include a significant level of subjective judgement and they are based on initiatives yet to be implemented and completed. Accordingly we have conducted a sensitivity analysis on some of the key assumptions underlying the APK Projections. We have conducted sensitivity analysis on the following variables:

- Scenario 1 - +/- 3% on electricity usage prices.
- Scenario 2 - +/- 3% on gas usage price.
- Scenario 3 - +/- 3% average gas and electricity usage per customer.
- Scenario 4 - +/- 3% on wholesale electricity and gas costs.
- Scenario 5 - gross monthly customer acquisitions are +/- 10% of those included in the APK Projections.

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Set out in the following table is a summary of our sensitivity analysis:

Sensitivities	Equity value of APK (A$000)		Per share value of APK (A$)		% change in equity interest	
	Low	High	Low	High	Low	High
Base case	93,459	106,386	0.488	0.555		
Electricity usage prices						
3% increase	143,108	157,596	0.747	0.823	53.1%	48.1%
3% decrease	43,805	55,171	0.229	0.288	(53.1)%	(48.1)%
Gas usage prices						
3% increase	115,425	129,059	0.603	0.674	23.5%	21.3%
3% decrease	71,497	83,717	0.373	0.437	(23.5)%	(21.3)%
Average gas and electricity usage per customer						
3% increase	104,131	117,416	0.544	0.613	11.4%	10.4%
3% decrease	82,769	95,338	0.432	0.498	(11.4)%	(10.4)%
Wholesale electricity and gas costs						
3% increase	69,410	81,591	0.362	0.426	(25.7)%	(23.3)%
3% decrease	117,508	131,181	0.614	0.685	25.7%	23.3%
Gross monthly customer acquisitions						
10% increase	96,688	109,900	0.505	0.574	3.5%	3.3%
10% decrease	89,559	102,178	0.468	0.533	(4.2)%	(4.0)%

Source: Calculations

These sensitivities do not represent a range of potential values of APK, but intend to show to APK Shareholders the sensitivity of our valuation assessment to changes in certain variables.

7.2 Valuation cross-check – enterprise value per customer

As a cross check, we have considered the reasonableness of our valuation by comparing the average cost per acquired customer implied by the DCF valuation with comparable transactions. We note that given the peculiarities of APK operations and the absence of other energy retailers listed on the ASX, we have disregarded the multiples of listed companies.

The enterprise value per customer implied in our DCF assessment is summarised below.

Customer multiples crosscheck	2013 Net active customers		2014 Net active customers	
	Low	High	Low	High
	A$'000	A$'000	A$'000	A$'000
Assessed enterprise value of APK (control basis)	**150,328**	**163,105**	**150,328**	**163,105**
Number of customers	353,990	353,990	340,600	340,600
Implied EV/customer Multiple	**424.7x**	**460.8x**	**441.4x**	**478.9x**

Source: APK Financial Model and GTCF calculations

Set out below are the enterprise value per customer multiples of the comparable transactions observed in the retail energy sector. Refer to Appendix C for further details on the target company's description.

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Comparable company transactions

Date	Target Company	Country	Bidder Company	Stake (%)	Enterprise value (A$'m)	Number of customers ('000)	EV per customer ($)
Electricity retailing - Australia and United States							
Jul-13	Bounce Energy, Inc.	United States	Direct LP, Inc.	100%	56	80	703
Jul-11	Fulcrum Retail Holdings LLC	United States	Just Energy (U.S.) Corp.	100%	95	240	396
Aug-09	Neighbourhood Energy Pty. Ltd.	Australia	Alinta Energy Limited (nka:Redbank Energy Limited)	35%	3	NA	NA
Jul-07	Neighbourhood Energy Pty. Ltd.	Australia	Alinta Energy Limited (nka:Redbank Energy Limited)	65%	10	NA	NA
Apr-07	Victoria Electricity Pty Limited	Australia	Infratil Limited	42%	56	150	720
Feb-07	Powerdirect Australia Pty Ltd. (nka:AGL Sales (Queensland Electricity) Pty Limited)	Australia	AGL Energy Limited	100%	1,200	473	2,537
Nov-06	Sun Retail Pty Limited	Australia	Origin Energy Limited	100%	916	833	1,100
Dec-05	Australian Energy Ltd.	Australia	Ergon Energy Corporation Limited	100%	103	NA	NA
High					**1,200**	**833**	**2,537**
Average					**305**	**355**	**1,091**
Median					**76**	**240**	**720**
Low					**3**	**80**	**396**
Gas retailing - Australia							
Nov-07	AlintaAGL Pty Limited	Australia	Alinta 2000 Limited (nka:WestNet Infrastructure Group Ltd.)	33%	522	NA	NA
Apr-07	Envestra Limited	Australia	Australian Pipeline Ltd.	17%	170	NA	NA
Nov-06	Sun Gas Retail Pty Ltd.	Australia	AGL Energy Limited	100%	75	71	1,059
High					**522**	**71**	**1,059**
Average					**256**	**71**	**1,059**
Median					**170**	**71**	**1,059**
Low					**75**	**71**	**1,059**
Electricity and Gas retailing - Australia and United States							
Dec-10	Retail Businesses of Integral Energy and Country Energy	Australia	Origin Energy Limited	100%	2,108	1,600	1,318
Dec-10	EnergyAustralia Retail	Australia	TRUenergy Pty Ltd. (nka:EnergyAustralia Pty Ltd)	100%	2,035	NA	NA
Apr-10	Hudson Energy Services, LLC	United States	Just Energy (U.S.) Corp.	100%	331	687	482
May-07	EnergyAustralia and International Power (Australia) Retail Energy Partnership (nka:Simply Energy)	Australia	Simply Energy (formerly: International Power plc)	50%	142	200	710
Apr-06	AlintaAGL Pty Limited	Australia	Australian Gas Light Co. (nka:AGL Energy Limited)	33%	367	NA	NA
High					**2,108**	**1,600**	**1,318**
Average					**997**	**829**	**837**
Median					**367**	**687**	**710**
Low					**142**	**200**	**482**

Source: Capital IQ, Mergermarket, and other publicly available sources

In relation to the enterprise value per customer multiples above, we note the following:

- The costs per customer implied by the transaction values may incorporate various levels of control premiums and special values paid for by the acquirers. Evidence from studies indicates that premiums for control on successful takeovers have frequently been in the range of 20% to 40% and that the premiums vary significantly from transaction to transaction.

- The transactions observed took place during the period from 2005 to 2013. Economic factors, including interest rates, CPI and consumer confidence, have varied during that period and may be different from those current as at the valuation date. These factors may influence the amounts paid by the acquirers for these businesses.

- We have also considered certain transactions in the United States, particularly in Texas where we have been advised that the regulatory environment is similar to Australia.

- It is common for retail energy businesses to be acquired on an asset basis only (i.e. customers plus receivables plus unbilled revenues) which results in a significantly higher EV per customer than a transaction such as the Proposed Offer where the EV per customer reflects a reduction for trade creditors and accruals.

The implied cost per customer based on our DCF valuation ranges between A$425/customer and A$479/customer. We note this is lower than the cost per customer realised in some of the recent energy retail transactions in Australia and in the US. We believe this is not unreasonable considering the following:

- Many of the target companies in the energy retailing sector were substantially larger and more diversified than APK and tend to be vertically integrated.

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- APK's high churn rates, lower average tenure and high bad debt provisions compared with peer companies (where public information is available) implies lower quality customers.
- The larger energy retailing companies benefit from higher economies of scale due to larger customer bases and accordingly they will be able to generate higher margins.
- Most of the comparable transactions occurred prior the GFC and therefore, may not accurately reflect current market conditions.
- Bounce Energy Inc., Fulcrum Retail Holdings LLC and Hudson Services LLC are US based energy retailing companies that operate in the US, UK or Canada and might be subject to different regulations, pricing structures, and energy market conditions.

Based on the above, we consider the enterprise value per customer implied in our DCF valuation of APK to be reasonable and to reflect the specific characteristics of APK business.

7.2.1 Quoted securities

Prior to reaching our valuation conclusion, we have also considered the quoted security price as a cross check to the values derived using the sum of parts approach. In accordance with the requirements of RG111, we have considered the listed securities' depth, liquidity, and whether or not the trading prices are likely to represent the market value of APK.

The following table summarises the monthly trading volume of APK since February 2012:

Month end	Volume traded	Monthly VWAP	Total value of shares traded	Volume traded as % of total shares
Feb 2012	1,022	0.4888	499	0.5%
Mar 2012	1,094	0.4902	536	0.6%
Apr 2012	6,452	0.4819	3,109	3.4%
May 2012	1,117	0.5014	560	0.6%
Jun 2012	3,666	0.5067	1,857	1.9%
Jul 2012	1,158	0.4991	578	0.6%
Aug 2012	787	0.4740	373	0.4%
Sep 2012	3,289	0.5202	1,711	1.7%
Oct 2012	3,580	0.5258	1,882	1.9%
Nov 2012	739	0.4972	367	0.4%
Dec 2012	4,817	0.4889	2,355	2.5%
Jan 2013	809	0.4530	366	0.4%
Feb 2013	904	0.4252	384	0.5%
Mar 2013	1,264	0.4355	551	0.7%
Apr 2013	252	0.3547	89	0.1%
May 2013	648	0.3342	216	0.3%
Jun 2013	332	0.3490	116	0.2%
Jul 2013	7,843	0.4964	3,894	4.1%

Source: CapitalIQ

Based on the above table we note the following:

- There has historically been a low level of trading in APK Shares.
- The monthly volume traded as a percentage of total shares outstanding ranged between 0.13% and 4.10% with an average of 1.16% before the announcement of the Share Offer.
- APK's Shares have been quite volatile in past months, with the minimum and maximum monthly VWAP price varying between $0.33 and $0.53 between February 2012 and July 2013.
- Notwithstanding the level of liquidity, APK complies with the full disclosure regime required by the ASX. As a result, the market is fully informed about the performance of APK.
- In the absence of a takeover or other share offers, the trading share price represents the value at which minority shareholders could sell their shares if they wanted to exit their investment.

Given the low level of liquidity of APK, we have only relied on the quoted listed securities valuation method as guidance and cross-check to our primary valuation methodology based on discounted cash flows.

Set out below is a summary of the recent share market prices of APK before the announcement of the Share Offer.

VWAP	Low	High	VWAP
Prior to 15 July 2013			
5 day	0.390	0.390	0.390
10 day	0.340	0.390	0.376
1 month	0.320	0.400	0.373
2 month	0.305	0.400	0.353
3 month	0.305	0.420	0.353
6 month	0.305	0.480	0.404
9 month	0.305	0.530	0.467

Source: CapitalIQ and calculations

Based on the above, the trading VWAPs of APK have ranged between A$0.353 and A$0.467 on a minority basis before the announcement of the Share Offer. However, we are of the opinion that the recent share trading is more relevant given the recent profit downgrade released by APK to the market. In the 3 month period before the Share Offer, trading shares prices of APK ranged between A$0.353 and A$0.390 on a minority basis.

A premium for control is applicable when the acquisition of control of a company or business would give rise to benefits such as:

- The ability to realise synergistic benefits.
- Access to cash flows.
- Access to tax benefits.

- Control of the board of directors of the company.

Evidence from studies indicates that premiums for control on successful takeovers have frequently been in the range of 20% to 40% in Australia and that the premiums vary significantly from transaction to transaction.

Based on the above table, the market value of APK based on recent trading in shares has been assessed between A$0.353 and A$0.390 on a minority basis, which supports our valuation assessment of APK on a control basis between A$0.488 and A$0.555.

We note that given APK's high churn rates, lack of vertical integration and relative size in comparison to its peers, it is unlikely that the high end of the observed control premium is applicable to APK.

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8 Valuation of APK Options

8.1 Consideration offered

In considering the fairness of the Option Offer, we have compared the value of the APK Options before the Option Offer with the value of the Option consideration being offered by AGL.

The consideration offered by AGL for the APK Option is set out in the table below:

Fairness assessment of Option Offer	Exercise price A$	Expiry date	Consideration per Option	Number of Options	Total value of Consideration
Fortess Options[1]	$0.40	22-Dec-14	0.1479	2,500,000	369,750
Fortess Options	$0.55	31-Dec-13	0.0440	5,000,000	220,000
David Franks	$0.35	31-Mar-14	0.1772	250,000	44,300
Employee options	$0.35	31-Oct-13	0.1647	513,031	84,496
Employee options	$0.40	30-Oct-14	0.1592	2,035,000	323,972
Employee options	$0.45	30-Oct-14	0.1303	1,500,000	195,450
Employee options	$0.50	30-Oct-14	0.0859	125,000	10,738
Employee options	$0.50	01-Oct-14	0.1028	500,000	51,400
Employee options	$0.55	30-Oct-14	0.1060	125,000	13,250
Employee options	$0.55	01-Oct-14	0.0826	500,000	41,300
Employee options	$0.55	30-Oct-15	0.0928	1,519,243	140,986
Unlisted options	$0.60	31-Dec-13	0.0289	18,900,000	546,210
Employee options	$0.60	30-Oct-15	0.0757	925,000	70,023
Employee options	$0.70	01-Jul-15	0.0421	500,000	21,050
James Myatt	$0.70	30-Oct-13	0.0052	500,000	2,600
James Myatt	$0.80	30-Oct-13	0.0013	500,000	650
Ian McGregor	$0.20	01-Jul-14	0.3174	1,000,000	317,400
Total				**36,892,274**	**2,453,574**

1. The exercise price is the lower of A$0.40 or the 30 day VWAP of APK at the time of exercise.

Source: BIA

The above consideration for the APK Options is based on a valuation of the APK Options undertaken by an independent valuer using the Black-Scholes methodology. A full copy of the independent valuer's valuation report is set out in Annexure A.

The key assumptions adopted by the independent valuer are set out below:

- Underlying Share Price of $0.52 in line with the Share Offer price.
- Exercise price based on the terms of the APK Options.
- Volatility in the range of 30.9% and 40%.
- Risk free rate of 2.64%.
- Annual dividend of 0.8 cents per share.

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8.2 Valuation assessment of APK Options

We have estimated the value of the APK Options prior to the Option Offer using the Binomial model based on the following assumptions:

- Underlying share price of A$0.39 before the announcement of the Option Offer. We note that in our valuation assessment of the fair market value of the APK Options, we have not adopted the Share Offer price of A$0.52 per share or our valuation assessment of APK on a control basis. In making this assumption, we have considered that the value of an option can be broken down into two main components:
  - Intrinsic value – the difference between exercise price and the underlying share price.
  - Time value – the holder of the option can wait until maturity to exercise the option and in the mean-time generates additional returns (assumed at the risk free rate).

  A control price is only accessible to the holder of the APK Options in conjunction with the sale or the exercise of the APK Options. Accordingly, if the underlying share price is based on the Share Offer price or our valuation assessment of APK on a control basis, the time value of money should be disregarded.
- Risk free rate of 2.5% being the yield on 2 year Australian Commonwealth Government Bond.
- Assessed volatility over the life of the APK Options ranging from 31% to 40%[28].
- Dividend yield of nil% in the low case and 2% in the high case.[29]

Based on the assumptions above, we have set out below a summary of our fairness assessment in relation to the Option Offer.

[28] Based on the historical volatility of the shares of APK observed over a period similar to the life of the Options.
[29] The dividend yield range selected is based on APK's historical dividend yield and discussions with Management. We note that APK has historically only paid a dividend in FY12 and FY13 and the dividend yield in FY13 was approximately 2%. The Directors do not intend to declare a dividend in conjunction with the release of the annual report and if the Share Offer lapses, APK may have limited working capital requirements to declare and pay a dividend.

Fairness assessment of Option Offer	Number of options	Total value of Consideration A$	Assessed option value Low (A$)	High (A$)
Fortess Options¹	2,500,000	369,750	132,759	148,515
Fortess Options	5,000,000	220,000	31,096	33,522
David Franks	250,000	44,300	17,945	18,905
Employee options	513,031	84,496	26,565	27,211
Employee options	2,035,000	323,972	133,428	145,282
Employee options	1,500,000	195,450	73,409	80,614
Employee options	125,000	10,738	4,536	5,023
Employee options	500,000	51,400	17,094	18,875
Employee options	125,000	13,250	3,358	3,748
Employee options	500,000	41,300	12,449	13,857
Employee options	1,519,243	140,986	43,686	52,677
Unlisted options	18,900,000	546,210	59,576	64,775
Employee options	925,000	70,023	20,030	24,455
Employee options	500,000	21,050	4,611	5,688
James Myatt	500,000	2,600	58	64
James Myatt	500,000	650	7	7
Ian McGregor	1,000,000	317,400	189,186	196,420
Total	**36,892,274**	**2,453,574**	**769,793**	**839,638**

1. The exercise price is the lower of A$0.40 or the 30 day VWAP of APK at the time of exercise.

Source: BIA and Grant Thornton Corporate Finance calculations

We note that if we adopt an underlying share price in line with the Share Offer of A$0.52 per share in the valuation of the APK Options, our assessment of the total value of the APK Options is consistent with the price offered by AGL.

We note that the consideration above does not include the value of the Election Rights.

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9 Sources of information, disclaimer and consents

9.1 Sources of information

In preparing this report Grant Thornton Corporate Finance has used various sources of information, including:

- Draft Target's Statement.
- Annual reports of APK for FY10, FY11 and FY12.
- Draft annual report of APK for FY13.
- Interim report of APK for half year ended on 31 December 2012.
- Releases and announcements by APK on the ASX.
- APK website.
- Capital IQ.
- Various broker's reports.
- Other publicly available information.

9.2 Qualifications and independence

Grant Thornton Corporate Finance Pty Ltd holds Australian Financial Service Licence number 247140 under the Corporations Act and its authorised representatives are qualified to provide this report.

Grant Thornton Corporate Finance provides a full range of corporate finance services and has advised on numerous takeovers, corporate valuations, acquisitions, and restructures. Prior to accepting this engagement, Grant Thornton Corporate Finance considered its independence with respect to and all other parties involved in the Share Offer and Option Offer with reference to the ASIC Regulatory Guide 112 "Independence of expert" and APES 110 "Code of Ethics for Professional Accountants" issued by the Accounting Professional and Ethical Standard Board. We have concluded that there are no conflicts of interest with respect to APK, its shareholders and all other parties involved in the Share Offer and Option Offer.

Grant Thornton Corporate Finance and its related entities do not have at the date of this report, and have not had within the previous two years, any shareholding in or other relationship with APK or its associated entities that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Share Offer and Option Offer.

Grant Thornton Corporate Finance has no involvement with, or interest in the outcome of the Share Offer and Option Offer, other than the preparation of this report.

Grant Thornton Corporate Finance will receive a fee based on commercial rates for the preparation of this report. This fee is not contingent on the outcome of the Share Offer and Option Offer. Grant Thornton Corporate Finance's out of pocket expenses in relation to the preparation of the report will be reimbursed. Grant Thornton Corporate Finance will receive no other benefit for the preparation of this report.

9.3 Limitations and reliance on information

This report and opinion is based on economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time. Grant Thornton Corporate Finance has prepared this report on the basis of financial and other information provided by APK and publicly available information. Grant Thornton Corporate Finance has considered and relied upon this information. Grant Thornton Corporate Finance has no reason to believe that any information supplied was false or that any material information has been withheld. Grant Thornton Corporate Finance has evaluated the information provided by APK through inquiry, analysis and review, and nothing has come to our attention to indicate the information provided was materially misstated or would not afford reasonable grounds upon which to base our report. Nothing in this report should be taken to imply that Grant Thornton Corporate Finance has audited any information supplied to us, or has in any way carried out an audit on the books of accounts or other records of APK.

The responsibility for business plan and forecasts, and the assumptions on which they are based, is solely that of the directors of the Company. It must be emphasised that all profit and cash flow forecasts necessarily depend on subjective judgement. They are, to a greater or lesser extent, according to the nature of the business and the period covered by the forecasts, subject to substantial inherent uncertainties. In consequence, they are not capable of being substantiated or audited in the same way as financial statements which present the results of completed accounting periods.

This report has been prepared to assist the directors of APK in advising the APK Shareholders and APK Optionholders in relation to the Share Offer and Option Offer. This report should not be used for any other purpose. In particular, it is not intended that this report should be used for any purpose other than as an expression of Grant Thornton Corporate Finance's opinion as to whether the Share Offer and Option Offer is fair and reasonable to the APK Shareholders and APK Optionholders.

APK has indemnified Grant Thornton Corporate Finance, its affiliated companies and their respective officers and employees, who may be involved in or in any way associated with the performance of services contemplated by our engagement letter, against any and all losses, claims, damages and liabilities arising out of or related to the performance of those services whether by reason of their negligence or otherwise, excepting gross negligence and wilful misconduct, and which arise from reliance on information provided by APK, which APK knew or should have known to be false and/or reliance on information, which was material information APK had in its possession and which APK knew or should have known to be material and which did not provide to Grant Thornton Corporate Finance. APK will reimburse any indemnified party for all expenses (including without limitation, legal expenses) on a full indemnity basis as they are incurred.

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9.4 Consents

Grant Thornton Corporate Finance consents to the issuing of this report in the form and context in which it is included in the Target Statement to be sent to APK Shareholders and APK Optionholders. Neither the whole nor part of this report nor any reference thereto may be included in or with or attached to any other document, resolution, letter or statement without the prior written consent of Grant Thornton Corporate Finance as to the form and content in which it appears.

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Appendix A – Valuation methodologies

Capitalisation of future maintainable earnings

The capitalisation of future maintainable earnings multiplied by appropriate earnings multiple is a suitable valuation method for businesses that are expected to trade profitably into the foreseeable future. Maintainable earnings are the assessed sustainable profits that can be derived by a company's business and excludes any abnormal or "one off" profits or losses.

This approach involves a review of the multiples at which shares in listed companies in the same industry sector trade on the share market. These multiples give an indication of the price payable by portfolio investors for the acquisition of a parcel shareholding in the company.

Discounted future cash flows

An analysis of the net present value of forecast cash flows or DCF is a valuation technique based on the premise that the value of the business is the present value of its future cash flows. This technique is particularly suited to a business with a finite life. In applying this method, the expected level of future cash flows are discounted by an appropriate discount rate based on the weighted average cost of capital. The cost of equity capital, being a component of the WACC, is estimated using the Capital Asset Pricing Model.

Predicting future cash flows is a complex exercise requiring assumptions as to the future direction of the company, growth rates, operating and capital expenditure and numerous other factors. An application of this method generally requires cash flow forecasts for a minimum of five years.

Orderly realisation of assets

The amount that would be distributed to shareholders on an orderly realisation of assets is based on the assumption that a company is liquidated with the funds realised from the sale of its assets, after payment of all liabilities, including realisation costs and taxation charges that arise, being distributed to shareholders.

Market value of quoted securities

Market value is the price per issued share as quoted on the ASX or other recognised securities exchange. The share market price would, prima facie, constitute the market value of the shares of a publicly traded company, although such market price usually reflects the price paid for a minority holding or small parcel of shares, and does not reflect the market value offering control to the acquirer.

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Comparable market transactions

The comparable transactions method is the value of similar assets established through comparative transactions to which is added the realisable value of surplus assets. The comparable transactions method uses similar or comparative transactions to establish a value for the current transaction.

Comparable transactions methodology involves applying multiples extracted from the market transaction price of similar assets to the equivalent assets and earnings of the company. The risk attached to this valuation methodology is that in many cases, the relevant transactions contain features that are unique to that transaction and it is often difficult to establish sufficient detail of all the material factors that contributed to the transaction price.

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Appendix B – Discount Rate

Introduction

The discount rate was determined using the WACC formula. The WACC represents the average of the rates of return required by providers of debt and equity capital to compensate for the time value of money and the perceived risk or uncertainty of the cash flows, weighted in proportion to the market value of the debt and equity capital provided. However, we note that the selection of an appropriate discount rate is ultimately a matter of professional judgment.

Under a classical tax system, the WACC is calculated as follows:

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

Where:

- Re = the required rate of return on equity capital;
- E = the market value of equity capital;
- D = the market value of debt capital;
- Rd = the required rate of return on debt capital; and
- t = the statutory corporate tax rate.

WACC Inputs

Required rate of return on equity capital

We have used the Capital Asset Pricing Model ("CAPM"), which is commonly used by practitioners, to calculate the required return on equity capital.

The CAPM assumes that an investor holds a large portfolio comprising risk-free and risky investments. The total risk of an investment comprises systematic risk and unsystematic risk. Systematic risk is the variability in an investment's expected return that relates to general movements in capital markets (such as the share market) while unsystematic risk is the variability that relates to matters that are unsystematic to the investment being valued.

The CAPM assumes that unsystematic risk can be avoided by holding investments as part of a large and well-diversified portfolio and that the investor will only require a rate of return sufficient to compensate for the additional, non-diversifiable systematic risk that the investment brings to the portfolio. Diversification cannot eliminate the systematic risk due to economy-wide factors that are assumed to affect all securities in a similar fashion. Accordingly, whilst investors can eliminate unsystematic risk by diversifying their portfolio, they will seek to be compensated for the non diversifiable systematic risk by way of a risk premium on the expected return. The extent of this compensation depends on the extent to which the company's returns are correlated with the market as a whole. The greater the systematic risk faced by investors, the larger the required return on capital will be demanded by investors.

The systematic risk is measured by the investment's beta. The beta is a measure of the co-variance of the expected returns of the investment with the expected returns on a hypothetical portfolio comprising all investments in the market – it is a measure of the investment's relative risk.

A risk-free investment has a beta of zero and the market portfolio has a beta of one. The greater the systematic risk of an investment the higher the beta of the investment.

The CAPM assumes that the return required by an investor in respect of an investment will be a combination of the risk-free rate of return and a premium for systematic risk, which is measured by multiplying the beta of the investment by the return earned on the market portfolio in excess of the risk-free rate.

Under the CAPM, the required nominal rate of return on equity (R_e) is estimated as follows:

$$R_e = R_f + \beta_e(R_m - R_f)$$

Where:

- R_f = risk free rate
- β_e = expected equity beta of the investment
- $(R_m - R_f)$ = market risk premium

Risk free rate

In the absence of an official risk free rate, the yield on the Australian Commonwealth Government Bonds is commonly used as a proxy. We have observed the yield on the 10 year Australian Commonwealth Government Bond for a period of 5, 10 and 20 days prior to 16 July 2013 as set out in the table below:

Australia Government Debt - 10 Year as at 16 July 2013		Range		Daily average
Previous 5 days trading	3.68%	-	3.78%	3.71%
Previous 10 days trading	3.68%	-	3.85%	3.74%
Previous 20 days trading	3.35%	-	3.99%	3.70%
Previous 30 days trading	3.00%	-	3.99%	3.38%
Previous 6 months trading	3.00%	-	3.99%	3.39%
Previous 1 year trading	2.71%	-	3.99%	3.25%
Previous 5 years trading	2.71%	-	6.48%	4.74%
Previous 10 years trading	2.71%	-	6.79%	5.26%

Source: RBA

Based on the above, we have adopted the risk free rate of 5%, which is primarily based on the 10-day average yield on the 10-year Australian Commonwealth Government Bond as at 16 July 2013.

Market risk premium

The market risk premium represents the additional return an investor expects to receive to compensate for additional risk associated with investing in equities as opposed to assets on which a risk free rate of return is earned.

Empirical studies of the historical risk premium in Australia over periods of up to 100 years suggest the premium is between 6% and 8%. For the purpose of the valuation, Grant Thornton Corporate Finance has adopted a market risk premium of 6%.

We note that our adopted premium is consistent with the market risk premium used by regulatory authorities in Australia (such as the Australian Competition and Consumer Commission and all other state based regulators).

Specific risk premium

As detailed in the beta section below we have adopted a beta with regard to APK's own observed historical beta, which largely reflects the historical risk of the business. In selecting an additional risk premium we have the following additional specific risks:

- We note that in recent years the average usage per customer has decreased slightly year on year due to higher energy costs and more focus on renewable energy sources (i.e., solar panels). Whilst, Management have assumed over the forecast period that the usage level would stabilise, there is a risk that the level of electricity usage will continue to decline.

- In FY13, APK experienced a significant increase in provision for bad debts. The bad debts provision increased from 2.5% to 5.0% of revenue. In the APK Projections, Management have assumed bad debts provision will reduce and remain steady at 3.5% of revenue. We understand that Management have engaged external consultants to review APK's internal collection procedures, however given the recent historic experience there is a risk that APK may continue to experience higher level of bad debts compared to the APK Projections.

- There is no certainty that door-to-door selling will continue to be allowed in Australia going forward and this may have a material impact on APK, given it is currently a key marketing channel for the Company.

- Political uncertainty relating to the upcoming Australian elections and the impact these elections could have on clean energy legislation including carbon tax reform.

Based on the above we have adopted a specific risk premium of 4% under the Base Case.

Beta

The beta measures the expected relative risk of the equity in a company. The choice of the beta requires judgement and necessarily involves subjective assessment as it is subject to measurement issues and a high degree of variation.

An equity beta includes the effect of gearing on equity returns and reflects the riskiness of returns to equity holders. However, an asset beta excludes the impact of gearing and reflects the riskiness of returns on the asset, rather than returns to equity holders. Asset betas can be compared across asset classes independent of the impact of the financial structure adopted by the owners of the business.

Equity betas are typically calculated from historical data. These are then used as a proxy for the future which assumes that the relative risk of the past will continue into the future. Therefore, there is no right equity beta and it is important not to simply apply historical equity betas when calculating the cost of equity.

For the purpose of this report, we have had regard to the observed betas (equity betas) of companies listed in Australia with energy retail operations. Our initial search revealed only two companies, other than APK, listed in Australia with retail operations; therefore we expanded the comparable company search to companies listed in Western Europe and the US with energy retail operations. An analysis of the betas of companies operating in the industry is set out below:

Company Beta analysis	Country	Market Cap A$'million	Equity Beta*	Gearing Ratio*	Ungeared Beta	Regeared Beta
Origin Energy Limited	Australia	13,692	0.61	25.6%	0.52	0.68
AGL Energy Limited	Australia	8,252	0.26	17.0%	0.23	0.30
Consolidated Edison Inc.	United States	18,952	0.41	74.5%	0.28	0.36
Sempra Energy	United States	22,141	0.74	67.0%	0.51	0.67
DTE Energy Company	United States	13,106	0.74	97.6%	0.45	0.58
OGE Energy Corp.	United States	7,713	0.79	66.9%	0.55	0.72
RWE AG	Germany	19,696	0.88	69.6%	0.59	0.77
Centrica plc	United Kingdom	32,070	0.53	21.3%	0.46	0.59
Just Energy Group Inc.	Canada	1,063	0.93	38.4%	0.70	0.91

* Equity betas are calculated using data provided by CapitalIQ. The betas are based on a five-year period with monthly obervations and have been degeared based on the average gearing ratio over five years.

On further analysis all identified listed companies with energy retail operations were found to be significantly different to APK due to larger size, vertical integration and profitability. The risk profiles of these large, well established and diverse companies bears limited resemblance to that of APK, despite operating in the same industry, and any conclusions drawn from comparison with these identified companies would likely be misleading.

In selecting the beta to be used for this valuation, and lacking any close comparable companies in the market, we have therefore had regard to the observed beta of APK itself over the period in which it has been operational in the energy retail industry. For the purposes of this valuation, we have selected a beta range of between 1.25 and 1.30 to calculate the required rate of return on equity capital for the business.

Cost of debt

For the purpose of estimating the cost of debt, Grant Thornton Corporate Finance has considered:

- The weighted average interest rate on credit outstanding for large businesses over the last 12 months as published by the Reserve Bank of Australia, which represents the all up interest cost of business loans (including risk margins) across all banks. We note that over the last 12 months, the weighted average interest rate was 420 basis points over the yield on 10-year Australian Commonwealth Government Bonds.

- The weighted average interest rate on credit outstanding for small businesses over the last 12 months as published by the Reserve Bank of Australia. The weighted average interest rate over the last 12 months was 225 basis points over the yield on 10-year Australian Commonwealth Government Bond.

- Current debt facilities of APK.

- The debt-to-equity ratio adopted for the purpose of the WACC.

Based on the above, Grant Thornton Corporate Finance has adopted the debt margin of 200 to 300 basis points over the risk free rate as the cost of debt for estimating the WACC. Based on the adopted risk free rate of 5%, the cost of debt adopted is in the range of 7% to 8%.

Capital structure

Grant Thornton Corporate Finance has considered the gearing ratio which a hypothetical purchaser of the business would adopt in order to generate a balanced return given the inherent risks associated with debt financing. Factors which a hypothetical purchaser may consider include the shareholders' return after interest payments, and the business' ability to raise external debt.

The appropriate level of gearing that is utilised in determining WACC for a particular company should be the "target" gearing ratio, rather than the actual level of gearing, which may fluctuate over the life of a company. The target or optimal gearing level can therefore be derived based on the trade-off theory which stipulates that the target level of gearing for a project is one at which the present value of the tax benefits from the deductibility of interest are offset by present value of costs of financial distress. In practice, the target level of gearing is evaluated based on the quality and variability of cash flows. These are determined by:

- The quality and life cycle of a company.

- Working capital.

- Level of capital expenditure.

- The risk profile of the assets.

For the purpose of the valuation, Grant Thornton Corporate Finance has adopted a debt to equity ratio of 20% debt and 80% equity.

WACC calculation

The discount rate is determined using the WACC formula is set out below:

WACC calculation	Low	High
Cost of equity		
Risk free rate	5.0%	5.0%
Beta	1.25	1.30
Market risk premium	6.0%	6.0%
Specific risk premium	4.0%	4.0%
Cost of equity	**16.5%**	**16.8%**
Cost of debt		
Cost of debt (pre tax)	7.0%	8.0%
Tax	30%	30%
Cost of debt (post tax)	**4.9%**	**5.6%**
Capital structure		
Proportion of debt	20%	20%
Proportion of equity	80%	80%
	100%	100%
WACC (post tax)	**14.2%**	**14.6%**

Source: Grant Thornton Corporate Finance calculations

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Appendix C – Comparable companies

Company	Description
Origin Energy Ltd	Origin Energy Limited is engaged in the operation of energy businesses, including exploration and production of oil and gas; electricity generation, and wholesale and retail sale of electricity and gas. It has four business segments. The Exploration & Production segment is engaged in natural gas exploration and production in Australia and New Zealand. The Retail segment retails natural gas, electricity, liquefied petroleum gas (LPG) and energy-related products and services in Australia and the Pacific. The Generation segment is involved in natural gas-fired cogeneration and power generation in Australia. The Contact Energy segment is engaged in the provision of natural gas and energy-related products and services in New Zealand; power generation in New Zealand, and LPG and related products and services in New Zealand.
AGL Energy Ltd	AGL Energy Limited is an Australia-based company. The Company is engaged in buying and selling of gas and electricity; construction and/or operation of power generation and energy processing infrastructure; development of natural gas production facilities, and exploration, extraction, production and sale of coal seam gas (CSG).
Consolidated Edison Inc	Consolidated Edison, Inc. (Con Edison) is the holding company of Consolidated Edison Company of New York, Inc. (CECONY), and Orange and Rockland Utilities, Inc. (O&R). CECONY's business operations are its regulated electric, gas and steam delivery businesses. O&R's principal business operations are its regulated electric and gas delivery businesses. Its competitive energy businesses sell electricity to wholesale and retail customers, provide certain energy-related services and participate in energy infrastructure projects. CECONY provides electric service to approximately 3.3 million customers in all of New York City (except part of Queens) and Westchester County, an approximately 660 square mile service area with a population of more than nine million. O&R and its utility subsidiaries, Rockland Electric Company (RECO) and Pike County Power & Light Company (Pike) provide electric service to approximately 0.3 million customers.
Sempra Energy	Sempra Energy is an energy services holding company. Sempra Energy has five segments: San Diego Gas & Electric Company (SDG&E), Southern California Gas Company (SoCalGas), Sempra Commodities, Sempra Generation and Sempra Pipelines & Storage. SoCalGas and SDG&E sell, distribute, and transport natural gas. SoCalGas purchases and stores natural gas for itself and SDG&E on a combined portfolio basis and provides natural gas storage services for others. SoCalGas provides natural gas storage services for core, non-core and non-end-use customers. Core customers are residential and commercial and industrial customers. Non-core customers at SoCalGas consist primarily of electric generation, wholesale, large commercial, industrial, and oil recovery customers.
DTE Energy Co	DTE Energy Company (DTE Energy) is engaged in the energy business. The Company's utility operations consist of The Detroit Edison Company (Detroit Edison) and Michigan Consolidated Gas Company (MichCon). The Company also has four segments that are engaged in a variety of energy-related business. Detroit Edison is engaged in the generation, purchase, distribution and sale of electricity to approximately 2.1 million customers in south-eastern Michigan. MichCon is engaged in the purchase, storage, transmission, gathering, distribution and sale of natural gas to approximately 1.2 million customers throughout Michigan. The other segments are involved in gas pipelines and storage; unconventional gas exploration, development and production; power and industrial projects and coal transportation and marketing, and energy marketing and trading operations.

Company	Description
OGE Energy Corp	OGE Energy Corp. is an energy and energy services provider offering physical delivery and related services for both electricity and natural gas primarily in the south central United States. The Company conducts these activities through four business segments: electric utility, natural gas transportation and storage, natural gas gathering and processing and natural gas marketing. The electric utility segment generates, transmits, distributes and sells electric energy in Oklahoma and western Arkansas. Its operations are conducted through Oklahoma Gas and Electric Company (OG&E). Enogex LLC and its subsidiaries (Enogex) provide integrated natural gas midstream services. Enogex is engaged in the business of gathering, processing, transporting and storing natural gas. Enogex's operations are organized into two business segments: natural gas transportation and storage and natural gas gathering and processing.
RWE AG	RWE AG is engaged in the business of generation, trading, transmission and supply of electricity and gas. The Company operates through seven divisions. Germany, Netherlands/Belgium, United Kingdom, Central and Eastern Europe, Renewables, Upstream gas and oil, and Trading/gas midstream. The Company acquired the Dutch energy utility Essent N.V. as of September 30, 2009. The Company's Germany division consists of the Generation and Sales and distribution networks business areas. It also includes the German regional utilities, which operate their own electricity generation facilities to a small extent, besides handling the network and end-customer business. The United Kingdom business division encompasses its entire United Kingdom generation and supply business with the exception of electricity production from renewables.
Centrica Plc	Centrica plc is an integrated energy company operating predominantly in the United Kingdom and North America. In the United Kingdom, it operates three segments: upstream, downstream and storage. Upstream includes production, generation and processing of gas and oil and trading in physical and financial energy contracts. Downstream includes supplying of gas and electricity to residential and business customers and offering a range of home energy solutions and low-carbon products and services. In North America, the Company supply gas, electricity and energy solutions to residential and business customers. In addition, it is also involved in gas production, power generation and procurement and trading activities in the North American wholesale energy markets.
Just Energy Group Inc.	Just Energy Group Inc. engages in the sale of natural gas and/or electricity to residential and commercial customers in Canada and the United States. Just Energy Group is a provider of energy solutions to residential and commercial customers through fixed and variable electricity and natural gas products, green energy products, home and commercial appliances (such as hot water heaters), solar products, and energy brokerage service. Just Energy currently serves over 1.8 million customers in the US.

Appendix D – Target companies

Target company	Description
Bounce Energy Inc.	Bounce Energy, Inc., an electricity company, retails electricity to residential and small business customers in Texas. The company was founded in 2008 and is based in Houston, Texas.
Fulcrum Retail Holdings LLC	Fulcrum Retail Holdings LLC engages in retail of electricity and sells fixed and index energy products under the brands Tara Energy, Amigo Energy, and Smart Prepaid Electric. The company is based in Houston, Texas. Fulcrum Retail Holdings LLC operates as a subsidiary of Fulcrum Power Services, L.P. As of October 3, 2011, Fulcrum Retail Holdings LLC operates as a subsidiary of Just Energy (U.S.) Corp.
Neighbourhood Energy Pty Ltd	Neighbourhood Energy Pty. Ltd., an electricity retail company, sells electricity to Victorian residential customers in Australia. The company was incorporated in 2004 and is based in Elsternwick, Australia. As of July 3, 2007, Neighbourhood Energy Pty. Ltd. operates as a subsidiary of Redbank Energy Limited.
Victoria Electricity Pty Ltd	Victoria Electricity Pty Limited buys and distributes gas and electricity to commercial and business operators. The company also offers community buying, financial counselor, and payment assistance services. It provides its services through gas pipes and meters, and electricity connections. The company was founded in 2002 and is based in Melbourne, Australia. Victoria Electricity Pty Limited operates as a subsidiary of Infratil Ltd.
Powerdirect Australia Pty Ltd (nka: AGL Sales Queensland Electricity)	AGL Sales (Queensland Electricity) Pty Limited supplies electricity for households, large corporations, and rural and small to medium sized enterprises in Australia. AGL Sales (Queensland Electricity) Pty Limited was formerly known as Powerdirect Australia Pty Ltd. and changed its name to AGL Sales (Queensland Electricity) Pty Limited in March 2007. The company was founded in 1997 and is based in Burwood East, Australia with offices in Queensland, South Australia, New South Wales, and Victoria, Australia. As of March 1, 2007, AGL Sales (Queensland Electricity) Pty Limited operates as a subsidiary of AGL Energy Limited.
Sun Retail Pty Ltd	Sun Retail Pty Limited distributes gas and electricity in South East Queensland and Northern New South Wales, Australia. The company purchases, markets, and sells gas products and services. Sun Retail Pty Limited was formerly known as Energex Retail Pty Ltd. and changed its name to Sun Retail Pty Limited in May 2006. The company was incorporated in 1997 and is based in Brisbane, Australia. Sun Retail Pty Limited operates as a subsidiary of Origin Energy Limited.
Australian Energy Limited	Australian Energy Limited engages in the retail sale of electricity to the small and medium sized business market in Australia. It offers tailored electricity rates depending on customer's needs through its brand Power direct. Customers of the company include manufacturing and retail sectors, as well as residential consumers, bakeries, restaurants, and cafes. As of April 24, 2006, Australian Energy Ltd. is a subsidiary of Ergon Energy Corporation Limited.
AlintaAGL Pty Limited	AlintaAGL Pty Limited operates as a distributor of natural gas and electricity in Western Australia. The company was incorporated in 2002 and is based in Perth, Australia. AlintaAGL Pty Limited operates as a subsidiary of WestNet Infrastructure Group Ltd.
Envestra Limited	Envestra Limited owns, operates, and manages transmission pipelines and gas distribution networks in Australia. The company provides natural gas haulage services to retailers. It owns approximately 22,200 kilometers of natural gas distribution networks and approximately 1,120 kilometers of transmission pipelines serving approximately 1.1 million consumers in South Australia, Victoria, Queensland, New South Wales, and the Northern Territory. The company was founded in 1861 and is based in Adelaide, Australia.

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Sun Gas Retail Pty Ltd	As of February 2, 2007, Sun Gas Retail Pty Ltd. of Energex Ltd. was acquired by AGL Energy Limited. Sun Gas Retail Pty, Ltd. supplies natural gas to commercial, industrial, and residential customers in Victoria, Queensland, and northern New South Wales in Australia. The company is based in Brisbane, Australia.
Retail Businessess of Integral Energy and Country Energy	As of March 1, 2011, retail businesses of Integral Energy and Country Energy were acquired by Origin Energy Ltd. Retail Businesses of Integral Energy and Country Energy comprises liquefied natural gas and electricity distribution customer contracts, supply contracts, gas transportation agreements, intellectual property, trademark, and brand names.
Energy Australia Retail	EnergyAustralia Retail retails electricity in Australia's National Electricity Market, retailing 21 terawatt-hour (TWh) per annum and provides natural gas, retailing 9 petajoule (PJ) per annum. The company is based in Australia. As of March 1, 2011, EnergyAustralia Retail operates as a subsidiary of TRUenergy Pty Ltd.
Hudson Energy Services LLC	Hudson Energy Services, LLC provides retail electricity and natural gas services to commercial, industrial, and residential customers. It serves markets in Texas, Illinois, New York, New Jersey, Massachusetts, Pennsylvania, Ohio, and California in the United States; Ontario and Alberta in Canada; and the United Kingdom. The company was founded in 2002 and is based in Suffern, New York. As of May 7, 2010, Hudson Energy Services, LLC operates as a subsidiary of Just Energy (U.S.) Corp.
Energy Australia and International Power Retail Energy Partnership	Simply Energy engages in the retail of electricity and gas to retail customers in Victoria and South Australia. The company is based in Australia. Simply Energy operates as a subsidiary of International Power plc.

Appendix E – Glossary

A$ or $	Australian dollar
ACCC	Australian Competition & Consumer Commission
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AGL	AGL Energy Limited
APK	Australian Power and Gas Company Limited
APK Shares	All ordinary shares in APK (191,526,610)
APK Shareholders	Shareholders of APK
APK Options	All options in APK (36,892,274)
APK Projections	Cash flow model for APK projected for the period from 1 July 2013 to 30 June 2017
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATO	Australian Tax Office
CAGR	Compound annual growth rate
CAPM	Capital Asset Pricing Model
Cobra Group	The Cobra Group Pty Limited
Code	Retail energy industry Code of Practice
Company	Australian Power and Gas Company Limited
Corporations Act	Corporations Act, 2001 (cth)
CSG	Coal seam gas
DCF	Discounted cash flow
Defeating Conditions	Share Offer becomes free of defeating conditions
EBITDAF	Earnings before interest, tax expense, depreciation and amortisation, and changes in the fair valuation of financial instruments and other assets
Election Rights	Election rights granted to Nippon (6,000,000)
Electricity Forward Contracts	Fixed forward commodity contracts
ESAA	Energy Supply Association of Australia
FSG	Financial Services Guide
FY/HY	Financial year/Half financial year
GFC	Global Financial Crisis
Grant Thornton Corporate Finance	Grant Thornton Corporate Finance Pty Ltd
GWh	Gigawatt hours
H1 FY13	Half year ended 31 December 2012
IPART	Independent Pricing and Regulatory Tribunal
LNG	Liquefied natural gas
Management	The management of APK
Macquarie	Macquarie Bank Limited

Macquarie Facility	Multi-option facility agreement with Macquarie
NEM	National Electricity Market
NEM Jurisdictions	The regulatory environment is mainly focussed on the states that are a part of the NEM
Nippon Gas	Nippon Gas Co. Ltd
NSW	New South Wales
QCA	QLD Competition Authority
QLD	Queensland
RET	Renewable Energy Target
RG 111	ASIC Regulatory Statement 111 "Content of expert reports"
RG 112	ASIC Regulatory Statement 112 "Independence of experts"
SA	South Australia
STTM	Short Term Trading Market
TAS	Tasmania
the Electricity Retail Industry	The electricity retail industry in Australia
VIC	Victoria
VWAP	Volume Weighted Average Price
VWGM	Victorian Wholesale Gas Market
WACC	Weighted Average Cost of Capital

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