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# REGIONAL EXPRESS HOLDINGS LIMITED

ISSUE OF CONVERTIBLE NOTES TO PAGAC REGULUS HOLDING PTE LTD

INDEPENDENT EXPERT'S REPORT AND FINANCIAL SERVICES GUIDE  
23 DECEMBER 2020



23 December 2020

The Directors  
Regional Express Holdings Limited  
81-83 Baxter Road  
Mascot NSW 2020

Dear Directors,

## Independent Expert's Report for Regional Express Holdings Limited

### 1. Introduction

Regional Express Holdings Limited ("**REX**") is a public company listed on the Australian Securities Exchange ("**ASX**") that has operated a regional airline in Australia since 2002.

Due to the turmoil in the domestic airline sector caused by the COVID-19 pandemic coupled with the insolvency of Virgin Australia Limited ("**Virgin**") in May 2020, the board of REX identified an opportunity to expand the business to provide regular public transport ("**RPT**") jet operations to capital cities in the domestic market, in particular between Sydney, Melbourne and Brisbane in the first instance ("**Domestic Services**"). The current environment was seen to be ideal to take advantage of a unique market opportunity to leverage the abundance of airport slots, infrastructure, aircraft, pilots, engineers and low fuel prices. On 13 May 2020, REX announced its intention to explore the possibility of establishing domestic capital city routes.

As part of the process to launch the Domestic Services, REX considered a number of funding alternatives including sale and leaseback of owned fleet, debt funding and equity and other capital injections from existing shareholders and other third parties. After considering the various options, management's preferred funding arrangement was via convertible notes from PAGAC Regulus Holding Pte Ltd ("**PAG**").

On 22 September 2020, REX announced that it had signed a long form term sheet with PAG, a fund affiliated with PAG Asia Capital (Hong Kong) Limited, regarding an investment, via convertible notes, of up to \$150 million ("**Proposed Transaction**") to support the launch of the Domestic Services. The funding is proposed to comprise first ranking senior secured convertible notes ("**Convertible Notes**"). It is proposed that an initial funding tranche of \$50 million will be drawn at completion, with the balance to be drawn over the following three years if required. The notes will be convertible at \$1.50 per share. If REX does not utilise the full \$150 million offered pursuant to the facility within three years post completion, PAG will be issued with warrants for nil consideration with an exercise price of A\$1.50 per share for the difference between the facility amount and the balance drawn ("**Warrants**").

Based on issued share capital at 12 November 2020, if the \$50 million first tranche is fully converted, PAG would hold approximately 23.3% of REX's total issued shares, and 47.6% if the full facility is drawn and converted. Further details of the Proposed Transaction are set out in Section 1 of our detailed report.

### 2. Purpose of the report

If the Proposed Transaction is approved, and the Convertible Notes are converted and/or Warrants exercised, PAG will acquire an interest of between 23.3% and 47.6% in REX, depending on the loan amount converted and the number of Warrants exercised. An acquisition of securities that enables a shareholder to increase its relevant interests in a listed company from below 20% to above 20% is prohibited, except in certain circumstances. One of the exceptions is if the acquisition is approved at a general meeting of the target company. The approval of the Proposed Transaction is therefore being sought at a general meeting of REX's shareholders.

In order to assist REX's shareholders ("**Shareholders**") evaluate the Proposed Transaction, the directors of REX have engaged Leadenhall Corporate Advisory Pty Ltd ("**Leadenhall**") to prepare an independent expert's report assessing whether the Proposed Transaction is fair and reasonable to Shareholders. This report is to be included in the notice of meeting regarding the Proposed Transaction ("**NOM**").

Further information regarding our scope and purpose is set out in Section 2 of our detailed report.

### 3. Basis of evaluation

In accordance with *Regulatory Guide 111: Content of Expert Reports* (“**RG111**”) issued by ASIC we have assessed the Proposed Transaction as if it was a takeover offer for REX. Accordingly, in order to assess whether the Proposed Transaction is fair and reasonable to shareholders, we have:

- ◆ Assessed it as fair if the value of a REX share after the Proposed Transaction is greater than or equal to the value of a REX share before the Proposed Transaction. Our valuation before the Proposed Transaction has been undertaken on a control basis whereas our valuation after the Proposed Transaction has been undertaken on a minority basis in accordance with RG111.
- ◆ Assessed it as reasonable if it is fair, or if despite not being fair, the advantages to shareholders outweigh the disadvantages.

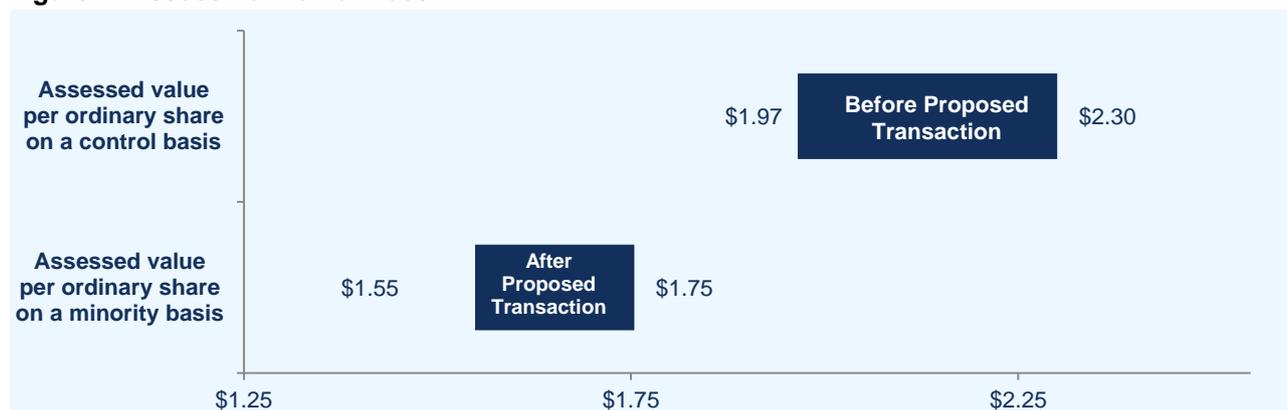
Further details of the basis of evaluation are provided in Section 2 of this report.

### 4. The Proposed Transaction is not fair

#### Summary

The following figure shows a comparison of our assessed value of a REX share before the Proposed Transaction (on a control basis) and our assessed value of a REX share after the Proposed Transaction (on a minority basis):

**Figure 1: Assessment of fairness**



Source: Leadenhall analysis

As the fair market value of a REX share after the Proposed Transaction is less than the fair market value of a REX share before the Proposed Transaction, we have assessed the Proposed Transaction as being not fair.

#### Value of REX before the Proposed Transaction

We have assessed the enterprise value of REX based on a cash flow model using separate assumptions for each part of the business. In conjunction with management, we have developed multiple potential scenarios for the Domestic Services expansion (including a potential failure of the business) and applied appropriate probability weightings to the outcomes.

We applied a discount rate of 11.0% (nominal, post-tax, WACC) to the projected cash flows to determine the value.

We undertook a sensitivity analysis to highlight which assumptions had the greatest impact on the valuation conclusion. The assumptions with the greatest impact are average fare and fuel prices as set out in Section 6. We note that any alternative reasonable set of assumptions would not impact our conclusion on the fairness or reasonableness of the Proposed Transaction.

Further details of our valuation of REX before the Proposed Transaction are provided in Section 6 of our detailed report.

## Value of REX after the Proposed Transaction

Our assessment of the value of a REX share after the Proposed Transaction was based on the same discounted cash flow analysis, adjusted for the impact of the Proposed Transaction.

In order to estimate the fair market value of REX if the Proposed Transaction proceeds, we have made the following adjustments to the value of REX prior to the Proposed Transaction:

- ◆ We have applied a lower probability of failure of the Domestic Services due to the funding certainty provided by the Proposed Transaction and a higher weighting to the high case to reflect the reduced risks for successfully implementing the Domestic Services.
- ◆ We applied a discount rate of 10.25% to the projected cash flows to reflect the increased scale and lower funding costs of REX if the Proposed Transaction proceeds.
- ◆ We have calculated the dilutionary impact of the conversion rights provided by the Convertible Notes and the Warrants using a Black Scholes option pricing model.
- ◆ Applied a discount for lack of control ("**DLOC**") as market trading in REX shares after the Proposed Transaction would be on a non-controlling or minority basis.

Further details of our valuation of REX after the Proposed Transaction are provided in Section 7 of our detailed report.

## 5. The Proposed Transaction is reasonable

In accordance with ASIC guidelines, we have defined the Proposed Transaction as reasonable if it is fair, or if despite not being fair, the advantages to shareholders outweigh the disadvantages. We have therefore considered the following advantages and disadvantages of the Proposed Transaction to shareholders.

### Advantages

#### Limited alternatives available to provide the financial flexibility offered by the Proposed Transaction

REX's management has considered various funding alternatives both to establish the Domestic Services and for future growth opportunities. It was seen as important for the board to demonstrate that the business was fully funded for the foreseeable future to provide comfort to stakeholders (such as travel agents, etc.) and to ensure any competitive response could be adequately absorbed. It was also important to the board to ensure there are adequate funds available to provide capital in the event that unforeseen economic or industry downside risks eventuated and alternative funding sources (such as sale and leaseback or equity capital markets) were not available.

As part of the fundraising process REX considered proposals from private equity, high-net worth and other institutional investors as well as raising funding internally through a combination of debt, equity and the sale and leaseback of existing owned aircraft. To this end, REX negotiated terms for a sale and leaseback transaction which could provide approximately \$30 million in near-term funding. However, based on discussions with existing lenders, there was limited debt funding available to establish the Domestic Services.

Any capital raising from existing shareholders was expected to be constrained by the following factors:

- ◆ REX's discussions with its major shareholders indicated that many of the large shareholders were unlikely to be able to participate in a capital raising of the size required.
- ◆ The vast majority of REX's shareholders are retail investors (including company management and directors). The lack of institutional investors is likely to limit the take-up of any capital raising from existing shareholders.

As a result of the above factors, funding the Domestic Services through a combination of equity raising, debt funding and sale and leaseback transactions would be subject to significant risks in respect of raising sufficient capital to launch and sustain the Domestic Services until profitability and accessing future capital when and if needed. Furthermore, despite a process undertaken to find third party capital providers, we understand that no alternate offers have been received by REX.

### Favourable interest rate

The Convertible Notes have a coupon rate of 4% payable quarterly in arrears with no further interest payable if the term is extended by 12 months at PAGs' request, lowering the effective interest rate below 4% in this instance. This rate is favourable compared to the likely cost if REX were to source debt funding through alternate means. For example, Qantas recently issued \$500 million of 10-year corporate bonds with a coupon of 5.25%. Due to its smaller size and higher degree of business concentration, the borrowing costs for REX would be at a significant premium to those of Qantas.

The benefit of the reduced interest cost needs to be considered in conjunction with the significant value to be provided to PAG in the form of conversion options as set out in our fairness assessment.

### Reduces risks for successfully implementing the Domestic Services expansion

The funding available to REX pursuant to the Proposed Transaction provides greater certainty of executing the Domestic Services expansion plan since:

- ◆ The availability of the funding provides important assurance to suppliers (including lessors of aircraft), corporate customers and passengers who choose to book in advance.
- ◆ Access to future funding also ensures that REX is sufficiently capitalised to endure any sustained competitive response from the incumbent operators, thereby reducing the risk of a highly aggressive response. Given the limited history of having three domestic airlines in Australia we consider this risk to be significant.

### Raising equity at a premium

The conversion price for the Convertible Notes of \$1.50 per share represents a premium of 43% and 37% to the 1 month and 3-month VWAP of REX before the announcement of the Proposed Transaction.

This is in contrast to equity raisings which typically occur at discounts to recent market trading prices. Furthermore, given the size of the funding requirement for REX represents a significant proportion of its market capitalisation prior to the announcement of the Proposed Transaction, it is likely that the discount for REX in this instance would be magnified.

Whilst more recent trading in REX shares has increased to levels above the Conversion Price for the Convertible Notes and the exercise price of the Warrants we consider this would be at least partially attributable to the progress of the Proposed Transaction.

### Share price may decline

Since the Proposed Transaction was announced, the share price in REX has increased approximately 75% from \$1.09 per share on 21 September 2020 to \$1.91 per share on 22 December 2020.

Whilst some of this increase is likely attributed to the announcement of the Domestic Services expansion as well as general improvement in market sentiment (including the easing of COVID-19 restrictions and increased visibility of a timeline for vaccine deployment which should facilitate an increase in interstate travel), it is likely that the share price of REX will decline below current levels if the Proposed Transaction does not proceed.

### Proposed Transaction increases alignment with key shareholder and Executive Chairman

As part of the Proposed Transaction, Mr Lim Kim Hai, Executive Chairman and founder of REX, has entered into an escrow deed in respect of his shareholding in REX for the term of the Convertible Notes (unless extended) subject to certain exceptions including if PAG sells all its notes and shares.

As a result, the Proposed Transaction ensures Mr Lim Kim Hai remains invested in the business for the near-term and is aligned to the interests of minority shareholders.

### May provide prospect for additional liquidity

The vast majority of existing REX shareholders are retail investors (including company management and directors). Currently, institutional investors comprise a very small proportion of the issued shares of REX.

Support from a large institutional investor such as PAG may provide a positive signal to other institutional investors which may improve the liquidity of REX shares over time.

Furthermore, the increased size of REX if the Proposed Transaction proceeds may also help improve liquidity as the enhanced scale may increase the investor universe and facilitate coverage from sell-side research analysts, etc. For example, since the announcement of the Proposed Transaction, the average daily value traded has risen from approximately \$100,000 per day for the 12 months prior to the Proposed Transaction to over \$350,000 per day since the announcement of the Proposed Transaction, an increase of over 200%.

## Disadvantages

The main disadvantages of the Proposed Transaction are:

### Impact on control

If the full amount of the Convertible Notes and/or Warrants are issued and then fully converted and exercised (which would be three years post completion at the earliest unless a trigger event such as a default event by REX or a takeover of REX), PAG would have an interest of up to 47.6% in REX at that time (based on the existing shares on issue). As the Proposed Transaction envisages REX either drawing the full amount of the facility or Warrants being issued for any amount of the facility which is undrawn, it is likely that PAG will have the ability to obtain a 47.6% interest in REX in the future. PAG has agreed to a standstill arrangement whereby its shareholding in REX will not exceed 47.6%. Due to PAG's potential shareholding, it is unlikely that any other prospective acquirers would make a takeover offer for REX without support from PAG. This may reduce the opportunity for Shareholders to receive a control premium in the future.

Whilst PAG's interest in REX will be below 50%, given the wide spread of other shareholdings, if the Proposed Transaction proceeds, PAG would likely become the largest individual shareholder of REX in the future. PAG will also be able to appoint two directors to the board of REX which will comprise nine directors. Whilst the PAG nominee directors do not have any special voting rights, given the potential shareholding of PAG in the future, PAG may be able to exert practical control over certain decisions of REX which are subject to an ordinary resolution. PAG's interest in these matters may not be aligned to the interests of minority shareholders, subject to compliance with relevant laws and regulations.

Furthermore, as is typical for financing transactions, there are some restrictions on certain actions without PAG's consent such as incurring indebtedness outside of the ordinary course of operations and entering into related party transactions. Therefore, PAG's position as financier may not always be entirely aligned with the interests of minority shareholders.

### Conclusion on reasonableness

In considering whether the Proposed Transaction is reasonable we considered the relative weight of the above factors.

In particular, it is likely that the Proposed Transaction will result in PAG obtaining a 47.6% interest in REX irrespective of the actual funding requirements of REX due to the presence of the Warrants. However, we consider the advantages of the Proposed Transaction outweigh the disadvantages, in particular:

- ◆ The Proposed Transaction is expected to increase the likelihood of the success of the Domestic Services which, if successful would be transformative for REX and could provide significant upside to Shareholders.
- ◆ The Proposed Transaction facilitates REX raising capital at a significant premium to the share price of REX prior to the announcement of the transaction. If this amount of equity were to be raised by REX through a traditional equity raising, it is likely that it would be at a significant discount to the prevailing share price of REX.
- ◆ We understand that there are no other alternatives currently available that provide the same level of funding certainty for the Domestic Services and there have been no superior offers despite the public nature of the Proposed Transaction.

After considering the above factors, we have concluded that, on balance, the advantages of the Proposed Transaction outweigh the disadvantages, and therefore in our opinion, the Proposed Transaction is reasonable to Shareholders in the absence of a superior proposal.

## 6. Opinion

In our opinion, the Proposed Transaction is not fair but reasonable to Shareholders in the absence of a superior proposal.

This opinion should be read in conjunction with our detailed report which sets out our scope, analysis and findings in more detail.

Yours faithfully



Dave Pearson  
**Director**



Andrew Steere  
**Director**

*Note: All amounts stated in this report are in Australian dollars unless otherwise stated.*

*Tables in this report may not add due to rounding.*

**LEADENHALL CORPORATE ADVISORY PTY LTD**

ABN 11 114 534 619

**Australian Financial Services Licence No: 293586**

***FINANCIAL SERVICES GUIDE***

Leadenhall Corporate Advisory Pty Ltd ("**Leadenhall**" or "**we**" or "**us**" or "**our**" as appropriate) has been engaged to issue general financial product advice in the form of a report to be provided to you.

**Financial Services Guide**

In providing this report, we are required to issue this Financial Services Guide ("**FSG**") to retail clients. This FSG is designed to help you to make a decision as to how you might use this general financial product advice and to ensure that we comply with our obligations as a financial services licensee.

**Financial Services We are Licensed to Provide**

We hold Australian Financial Services Licence 293586 which authorises us to provide financial product advice in relation to securities (such as shares and debentures), managed investment schemes and derivatives.

We provide financial product advice by virtue of an engagement to issue a report in connection with a financial product. Our report will include a description of the circumstances of our engagement and the party who has engaged us. You will not have engaged us directly but will be provided with a copy of the report because of your connection to the matters in respect of which we have been engaged to report.

Any report we provide is provided on our own behalf as a financial service licensee authorised to provide the financial product advice contained in that report.

**General Financial Product Advice**

The advice produced in our report is general financial product advice, not personal financial product advice, because it has been prepared without taking into account your personal objectives, financial situation or needs. You should consider the appropriateness of this general advice having regard to your own objectives, financial situation and needs before you act on the advice. Where the advice relates to the acquisition or possible acquisition of a financial product, you should also obtain a product disclosure statement relating to the product and consider that statement before making any decision about whether to acquire the product.

**Benefits that We May Receive**

We charge fees for providing reports. These fees will be agreed with the person who engages us to provide the report. Fees will be agreed on either a fixed fee or time cost basis. Leadenhall is entitled to receive a fixed fee of \$145,000 (excl. GST) for preparing this report. This fee is not contingent upon the outcome of the Proposed Transaction.

Except for the fees referred to above, neither Leadenhall, nor any of its directors, consultants, employees or related entities, receive any pecuniary or other benefit, directly or indirectly, for or in connection with the provision of this report.

**Remuneration or Other Benefits Received by our Employees, Directors and Consultants**

All our employees receive a salary. Our employees are eligible for bonuses which are not based on the outcomes of any specific engagement or directly linked to the provision of this report. Our directors and consultants receive remuneration based on time spent on matters.

## **Referrals**

We do not pay commissions or provide any other benefits to any person for referring clients to us in connection with the reports that we are licensed to provide.

## **Complaints Resolution**

As the holder of an Australian Financial Services Licence, we are required to have a system in place for handling complaints from persons to whom we have provided reports. All complaints must be in writing, to the following address:

Leadenhall Corporate Advisory Pty Ltd  
GPO Box 1572  
Adelaide SA 5001

Email: [office@leadenhall.com.au](mailto:office@leadenhall.com.au)

We will try to resolve your complaint quickly and fairly and will endeavour to settle the matter within 14 days from the time the matter is brought to our attention.

If you do not get a satisfactory outcome, you have the option of contacting the Financial Ombudsman Service ("**FOS**"). The FOS will then be able to advise you as to whether or not they can assist in this matter. The FOS can be contacted at the following address:

Financial Ombudsman Service  
GPO Box 3  
Melbourne VIC 3001

Telephone: 1300 780 808  
Email: [info@fos.org.au](mailto:info@fos.org.au)

## **Compensation Arrangements**

Leadenhall holds professional indemnity insurance in relation to the services we provide. The insurance cover satisfies the compensation requirements of the Corporations Act 2001.

23 December 2020

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# 1 THE PROPOSED TRANSACTION

## 1.1 Background

REX is a public company listed on the ASX that is engaged in operating a regional airline within Australia.

On 13 May 2020, REX announced its intention to explore the possibility of establishing domestic capital city major routes. On 29 June 2020, the board of REX approved management to commence preparations for the operation of an initial fleet of five to ten jet aircraft to service the Sydney-Melbourne-Brisbane routes with a targeted start date of 1 March 2021. At the time, the board of REX approved an initiative to raise funding, through a range of sources for the launch of the Domestic Services.

On 22 September 2020, REX announced the Proposed Transaction whereby PAG would make an initial investment of \$50 million and a total investment of up to \$150 million to support the launch of the Domestic Services.

The funding is proposed to comprise first ranking senior secured convertible notes. If REX does not utilise the full \$150 million offered pursuant to the facility within three years post completion, PAG will be issued with zero-cost warrants with an exercise price of A\$1.50 per share for the difference between the facility amount and the balance drawn.

Based on the current shares on issue of REX, if the \$50 million first tranche is fully converted, PAG would hold approximately 23.3% of REX's total issued shares, and if the full \$150 million is drawn and converted, PAG would hold approximately 47.6% of REX's issued shares.

## 1.2 Terms of the Convertible Notes

A summary of the key terms of the Convertible Notes is presented in the table below. Further details are set out in Schedule 3 of the NOM.

Term	Description
<b>Face value and limit</b>	The Convertible Notes will have a face value of \$1.00 per Convertible Note and an aggregate facility limit of \$150 million.
<b>Use of proceeds</b>	The proceeds from the issue of the Convertible Notes are for the establishment, launch, operation and expansion of the Domestic Services.
<b>Drawdown</b>	50 million Convertible Notes will be issued to PAG for \$50 million on completion of the conditions precedent summarised below ("First Drawdown Date"). Provided that at least 75% of the funding previously provided by PAG has been utilised, up to a further 100 million Convertible Notes may be issued to PAG during the three-year period following the First Drawdown Date. Once \$75 million is drawn pursuant to this facility, further drawdowns are subject to confirmation that the Domestic Services have a likely pathway to sustainable positive operating cash flow over the next 12 months, unless unanimously agreed by the board.
<b>Maturity</b>	Five years following the First Drawdown Date (" <b>Maturity Date</b> "), extendable at the election of either party by a further one year (" <b>Extended Term</b> ").
<b>Security</b>	The Convertible Notes will be secured by a first ranking security over all the assets and undertakings of all the entities within the REX Group other than NAA Pty Ltd, VAA Pty Ltd and Pel-Air Aviation Pty Ltd. A guarantee will also be provided by each of the applicable REX Group entities in favour of PAG.

Term	Description
<b>Interest rate</b>	Interest will be payable at 4% per annum payable on the face value of drawn Convertible Notes, quarterly in arrears. If the term is extended by a further year at the election of PAG, then REX will not be liable to pay any interest on the Face Value of the drawn Convertible Notes for that further one-year period. In an event of default interest will accrue at a rate of 12% per annum.
<b>Conversion price</b>	The conversion price will be \$1.50 per share, subject to customary adjustments (" <b>Conversion Price</b> ").
<b>On-sale</b>	<p>Prior to the third anniversary of completion, the Convertible Notes are not transferable without the prior written consent of REX. After the third anniversary, any transfer of the Convertible Notes by PAG will be subject to a right of first offer in favour of REX.</p> <p>If, after the first anniversary of completion, the market price of REX shares is equal to or greater than 150% of the conversion price of the Convertible Notes, PAG may dispose of up to one-third of its notes to institutional investors (with REX's consent) or convert up to one-third of the notes.</p>
<b>Conversion</b>	Subject to necessary shareholder and other approvals being obtained, PAG may convert the Convertible Notes to ordinary REX shares at any time from the third anniversary of the First Drawdown Date to the Maturity Date. PAG may convert all or a portion of the Convertible Notes. Conversion may occur prior to the third anniversary of the First Drawdown Date upon certain trigger events primarily associated with a material breach of the agreement with PAG, an event of default, a change of control transaction or where Domestic Operations for the Northern Summer Scheduling 2021 with 5 aircraft have not commenced by 30 June 2021. Shares issued on conversion of the Convertible Notes will be fully paid and will rank equally in all respects with ordinary shares of REX.
<b>Redemption</b>	<p>PAG can elect to redeem the Convertible Notes and receive the redemption amount, being the face value and accrued interest on drawn Convertible Notes, on the Maturity Date or prior to the Maturity Date in the event certain trigger events occur. These trigger events primarily relate to material breaches of the agreement, an event of default, relevant approvals not being granted (including shareholder approval of the Proposed Transaction) and Domestic Operations for the Northern Summer Scheduling 2021 with 5 aircraft not having commenced by 30 June 2021. On redemption at the Maturity Date PAG will receive the face value and accrued interest in drawn Convertible Notes.</p> <p>In the event of a control transaction for REX and the share price of REX at the time is not representative of fair value, PAG may be eligible to redeem the Convertible Notes and receive a higher amount based on the fair market value of the Convertible Notes.</p>
<b>Warrants</b>	If REX does not utilise the full \$150 million offered pursuant to the facility within three years post completion, PAG will be issued with zero-cost warrants with an exercise price of A\$1.50 per share for the difference between the facility amount and the balance drawn except in certain limited instances, namely REX determining to cease the Domestic Operations or if PAG fails to provide funds under the facility when it is obliged to do so.
<b>Other funding</b>	PAG will have a first right of refusal to provide its pro rata share of funding to REX (on commercial market terms) in the event that additional equity or debt is required to be raised.
<b>Director Appointment</b>	PAG will have a right to nominate up to two non-executive directors to the board. If the Proposed Transaction proceeds it is expected that the REX board which will comprise nine directors which will include four independent directors, three executive directors and two PAG-appointed directors.

Source: REX

### 1.3 Conditions precedent

The Proposed Transaction is subject to the following conditions precedent:

- ◆ PAG obtaining approval from the Foreign Investment Review Board in accordance with the Foreign Acquisitions and Takeovers Act
- ◆ REX obtaining:
  - Shareholder approval in accordance with item 7 of section 611 of the Corporations Act
  - All approvals required from ASX or under the Listing Rules
  - Approval from the Civil Aviation Safety Authority ("**CASA**") in the form of a High Capacity Air Operator's Certificate ("**AOC**")

The first drawdown of \$50 million and issue of 50 million Convertible Notes will occur within 10 business days after satisfaction of all Conditions Precedent.

### 1.4 Future intentions of PAG

PAG is part of an Asia Pacific focused private investment firm with over \$40 billion in funds under management across three major businesses:

- ◆ Private equity buyout and growth funds
- ◆ Real estate investments
- ◆ Absolute return including private debt and public market strategies.

As disclosed in the NOM, PAG has no current intention to:

- ◆ Make any significant changes to the existing business of REX
- ◆ Inject further capital into REX although additional capital is available in the event it is required
- ◆ Make changes regarding the future employment of REX's present employees
- ◆ Transfer any assets between REX and itself or any person associated with it
- ◆ Otherwise redeploy the fixed assets of REX
- ◆ Change REX's existing financial or dividend policies significantly

## 2 SCOPE

### 2.1 Purpose of the report

An acquisition of securities that enables a shareholder to increase its relevant interests in a listed company from below 20% to above 20% is prohibited under Section 606 of the Corporations Act 2001 ("**s606**"), except in certain circumstances. In the event that PAG exercises its option to convert the Convertible Notes and/or exercise the Warrants, it will own up to 47.6% of the shares in REX. Currently PAG does not hold any interest in REX.

One of the exceptions to s606 is where the acquisition is approved at a general meeting of the target company in accordance with item 7 ("**Item 7**") of Section 611 of the Corporations Act 2001 ("**s611**"). Approval for the Proposed Transaction is therefore being sought at a general meeting of REX's shareholders in accordance with Item 7.

Item 7 requires shareholders to be provided with all of the information known to the company and to the potential acquirer that is material to the shareholders' decision. *Regulatory Guide 74: Acquisitions Approved by Members* ("**RG74**") issued by the Australian Securities and Investment Commission ("**ASIC**") provides additional guidance on the information to be provided to shareholders. RG74 states that the directors of the target company should provide shareholders with an independent expert's report or a detailed directors' report in relation to transactions to be approved under Item 7. *Regulatory Guide 111: Content of Expert Reports* ("**RG111**") issued by ASIC requires an independent expert assessing a transaction that has a similar effect to a takeover bid to assess whether the transaction is fair and reasonable.

The directors of REX have therefore requested Leadenhall to prepare an independent expert's report assessing whether the Proposed Transaction is fair and reasonable to REX's shareholders. This report has been prepared for the exclusive purpose of assisting Shareholders in their consideration of the Proposed Transaction.

### 2.2 Basis of evaluation

#### Introduction

RG111.25 requires an independent expert to evaluate an issue of securities under s611 that has a similar effect to a takeover offer as if it was a takeover offer. As PAG will hold greater than 20% of the shares outstanding in REX should the Proposed Transaction be approved and the Convertible Notes are converted and/or the Warrants are exercised, we have assessed the Proposed Transaction as a control transaction. RG111 requires a separate assessment of whether a control transaction under s611 is '*fair*' and whether it is '*reasonable*'. We have therefore considered the concepts of '*fairness*' and '*reasonableness*' separately. The basis of assessment selected and the reasons for that basis are discussed below.

#### Fairness

RG111.11 defines a takeover offer as being fair if the value of the consideration is equal to, or greater than, the value of the securities subject to the offer. Accordingly, we have assessed whether the Proposed Transaction is fair by comparing the value of a REX share before the Proposed Transaction with the consideration offered to Shareholders. As Shareholders would retain their interest in REX if the Proposed Transaction proceeds (as opposed to exchanging them for cash or the acquirer's scrip as in a takeover offer) the effective consideration is the continued ownership of a REX share.

The value of a REX share before the Proposed Transaction has been determined on a control basis (i.e. including a control premium). This is consistent with the requirement of RG111.11 that the comparison for a takeover must be made assuming a 100% interest in the target company.

After the Proposed Transaction, Shareholders will retain their interest in REX. This has been assessed on a minority interest basis (i.e. excluding a control premium) as Shareholders would own a minority stake in REX should the Proposed Transaction occur and the Convertible Notes are converted and/or the Warrants are exercised.

We have assessed the values of a REX share before and after the Proposed Transaction at fair market value, which is defined by the International Glossary of Business Valuation Terms as:

*The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.*

While there is no explicit definition of value in RG111, this definition of fair market value is consistent with basis of value described at RG111.11 and common market practice.

Special value is defined as the amount a specific purchaser is willing to pay in excess of fair market value. A specific purchaser may be willing to pay a premium over fair market value as a result of potential economies of scale, reduction in competition or other synergies they may enjoy arising from the acquisition of the asset. However, to the extent a pool of hypothetical purchasers could all achieve the same level of synergies the value of those synergies may be included in fair market value. Special value is typically not considered in forming an opinion on the fair market value of an asset. Our valuation of REX before and after the Proposed Transaction does not include any special value.

### **Reasonableness**

In accordance with RG111, we have defined the Proposed Transaction as being reasonable if it is fair, or if, despite not being fair, Leadenhall believes that there are sufficient reasons for Shareholders to vote for the proposal. We have therefore considered whether the advantages to Shareholders of the Proposed Transaction outweigh the disadvantages. To assess the reasonableness of the Proposed Transaction we have considered the following significant factors recommended by RG111.13:

- ◆ The liquidity of the market in REX's shares
- ◆ Any special value of REX to PAG
- ◆ The likely market price of REX shares if the Proposed Transaction is rejected
- ◆ The value of REX to an alternative bidder and the likelihood of an alternative offer

We have also considered other significant advantages and disadvantages to Shareholders of the Proposed Transaction.

## **2.3 Individual circumstances**

We have evaluated the Proposed Transaction for Shareholders as a whole. We have not considered its effect on the particular circumstances of individual investors. Due to their personal circumstances, individual investors may place a different emphasis on various aspects of the Proposed Transaction from the one adopted in this report. Accordingly, individuals may reach a different conclusion to ours on whether the Proposed Transaction is fair and reasonable. If in doubt investors should consult an independent financial adviser about the impact of the Proposed Transaction on their specific financial circumstances.

## 3 INDUSTRY ANALYSIS

### 3.1 Introduction

The domestic passenger aviation industry in Australia is dominated by two airlines, the Qantas Group, including its low-cost carrier Jetstar, and Virgin Australia which finalised the acquisition of low-cost carrier Tigerair in 2014. These two airlines typically account for approximately 90%<sup>1</sup> of domestic market share. There are a number of smaller domestic and charter airlines which predominantly service regional markets, in particular tourism and mining hubs. In 2020, the aviation industry in Australia has been severely impacted by COVID-19. Various travel restrictions at both a national and state level have reduced passenger numbers from an average of 5.1 million domestic travellers per month in the calendar year 2019 to just 145,895 in April 2020, recovering to 727,979 in July 2020<sup>2</sup>. Furthermore, the restrictions associated with COVID-19 caused Virgin Australia to enter voluntary administration on 21 April 2020. A sale to Bain Capital has subsequently been negotiated, however it is yet to be seen what impact this will have on industry competition going forward. As domestic COVID-19 restrictions are eased, the sector expects a rapid recovery as pent up demand and continuing restrictions on international travel are likely to result in record levels of domestic tourism.

### 3.2 General Characteristics

The airline industry exhibits the following key characteristics:

- ◆ Businesses operating in the industry have a high degree of operating leverage as a high proportion of costs are fixed. This can result in relatively high earnings volatility compared to other industries.
- ◆ A high degree of operational complexity in terms of both day to day business management (e.g. scheduling, staffing, passenger and luggage handling and maintenance and safety requirements) and long-term capital planning (e.g. fleet and financing requirements).
- ◆ The industry is subject to a high degree of government regulation and policy (particularly in relation to international traffic rights, ownership restrictions and safety regulation).
- ◆ There is a high level of capital intensity which, along with government restrictions, creates high barriers to entry for potential new entrants.
- ◆ It is labour intensive with highly unionised workforces.
- ◆ It is highly susceptible to international shocks, particularly those which restrict international travel. Over the last 20 years the industry has been impacted by pandemics (e.g. SARS and COVID-19), global terrorism and dramatic fluctuations in fuel prices.

As a result of the above, earnings fluctuate dramatically in the industry from year to year.

#### Business models

As noted above, the domestic airline industry in Australia is a duopoly dominated by Qantas and Virgin Australia. Qantas and Virgin Australia are considered full-service airlines, whilst Jetstar (a subsidiary of Qantas) and Tigerair (a subsidiary of Virgin Australia) are the domestic low-cost carriers. However, in August 2020, Virgin Australia announced that the Tigerair brand will be discontinued as part of its restructure strategy. To date Virgin Australia has not announced whether it intends to offer an alternative low-cost service in the future.

<sup>1</sup> IBISWorld, *Domestic Airlines in Australia*

<sup>2</sup> Bureau of Infrastructure, Transport and Regional Economics

The key characteristics of the two types of carrier are set out in the table below:

**Table 1: Characteristics of low cost and full-service airlines**

Low cost	Full Service
<ul style="list-style-type: none"> <li>◆ Low fares</li> <li>◆ Use it or lose it rules (travel dates cannot be changed)</li> <li>◆ Ancillary fees for extras</li> <li>◆ Use of secondary airports</li> <li>◆ No loyalty programs</li> <li>◆ No airport lounges</li> <li>◆ Single-class cabins</li> <li>◆ Online direct booking</li> <li>◆ No corporate deals</li> <li>◆ Limited interline arrangements</li> </ul>	<ul style="list-style-type: none"> <li>◆ Generally higher fares</li> <li>◆ Special corporate deals</li> <li>◆ More inclusions e.g. luggage and meals</li> <li>◆ More extensive routes</li> <li>◆ Loyalty programs</li> <li>◆ Airport lounges</li> <li>◆ Global alliances</li> <li>◆ Multi-class cabins</li> </ul>

Source: QBT Travel and Leadenhall analysis

As at March 2020, 67.2% of industry revenue was generated by full-service carriers, 22.2% was generated by low cost carriers and freight transport and other services account for the remaining 10.6%<sup>3</sup>.

### 3.3 Competitors

Qantas, Virgin and Qantas subsidiary Jetstar are the three largest domestic airlines in Australia. Outside of these carriers, there is REX which currently services regional hubs throughout Australia.

A summary of key information for the major players in the industry is set out in the table below.

**Table 2: Summary of major domestic Australian Airlines**

	Qantas Domestic	Virgin <sup>2</sup>	Jetstar <sup>3</sup>	REX
<b>Main hub</b>	Sydney	Brisbane	Melbourne	Sydney
<b>Destinations<sup>1</sup></b>	55	33	21	60
<b>Flights per week<sup>1</sup></b>	4,500	Over 3,000	Over 5,000	1,500
<b>Number of aircraft<sup>1</sup></b>	221	99	87	60
<b>On time departure<sup>4</sup> (FY19/FY20)</b>	4 <sup>th</sup> / 5 <sup>th</sup>	3 <sup>rd</sup> / 4 <sup>th</sup>	6 <sup>th</sup> / 6 <sup>th</sup>	2 <sup>nd</sup> / 1 <sup>st</sup>
<b>Cancellation Rate (FY19/FY20)</b>	2.4% / 4.33%	1.96% / 4.27%	2.52% / 5.74%	0.99% / 2.89%
<b>Revenue (FY19/FY20)</b>	\$4,672 / \$6,098 million	\$3,915 / n/a million	\$3,006 / \$3,961 million	\$260 / \$322 million <sup>5</sup>
<b>Underlying EBIT (FY19/FY20)</b>	\$778 / \$173 million	\$133 / n/a million	\$400 / (\$26) million	\$26.2 / (\$27) <sup>6</sup> million
<b>ASK's (FY19/FY20)</b>	25,773 / 33,866 million	51,203 / n/a million <sup>7</sup>	35,613 / 47,993 million	808 / 630 million
<b>Load factor (FY19/FY20)</b>	75.9% / 77.8%	80.2% <sup>7</sup> / n/a	84.3% / 86.1%	63.1% / 59.5%

Source: FY20 annual reports for Qantas and REX, FY19 annual report for Virgin and airline websites.

Notes:

1. Destinations, flights per week and number of aircraft pre-COVID-19 and pre-Virgin administration figures.
2. FY20 financial results are not available due to the appointment of administrators in April 2020.
3. Jetstar includes international operations.

<sup>3</sup> IBISWorld, Domestic Airlines in Australia

4. On time departure rankings also include QantasLink, Virgin Australia Regional Airlines and Tigerair. FY20 on time departure rankings are for the period 1 July 2019 to 31 March 2020.
5. FY20 revenue excludes \$62 million in government grants received
6. REX underlying EBIT excludes government grants received in FY20, if these were included underlying EBIT would be \$35 million.
7. Figures are for the entire Virgin group including international operations and Tigerair.

Beside COVID-19, the biggest change in the competitive landscape of the Australian airline industry in 2020 was the collapse of Virgin which was placed in voluntary administration in April 2020 following years of underperformance and the impacts of COVID-19 on domestic and international travel. Subsequently the administrators sold the business to private equity firm Bain Capital for \$3.5 billion<sup>4</sup>. There is relatively little publicly available information on the future strategic direction of Virgin under new ownership. To date it has been disclosed that<sup>5</sup>:

- ◆ Focus will be on the core domestic and short-haul international business
- ◆ There will be cost base reductions to meet sector uncertainty and COVID-19 market conditions
- ◆ 3,000 jobs will be lost permanently whilst 6,000 will be secured post market recovery
- ◆ Most 737's will be retained as well as the regional and charter fleet with other aircraft types removed
- ◆ The Tigerair brand will be discontinued with the Air Operator Certificate and necessary support maintained to provide an option for ultra-low-cost operation when the market recovers
- ◆ There is a continued commitment to regional and charter flying
- ◆ For regional routes, there is often limited competition from other carriers with the main competition being from road transport such as buses or self-driving

### 3.4 Popular routes

The most popular domestic route is between Melbourne and Sydney, the two largest commercial centres of Australia, which is one of the busiest airline routes in the world. Travel between state capitals dominates the top flight routes in Australia. According to The Bureau of Infrastructure and Transport Research Economics ("BITRE"), load factors have grown steadily on most popular flight routes over the past five years which has promoted higher airfares and improved profitability. The top five routes by number of passengers is set out in the figure below.

**Figure 1: Top five domestic flight routes by passenger number**



Source: BITRE

In percentage terms, the fastest growing routes over the past five years have primarily been leisure destinations. These routes include Melbourne-Sunshine Coast, Ballina-Sydney and Hobart-Sydney. In contrast there have been sharp declines in trips to and from significant mining destinations, such as Karratha and Gladstone, as the mining sector moves away from fly-in-fly-out production toward automated operations.

<sup>4</sup> Australian Financial Review, "Creditors approve \$3.5b Virgin sale to Bain", 4 September 2020

<sup>5</sup> VAH ASX release, "Virgin Australia Group Announces Plan to Focus on Core Strengths, Re-Establishing Itself as an Iconic Australian Airline", 5 August 2020

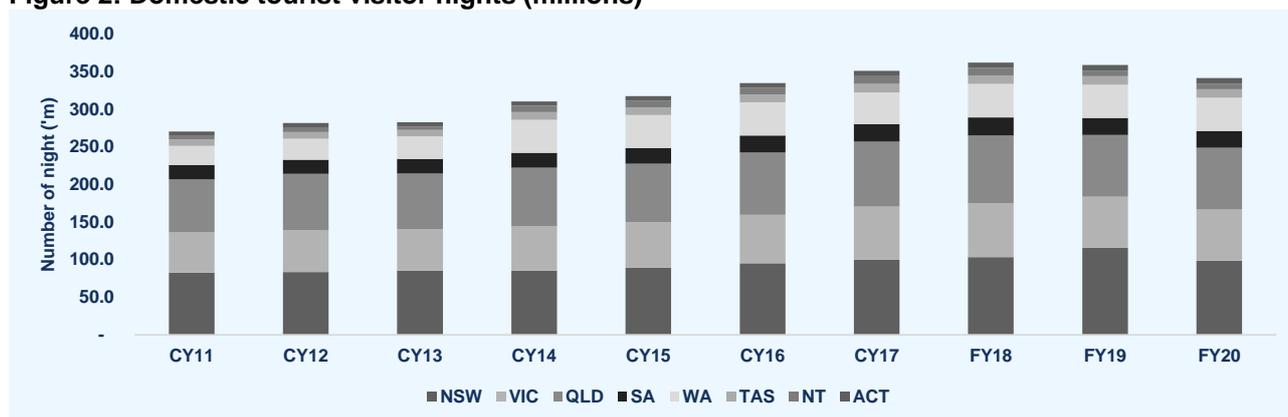
### 3.5 Industry drivers

The summary below sets out the key external drivers of domestic Australian airline financial performance.

#### Domestic tourist visitor nights

Measures overnight stays at locations more than 40 kilometres from home. Domestic air travel tends to increase when the number of domestic tourist visitor nights rises. Historical visitor nights are shown in the figure below.

**Figure 2: Domestic tourist visitor nights (millions)**



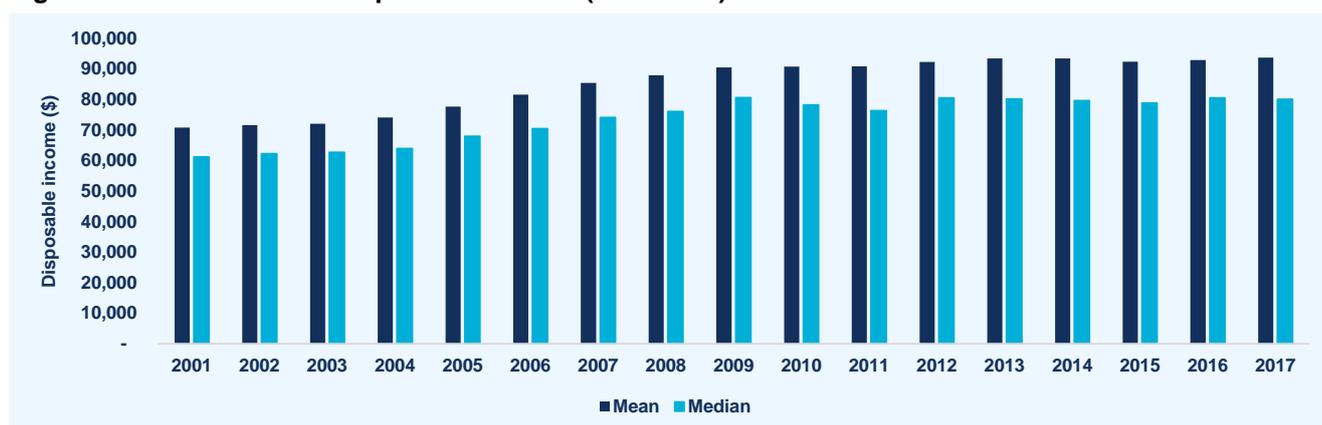
Source: Tourism Research Australia

In July 2020, domestic visitor nights were down 35% on the same month in the previous year due to the effects of COVID-19. Case numbers have remained low for a number of months allowing for state-based tourism to resume. As national borders reopen, pent up demand for travel will fuel growth in the local industry. In the medium term, domestic travel will be buoyed by a lack of international travel options which are not expected to resume until a COVID-19 vaccine is available and widely administered globally.

#### Real household discretionary income

When income growth is strong, households tend to increase spending on discretionary items such as holidays. Historical levels of discretionary income are shown in the figure below.

**Figure 3: Real household disposable income (2017 AUD)**



Source: The Household, Income and Labour Dynamics in Australia Survey, 2019

Median real household disposable income has stagnated in the current decade primarily due to the impacts of the global financial crisis early in the decade followed by low wages growth and trends towards a greater reliance on casual and part-time workers. The impact of COVID-19 on household finances has been somewhat cushioned by government support packages. Nevertheless, the RBA expects unemployment to peak at 10% or over 1.3 million by the end of 2020 (up from 700,000 in December 2019) and stay at these levels until mid-2021. This increase in unemployment will likely negatively impact spending capacity despite government assistance.

### Aircraft kilometres flown

This is used as a measure of domestic aviation activity. An increase in this measure indicates an increase in passengers and freight which tends to boost industry revenue. Historical levels are shown in the figure below.

**Figure 4: Domestic aircraft kilometres flown Australia ('000)**



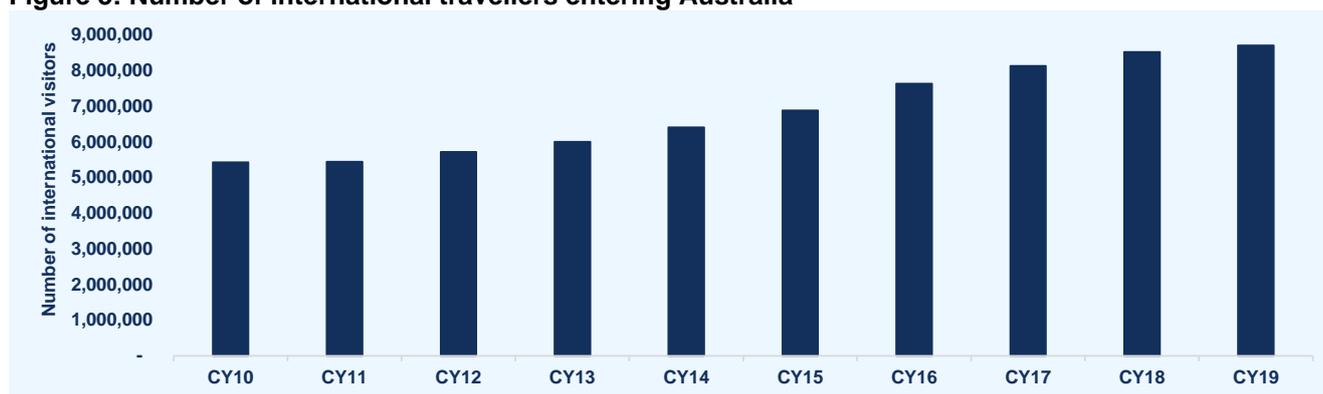
Source: Bureau of Infrastructure, Transport and Regional Economics

Aircraft kilometres flown were reasonably stable over the past 10 years until COVID-19 grounded the majority of domestic flights from April 2020, resulting in a significant drop in activity in FY20. Aircraft kilometres are not expected to recover as quickly as tourist nights as state-based border closures are still significantly restricting interstate air travel. In particular, the three most popular routes in Australia are currently subject to significant restrictions. Currently, domestic border and quarantine restrictions seem likely to be in place at least until the end of 2020, with some states indicating border restriction will not ease until well into 2021. In addition, any further mass outbreaks would result in new border closures.

### International travel to Australia

International travellers are an important source of demand as they often take domestic flights to visit different parts of Australia. Full service airlines often align themselves with international carriers to facilitate transfers between international and domestic flights. Historical international traveller numbers are shown in the figure below.

**Figure 5: Number of international travellers entering Australia**



Source: Tourism Research Australia

International tourist numbers have risen steadily over the last ten years from 5.4 million in 2010 to 8.7 million in 2019. The biggest increase has been in visitors from China which grew from 0.43 million in 2010 to 1.33 million in 2019. The international travel industry has been decimated by COVID-19 with most countries closing their borders to tourists. Australia has taken a particularly strong stance to its international border closure in order to protect from mass outbreaks which have been fuelled by international arrivals throughout the COVID-19 pandemic. Qantas announced that it does not expect to resume full international services until 2022. However, limits on international travel are not expected to have a significant impact on the domestic industry as local consumers are expected to travel domestically more frequently during this period.

### Fuel Prices

Fuel is one of the most significant costs for airlines. Airlines generally use hedging contracts to lock in short-term fuel costs to assist with pricing decisions. Increases in fuel price place downward pressure on profits whilst the benefits of decreases can take some time to filter through to performance due to hedging strategies. Fuel prices are closely linked to the oil price. Forecast oil prices are set out in the figure below.

**Figure 6: Forecast crude oil price (US\$/barrel)**



Source: S&P CapIQ, average of broker forecasts as at 12 November 2020

Between March 2011 and September 2014, Brent oil generally traded between US\$100 and US\$120/barrel. By January 2015 Brent prices had dropped to US\$25/barrel due to an increase in global supply. Oil prices recovered to reach US\$92/barrel in October 2018 before trading in the range of US\$60 to US\$80 until the COVID-19 pandemic and the Russia/Saudi price war resulted in a ten year low price for Brent of US\$20/barrel in April 2020. Analysts expect oil prices to remain subdued over the medium term as travel restrictions are expected to heavily impact demand. Airlines generally hedge oil price exposure, effectively locking in future prices. Therefore, the current decline in oil prices may not be fully realised by airlines in the short term.

### Consumer Sentiment Index

The Consumer Sentiment Index measures households' opinions regarding their financial situation and the economy. Negative consumer sentiment tends to reduce demand as pessimistic consumers are more likely to defer travel and businesses may seek to cut costs. Historical index levels are set out in the figure below.

**Figure 7: ANZ-Roy Morgan Consumer Confidence rating**



Source: Roy Morgan

Consumer confidence was relatively stable over the ten years to 2019. As expected, COVID-19 caused a significant decline in consumer confidence in March and April 2020 as households across the country endured lockdown restrictions. Consumer confidence has been slow to recover since the peak of COVID-19 restrictions. Recovery has been hampered by the second wave in Victoria which resulted in a more modest fall from July to September 2020. In contrast, business confidence had recovered to near pre COVID-19 levels by October 2020. The potential for more significant falls in both consumer and business confidence were largely offset by significant government stimulus. In the absence of an effective vaccine and/or an efficient testing process, it is expected that consumers will remain cautious and business travel will remain subdued whilst the risk of further outbreaks remains. A significant reduction in government spending would likely also have a negative impact.

## 3.6 Industry trends

### Current performance

Prior to the COVID-19 outbreak, the industry's major operators benefitted from a mostly upward trend in domestic passenger traffic over the last five years. Increased route efficiencies have led to higher airfares and more refined business strategies and market segmentation have driven profitability. Furthermore, the depreciation of the Australian dollar reduced local demand for international travel in favour of domestic travel, whilst also attracting international visitors. IBISWorld estimated that industry revenue will fall 15.3% in FY20 as a result of the east coast bushfires and COVID-19.

### Rising airfares

At the beginning of the last decade, domestic airfares fluctuated due to price wars between Qantas and Virgin as both sought to increase market share on key domestic routes. However, direct price competition between the two has reduced over the past five years with a greater focus on profitability rather than market share. This has contributed to a strong rise in airfares over this period, despite a decline in household discretionary income. Both Qantas and Virgin have successfully targeted the small-to-medium business market, with positive business confidence over the period supporting demand growth. According to the BITRE, in June 2019, the full-economy airfare index reached its highest point since October 2007. However, prices of business class airfares have dropped substantially over the same time on the back of softening demand.

### Fuel prices

Fluctuations in fuel prices can significantly influence industry profit margins. The price of aviation fuel increased from a low base over the four years through FY19. This trend was exacerbated by a decline in the Australian dollar as fuel is priced in US dollars. However, the price of fuel has dipped sharply in FY20 due to the COVID-19 outbreak. Additional downward price pressure has resulted from a price war between the significant oil producing nations of Saudi Arabia and Russia.

### Profit

Over the last five years, industry participants have engaged in significant cost cutting exercises to increase profit. The cost cutting initiatives have focused on headcount reductions, wage freezes and cutting excess costs. Furthermore, a renewed focus on defining and focusing on core markets has contributed to a focus on profitability.

## 3.7 Outlook

### COVID-19

2020 saw a marked increase in domestic flights, however the emerging recovery was hampered by a significant COVID-19 outbreak in Melbourne which prompted domestic border closures which still have not been fully withdrawn. In addition to short-term industry disruption, COVID-19 may contribute to structural changes in the industry in particular in respect of lucrative business travellers. The rise in the successful use of virtual communication technology during the COVID-19 crisis may be a long-lasting trend which could significantly impact the level of business travel in the future. There is some evidence that the recovery in business travel is lagging the recovery in leisure travel in China where domestic leisure travel has almost returned to pre COVID-19 levels.

Domestic travel recovery in Australia is facing headwinds from a period of prolonged state border closures, preventing the re-establishment of the most popular business and tourism routes in Australia. As of the date of this report, there were plans in place to re-open most state borders. In the absence of growing case numbers, airlines and analysts expect domestic travel to begin to increase in early to mid-2021, with industry participants reporting expectations of steady growth until 2019 levels anticipated to be reached by FY23 or FY24. The recovery is expected to be driven by domestic tourism as international travel restrictions are expected to extend until a vaccine is available and widely administered globally.

Currently domestic airlines are receiving the following government support packages:

- ◆ Australian Airline Financial Relief Package will operate over a period of nine months from 1 April 2020 to 31 December 2020 and includes the refunding and ongoing waiving of a range of government charges including aviation fuel excise, Airservices Australia charges and domestic and regional aviation security charges. The package is worth \$715 million.
- ◆ Domestic Aviation Network Support and Regional Airline Network Support programs provide shortfall subsidies to eligible airlines maintaining a minimum air transport network during COVID-19.
- ◆ Regional Airlines Funding Assistance program provides \$100 million as a last resort cash flow assistance to regional airlines that provide essential services to regional and remote locations.
- ◆ The Regional Air Network Assistance Package which provides \$198 million to ensure core regional routes for domestic air freight will remain open and essential workers employed.

Government funding has been critical in maintaining the viability of the domestic airline sector, particular for smaller airlines. Early termination of assistance programs could jeopardise the recovery of the industry.

### Profit

During the COVID-19 recovery period, available seat kilometre capacity will be higher than demand in the short-term leading to strong competition for market share until passenger demand more closely reflects pre COVID-19 demand levels. Post COVID-19, demand for domestic travel is anticipated to increase over the next five years, primarily underpinned by rising discretionary income and greater demand for domestic tourism as international borders take longer to reopen than domestic borders. Over this period, profit margins are expected to remain strong as airlines continually focus on cost reduction and fleet efficiency.

Airlines are expected to continue to phase out older aircraft in favour of new fuel-efficient aircraft which is expected to reduce fuel and maintenance costs. Although the Qantas Virgin price war ended in 2015, moderated price competition is anticipated to continue. On the other hand, the absence of Tigerair in the low-cost segment will likely reduce price competition in this sector.

### Competition

Post-administration, the Virgin offering is expected to be significantly reduced as demonstrated by the reduction in the number of aircraft taken on by the new owners. Furthermore, competition in the low cost segment will significantly change in the post COVID-19 and Virgin administration era as Virgin has announced the retirement of the Tigerair brand, however Virgin will maintain the ability to launch a low cost service in the future.

In June 2020, REX obtained board approval to launch the Domestic Services in Australia. The plan involves an initial fleet of five to ten narrow-body jet aircraft to be based out of Sydney and/or Melbourne to service the golden triangle (Sydney-Melbourne-Brisbane) with a target start date of 1 March 2021, subject to regulatory approval.

In May 2015, the federal government proposed plans to allow foreign airlines to fly domestic routes in Northern Australia to encourage economic development. This proposal was scrapped following intense lobbying from incumbent airlines. As such, it seems unlikely that foreign players would be allowed to enter the domestic market in the short to medium term. The number of smaller local industry participants is expected to rise over the next five years as tourism growth encourages industry expansion in rural areas. Airlines are anticipated to open more flight routes to regional areas over the next five years in response to increasing demand from international tourists.

Subscription-based private flight providers, which charge a monthly fee for unlimited flights between several domestic airports, represent a potential, albeit small, disruptor to the industry. Similarly, technology-based airline services that pool customers to allow lower per person prices are likely to become more common. For instance, Uber Air, an aerial ridesharing platform, has indicated Melbourne will be one of three international cities to host demonstrator flights, with commercial flights expected to become available to the public in 2023.

## Opportunities

Technological changes offer significant opportunity for airlines to increase efficiency and improve customer experience through the following:

- ◆ Fleet upgrades to focus on fuel efficient aircraft
- ◆ Focus on advances in big data to analyse patterns in human behaviour to personalise flying experiences as well as reducing costs through predictive analytics in relation to future demand, route optimisation and load factor improvements
- ◆ Use of smart phone apps and other digital media to provide customised service and product offers

Regional airlines have opportunities to continue to fill niche tourist routes between major population centres to popular tourist destinations. In the longer-term, regional airlines may benefit from subcontracting relationships with major airlines, leaving them to concentrate on competing for market share on the main passenger routes.

## 4 PROFILE OF REX

### 4.1 Background

REX is Australia's largest independent regional airline. REX was established in 2002 upon the merger between regional airlines, Hazelton Airlines and Kendell Airlines following the collapse of the Ansett Group. REX owns and operates a fleet of 60 Saab 340 aircraft, flying 1,500 weekly flights (pre-COVID) to 60 destinations throughout all states in Australia. In addition to the airline business, REX provides a variety of air services including charter, freight and aeromedical services through its wholly owned subsidiary, Pel-Air Aviation ("**Pel-Air**"). REX also offers pilot training programs through The Australian Airline Pilot Academy ("**AAPA**") at two locations, Wagga Wagga, NSW and Ballarat, Victoria.

On 29 June 2020, REX announced its intention to commence the Domestic Services in Australia following the board approval. The plan involves an initial fleet of five to ten narrow-body jet aircraft to be based out of Sydney and/or Melbourne to service the golden triangle (Sydney-Melbourne-Brisbane) starting 1 March 2021.

### 4.2 Corporate Timeline

A brief history of REX is set out in the table below:

**Table 3: REX's Corporate Timeline**

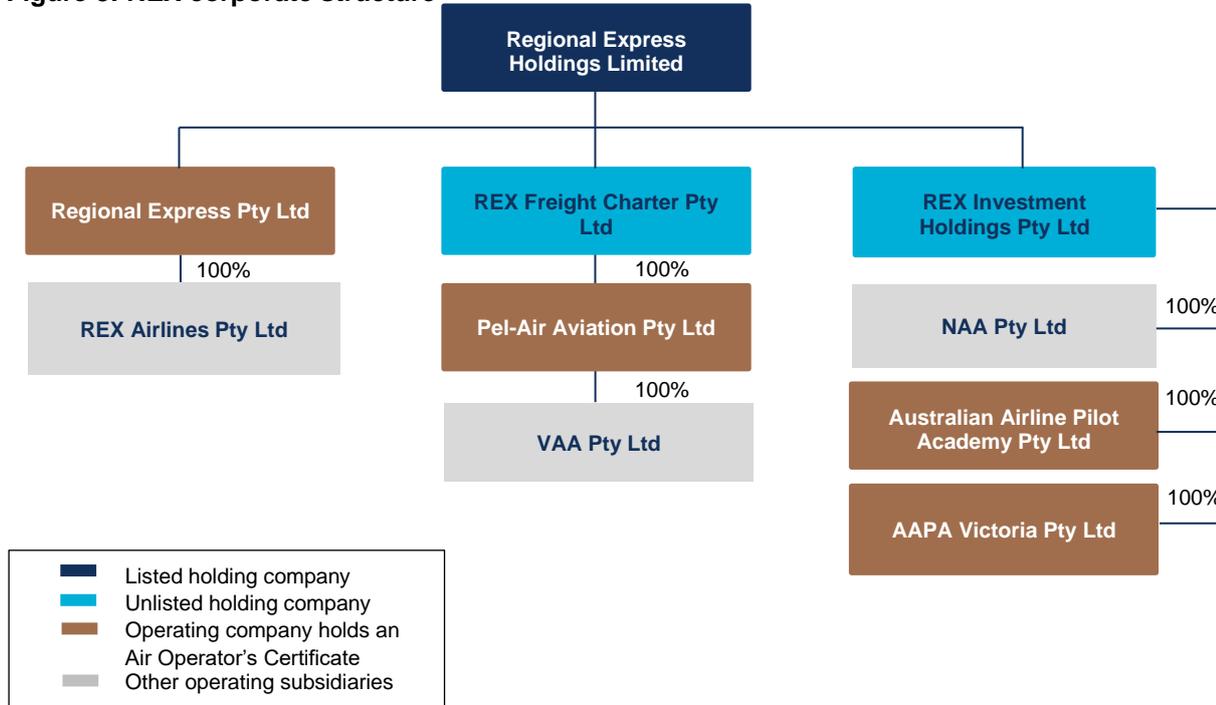
Year	Event
2002	◆ Incorporation
2005	◆ Acquisition of 50% stake in Pel-Air
	◆ Listed on the ASX
	◆ Acquisition of 100% of Air Link Pty Ltd (" <b>Air Link</b> "), a Dubbo-based regional airline
2007	◆ Acquisition of the remaining 50% stake in Pel-Air
	◆ Establishment of Civil Aviation Training Academy Pty Ltd (" <b>CATA</b> ") through a Joint Venture with Mangalore Airport Pty Ltd
2008	◆ Acquisition of the remaining 50% stake in CATA which was then renamed to AAPA
2010	◆ Pel-Air was awarded a 10-year contract for the provision of Fixed Wing Patient Transport Services by Ambulance Victoria, commencing in mid-2011
2011	◆ Pel-Air was awarded a 3-year contract for the provision of jet aircraft services to support Australian Defence Force Training, commencing in October 2011
2018	◆ Sale of Air Link
2019	◆ Pel-Air's contract extension with Ambulance Victoria until 2023
	◆ Acquisition of Aviation Training Academy Australia Pty Ltd (" <b>ATAA</b> ") and The Australian Airline Pilot Academy Victoria Pty Ltd (" <b>AAPAV</b> ") from Singapore Technologies Engineering Ltd for \$9.4 million
2020	◆ Pel-Air was awarded a 10-year contract for the provision of Fixed Wing Patient Transport Services by NSW Ambulance, commencing in 2022
	◆ Board approved plans for the Domestic Services commencing in March 2021

Source: REX

### 4.3 Corporate Structure

The corporate structure of REX is set out in the figure below:

**Figure 8: REX corporate structure**



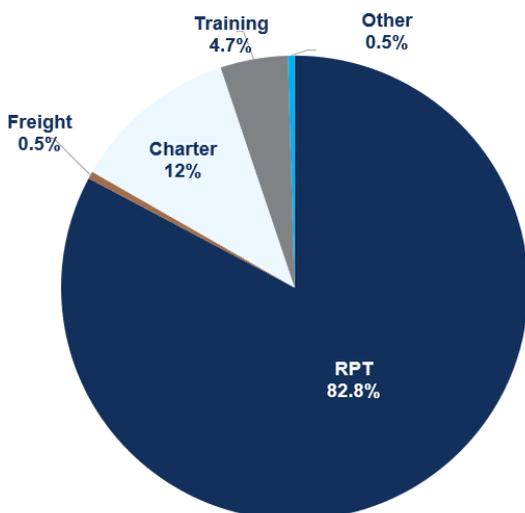
Source: REX

### 4.4 Overview of Operations

REX engages in the provision of a range of air services including transportation of passengers, freight, aeromedical services, and pilot training, employing over 1,000 people. It operates through two main segments, Regular Public Transport (“RPT”) through the Regional Express branded airline and Charter through the Pel-Air business with RPT accounting for the largest portion of total revenue (FY20: 83%).

The breakdown of FY20 revenue is as follows:

**Figure 9: FY20 Revenue breakdown**



Source: REX

Further information in respect of the operations of each of the REX businesses is set out below.

### Regional Express Airline (Regional Express)

Regional Express was founded in 2002 through the purchase and combination of two smaller regional airlines after the collapse of Ansett. Today, Regional Express is the largest regional carrier (outside of the Qantas group of companies) in Australia and the fourth largest airline by revenue employing over 900 staff.

Prior to COVID-19, Regional Express serviced 60 destinations across all states of Australia via 60 fully owned aircraft, flying 78,000 flights per year and servicing over 1.2 million passengers per annum (pre-COVID). NSW represented the largest market with over 40% of passengers. The figure below sets out the extensive flight network of REX.

**Figure 10 Regional Express' flight network**



Source: REX

In addition to the legacy regional operations, REX announced its intention to launch the Domestic Services, initially covering the three cities of the “Golden Triangle” being Sydney, Melbourne and Brisbane commencing 1 March 2021.

The Domestic Services will initially involve three jets servicing the Sydney to Melbourne route. By Easter 2021, it is proposed that two additional jets will be added to service the Golden Triangle.

Subject to market demand, REX is expected to deploy up to ten jets in total by the end of 2021. This would allow REX's network to expand to cover a majority of the top ten domestic routes in Australia which are all based out of Sydney or Melbourne.

Over the past 5 years, Regional Express has been Australia's most reliable airline when combining on time performance and cancellation rates.

### **Pel-Air Aviation Pty Limited (Pel-Air)**

Pel-Air is a wholly owned subsidiary of REX with a fleet of 16 aircraft and access to additional fleet within the Group. It operates both turboprop and jet aircraft in Australia and overseas. The company specialises in various air charter services such as FIFO, Corporate Jet, Air tours and freight. It also provides defence support missions and aeromedical transport services.

In February 2020, Pel-Air was awarded a 10-year contract to provide Fixed Wing Patient Transport Services to NSW Ambulance, commencing in January 2022, which involves the supply of five fixed-wing aircraft, pilots and engineering support to enable the aerial transport of NSW Ambulance medical personnel and patients throughout regional NSW.

Pel-Air currently has a similar contract with Ambulance Victoria which is due to expire in 2023.

### **The Australian Airline Pilot Academy (AAPA)**

Founded in 2007, AAPA is a Registered Training Organisation (“**RTO**”) for pilots in Wagga Wagga, NSW. It has also been accredited by several civil aviation regulatory bodies around the world including Australia, China, Vietnam, Singapore, and United Arab Emirates to deliver various qualifications such as Integrated Commercial Pilot Licence (“**CPL**”), Air Transport Pilot Licence (“**ATPL**”) and Multi Crew Cooperation (“**MCC**”).

The company offers intensive training programs for pilots from Australian and international airlines as well as private candidates. On completion of the programs, students will graduate with a CPL, Multi-Engine Rating, Instrument Rating and other skills that cater to the needs of different airlines. Over half of REX’s active pilot strength are made up of graduates from these programs.

In November 2019, REX acquired ATAA which then became AAPAV located in Ballarat, Victoria. AAPA and AAPAV have a total combined capacity of over 400 cadets a year for its residential CPL programme.

## 4.4.1 Key Personnel

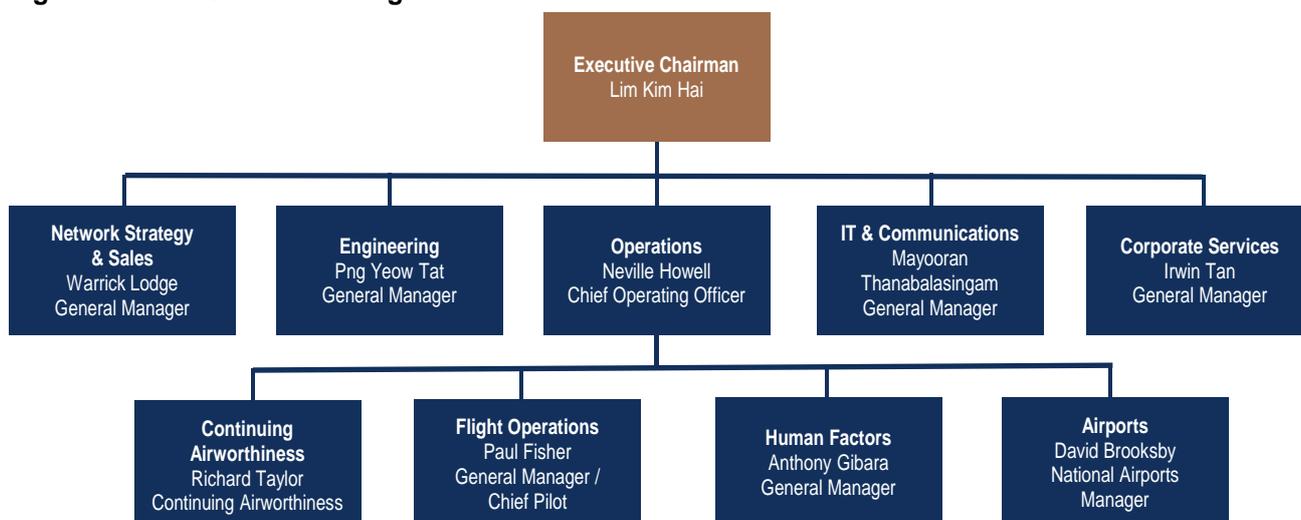
The board of directors and senior management of REX comprises:

**Table 4: The board of directors of REX**

Name	Title	Details
<b>Lim Kim Hai</b>	Executive Chairman	Mr Lim was one of the founding shareholders and directors of REX and has been the Executive Chairman of the REX Group of companies since July 2003.
<b>The Hon. John Sharp AM</b>	Deputy Chairman and Independent Director	First appointed as a director of REX in 2005, Mr Sharp is an aviator, having been a licensed pilot of both fixed-wing and rotary-wing aircraft. He is also the former Federal Minister for Transport and Regional Development in the Federal Government.
<b>Lee Thian Soo</b>	Non-executive Director	Mr Lee was one of the founding shareholders and directors of REX in August 2002.
<b>Neville Howell</b>	Chief Operating Officer	Mr Howell is a highly qualified and experienced simulator and aircraft instructor. He is also the Accountable Manager for the REX Air Operator Certificate.
<b>Chris Hine</b>	Group Flight Operations	Mr Hine joined REX in 2002 and worked in various roles within the company including General Manager Flight Operations, Chief Pilot and COO. He is also the Executive Chairman of AAPA.
<b>James Davis</b>	Independent Director	Mr Davis has 26 years' experience as a pilot flying around Australia and overseas. Since joining REX in 2002, Mr Davis worked in several positions within the group such as managing director and chairman of AAPA.
<b>Prof. Ronald Bartsch</b>	Independent Director	Professor Bartsch has over 40 years' experience in the aviation industry in a variety of senior operational, safety and regulatory roles. He was head of safety and regulatory compliance for Qantas Airways Limited's AOC and manager of CASA's Sydney Airline Transport Field Office.

Source: REX

**Figure 11: REX's senior management structure**



Source: REX

## 4.5 Financial performance

The audited statements of financial performance for the financial reporting periods between 30 June 2017 and 30 June 2020 are set out below.

**Table 5: REX's financial performance**

\$'000	FY17	FY18	FY19	FY20
<b>Revenue</b>	<b>279,048</b>	<b>293,413</b>	<b>314,353</b>	<b>257,423</b>
Other income	2,113	2,413	4,407	1,478
Government grants	-	-	-	62,095
<b>Total revenue</b>	<b>281,161</b>	<b>295,826</b>	<b>318,760</b>	<b>320,996</b>
<b>Operating costs</b>				
Direct costs of providing services	(124,539)	(129,573)	(145,625)	(141,407)
Salaries and employee-related	(105,533)	(107,726)	(112,238)	(103,938)
Selling and marketing	(7,465)	(7,948)	(8,797)	(6,686)
Administration	(7,540)	(7,681)	(7,838)	(8,684)
Other costs	-	-	-	(3,387)
<b>EBITDAR</b>	<b>36,084</b>	<b>42,898</b>	<b>44,262</b>	<b>56,894</b>
Non cancellable operating lease payment/ Leases related D&A <sup>1</sup>	(801)	(783)	(822)	(385)
<b>EBITDA</b>	<b>35,283</b>	<b>42,115</b>	<b>43,440</b>	<b>56,509</b>
Depreciation and amortisation	(16,268)	(16,218)	(17,178)	(21,547)
Impairment	-	-	-	(62,084)
<b>EBIT</b>	<b>19,015</b>	<b>25,897</b>	<b>26,262</b>	<b>(27,122)</b>
Finance income	770	1,153	895	556
Finance costs	(1,975)	(1,975)	(1,956)	(850)
<b>Profit before tax</b>	<b>17,810</b>	<b>25,075</b>	<b>25,201</b>	<b>(27,416)</b>
Tax (expense) / benefit	(5,190)	(8,162)	(7,684)	8,019
<b>Profit after tax</b>	<b>12,620</b>	<b>16,913</b>	<b>17,517</b>	<b>(19,397)</b>
<i>Other metrics</i>				
ASKS ('m)	814	785	808	630
Load factor	57%	61%	63%	60%
EBITDAR Margin %	13%	15%	14%	18%
EBITDA Margin %	13%	14%	14%	18%
EBIT Margin %	7%	9%	8%	-8%

Source: REX

Note 1: This relates to the depreciation and amortisation expenses recognised on right-of-use assets under AASB 16 Leases

In relation to the historical financial performance of REX set out above, we note the following:

- ◆ REX demonstrated consistent growth in profitability between FY17 and FY19 due to an improvement in passenger numbers coupled with a growing contribution from FIFO operations. The substantial loss in FY20 was largely due to the disruption to the operation of the business and the recognition of impairment losses as a result of the onset of COVID-19 in early 2020.
- ◆ Revenue consists of revenue from passenger transportation, charter services, freight and pilot training. The sharp decline in FY20 is attributable to government-imposed travel restrictions and inter-state border closures as part of the pandemic-related measures significantly impeding demand for RPT services.
- ◆ Other income primarily makes up of sales of engineering parts and rent.
- ◆ Government grants in FY20 relates to a number of grants such as Regional Airline Funding Assistance ("RAFA"), Regional Airline Network Support Program ("RANS") and Jobkeeper in order to fund continued operation of key regional services during the pandemic.

- ◆ Direct costs of providing services are the largest cost for REX. These pertain to the flight and port operations, fuel, engineering and maintenance of aircraft. These costs have decreased slightly in FY20, due to the decline in fuel and other operating costs from reduced schedule frequency. The impact of these reductions was partially offset by higher maintenance costs in FY20 which relate to the aircraft and other assets acquired with the AAPA business.
- ◆ Salaries and employee-related costs have decreased in FY20 as most of the operational staff were stood down with the remaining non-operational staff working reduced hour as part of the cost-cutting initiatives for COVID-19.
- ◆ Other costs relate to the impact of de-designating the portion of the fuel swap hedges which are in excess of the projected activity and therefore ineffective.
- ◆ The increase in depreciation and amortisation expenses in FY20 primarily pertains to the assets acquired as part of the acquisition of AAPAV. In addition, the adoption of AASB 16 Leases during the year resulted in \$385,000 of depreciation expenses being recognised on right-of-use assets (namely, leased property and aircraft).
- ◆ Impairment losses were recognised on various assets pertaining to the RPT business in FY20 as management expect COVID-19-related demand constraint to prevail through to FY23. These include goodwill, property, plant and equipment, right-of-use assets, other intangible assets and consumable inventories.

## 4.6 Financial position

The audited statements of financial position as at 30 June 2017, 30 June 2018, 30 June 2019 and 30 June 2020 are set out in the table below.

**Table 6: REX's financial position**

<b>\$'000</b>	<b>30-Jun-17</b>	<b>30-Jun-18</b>	<b>30-Jun-19</b>	<b>30-Jun-20</b>
<b>Current assets</b>				
Cash and bank balances	26,257	24,019	21,727	11,198
Trade and other receivables	9,531	10,166	12,069	11,122
Inventories	12,793	11,778	13,439	8,410
Other current assets	1,274	3,861	4,605	7,231
Derivative financial instruments	140	-	360	40
<b>Total current assets</b>	<b>49,995</b>	<b>49,824</b>	<b>52,200</b>	<b>38,001</b>
<b>Non-current assets</b>				
Other receivables	6,515	5,808	6,679	7,114
Inventories	11,852	12,356	8,055	11,303
Property, plant and equipment	203,584	204,805	203,278	172,417
Right-of-use assets	-	-	-	1,283
Investments - fair value through equity	9	9	9	9
Intangible assets	853	824	731	181
Deferred tax assets	-	1,585	1,897	22,537
<b>Total non-current assets</b>	<b>222,813</b>	<b>225,387</b>	<b>220,649</b>	<b>214,844</b>
<b>Total assets</b>	<b>272,808</b>	<b>275,211</b>	<b>272,849</b>	<b>252,845</b>
<b>Current liabilities</b>				
Trade and other payables	(18,330)	(18,813)	(20,939)	(19,483)
Provisions	(7,172)	(8,124)	(9,217)	(8,117)
Unearned revenue	(22,698)	(24,693)	(24,502)	(16,027)
Interest bearing liabilities	(7,075)	(7,509)	(3,852)	(14,220)
Lease liabilities	-	-	-	(130)
Current tax payable	(1,172)	(5,728)	(2,452)	(7,689)
Derivative financial instruments	(70)	-	-	(6,255)
<b>Total current liabilities</b>	<b>(56,517)</b>	<b>(64,867)</b>	<b>(60,962)</b>	<b>(71,921)</b>
<b>Non-current liabilities</b>				
Provisions	(1,371)	(1,815)	(2,248)	(2,949)
Interest bearing liabilities	(16,551)	(9,045)	(4,220)	-
Lease liabilities	-	-	-	(2,329)
Derivative financial instruments	(1,924)	-	-	(1,988)
<b>Total non-current liabilities</b>	<b>(19,846)</b>	<b>(10,860)</b>	<b>(6,468)</b>	<b>(7,266)</b>
<b>Total liabilities</b>	<b>(76,363)</b>	<b>(75,727)</b>	<b>(67,430)</b>	<b>(79,187)</b>
<b>Net assets</b>	<b>196,445</b>	<b>199,484</b>	<b>205,419</b>	<b>173,658</b>
<b>Other metrics</b>				
<i>Net tangible operating assets</i>	270,532	268,932	265,247	221,564
<i>Net debt</i>	2,631	9,411	15,623	(3,433)
<i>Net working capital</i>	3,994	3,131	4,569	49
<i>Net assets per share (\$)</i>	1.8	1.8	1.9	1.6

Source: REX

In relation to the historical financial position of REX set out above, we note the following:

- ◆ Cash and cash equivalents decreased year on year due to dividends paid and a high level of capital expenditure consistent with the nature of the industry. The significant reduction in the cash balance in FY20 is primarily driven by a combination of the impact of COVID-19 hampering passenger demand, the acquisition of AAPAV and the purchase of new aircraft for the NSW Air Ambulance contract.
- ◆ Trade and other receivables are non-interest bearing with 30-day payment terms. Over 90% of the outstanding trade receivables balance is within its payment terms. The reduction in the receivable balances in FY20 is in line with the fall in revenue.
- ◆ Inventories relate to consumables or parts required for the maintenance and repair of aircraft, engines, equipment, and other components, recorded at the lower of cost and net realisable value.
- ◆ Other current assets include prepayments and term deposit held for workers compensation obligations.
- ◆ Derivative financial instruments pertain to forward foreign exchange contracts, jet fuel price swaps and interest rate swaps. The carrying values of these instruments are recorded at amortised cost which approximates their fair values.
- ◆ Property, plant and equipment ("**PP&E**") is largely comprised of aircraft, rotatable assets and land/buildings. The fall in FY20 is attributable to \$52 million of impairment losses recognised on the REX CGU offsetting the PP&E acquired as part of the purchase of ATAA which included 15 aircraft and other fixed assets.
- ◆ REX adopted AASB 16 Leases as at 1 July 2019. As a result, right-of-use assets and corresponding lease liabilities are recognised for business premises and aircraft leases.
- ◆ The substantial increase in deferred tax assets in FY20 is due to the impairment losses recognised during the year as the accounting impairment does not impact the tax carrying values.
- ◆ Trade and other payables represent liabilities for goods and services received by REX that remain unpaid at the end of the reporting period. These liabilities have payment terms of 7 to 30 days. The balance has decreased in line with lowered activity level due to COVID-19.
- ◆ Unearned revenue is made up of passenger and charter revenue which are flights booked but not yet flown as well as training revenue.
- ◆ Current interest-bearing liabilities consist of:
  - The Victorian Air Ambulance debt facility of \$5.5 million, at an effective interest rate of 9.10%, \$4.2 million of which has been drawn down as at 30 June 2020. The facility relates to the acquisition of aircraft for the Victorian Air Ambulance operations.
  - An advance of \$10 million provided by NSW Air Ambulance, at an effective interest rate of 0.15% to assist REX in meeting the capital expenditure needs for the NSW medical evacuation contract beginning in FY22. The advance is repayable from December 2020 to June 2021.

## 4.7 Cash flows

The audited statements of cash flows for the financial reporting periods between 30 June 2017 and 30 June 2020 are set out below.

**Table 7: REX's cash flows**

\$'000	30-Jun-17	30-Jun-18	30-Jun-19	30-Jun-20
Receipts from customers	312,112	324,122	344,970	275,594
Proceeds from government grants and subsidies	-	-	-	64,318
Payments to suppliers, employees and others	(280,218)	(279,926)	(299,417)	(292,909)
Interest paid	(1,912)	(1,526)	(1,056)	(850)
Income tax paid	(3,869)	(7,115)	(11,456)	(5,311)
<b>Net cash flows from operating activities</b>	<b>26,113</b>	<b>35,555</b>	<b>33,041</b>	<b>40,842</b>
Interest received	770	1,153	895	556
(Payments for acquisition) / proceeds from disposal of business	-	-	908	(8,650)
Proceeds from disposal of property, plant and equipment	2,262	1,951	2,403	27
Payments for aircraft for tendered contract	-	-	-	(21,845)
Payments for property, plant and equipment	(20,576)	(18,677)	(18,030)	(17,874)
<b>Net cash flows used in investing activities</b>	<b>(17,544)</b>	<b>(15,573)</b>	<b>(13,824)</b>	<b>(47,786)</b>
Dividends paid	-	(15,062)	(13,027)	(8,725)
Shares purchased as reserve shares	(2,488)	(86)	-	(623)
Lease liabilities paid	-	-	-	(385)
Repayment of interest bearing liabilities - non-related parties	(6,645)	(7,072)	(8,482)	(20,375)
Proceeds from interest bearing liabilities - non-related parties	-	-	-	26,523
<b>Net cash flows used in financing activities</b>	<b>(9,133)</b>	<b>(22,220)</b>	<b>(21,509)</b>	<b>(3,585)</b>
<b>Net decrease in cash held</b>	<b>(564)</b>	<b>(2,238)</b>	<b>(2,292)</b>	<b>(10,529)</b>
Cash at the beginning of the financial year	26,821	26,257	24,019	21,727
Cash at the end of the financial year	26,257	24,019	21,727	11,198

Source: REX

In relation to the historical cash flows position of REX set out above, we note the following:

- ◆ REX has experienced net cash outflow in each of the periods presented above. This arose due to dividends paid and capital investment exceeding operating cash inflows for the period.
- ◆ The substantial net cash outflow in FY20 is largely attributable to the acquisition of ATAA and the purchase of new aircraft in relation to the NSW Air Ambulance contract coupled with the decline in revenue from weakened passenger demand and reduced services. The cash outflow is moderated by various government grants and subsidies, a reduction in dividend payments and the advance from NSW Air Ambulance.

## 4.8 Capital structure and shareholders

As at 7 October 2020 REX had a total of 110,154,375 ordinary shares on issue. The following table sets out details of REX's substantial shareholders as at that date:

**Table 8: REX's substantial shareholders**

Shareholder	Number of shares	% Total interest
Mr Lim Kim Hai	18,998,346	17.25%
BNP Paribas Nominees Pty Ltd	16,234,094	14.74%
Thian Soo Lee	7,722,181	7.01%
Joo Chye Chua	7,454,362	6.77%
Ming Yew See Toh & Hui Ing Tjoa	7,454,362	6.77%
Ms Hui Ling Tjoa	5,755,513	5.22%
Other Shareholders	46,535,517	42.25%
<b>Total</b>	<b>110,154,375</b>	<b>100.00%</b>

Source: REX

According to Capital IQ, over 50% of the shares are held by individuals which includes senior management of REX and their related parties. We understand that the majority of shareholders are resident overseas.

## 4.9 Share price performance

The following chart shows the share market trading of REX shares, for the 12 months to 9 December 2020:

**Figure 12: REX's share performance**



Source: CapIQ

In relation to the trading of REX shares over the past 12 months, we note the following:

- ◆ Shares have been relatively thinly traded with an average daily value of approximately \$164,450 over the twelve months to 9 December 2020.
- ◆ Between 17 March 2020 and 20 March 2020, the share price fell from \$0.83 to \$0.56. The sharp fall was the result of the withdrawal of the original profit guidance released on 28 February 2020 due to the high level of uncertainty posed by the COVID-19 pandemic and near-term risks to the viability of the business subject to government intervention. Subsequent announcements of the decreased schedule frequency and potential suspension of all passenger air services pushed the share price down to \$0.40 in late March 2020.
- ◆ The spike in trading volume and share price on 30 March 2020 related to the announcement of the RANS program and the RAFA program which totalled \$298 million.
- ◆ The share price gradually recovered during April and mid May 2020 following REX obtaining funding from governments to maintain a minimum weekly flight service.
- ◆ On 13 May 2020, the media coverage of REX's aspiration to launch the Domestic Services to compete with Qantas, Jetstar and Virgin led to a surge in trading volumes and the share price rose from \$0.90 per share to \$1.19 per share the following day.
- ◆ The share price increased above \$1.00 per share following the board approval of the plan for the Domestic Services at the end of June.
- ◆ In September 2020, several progress updates on the Domestic Services were announced, including the Proposed Transaction as well as the jet aircraft lease arrangements lifting the share price back to pre COVID levels, just under \$1.40 per share.
- ◆ Over the twelve-month period observed, share price has generally traded below the company's net tangible assets of \$1.57 per share.
- ◆ Since 1 December 2020, the share price of REX has increased significantly which is likely due to a number of factors including:
  - The successful launch and promotion of ticket sales for Domestic Services.
  - Further progress of the Proposed Transaction including FIRB approval being granted.
  - Improved sentiment in the aviation sector due to the re-opening of domestic borders which has increased demand for passenger services.
  - The lack of liquidity of REX shares which can cause significant short-term share price movements.

#### **4.10 Outlook**

The combination of cheap aircraft leases in a distressed aviation market, historically low jet fuel prices and reduced competition arising from the Virgin collapse, presents a unique opportunity for REX to pursue the Domestic Services. However, the success of the expansion is largely dependent on the easing of COVID-19 related restrictions such as quarantine requirement, border closures and subsequent recovery of domestic air travel volumes as well as the competitive response from incumbent airlines.

## 5 VALUATION METHODOLOGY

### 5.1 Available Valuation Methodologies

To estimate the fair market value of REX, we have considered common market practice and the valuation methodologies recommended in RG 111. There are a number of methods that can be used to value a business including:

- ◆ The discounted cash flow method
- ◆ The capitalisation of future maintainable earnings method
- ◆ Asset based methods
- ◆ Analysis of share market trading
- ◆ Industry specific rules of thumb

Each of these methods is appropriate in certain circumstances and often more than one approach is applied. The choice of methods depends on several factors such as the nature of the business being valued, the return on the assets employed in the business, the valuation methodologies usually applied to value such businesses and availability of the required information. A detailed description of these methods and when they are appropriate is provided in Appendix 2.

### 5.2 Selected Methodology

In selecting an appropriate valuation methodology for REX (both before and after the Proposed Transaction), we have considered the following:

**Table 9: Consideration of methodologies**

Method	Considerations	Approach
<b>Discounted cash flow</b>	<ul style="list-style-type: none"> <li>◆ REX's regional business is currently loss-making and the future profitability is dependent on the timing and extent of recovery in regional travel. Furthermore, the launch of the Domestic Services is a start-up operation which represents a significant change in the business model of REX. Due to the variability in near-term earnings, capital costs and cash flows in the short to medium term we consider that the value of REX is best evaluated with a discounted cash flow method.</li> <li>◆ We have been provided with financial projections for REX prepared by REX management. We have used the projections as a basis for our own cash flow model</li> </ul>	Selected
<b>Capitalisation of earnings</b>	<ul style="list-style-type: none"> <li>◆ There are a limited number of transactions (market trading and M&amp;A) involving regional airlines.</li> <li>◆ Due to the impact of COVID-19 and the expected expansion of the business to incorporate the Domestic Services, REX has experienced operating losses recently which may persist in the near-term. Therefore, the capitalisation of earnings method is not likely to result in meaningful conclusions.</li> </ul>	Not considered
<b>Asset based methods</b>	<ul style="list-style-type: none"> <li>◆ Asset based methods are generally not appropriate for operating businesses as they ignore the value of most internally generated intangible assets. However, due to the capital-intensive nature of REX's business, we have considered net assets as a high-level cross-check</li> </ul>	High-level cross-check

Method	Considerations	Approach
<p><b>Share trading</b></p>	<ul style="list-style-type: none"> <li>◆ Share market trading in REX shares has been reasonably liquid. However, we do not consider that an analysis of share market trading is as reliable as the discounted cash flow method as a primary valuation methodology in assessing the intrinsic value of a REX share.</li> <li>◆ As a broad cross-check to the discounted cash flow valuation:                             <ul style="list-style-type: none"> <li>● <b>Before the Proposed Transaction</b> – we have analysed share market trading in REX shares before announcement of the Proposed Transaction and the control premium implied by our assessed value per share.</li> <li>● <b>After the Proposed Transaction</b> – we have compared our analysis of share market trading in REX shares since the announcement of the Proposed Transaction with our assessed value per share on a minority basis.</li> </ul> </li> </ul>	<p>Cross-check</p>

## 6 VALUATION OF REX BEFORE THE PROPOSED TRANSACTION

### 6.1 Background

We have assessed the fair market value of REX using the discounted cash flow method, with cross-checks by reference to net assets, and an analysis of share marketing trading in REX shares leading up to the announcement of the Proposed Transaction. This assessment has been made on a control basis in accordance with RG 111, as PAG may acquire an interest in excess of 20% if the Proposed Transaction proceeds.

### 6.2 Discounted cash flow analysis

#### 6.2.1 Approach

In order to determine the value of a REX share on a control basis prior to the Proposed Transaction using the discounted cash flow method, we considered the following:

- ◆ Projected cash flows for REX
- ◆ An appropriate discount rate
- ◆ Terminal value beyond the projected cash flow period
- ◆ The value of any surplus assets or non-operating liabilities

These are discussed below.

#### 6.2.2 Projected cash flows

##### Introduction

REX management have prepared projections for the regional business as well as for the domestic expansion under a number of scenarios ("**REX Projections**"). We have used the REX Projections in order to prepare our own cash flow model which we consider is appropriate for valuation purposes as reasonably representative of the assumptions that could be adopted by a potential acquirer of REX ("**LCA Model**").

In preparing the LCA Model we have undertaken a detailed analysis of the REX Projections and have discussed the key assumptions with REX management. We have considered supporting information, available market data and other relevant information in order to determine the reasonableness of the cash flow projections and considered the residual risks associated with achieving the projections. Based on these discussions and analysis, we consider the assumptions adopted in the LCA Model to be reasonable for the purposes of our analysis.

The detailed projections are not included in this report due to commercial sensitivity. However, the key assumptions underpinning the projections and the information considered in assessing the reasonableness of these assumptions are discussed below.

We note that preparing projections for regional and domestic airlines is subject to considerable uncertainty as these businesses generally operate in highly competitive environments and are susceptible to external shocks. These challenges are exacerbated due to the impacts of COVID-19 on the domestic aviation sector and the changing competitive landscape as a consequence of the collapse of Virgin. In preparing the LCA model we have therefore considered:

- ◆ The current activity level of the regional business and the path to recovery to pre COVID-19 levels under a low scenario and high scenario
- ◆ Several potential scenarios for the Domestic Services expansion with different capacity, price and demand characteristics.

### Regional business projections and assumptions

REX's regional aviation business is operating at activity levels significantly below the level of operating activity prior to the outbreak of COVID-19. Revenue and expense projections are based on FY19 results (being the last full year of operations prior to the impact of COVID 19), adjusted to reflect:

- ◆ Expected inflation
- ◆ Changes in the level of operating activity, measured by passenger numbers or available seat kilometres ("ASK")
- ◆ Changes In the price of jet fuel

The historical and projected activity levels are summarised below:

**Table 10: Activity level scenarios**

Scenario	Passenger numbers	Million ASK
<b>Low</b>		
<b>High</b>		

Source: REX, Leadenhall Analysis

The low case assumes the activity in the second quarter of FY21 remains constant from actual activity as at November 2020, and that passenger numbers and ASK recover to 2019 levels by FY24. It is expected that ASK recovers initially at a slightly faster rate than passengers. No further growth in activity is assumed beyond 2019 levels.

The high case assumes the activity in the second quarter of FY21 remains constant from actual activity as at November 2020, and that passenger numbers and ASK recover to 2019 levels by FY23. Similar to the low case, it is expected that ASK recovers initially at a slightly faster rate than passengers. Growth in activity beyond FY23 (passenger numbers and ASK) is modest at 1% every 2 years.

Other detailed model assumptions are summarised below:

**Table 11: LCA Model assumptions**

Item	Assumption
<b>Expected life of aircraft</b>	<ul style="list-style-type: none"> <li>◆ REX operates a fleet of Saab 340 aircraft with technical characteristics supporting a life that may exceed 20 years</li> <li>◆ 15 years has been adopted as the economic life of the aircraft, consistent with the lower end of REX management's estimate</li> </ul>
<b>Revenue</b>	<ul style="list-style-type: none"> <li>◆ Revenue per passenger is calculated by adjusting the FY19 actual revenue for inflation and fuel price movements</li> </ul>
<b>Fuel cost</b>	<ul style="list-style-type: none"> <li>◆ Fuel cost is calculated by adjusting the FY19 cost for the level of activity (ASK) and fuel price</li> <li>◆ Fuel prices are calculated based on the prevailing fuel swap rates, after which the brent crude curve is adopted as discussed further below</li> </ul>
<b>Labour cost</b>	<ul style="list-style-type: none"> <li>◆ Staffing levels return to pre COVID-19 levels in line with the projected increase in ASK, adjusted for wage indexation</li> <li>◆ Wage cost escalation at 2% p.a. or in accordance with existing enterprise bargaining agreements</li> </ul>
<b>Government grants</b>	<ul style="list-style-type: none"> <li>◆ Assistance under both the RAFA program and the RANS program will continue to be received to the extent granted to REX or publicly announced by the relevant government bodies</li> <li>◆ Jobkeeper support will continue to be received to the extent publicly announced by relevant government bodies</li> </ul>
<b>Capital expenditure</b>	<ul style="list-style-type: none"> <li>◆ Capital expenditure is based on maintenance capex over the projection period</li> <li>◆ Expansionary capital expenditure has been excluded consistent with the activity level assumptions</li> </ul>
<b>Other airline costs</b>	<ul style="list-style-type: none"> <li>◆ Port costs, selling costs and maintenance/engineering costs return to pre COVID-19 levels in line with the recovery (increase) in ASK</li> <li>◆ Marketing and corporate costs are assumed to be fixed and increase in line with inflation</li> </ul>
<b>Pel-Air &amp; training</b>	<ul style="list-style-type: none"> <li>◆ Pilot training continues at pre COVID-19 levels</li> <li>◆ Charter and freight operations continue at pre COVID-19 levels</li> <li>◆ Victorian Air Ambulance contract concludes in FY23</li> <li>◆ NSW Air Ambulance contract commences in FY22</li> </ul>

### Domestic Services projections and assumptions

The Domestic Services assumptions have been developed based on the REX Projections and other assumptions provided by REX management regarding the level of activity, together with other revenue and cost drivers.

For the purpose of our discounted cash flow analysis we developed 4 scenarios to recognise the wide range of potential outcomes associated with the Domestic Services. The projections are over the 4 years to FY25 consistent with management projections, allowing for a period of establishment of REX in the domestic market and for passenger demand to fully recover from the effects of COVID-19.

**Table 12: Summary of Cash Flow Scenarios**

Scenario	Activity	Pricing and load factor <sup>1</sup>
<b>Low</b>	5 Boeing 737-800 aircraft operating 30 flights a day across the Golden Triangle routes	<ul style="list-style-type: none"> <li>◆ Average price remains at the low end of management expectations at \$105 per passenger</li> <li>◆ Average load factor commences at 70% increasing to 75% by FY25</li> </ul>

Scenario	Activity	Pricing and load factor <sup>1</sup>
Base	7 Boeing 737-800 aircraft operating 42 flights a day across the Golden Triangle routes	<ul style="list-style-type: none"> <li>◆ Average price commences at the low end of management expectations at \$105 per passenger, increasing to \$120 per passenger</li> <li>◆ Average load factor commences at 72.5% increasing to 77.5% by FY25</li> </ul>
High	7 Boeing 737-800 aircraft operating 42 flights a day across the Golden Triangle routes	<ul style="list-style-type: none"> <li>◆ Average price commences at the low end of management expectations at \$105 per passenger, increasing to the high end of management expectations at \$135 per passenger</li> <li>◆ Average load factor commences at 75% increasing to 80.25% by FY24</li> </ul>

Source: Leadenhall analysis

Note: Prices are exclusive of airport aeronautical charges and GST.

In addition, we considered a 'failure' scenario in which the expansion into domestic routes is unsuccessful, and REX management determined there was no likely pathway toward generating positive operating cashflow and therefore generates a net loss on this venture.

The major assumptions in the LCA Model are summarised below:

**Table 13: LCA Model assumptions**

Item	Assumption
Revenue	<ul style="list-style-type: none"> <li>◆ Passenger numbers derived from assumptions regarding number of aircraft, sectors flown, available seats per aircraft and average load factors under each scenario</li> <li>◆ Passenger revenue is based on average prices per passenger under each scenario</li> <li>◆ Other revenue includes lounge membership, freight and commissions</li> </ul>
Fuel cost	<ul style="list-style-type: none"> <li>◆ Fuel cost is based on fuel consumption estimated per block hour and the expected fuel price</li> <li>◆ Fuel prices are calculated based on the prevailing fuel swap rates, after which the brent crude curve is adopted as discussed further below</li> </ul>
Labour cost	<ul style="list-style-type: none"> <li>◆ Based on cost per crew-set and number of crew-sets required to service destinations and required block hours under each scenario, together with management and overhead</li> </ul>
Operating lease costs	<ul style="list-style-type: none"> <li>◆ All aircraft are assumed to be leased</li> <li>◆ Lease costs per aircraft are consistent with the jet aircraft lease arrangements announced, and based on the number of aircraft assumed in each scenario</li> </ul>
Capex	<ul style="list-style-type: none"> <li>◆ Minimal capital expenditure is planned due to REX having existing infrastructure and as aircraft are assumed to be leased</li> </ul>
Port Costs	<ul style="list-style-type: none"> <li>◆ Navigation and slot charges are calculated based on the number of aircraft flying under each scenario</li> <li>◆ Airport ground handling and passenger/baggage security is calculated based on expected passenger numbers under each scenario</li> </ul>

Item	Assumption
<b>Other airline costs</b>	<ul style="list-style-type: none"> <li>Maintenance/engineering costs scale with aircraft and flight time and include all costs subject to maintenance reserving under the jet aircraft lease arrangements announced</li> <li>Selling costs scale with the number of passengers and revenue</li> <li>Marketing and corporate costs scale with additional aircraft and passengers, and include an allowance for initial marketing of the Domestic Services in year 1 of operation</li> </ul>
<b>Mobilisation and start-up costs</b>	<ul style="list-style-type: none"> <li>Based on a cost per aircraft to allow for test flights, liveries, IT system infrastructure and simulation and training</li> <li>Additional marketing budget allowed during the start-up period</li> </ul>

Source: Leadenhall Analysis

The following table summarises high level metrics for the base case scenario:

**Table 14: Summary of Cash Flow Scenarios**

	FY22	FY23	FY24	FY25
<b>Passenger Numbers</b>	1,918,350	1,951,425	1,984,500	2,050,650
<b>ASK</b>	1,922	1,922	1,922	1,922
<b>Load factor</b>	72.5%	73.8%	75.0%	77.5%
<b>RASK (all revenue)</b>	0.134	0.153	0.161	0.172

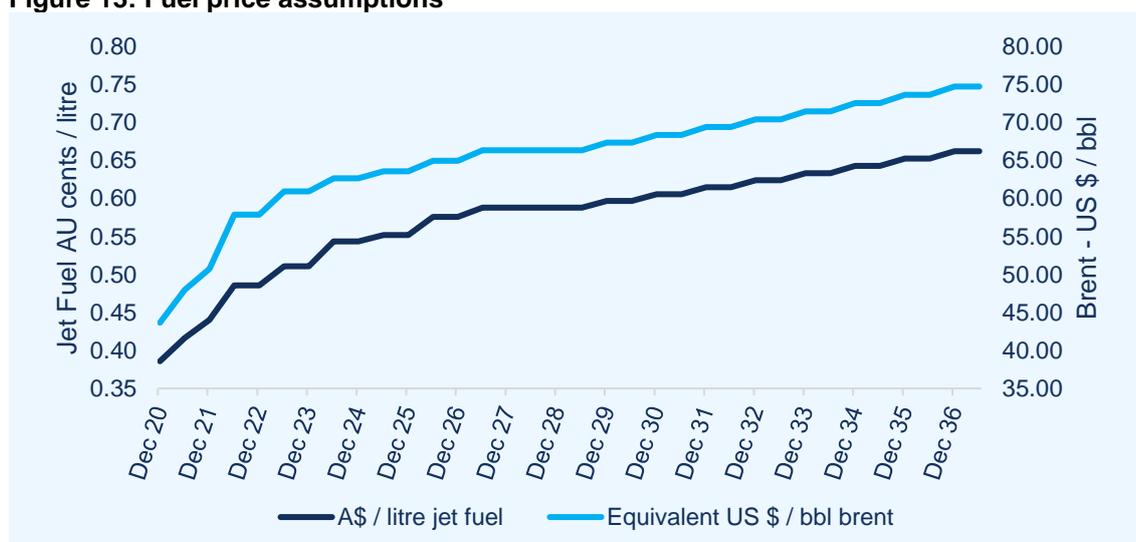
Source: Leadenhall Analysis

Notes: RASK = Revenue per ASK and CASK = Cost per ASK

## Fuel price

Jet fuel prices have fallen substantially since FY19 as a result of the global economic downturn triggered by the outbreak of COVID-19 and price competition between Russia and Saudi Arabia, recovering as Saudi Arabia and Russia agreed to production cuts. The following figure presents our jet fuel assumptions:

**Figure 13: Fuel price assumptions**



Source: CapIQ, Consensus Economics, Leadenhall analysis

The main assumptions underlying the fuel price in the LCA Model are:

- ◆ The price of fuel in the short term (18 months to Dec 21) is based on swap prices
- ◆ Fuel prices beyond December 21 are indexed based on consensus economic forecast movements in Brent oil prices and general inflation beyond the consensus forecast period, after adjusting for movements in exchange rates between AUD and USD.

#### Other assumptions

Other general assumptions applied in LCA Model include:

- ◆ General cost inflation of 1.5% throughout the period
- ◆ Corporate income tax at 30% consistent with the Australian general corporate tax rate
- ◆ The USD / AUD exchange rate is assumed to rise to 75 cents by the first half of FY24. After which, the exchange rate is expected to gradually settle at the long-term average of 71 cents by FY26. Foreign exchange rates are relevant for determining AUD costs for fuel and many engineering costs.
- ◆ Working capital is typically negative and consists of payables, prepaid fares, receivables, and inventory. Inventory levels are assumed to be held constant in real terms. Payables, prepaid fares and receivables increase as activity levels increase.

#### Reasonableness of assumptions

While we have not undertaken a review of management projections in accordance with AUS 804 – The Audit of Prospective Financial Information, we have undertaken a detailed review of the projections prepared by management and have discussed the key assumptions with management. Based on this analysis we consider these assumptions to be reasonable for the purposes of our analysis. We note that any reasonable alternate assumptions adopted would not change our conclusions on the Proposed Transaction.

#### 6.2.3 Discount rate

We have applied a discount rate of 11.0% (nominal, post-tax, WACC) to the projected cash flows. We calculated the discount using the capital asset pricing model based on the assumptions set out in Appendix 3.

#### 6.2.4 Terminal value

The terminal value represents the value of the cash flows beyond the projection period. Terminal values are commonly calculated based on the expected long-term growth rate of future cash flows. In determining an appropriate terminal growth rate, we have considered the following factors:

- ◆ **Regional business:** the economic life of the existing aircraft is expected to be between 15 to 20 years. There is no significant residual (sale) value for the aircraft expected at the end of the economic life. We have not included a terminal value as we assume any replacement fleet will earn REX no more than its cost of capital
- ◆ **Domestic expansion plan:** The domestic business is currently an expansion plan, based on a 4-year projection. At the date of this report REX has not committed any significant capital to the Domestic Services expansion. For the low scenario and base case scenario we have not included a terminal value, assuming that REX may generate economic profits in the short term, but generating returns in excess of the cost of capital injected over the longer term may be unlikely. This is consistent with the experience in the airline industry over the longer term. For the high case we have assumed a terminal value based on FY25 projections and no growth in earnings beyond the terminal year. The zero earnings growth reflects that the industry experiences a decline in RASK in real terms over time as aircraft become more efficient, while operating costs are likely to rise. Applying a zero-growth rate and the above discount rate implies a terminal EBITDAR multiple of 4.75 times which we do not consider to be unreasonable.

### 6.2.5 Probability weightings

Due to the wide range of potential outcomes for the Domestic Services, in order to estimate a reasonable valuation range, we have assigned probabilities to each of the identified scenarios for Domestic Services. In estimating the probability weightings for each scenario we have identified the risks associated with each scenario and held discussions with REX management. Based on this analysis we have adopted the following probabilities for each scenario:

**Table 15: Domestic Services Scenarios**

Domestic Services Scenario	Probability
Low	25.0%
Base	60.0%
High	5.0%
Unsuccessful	10.0%
<b>Total</b>	<b>100.0%</b>

Source: Leadenhall Analysis

While the above probabilities are somewhat subjective, any reasonable alternate assessment of the probabilities would not change our conclusions on the Proposed Transaction.

### 6.2.6 Discounted cash flow summary

Based on the analysis above, we have assessed the enterprise value of REX share to be in the range of \$227.3 million to \$264.2 million. The low end of this range is based on the low case activity level for the regional business and the expected (probability weighted) scenario for the Domestic Services, whereas the high end of the range is based on the high case activity level for the regional business and the expected scenario for the Domestic Services.

### 6.2.7 Surplus Assets & Non-operating Liabilities

In order to assess the equity value of REX, it is necessary to identify any non-operating assets and liabilities not used in generating the enterprise value. These can be:

- ◆ **Surplus assets:** assets held by the company that are not utilised in its business operation. This could be investments, unused plant and equipment held for resale, or any other assets not required to run the operating business. It is necessary to ensure that any income from surplus assets (i.e. rent / dividends) is excluded from the business value.
- ◆ **Non-operating liabilities:** liabilities of a company not directly related to its current business operations, although they may relate to previous business activities, for example claims against the entity.

As at 30 September 2020, REX has the following surplus assets and non-operating liabilities.

**Table 16: Surplus assets summary**

(\$'000)	
Surplus assets	6,000
Fuel hedge liability	(2,302)
Excess tax liability	(10,000)
<b>Surplus assets/(liabilities)</b>	<b>(6,302)</b>

Source: Leadenhall analysis

- ◆ **Surplus assets:** includes four King Air aircraft valued at \$1.5 million each, which will become available at the end of Victorian Air Ambulance contract.

- ◆ **Fuel hedge liability:** relates to the jet fuel swap contracts for the notional monthly purchases of 3.5 million litres of fuel to June 2021.
- ◆ **Excess tax liability:** includes income tax liability for FY20 and the PAYG instalments for the quarter ended 30 September 2020, to the extent they are more than outstanding tax payments typically observed under the PAYG instalment system.

### 6.2.8 Net debt position

The net debt position of REX, as at 30 September 2020, is set out in the table below:

**Table 17: Net debt summary**

(\$'000)	
Cash	19,011
Borrowings	(23,501)
<b>Net cash/(debt)</b>	<b>(4,490)</b>

Source: Leadenhall analysis

- ◆ **Cash:** reflects cash and bank balances held by group entities. There are no restrictions on the use of cash balances.
- ◆ **Borrowings:** includes \$21.1 million in loans and \$2.4 million in lease liabilities associated with property leases.

### 6.2.9 Shares on issue before the Proposed Transaction

In our consideration of the number of shares before the Proposed Transaction, we have included 110,154,375 ordinary shares on issue as detailed in section 4.8.

As at the date of this valuation, there are no options on issue. A management incentive scheme ("MIS") has been proposed for approval at the annual general meeting. The MIS has not been reflected in our valuation and if included would have no impact on our conclusions.

## 6.3 Assessed Value Before the Proposed Transaction

### Summary

The value of a REX share before the Proposed Transaction, on a control basis is set out in the following table:

**Table 18: Assessed value of a REX share before the Proposed Transaction**

(\$'000)	Low	High
<b>Enterprise value</b>	<b>227,273</b>	<b>264,201</b>
Surplus assets / (liabilities)	(6,302)	(6,302)
Net cash / (debt)	(4,490)	(4,490)
<b>Total equity value including conversion option</b>	<b>216,481</b>	<b>253,410</b>
Total shares on issue	110,154	110,154
<b>Assessed value per share (\$)</b>	<b>1.97</b>	<b>2.30</b>

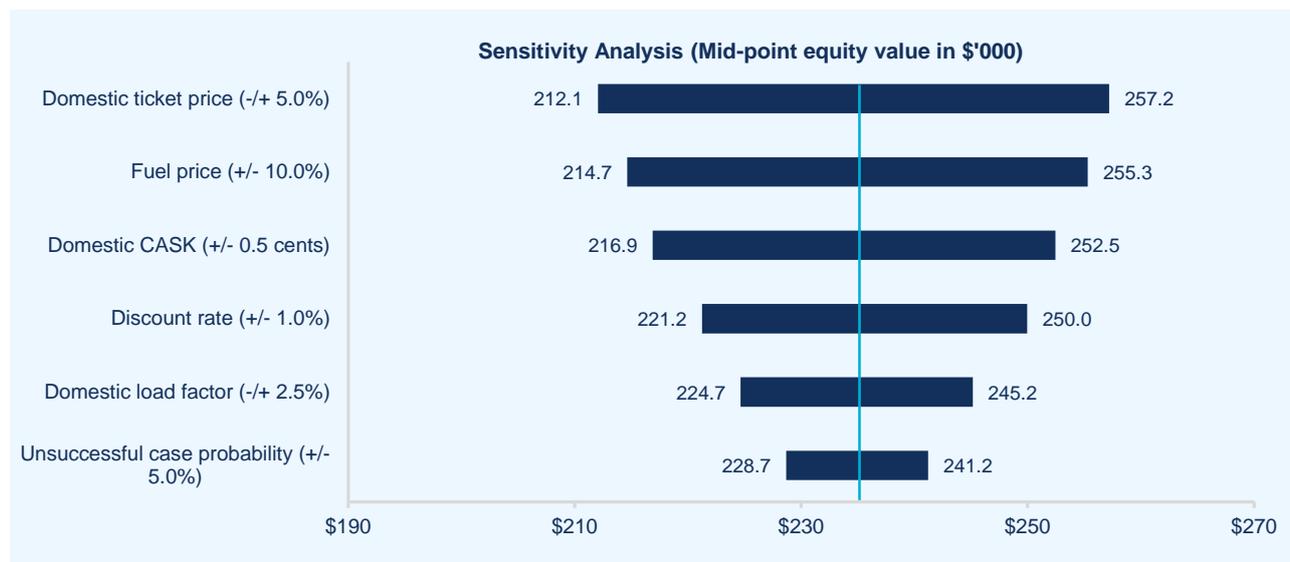
Source: Leadenhall analysis

## Sensitivity analysis

As discussed above, the values from the discounted cash flow analysis demonstrate a relatively wide range across the different scenarios, highlighting the sensitivity to relatively small changes in assumptions.

In particular, the analysis above is highly sensitivity to average domestic passenger fare and fuel prices as set out below:

**Figure 14: Sensitivity analysis**



Source: Leadenhall analysis

We note that any reasonable alternate assumptions for the above valuation inputs would not alter our conclusions on the Proposed Transaction.

## 6.4 Cross-checks

### 6.4.1 Net assets

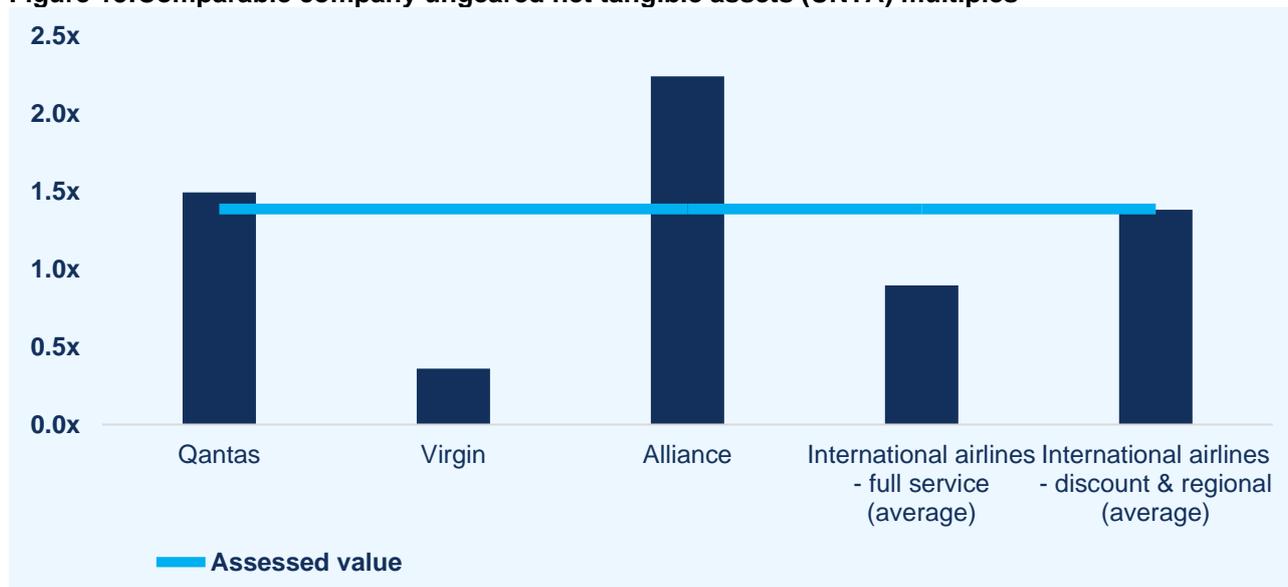
The net assets and net tangible assets per share for REX as at 30 June 2020 are presented below.

**Table 19: REX's net assets and net tangible assets per share as at 30 June 2020**

\$'000	30-Jun-20
Total tangible assets	252,664
Other assets	181
Total assets	252,845
Total liabilities	(79,187)
<b>Net assets</b>	<b>173,658</b>
<b>Net tangible assets</b>	<b>173,477</b>
<b>Net debt</b>	<b>3,433</b>
<b>Net assets per share (\$)</b>	<b>1.58</b>
<b>Net tangible assets per share (\$)</b>	<b>1.57</b>
<b>Ungeared net tangible assets per share (\$)</b>	<b>1.61</b>

Source: REX

**Figure 15: Comparable company ungeared net tangible assets (UNTA) multiples**



Source: CapIQ and Leadenhall analysis

Notes

1. UNTA Multiple represents ungeared net tangible multiple. It is calculated as gross market capitalisation (market capitalisation + borrowings – cash) divided by ungeared net tangible assets (Shareholder's funds – intangible assets + borrowings – cash)
2. Qantas Airways Limited ("Qantas"); Virgin Australia Holdings ("Virgin"); Alliance Aviation Services ("Alliance").

The net assets and net tangible assets for REX as at 30 June 2020 were \$1.58 per share and \$1.57 per share respectively compared to the assessed midpoint value of \$2.13 per share. We do not consider this unreasonable since:

- ◆ The NTA does not include any value attributable to the Domestic Services whereas our assessed value of REX does
- ◆ Our assessed value multiple is based on control value whereas the comparable airlines multiples are on a minority basis.
- ◆ The comparable airlines are trading at an average UNTA multiple of 1.91x indicating, in general, that the market value of airline companies exceeds the book values of their tangible assets.
- ◆ Since REX owns all of its aircraft (for the regional business) this could have a downward impact on the UNTA multiple for REX as leasing aircraft is more common among the comparable airlines. Should REX lease more of its aircraft, we would expect a higher multiple.

Having regard to the above, this provides broad support to our valuation conclusion.

#### 6.4.2 Implied control premium

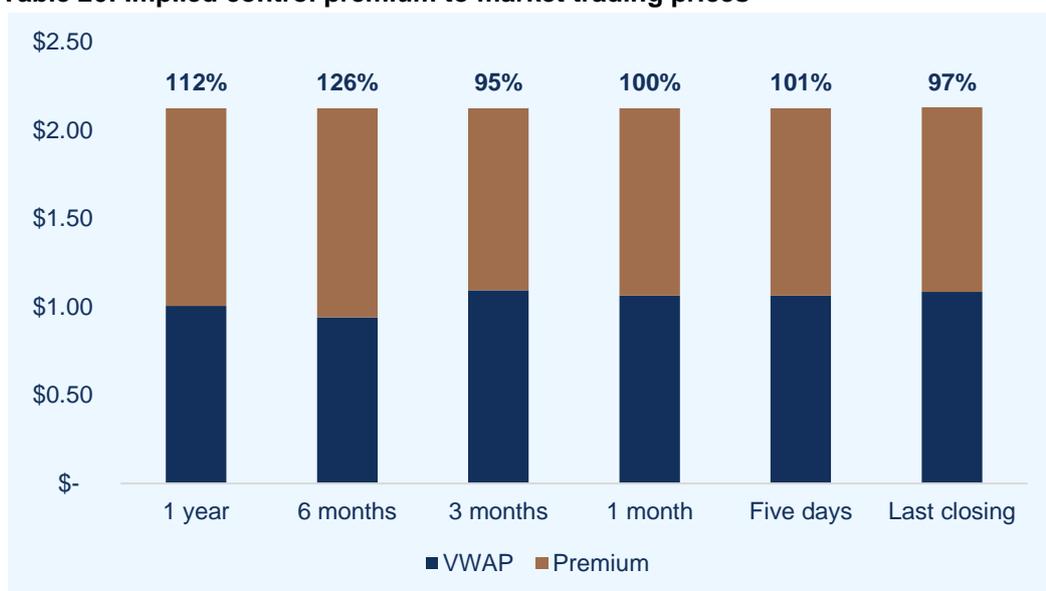
Market trading in REX shares prior to the announcement of the Proposed Transaction provides an indication of the market's assessment of the value of REX prior to the Proposed Transaction on a minority basis. We have presented an analysis of recent trading in REX shares in Section 4.9 above. When assessing market trading, it is necessary to consider whether the market is informed and liquid. In this regard, we note:

- ◆ REX shares are closely held by REX's management and their associates. This is in line with the relatively low average daily value traded observed over the twelve-month period prior to the announcement, at approximately \$99,359. This level is below the level at which many institutional investors may wish to trade and may be seen as a deterrent for other significant investors.
- ◆ REX is a listed company with continuous disclosure obligations under the ASX Listing Rules, thus the market is reasonably informed about its activities.
- ◆ REX has no sell-side research coverage and limited institutional investors which limits the liquidity of its shares.

Having regard to the above, we consider the market trading in REX shares to be reasonably well informed and moderately liquid. We have therefore undertaken only a high-level analysis of share market trading, by assessing the level of control premium implied by our valuation range compared to the volume weighted average price ("VWAP") of a REX share over the year leading up to the announcement of the Proposed Transaction on 21 September 2020, as set out in the figure below.

The figure below sets out the control premium implied by the mid-point of our valuation range:

**Table 20: Implied control premium to market trading prices**



Source: CapIQ and Leadenhall analysis

The generally observed range for control premiums is between 20% and 40%. Further information on observed control premiums and takeover premiums is included in Appendix 6.

The control premium implied by our assessed value of a REX share exceeds the generally observed range. However, we do not consider this to be unreasonable given the following factors:

- ◆ It is likely that the market might have priced in significant funding and/or insolvency risk for the company prior to the announcement of the Proposed Transaction given the significant losses announced by the company in FY20, the uncertainty over the availability of government grants and subsidies as well as the ongoing impact of COVID-19 related restrictions on the aviation industry and the business operation in the near-term.
- ◆ The substantial risks in successfully implementing the Domestic Services in a distressed market as a result of COVID-19.
- ◆ Since the announcement of the Proposed Transaction, there have been further easing of COVID restrictions across Australia and REX have made further announcements in respect of the plans for the Domestic Services. These factors would not be reflected in REX's share price prior to the Proposed Transaction but are reflected in our assessed value of REX.

## 6.5 Conclusion on value before Proposed Transaction

Based on our DCF analysis we have selected a valuation range for a share in REX of between \$1.97 and \$2.30, on a control basis.

## 7 VALUATION OF REX AFTER THE PROPOSED TRANSACTION

### 7.1 Introduction

If the Proposed Transaction is approved, REX shareholders will continue to own their REX shares. However, RG111.25 requires an independent expert to evaluate an issue of securities under s611 as if it was a takeover offer.

Accordingly, the value of a REX share after the Proposed Transaction has been assessed on a minority interest basis (i.e. excluding a control premium).

### 7.2 Assessed Value After the Proposed Transaction

Our assessment of the value of a REX share after the Proposed Transaction was based on the discounted cash flow analysis set out in Section 6, adjusted for the impact of the Proposed Transaction.

In order to estimate the fair market value of REX if the Proposed Transaction proceeds, we have made the following adjustments to the value of REX prior to the Proposed Transaction:

- ◆ We have applied a lower probability of failure of the Domestic Services due to the funding certainty provided by the Proposed Transaction and a higher weighting to the high case to reflect the reduced likelihood competitors would enter into a protracted price or capacity war.
- ◆ We applied a discount rate of 10.25% (compared to 11% before the Proposed Transaction) to reflect the increased scale and reduced funding costs for REX if the Proposed Transaction proceeds, as set out in Appendix 3
- ◆ We have calculated the dilutionary impact of the conversion feature of the Convertible Notes ("**Conversion Option**") and/or the Warrants using a Black Scholes option pricing model as discussed further below
- ◆ Applied a DLOC as discussed further below as market trading in REX shares after the Proposed Transaction would be on a non-controlling, or minority, basis.

The value of a REX share after the Proposed Transaction is as follows:

**Table 21: Assessed value of a REX share after the Proposed Transaction**

(\$'000)	Low	High
<b>Enterprise value</b>	<b>261,774</b>	<b>299,883</b>
Surplus assets / (liabilities)	(6,302)	(6,302)
Net cash / (debt)	(4,490)	(4,490)
<b>Total equity value including Conversion Option</b>	<b>250,982</b>	<b>289,091</b>
Minority discount	(50,196)	(57,818)
<b>Total equity value including Conversion Option - minority</b>	<b>200,786</b>	<b>231,273</b>
Allocation to Conversion Options	(30,203)	(38,041)
<b>Value allocated to shares</b>	<b>170,583</b>	<b>193,231</b>
Total shares on issue	110,154	110,154
<b>Assessed value per share (\$)</b>	<b>1.55</b>	<b>1.75</b>

Source: Leadenhall analysis

### Dilutionary impact of the Convertible Notes and Warrants

In estimating the value of the Conversion Option using the Black-Scholes option pricing model, we have utilised the following inputs into the model:

- ◆ **Spot Price:** \$1.55 to \$1.75 as set out in the table above.
- ◆ **Exercise Price:** \$1.50 per share being the Conversion Price of the Convertible Notes and exercise price of the Warrants.
- ◆ **Term:** based on the terms of the Convertible Notes being up to six years (including the Extended Term).
- ◆ **Dividend yield:** of 7.5% consistent with the expected performance of the regional business and Domestic Services but lower than historical dividend yield of REX (of 8.5 to 9% in FY17 to FY19), reflecting the path to recovery following the impact of COVID-19 and the required investment in the Domestic Services expansion.
- ◆ **Risk-free rate:** of approximately 0.31% based on the yield on Australian treasury bonds matching assumed life of the Convertible Notes
- ◆ **Volatility:** of 45% based on analysis of observed historical volatility of a range of comparable entities, as well as that of REX as set out in Appendix 7.

For the purpose of our analysis we have assumed dilution for the facility amount of \$150 million. In certain limited instances, the total of the face value of the Convertible Notes and Warrants issued may be less than \$150 million. As there is limited value attributable to the optionality of these instruments in these scenarios, the impact on our analysis would be negligible and would not impact our conclusions on the Proposed Transaction.

### Discount for lack of control (“DLOC”)

As REX shareholders would retain their REX shares if the Proposed Transaction proceeds, they would continue to own a minority stake in REX. Consistent with the requirements of RG 111, the value of the consideration must be determined on a minority interest basis. In order to estimate the value of a minority interest it is necessary to apply a DLOC to the value of a 100% equity interest in the business. This discount takes into account the lack of control that a minority shareholder has over the affairs of a company and is described in more detail in Appendix 6.

A DLOC is effectively the inverse of a control premium. Australian studies have indicated that control premiums generally range from 20% to 40%. This implies a range for DLOC of approximately 17% to 29%. In selecting a suitable DLOC, we have considered:

**Table 22: Factors affecting DLOC**

DLOC considerations	
Factors indicative of lower DLOC	Factors indicative of higher DLOC
<ul style="list-style-type: none"> <li>◆ If the Proposed Transaction proceeds the REX Board would comprise nine members, two of which would be PAG appointees and four would be independent. The existence of independent directors would tend to reduce the level of DLOC.</li> </ul>	<ul style="list-style-type: none"> <li>◆ The Proposed Transaction would result in PAG having a potential shareholding in REX of between 23.3% and 47.6%. Thus, its degree of control at a shareholder level would be significant but not absolute as PAG would be able to block special resolutions at a minimum but would be unable to pass a special resolution without the support of other shareholders.</li> <li>◆ Under the Proposed Transaction there would be two PAG representatives on the board, thus increasing PAG's ability to control REX.</li> <li>◆ Shares in REX are widely dispersed over a large number of holders. A wider dispersion of holdings generally increases the DLOC.</li> <li>◆ REX has had an inconsistent dividend history. A low dividend pay-out typically results in a higher DLOC.</li> </ul>

Source: Leadenhall analysis

As a result of these considerations, we have selected a DLOC of 20%. Any reasonable assumption for the DLOC does not impact our conclusion on the Proposed Transaction.

### **7.3 Cross-Check**

Market trading in REX shares since the announcement of the Proposed Transaction provides an indication of the market's assessment of the value of REX on a minority basis. When assessing market trading, it is necessary to consider whether the market is informed and liquid. In this regard, we note:

- ◆ There was an increase in liquidity since the announcement of the Proposed Transaction. The average daily values traded have more than doubled to approximately \$368,966 on 22 December 2020
- ◆ REX has announced further progress in respect of the Domestic Services in particular executing lease arrangements for new aircraft to be utilised for the new routes.

Having regard to the above, we consider the market trading in REX shares to be reasonably well informed and moderately liquid. After the Proposed Transaction was announced REX shares have traded in the range of \$1.14 to \$2.28 with a VWAP of \$1.69. The VWAP implied by more recent trading is consistent with our assessed range which we consider provides broad support for our assessed range.

### **7.4 Conclusion on Value After the Proposed Transaction**

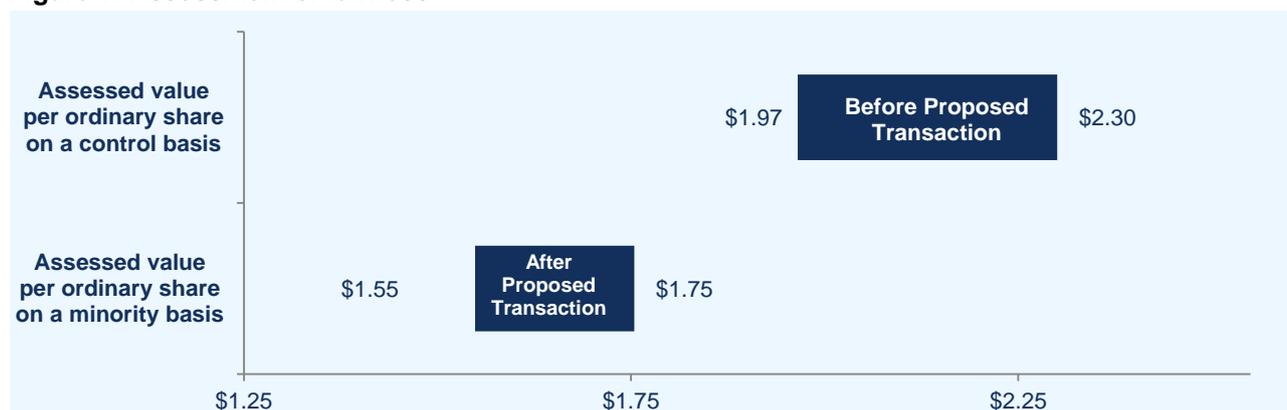
Based on our DCF analysis set out above we have selected a valuation range for a share in REX of between \$1.55 and \$1.75 after the Proposed Transaction, on a minority basis.

## 8 EVALUATION

### 8.1 Fairness

We have assessed the Proposed Transaction as fair if the fair market value of a REX share before the Proposed Transaction (on a control basis) is less than or equal to the fair market value of a REX share after the Proposed Transaction (on a minority basis). This comparison is shown in the following figure:

**Figure 1: Assessment of fairness**



Source: Leadenhall analysis

As the value of a REX share after the Proposed Transaction (on a minority basis) is less than the assessed value of a REX share before the Proposed Transaction (on a control basis), we have assessed the Proposed Transaction as being not fair.

### 8.2 Reasonableness

We have defined the Proposed Transaction as reasonable if it is fair, or if despite not being fair, there are sufficient reasons for REX's shareholders to vote for the proposal. We have therefore considered the following advantages and disadvantages of the Proposed Transaction to shareholders.

#### Advantages

##### Limited alternatives available to provide the financial flexibility offered by the Proposed Transaction

REX's management has considered various funding alternatives both to establish the Domestic Services and for future growth opportunities. It was seen as important for the board to demonstrate that the business was fully funded for the foreseeable future to provide comfort to stakeholders (such as travel agents, etc.) and to ensure any competitive response could be adequately absorbed. It was also important to the board to ensure there are adequate funds available to provide capital in the event that unforeseen economic or industry downside risks eventuated and alternative funding sources (such as sale and leaseback or equity capital markets) were not available.

As part of the fundraising process REX considered proposals from private equity, high-net worth and other institutional investors as well as raising funding internally through a combination of debt, equity and the sale and leaseback of existing owned aircraft. To this end, REX negotiated terms for a sale and leaseback transaction which could provide approximately \$30 million in near-term funding. However, based on discussions with existing lenders, there was limited debt funding available to establish the Domestic Services.

Any capital raising from existing shareholders was expected to be constrained by the following factors:

- ◆ REX's discussions with its major shareholders indicated that many of the large shareholders were unlikely to be able to participate in a capital raising of the size required.
- ◆ The vast majority of REX's shareholders are retail investors (including company management and directors). The lack of institutional investors is likely to limit the take-up of any capital raising from existing shareholders.

As a result of the above factors, funding the Domestic Services through a combination of equity raising, debt funding and sale and leaseback transactions would be subject to significant risks in respect of raising sufficient capital to launch and sustain the Domestic Services until profitability and accessing future capital when and if needed. Furthermore, despite a process undertaken to find third party capital providers, we understand that no alternate offers have been received by REX.

### **Favourable interest rate**

The Convertible Notes have a coupon rate of 4% payable quarterly in arrears with no further interest payable if the term is extended by 12 months by PAG, lowering the effective interest rate below 4% in this instance. This rate is favourable compared to the likely cost if REX were to source debt funding through alternate means. For example, Qantas recently issued \$500 million of 10-year corporate bonds with a coupon of 5.25%. Due to its smaller size and higher degree of business concentration, the borrowing costs for REX would be at a significant premium to those of Qantas.

The benefit of the reduced interest cost needs to be considered in conjunction with the significant value to be provided to PAG in the form of conversion options as set out in our fairness assessment.

### **Reduces risks for successfully implementing the Domestic Services expansion**

The funding available to REX pursuant to the Proposed Transaction provides greater certainty of executing the Domestic Services expansion plan since:

- ◆ The availability of the funding provides important assurance to suppliers (including lessors of aircraft), corporate customers and passengers who choose to book in advance.
- ◆ Access to future funding also ensures that REX is sufficiently capitalised to endure any sustained competitive response from the incumbent operators, thereby reducing the risk of a highly aggressive response. Given the limited history of having three domestic airlines in Australia we consider this risk to be significant.

### **Raising equity at a premium**

The conversion price for the Convertible Notes of \$1.50 per share represents a premium of 43% and 37% to the 1 month and 3-month VWAP of REX before the announcement of the Proposed Transaction.

This is in contrast to equity raisings which typically occur at discounts to recent market trading prices. Furthermore, given the size of the funding requirement for REX represents a significant proportion of its market capitalisation prior to the announcement of the Proposed Transaction, it is likely that the discount for REX in this instance would be magnified.

Whilst more recent trading in REX shares has increased to levels above the Conversion Price for the Convertible Notes and the exercise price of the Warrants we consider this would be at least partially attributable to the progress of the Proposed Transaction.

### **Share price may decline**

Since the Proposed Transaction was announced, the share price in REX has increased approximately 75% from \$1.09 per share on 21 September 2020 to \$1.91 per share on 22 December 2020.

Whilst some of this increase is likely attributed to the announcement of the Domestic Services expansion (including the more recent announcements about the successful launch and promotion of ticket sales) as well as general improvement in market sentiment (including the easing of COVID-19 restrictions and increased visibility of a timeline for vaccine deployment which should facilitate an increase in interstate travel), it is likely that the share price of REX will decline below current levels if the Proposed Transaction does not proceed.

### **Proposed Transaction increases alignment with key shareholder and Executive Chairman**

As part of the Proposed Transaction, Mr Lim Kim Hai, Executive Chairman and founder of REX, has entered into an escrow deed in respect of his shareholding in REX for the term of the Convertible Notes (unless extended) subject to certain exceptions including if PAG sells all its notes and shares).

As a result, the Proposed Transaction ensures Mr Lim Kim Hai remains invested in the business for the near-term and is aligned to the interests of minority shareholders.

### May provide prospect for additional liquidity

The vast majority of existing REX shareholders are retail investors (including company management and directors). Currently, institutional investors comprise a very small proportion of the issued shares of REX.

Support from a large institutional investor such as PAG may provide a positive signal to other institutional investors which may improve the liquidity of REX shares over time.

Furthermore, the increased size of REX if the Proposed Transaction proceeds may also help improve liquidity as the enhanced scale may increase the investor universe and facilitate coverage from sell-side research analysts, etc. For example, since the announcement of the Proposed Transaction, the average daily value traded has risen from approximately \$100,000 per day for the 12 months prior to the Proposed Transaction to over \$350,000 per day since the announcement of the Proposed Transaction, an increase of over 200%.

### Disadvantages

The main disadvantages of the Proposed Transaction are:

#### Impact on control

If the full amount of the Convertible Notes and/or Warrants are issued and then fully converted and exercised (which would be three years post completion at the earliest unless a trigger event such as a default event by REX or a takeover of REX), PAG would have an interest of up to 47.6% in REX (based on the existing shares on issue). As the Proposed Transaction envisages REX either drawing the full amount of the facility or Warrants being issued for any amount of the facility which is undrawn, it is likely that PAG will have the ability to obtain a 47.6% interest in REX in the future. PAG has agreed to a standstill arrangement whereby its shareholding in REX will not exceed 47.6%. Due to PAG's potential shareholding, it is unlikely that any other prospective acquirers would make a takeover offer for REX without support from PAG. This may reduce the opportunity for Shareholders to receive a control premium in the future.

Whilst PAG's interest in REX will be below 50%, given the wide spread of other shareholdings, if the Proposed Transaction proceeds, PAG would likely become the largest individual shareholder of REX in the future. PAG will also be able to appoint two directors to the board of REX which will comprise nine directors. Whilst the PAG nominee directors do not have any special voting rights, given the potential shareholding of PAG in the future, PAG may be able to exert practical control over certain decisions of REX which are subject to an ordinary resolution. PAG's interest in these matters may not be aligned to the interests of minority shareholders, subject to compliance with relevant laws and regulations.

Furthermore, as is typical for financing transactions, there are some restrictions on certain actions without PAG's consent such as incurring indebtedness outside of the ordinary course of operations and entering into related party transactions. Therefore, PAG's position as financier may not always be entirely aligned with the interests of minority shareholders.

### **Conclusion on reasonableness**

In considering whether the Proposed Transaction is reasonable we considered the relative weight of the above factors.

In particular, it is likely that the Proposed Transaction will result in PAG obtaining a 47.6% interest in REX irrespective of the actual funding requirements of REX due to the presence of the Warrants. However, we consider the advantages of the Proposed Transaction outweigh the disadvantages, in particular:

- ◆ the Proposed Transaction is expected to increase the likelihood of the success of the Domestic Services which, if successful would be transformative for REX and could provide significant upside to REX shareholders.
- ◆ the Proposed Transaction facilitates REX raising capital at a significant premium to the share price of REX prior to the announcement of the transaction. If this amount of equity were to be raised by REX through a traditional equity raising, it is likely that it would be at a significant discount to the prevailing share price of REX
- ◆ we understand that there are no other alternatives currently available that provide the same level of funding certainty for the Domestic Services and there have been no superior offers despite the public nature of the Proposed Transaction.

After considering the above factors, we have concluded that, on balance, the advantages of the Proposed Transaction outweigh the disadvantages, and therefore in our opinion, the Proposed Transaction is not fair but reasonable to Shareholders in the absence of a superior proposal.

### **8.3 Opinion**

The Proposed Transaction is not fair but reasonable to Shareholders.

An individual shareholder's decision in relation to the Proposed Transaction may be influenced by their own particular circumstances. If in doubt, the shareholder should consult an independent financial adviser.

## APPENDIX 1: GLOSSARY

Term	Meaning
AAPA	Australian Airline Pilot Academy
AAPAV	AAPA Victoria Pty Ltd
Air Link	Air Link Pty Ltd
AOC	Air Operator's Certificate
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
ATAA	Aviation Training Academy Australia Pty Ltd
ATPL	Air Transport Pilot Licence
AUD	Australian Dollar
BITRE	Bureau of Infrastructure and Transport Research Economics
CASA	Civil Aviation Safety Authority
CATA	Civil Aviation Training Academy Pty Ltd
Conversion Price	Of the Convertible Notes being \$1.50 per share, subject to customary adjustments
Convertible Notes	First ranking senior secured convertible notes
Corporations Act	The Corporations Act 2001
CPL	Commercial Pilot Licence
Domestic Services	Limited domestic major city jet operations
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
EBITDAR	Earnings before interest, tax, depreciation, amortisation, and aircraft rent
First Drawdown Date	The date on which the first \$50 million of Convertible Notes are issued to PAG
FOS	Financial Ombudsman Service
FSG	Financial Services Guide
FY	Financial year
Item 7	Item 7 of Section 611 of the Corporations Act
LCA Model	The cash flow model prepared by Leadenhall using the REX projection
Leadenhall	Leadenhall Corporate Advisory Pty Ltd
Maturity Date	Five years following the First Drawdown Date
MC / UNTA	Market Capitalisation / Ung geared net tangible assets
MCC	Multi Crew Cooperation
NOM	Notice of Meeting
NPAT	Net profit after tax
P / E	Price to Earnings
PAG	PAG Asia Capital
PBT	Profit before tax
Pel-Air	Pel-Air Aviation Pty Ltd
PP&E	Property, plant and equipment
RAFA	Regional Airline Funding Assistance
RANS	Regional Airline Network Support Program
REX	Regional Express Holdings Pty Ltd
RG111	Regulatory Guide 111: Content of Expert Reports
RG74	Regulatory Guide 74: Acquisitions Approved by Members
RTO	Registered Training Organisation
s606	Section 606 of the Corporations Act 2001
S611	Section 611 of the Corporations Act 2001
Shareholders	Current holders of REX securities
USD	US Dollar
VWAP	Volume Weighted Average Price
WACC	Weighted Average Cost of Capital

## APPENDIX 2: VALUATION METHODOLOGIES

In preparing this report we have considered valuation methods commonly used in practice and those recommended by RG 111. These methods include:

- ◆ The discounted cash flow method
- ◆ The capitalisation of earnings method
- ◆ Asset based methods
- ◆ Analysis of share market trading
- ◆ Industry specific rules of thumb

The selection of an appropriate valuation method to estimate fair market value should be guided by the actual practices adopted by potential acquirers of the company involved.

### Discounted Cash Flow Method

#### Description

Of the various methods noted above, the discounted cash flow method has the strongest theoretical standing. It is also widely used in practice by corporate acquirers and company analysts. The discounted cash flow method estimates the value of a business by discounting expected future cash flows to a present value using an appropriate discount rate. A discounted cash flow valuation requires:

- ◆ A forecast of expected future cash flows
- ◆ An appropriate discount rate

It is necessary to project cash flows over a suitable period of time (generally regarded as being at least five years) to arrive at the net cash flow in each period. For a finite life project or asset this would need to be done for the life of the project. This can be a difficult exercise requiring a significant number of assumptions such as revenue growth, future margins, capital expenditure requirements, working capital movements and taxation.

The discount rate used represents the risk of achieving the projected future cash flows and the time value of money. The projected future cash flows are then valued in current day terms using the discount rate selected.

The discounted cash flow method is often sensitive to a number of key assumptions such as revenue growth, future margins, capital investment, terminal growth and the discount rate. All of these assumptions can be highly subjective sometimes leading to a valuation conclusion presented as a range that is too wide to be useful.

#### Use of the Discounted Cash Flow Method

A discounted cash flow approach is usually preferred when valuing:

- ◆ Early stage companies or projects
- ◆ Limited life assets such as a mine or toll concession
- ◆ Companies where significant growth is expected in future cash flows
- ◆ Projects with volatile earnings

It may also be preferred if other methods are not suitable, for example if there is a lack of reliable evidence to support a capitalisation of earnings approach. However, it may not be appropriate if:

- ◆ Reliable projections of cash flow are not available and cannot be determined
- ◆ There is an inadequate return on investment, in which case a higher value may be realised by liquidating the assets than through continuing the business

## Capitalisation of Earnings Method

### Description

The capitalisation of earnings method is a commonly used valuation methodology that involves determining a future maintainable earnings figure for a business and multiplying that figure by an appropriate capitalisation multiple. This methodology is generally considered a short form of a discounted cash flow, where a single representative earnings figure is capitalised, rather than a stream of individual cash flows being discounted. The capitalisation of earnings methodology involves the determination of:

- ◆ A level of future maintainable earnings
- ◆ An appropriate capitalisation rate or multiple.

A multiple can be applied to any of the following measures of earnings:

**Revenue** – most commonly used for companies that do not make a positive EBITDA or as a cross-check of a valuation conclusion derived using another method.

**EBITDA** - most appropriate where depreciation distorts earnings, for example in a company that has a significant level of depreciating assets but little ongoing capital expenditure requirement.

**EBITA** - in most cases EBITA will be more reliable than EBITDA as it takes account of the capital intensity of the business.

**EBIT** - whilst commonly used in practice, multiples of EBITA are usually more reliable as they remove the impact of amortisation which is a non-cash accounting entry that does not reflect a need for future capital investment (unlike depreciation).

**NPAT** - relevant in valuing businesses where interest is a major part of the overall earnings of the group (e.g. financial services businesses such as banks).

Multiples of EBITDA, EBITA and EBIT are commonly used to value whole businesses for acquisition purposes where gearing is in the control of the acquirer. In contrast, NPAT (or P/E) multiples are often used for valuing minority interests in a company.

The multiple selected to apply to maintainable earnings reflects expectations about future growth, risk and the time value of money all wrapped up in a single number. Multiples can be derived from three main sources. Using the guideline public company method, market multiples are derived from the trading prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market, such as the ASX. The merger and acquisition method is a method whereby multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business. It is also possible to build a multiple from first principles.

### Use of the Capitalisation of Earnings Method

The capitalisation of earnings method is widely used in practice. It is particularly appropriate for valuing companies with a relatively stable historical earnings pattern which is expected to continue. This method is less appropriate for valuing companies or assets if:

- ◆ There are no suitable listed company or transaction benchmarks for comparison
- ◆ The asset has a limited life
- ◆ Future earnings or cash flows are expected to be volatile
- ◆ There are negative earnings or the earnings of a business are insufficient to justify a value exceeding the value of the underlying net assets

## Asset Based Methods

### Description

Asset based valuation methods estimate the value of a company based on the realisable value of its net assets, less its liabilities. There are a number of asset-based methods including:

- ◆ Orderly realisation
- ◆ Liquidation value
- ◆ Net assets on a going concern basis
- ◆ Replacement cost
- ◆ Reproduction cost

The orderly realisation of assets method estimates fair market value by determining the amount that would be distributed to shareholders, after payment of all liabilities including realisation costs and taxation charges that arise, assuming the company is wound up in an orderly manner. The liquidation method is similar to the orderly realisation of assets method except the liquidation method assumes the assets are sold in a shorter time frame. Since wind up or liquidation of the company may not be contemplated, these methods in their strictest form may not necessarily be appropriate. The net assets on a going concern basis method estimates the market values of the net assets of a company but does not take account of realisation costs.

The asset / cost approach is generally used when the value of the business' assets exceeds the present value of the cash flows expected to be derived from the ongoing business operations, or the nature of the business is to hold or invest in assets. It is important to note that the asset approach may still be the relevant approach even if an asset is making a profit. If an asset is making less than an economic rate of return and there is no realistic prospect of it making an economic return in the foreseeable future, an asset approach would be the most appropriate method.

### Use of Asset Based Methods

An asset-based approach is a suitable valuation method when:

- ◆ An enterprise is loss making and is not expected to become profitable in the foreseeable future
- ◆ Assets are employed profitably but earn less than the cost of capital
- ◆ A significant portion of the company's assets are composed of liquid assets or other investments (such as marketable securities and real estate investments)
- ◆ It is relatively easy to enter the industry (for example, small machine shops and retail establishments)

Asset based methods are not appropriate if:

- ◆ The ownership interest being valued is not a controlling interest, has no ability to cause the sale of the company's assets and the major holders are not planning to sell the company's assets
- ◆ A business has (or is expected to have) an adequate return on capital, such that the value of its future income stream exceeds the value of its assets

## Analysis of Share Trading

The most recent share trading history provides evidence of the fair market value of the shares in a company where they are publicly traded in an informed and liquid market. There should also be some similarity between the size of the parcel of shares being valued and those being traded. Where a company's shares are publicly traded then an analysis of recent trading prices should be considered, at least as a cross-check to other valuation methods.

## Industry Specific Rules of Thumb

Industry specific rules of thumb are used in certain industries. These methods typically involve a multiple of an operating figure such as eyeballs for internet businesses, numbers of beds for hotels etc. These methods are typically fairly crude and are therefore usually only appropriate as a cross-check to a valuation determined using an alternative method.

## APPENDIX 3: DISCOUNT RATE

### Introduction

The selected discount rate applied in our discounted cash flow analysis for REX is a weighted average cost of capital. We have estimated the cost of equity with the capital asset pricing model (“**CAPM**”). The CAPM is based on the assumption that investors require a premium for investing in equities rather than in risk-free investments (such as government bonds). The cost of equity,  $K_e$ , is the rate of return that investors require to make an equity investment in a firm.

The cost of equity capital under CAPM is determined using the following formula:

$$K_e = R_f + \beta \times (R_m - R_f) + \alpha$$

The components of the CAPM formula are:

**Table 23: Components of CAPM**

Input	Definition
$K_e$	The required post-tax return on equity
$R_f$	The risk-free rate of return
$R_m$	The expected return on the market portfolio
<b>EMRP</b>	The market risk premium ( $R_m - R_f$ )
$\beta$	The beta, the systematic risk of a stock (this is an equity or levered beta)
$\alpha$	The specific company risk premium

Each of the components in the above equation is discussed below.

### Post-tax weighted average cost of capital (WACC)

WACC reflects the rate of return expected for an asset, adjusted for its underlying funding structure, such as relative components of debt and equity, calculated as follows:

$$WACC = (K_e \times E/V) + (K_d \times D/V + (1 - t_c))$$

The components of the WACC formula are:

**Table 24: Components of WACC**

Input	Definition
<b>WACC</b>	The post-tax weighted average cost of capital
$K_e$	The required post-tax return on equity
$t_c$	The corporate tax rate
$K_d$	The required pre-tax return on debt
<b>D</b>	The market value of debt
<b>E</b>	The market value of equity
<b>V</b>	The market value of business, where $V = D + E$

Each of the components in the above equation is discussed below.

### Risk-free rate ( $R_f$ )

The relevant risk-free rate of return is the return on a risk-free security, typically over a long-term period. In practice, long dated government bonds are an acceptable benchmark for the risk-free security. We have selected a risk-free rate of 1.02%, being the yield on 10-year Australian Government bonds as at 8 December 2020.

### Equity market risk premium (EMRP)

The EMRP ( $R_m - R_f$ ) represents the additional return that investors expect from an investment in a well-diversified portfolio of assets (such as a market index). It is the excess return above the risk-free rate that investors demand for their increased exposure to risk, when investing in equity securities.

Leadenhall undertakes a review of the EMRP at least every six months, taking account of market trading levels and industry practice at the time. Our most recent analysis of the implied EMRP in Australia was as at November 2020. As a result, we are currently recommending an EMRP of 7.25% to 7.75% for Australia.

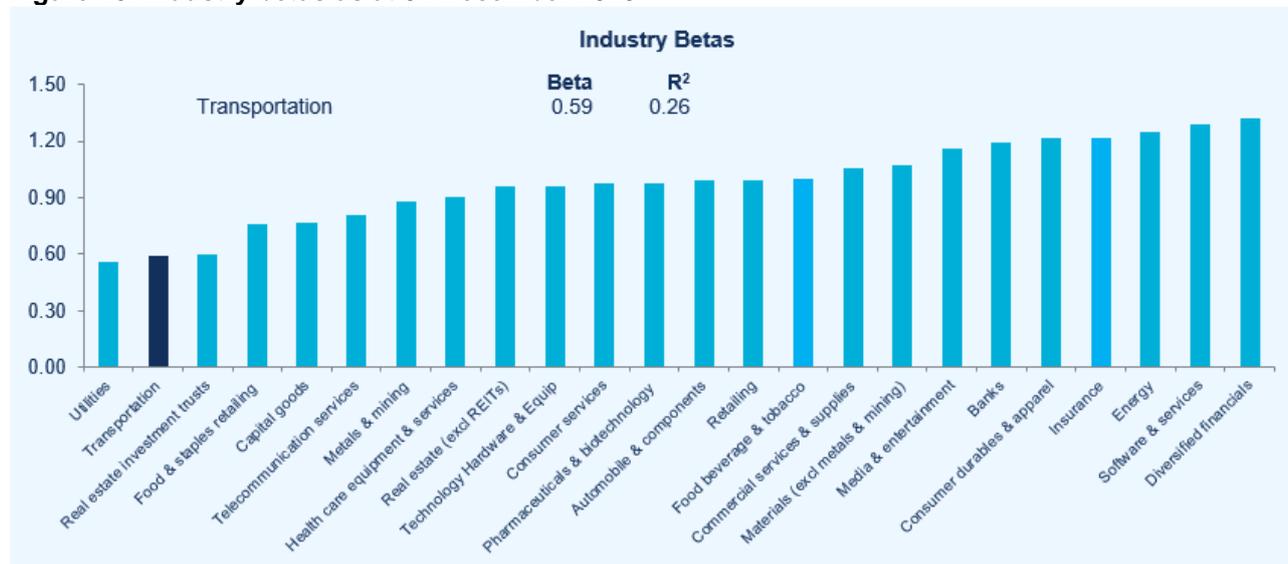
### Beta estimate ( $\beta$ )

#### Description

The beta factor is a measure of the risk of an investment or business operation, relative to a well-diversified portfolio of assets. The only risks that are captured by beta are those risks that cannot be eliminated by the investor through diversification. Such risks are referred to as systematic, undiversifiable or uninsurable risk.

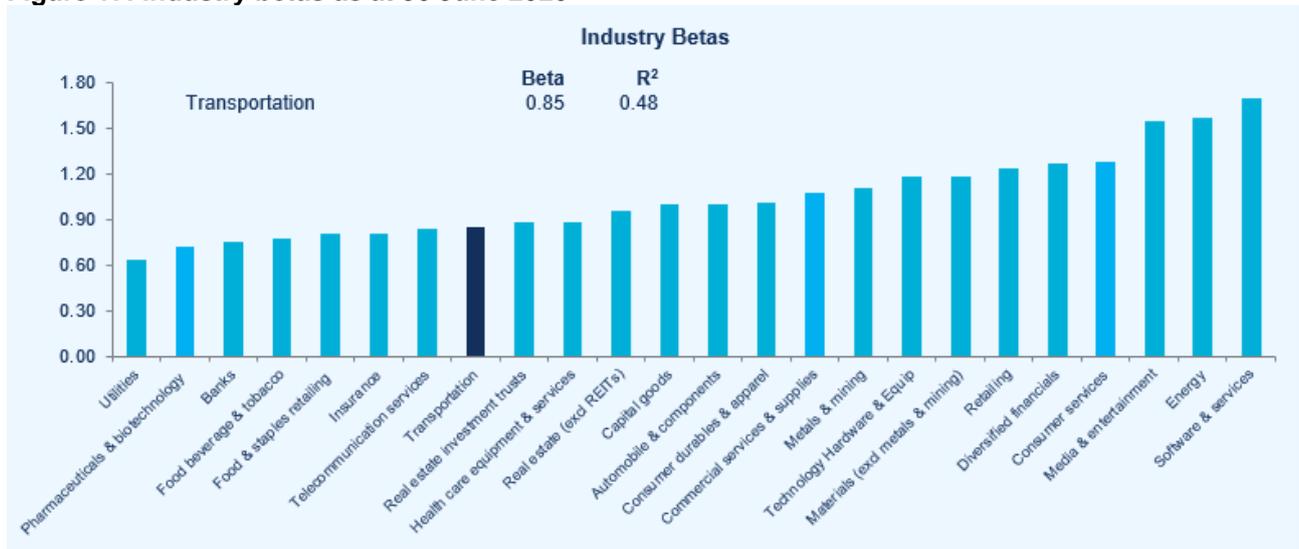
Beta is a measure of the relative riskiness of an asset in comparison to the market as a whole – by definition the market portfolio has an equity beta of 1.0. The equity betas of various Australian industries listed on the Australian Stock Exchange are reproduced below. Given the significant unusual market movements driven by COVID-19 in early 2020, we have considered data for December 2019 (pre-COVID-19) as well as October 2020 (Valuation Date) in estimating our beta.

**Figure 16: Industry betas as at 31 December 2019**



Source: SIRCA

**Figure 17: Industry betas as at 30 June 2020**



Source: SIRCA

Betas derived from share market observations represent equity betas, which reflect the degree of financial gearing of the company. In order to eliminate the impact of differing capital structures, analysts often 'unlever' observed betas to calculate an asset beta. The selected asset beta is then 'relevered' with a target level of debt. The betas of companies comparable to REX are included in the following table.

**Table 25: Comparable company betas**

Company	As at 20 October 2020								As at 31 December 2019					
	Market Cap	Enterprise Value	SIRCA		Capital IQ		Leadenhall		SIRCA		Capital IQ		Leadenhall	
	AU\$m	AU\$m	Equity beta	R <sup>2</sup>	Equity beta	R <sup>2</sup>	Equity beta	R <sup>2</sup>	Equity beta	R <sup>2</sup>	Equity beta	R <sup>2</sup>	Equity beta	R <sup>2</sup>
Regional Express Holdings	157	163	2.17	0.52	1.89	0.36	2.28	0.41	0.33	0.01	0.22	0.01	0.61	0.07
<b>Australian airlines</b>														
Qantas Airways Limited	8,183	13,201	1.54	0.45	1.31	0.31	1.83	0.41	0.33	0.01	0.24	0.01	0.70	0.08
Virgin Australia Holdings	726	4,908	0.89	0.14	0.67	0.08	1.03	0.20	1.29	0.09	1.03	0.06	0.68	0.04
Alliance Aviation Services	558	522	1.35	0.28	1.46	0.34	1.80	0.42	0.58	0.02	0.31	0.01	0.71	0.05
<b>Median (excluding outliers)</b>	<b>726</b>	<b>4,908</b>	<b>1.45</b>		<b>1.39</b>		<b>1.81</b>		<b>0.46</b>		<b>0.28</b>		<b>0.71</b>	
<b>Average (excluding outliers)</b>	<b>3,156</b>	<b>6,210</b>	<b>1.45</b>		<b>1.39</b>		<b>1.81</b>		<b>0.46</b>		<b>0.28</b>		<b>0.71</b>	
<b>Average</b>	<b>3,156</b>	<b>6,210</b>	<b>1.26</b>		<b>1.15</b>		<b>1.55</b>		<b>0.73</b>		<b>0.53</b>		<b>0.70</b>	
<b>International airlines - full service</b>														
Delta Air Lines, Inc.	28,802	58,599	n/a	n/a	1.35	0.37	1.55	0.39	n/a	n/a	1.30	0.31	1.17	0.22
United Airlines Holdings, Inc.	14,879	43,404	n/a	n/a	1.51	0.33	1.89	0.38	n/a	n/a	1.33	0.23	1.24	0.19
Singapore Airlines Limited	10,879	20,493	n/a	n/a	1.09	0.39	0.88	0.17	n/a	n/a	0.44	0.23	0.51	0.14
American Airlines Group Inc.	9,231	52,105	n/a	n/a	1.80	0.43	2.07	0.47	n/a	n/a	1.87	0.37	1.90	0.35
International Consolidated Airlines Group	9,747	27,299	n/a	n/a	2.28	0.37	2.76	0.38	n/a	n/a	0.92	0.09	1.50	0.23
Deutsche Lufthansa AG	8,241	20,602	n/a	n/a	1.34	0.31	1.55	0.31	n/a	n/a	1.21	0.20	1.45	0.20
Alaska Air Group, Inc.	7,001	9,102	n/a	n/a	1.69	0.51	1.99	0.52	n/a	n/a	1.27	0.25	1.31	0.24
Air Canada	5,100	10,545	n/a	n/a	1.96	0.29	2.34	0.34	n/a	n/a	0.78	0.03	1.28	0.14
Copa Holdings, S.A.	3,142	3,919	n/a	n/a	1.31	0.27	1.72	0.35	n/a	n/a	0.78	0.07	0.97	0.10
Air New Zealand Limited	1,584	4,632	n/a	n/a	2.95	0.44	2.82	0.46	n/a	n/a	0.31	0.01	0.46	0.04
Hawaiian Holdings, Inc.	928	2,063	n/a	n/a	2.37	0.51	2.76	0.54	n/a	n/a	1.76	0.25	1.83	0.24
<b>Median (excluding outliers)</b>	<b>8,241</b>	<b>20,493</b>	<b>n/a</b>		<b>1.43</b>		<b>1.72</b>		<b>n/a</b>		<b>1.06</b>		<b>1.26</b>	
<b>Average (excluding outliers)</b>	<b>9,049</b>	<b>22,978</b>	<b>n/a</b>		<b>1.51</b>		<b>1.66</b>		<b>n/a</b>		<b>1.00</b>		<b>1.18</b>	
<b>Average</b>	<b>9,049</b>	<b>22,978</b>	<b>n/a</b>		<b>1.79</b>		<b>2.03</b>		<b>n/a</b>		<b>1.09</b>		<b>1.24</b>	
<b>International airlines - discount &amp; regional</b>														
Southwest Airlines Co.	33,591	29,390	n/a	n/a	1.26	0.32	1.37	0.35	n/a	n/a	1.60	0.38	1.69	0.40
Ryanair Holdings plc	23,405	24,922	n/a	n/a	1.40	0.59	1.61	0.53	n/a	n/a	1.32	0.50	1.28	0.24
Wizz Air Holdings Plc	5,423	6,641	n/a	n/a	1.83	0.40	2.13	0.57	n/a	n/a	0.76	0.06	1.24	0.20
JetBlue Airways Corporation	4,751	8,516	n/a	n/a	1.63	0.47	1.95	0.51	n/a	n/a	1.19	0.23	1.24	0.23
easyJet plc	4,354	5,212	n/a	n/a	2.27	0.45	2.58	0.51	n/a	n/a	0.99	0.08	1.87	0.27
Allegiant Travel Company	3,040	4,372	n/a	n/a	1.81	0.42	2.05	0.47	n/a	n/a	1.48	0.26	1.33	0.19
Spirit Airlines, Inc.	2,370	6,321	n/a	n/a	1.76	0.30	2.23	0.34	n/a	n/a	0.53	0.04	0.24	0.01
SkyWest, Inc.	2,209	5,807	n/a	n/a	1.95	0.50	2.14	0.49	n/a	n/a	1.59	0.30	1.66	0.30
<b>Median (excluding outliers)</b>	<b>4,553</b>	<b>6,481</b>	<b>n/a</b>		<b>1.76</b>		<b>1.95</b>		<b>n/a</b>		<b>1.32</b>		<b>1.33</b>	
<b>Average (excluding outliers)</b>	<b>9,893</b>	<b>11,398</b>	<b>n/a</b>		<b>1.66</b>		<b>1.82</b>		<b>n/a</b>		<b>1.28</b>		<b>1.47</b>	
<b>Average</b>	<b>9,893</b>	<b>11,398</b>	<b>n/a</b>		<b>1.74</b>		<b>2.01</b>		<b>n/a</b>		<b>1.18</b>		<b>1.32</b>	
<b>Airline Indices</b>														
NYSE Arca Airline Index	61	n/a	n/a	n/a	n/a	n/a	2.15	0.63	n/a	n/a	n/a	n/a	1.43	0.52
STOXX Europe Total Market Airlines	109	n/a	n/a	n/a	n/a	n/a	1.79	0.57	n/a	n/a	n/a	n/a	1.24	0.28

Source: S&P Capital IQ as at 31 December 2019 and 20 October 2020; SIRCA as at 31 December 2019 and 30 June 2020

Notes:

1. Leadenhall equity betas are calculated by regressing against MSCI World Index, except for REX, which is regressed against S&P/ASX All Ordinaries Index.
2. The outliers are highlighted in grey.

### Selected beta ( $\beta$ )

In selecting an appropriate beta for REX, we have considered the following:

- ◆ The outbreak of COVID-19 in early 2020 has introduced significant variability into beta estimation. The impact of the pandemic varies across industries. We have therefore also considered pre-COVID data as at 31 December 2019 for our estimation.
- ◆ The Australian transportation industry is a broad category therefore we have not relied on the industry beta in selecting the appropriate beta for REX.
- ◆ Having regard to REX's cost structure and operation which is Australia-focused, we consider REX to be more comparable to the listed Australian comparable airlines as well as the international discount and regional airlines. We have therefore placed greater reliance on the betas for these two groups of comparable airlines in selecting an equity beta of 1.20 to 1.30.

- ◆ Despite being larger in size, Southwest and Ryanair are considered more comparable to REX due to the similar cost structure and operations. Both airlines provide low cost, short haul flights with bundled services, primarily using a single type aircraft being Boeing 737. They also owned 80-90% of their aircraft.

### Specific company risk premium ( $\alpha$ )

#### Size premium

The size premium is the additional return that investors require for the risks of investing in small businesses. To date, whilst it has not been possible to isolate the specific causes of size premiums (other than simply size), many factors have been suggested, including:

- ◆ Depth of management
- ◆ Reliance on key personnel
- ◆ Weak market position
- ◆ Reliance on key customers
- ◆ Reduced access to capital
- ◆ Deeper pool of investors for larger companies
- ◆ Reliance on key suppliers
- ◆ Lack of geographic diversification
- ◆ Limited access to technology
- ◆ Absence of broker analysis
- ◆ Supplier concentration
- ◆ Investors in large companies often more diversified

The size premium can be observed in earnings multiples of listed companies, with large companies trading on higher multiples than small companies, all else being equal. Size premiums are observed consistently across time, across different markets and across a very wide range of company values.

A number of studies have been undertaken attempting to measure the size premium, in particular in the US. The Duff & Phelps Cost of Capital Navigator is an online application that provides guidance in estimating cost of capital. It contains calculations of the size premium for each decile of market capitalisation. As the size premium is most significant for very small companies, the tenth decile is then further divided into four equal segments. The following chart summarises the size premium data from the Duff & Phelps Cost of Capital Navigator.

**Table 26: Evidence of size premium**



Source: Duff & Phelps Cost of Capital Navigator, data through 31 December 2018

Note: The first decile represents the largest companies while the 10z decile represents the smallest companies by market capitalisation.

As mentioned above, the existence of the size premium has been well documented. However, there are limited studies setting out the appropriate bands of size premium and the quantum of size premium applicable to each band. For this reason, the above table should be taken as broad support for the size effect and not an exact guide to the extent of any particular discount or premium that should be applied.

Although there is considerable evidence from the US, in the Australian context, the relatively small size of the Australian equity market makes it more difficult to observe the existence of this phenomenon.

Leadenhall and others have conducted a number of high-level studies which have confirmed the existence of the size effect in the Australian market. However, we are not aware of any Australian studies that have been performed with the same detail and rigour as the US studies, such as the Duff & Phelps data presented above. Based on the evidence from US studies and our knowledge of prices actually paid in Australian transactions, from which a discount rate can be implied, we believe the size premium ranges in the below table are appropriate. This table should be taken as a guide to the appropriate size premium for a given business and needs to be considered in conjunction with the specific circumstances of a particular business.

**Table 27: Leadenhall size premium bandings**

Size Premium Guide for Australia				
Size	Mkt Cap Range (AU\$m)		Size Premium	
	Low	High	Low	High
Largest	4,000	Above	-	-
Large	1,000	4,000	-	1.0%
Mid-cap	300	1,000	1.0%	2.0%
Low-cap	100	300	2.0%	3.0%
Small-cap	50	100	3.0%	5.0%
Micro-cap	10	50	5.0%	8.0%
Medium private <sup>1</sup>	5	10	8.0%	11.0%
Small private <sup>1</sup>	2	5	11.0%	15.0%
Smallest <sup>1</sup>	-	2	15.0%	20.0%

Source: Leadenhall analysis

Note 1: We do not generally consider the CAPM model to be reliable for entities of this size as they often do not meet the background assumptions underpinning the CAPM. Investors are often not diversified, and it is rarely possible to lend or borrow stock of entities this size. These suggested size premiums are therefore presented as an approximate guide only as alternate models, studies and rules of thumb are commonly utilised for these types of companies.

Based on market capitalisation, REX would be considered a low cap company and as such a size premium of between 2% and 3% would generally apply. We have therefore selected a size premium of 3.0% and 2.5% for before and after the Proposed Transaction, respectively.

### **Other company specific risks**

The specific company risk premium adjusts the cost of equity for company specific factors, including unsystematic risk factors such as reliance on key customers, reliance on key suppliers, existence of contingent liabilities etc. We have not allowed for specific risk premiums for REX as we believe that the risk inherent in the business has been adequately reflected in the other components of the valuation analysis, in particular the DCF scenarios adopted and probability weightings applied for the Domestic Services.

### **Dividend Imputation**

Since July 1987, Australia has had a dividend imputation system in place, which aims to remove the double taxation effect of dividends paid to investors. Under this system, domestic equity investors receive a taxation credit (franking credit) for any tax paid by a company. The franking credit attaches to any dividends paid out by a company and the franking credit offsets personal tax. To the extent the investor can utilise the franking credit to offset personal tax, then the corporate tax is now not a real impost. It is best considered as a withholding tax for personal taxes. It can therefore be argued that the benefit of dividend imputation should be added to any analysis of value.

However, in our view, the evidence relating to the value that the market ascribes to imputation credits is inconclusive. There are diverse views as to the value of imputation credits and the appropriate method that should be employed to calculate this value. Due to the uncertainty surrounding the extent to which acquirers of assets factor in dividend imputation, we have taken the conservative approach and not factored in dividend imputation (in both the before and after Proposed Transaction valuation).

## Conclusion on cost of equity

The following table sets out our cost of equity estimate for REX based on the assumptions and inputs discussed above:

**Table 28: Estimated cost of equity for REX**

Discount Rate Summary				
	Pre-transaction		Post-transaction	
	Low	High	Low	High
Risk free rate ( $R_f$ )	1.02%	1.02%	1.02%	1.02%
Equity beta ( $\beta_E$ )	1.20	1.30	1.20	1.30
Equity market risk premium (EMRP)	7.25%	7.75%	7.25%	7.75%
Size premium ( $\alpha_{size}$ )	3.00%	3.00%	2.50%	2.50%
Specific risk premium ( $\alpha_c$ )	0.00%	0.00%	0.00%	0.00%
<b>Assessed cost of equity (<math>k_e</math>)</b>	<b>12.72%</b>	<b>14.10%</b>	<b>12.22%</b>	<b>13.60%</b>

Source: Leadenhall analysis

## Corporate tax rate ( $t_c$ )

The corporate tax rate in Australia is 30% and we have adopted this rate in calculating the WACC for REX.

## Cost of debt capital ( $K_d$ )

The cost of borrowing is the expected future borrowing cost of the relevant project and/or business. It is related to the size of the business, the level of gearing and the riskiness of lending to the business.

The RBA provides indicative lending rates for small and large businesses presented in the table below:

**Table 29: RBA Indicator Lending rates**

RBA Indicator Lending rates		
Debt category	Small Business	Large Business
Overdraft	6.51%	N/A
Small Overdraft	7.92%	N/A
Weighted average rate on credit	5.20%	3.09%
BBB three-year yield on non-financial corporate bonds	N/A	1.56%
BBB five-year yield on non-financial corporate bonds	N/A	1.90%

Source: RBA

Based on the RBA indicators, REX would be considered a medium sized business and attract a cost of debt of between 3.09% to 5.20%. As part of our assessment, we have also taken into account REX's current borrowing costs. As at 22 October 2020, the weighted average interest rate on borrowings for REX is 9.1% per annum on a 10-year bank loan which was fully repaid in August 2020, as well as the terms of recent aircraft leases. In consideration of the above data, we have therefore selected a rate of 7% to 8% as the cost of debt for REX before the Proposed Transaction. Having regard to the proposed interest rate on the Convertible notes, the cost of debt for REX would expect to decrease should the Proposed Transaction proceed. We have therefore selected a rate of 6.5% to 7.5% as the cost of debt for REX before Proposed Transaction and a rate of 5% to 6% as the cost of debt for REX after the Proposed Transaction.

## Debt and equity mix

The selection of an appropriate capital structure is a subjective exercise. The tax deductibility of the cost of debt means that the higher the proportion of debt, the lower the WACC for a given cost of equity. However, at significantly higher levels of debt, the marginal cost of borrowing would increase due to the greater risk which debt holders are exposed to. In addition, the cost of equity would also be likely to increase due to equity investors requiring a higher return given the higher degree of financial risk that they have to bear.

Ultimately for each company there is likely to be a level of debt/equity mix that represents the optimal capital structure for that company. In estimating the WACC, the debt/equity mix assumption should reflect what would be the optimal or target capital structure for the relevant asset.

An analysis of relevant comparable companies' gearing levels (net debt to enterprise value) is presented in Appendix 5. We note that:

- ◆ The accounting standard, IFRS 16 - Leases (or in the case of Australian companies, AASB 16) became effective as at 1 January 2019. This standard changes the accounting for operating leases which are capitalised post adoption of IFRS 16, in addition to the creation of Right of Use Assets. The airline industry is one of the industries which are the most heavily impacted by the adoption of IFRS 16. As a result, the five-year averages are not representative of the optimal gearing levels for the future. Therefore, we have placed greater reliance on the most recent gearing levels as at the valuation date in determining the optimal capital structure.
- ◆ Companies with zero or negative or abnormally high D/V ratios have been excluded from the average. We have calculated the average gearing for companies that have adopted IFRS 16 as at 20 October 2020.
- ◆ Since the onset of COVID-19, the market capitalisation of many companies has fallen while debt levels have remained fairly constant. This leads to an increase in gearing as a percentage of market capitalization. However, given the current economic conditions, the levels of debt that would be available to many borrowers will be lower than the levels of debt actually held. As a result, we have not factored the apparent increase in gearing levels into our market efficient capital structures.

Based on the above analysis, we have selected a capital structure with debt in the range of 25% to 30% for REX which is more comparable to those of discount and regional airlines' gearing level.

### Calculation of Weighted Average Cost of Capital (WACC)

The following table sets out our cost of equity estimate for REX based on the assumptions and inputs discussed above:

**Table 30: Estimated WACC for REX**

Discount Rate Summary				
	Pre-transaction		Post-transaction	
	Low	High	Low	High
Risk free rate ( $R_f$ )	1.02%	1.02%	1.02%	1.02%
Equity beta ( $\beta_E$ )	1.20	1.30	1.20	1.30
Equity market risk premium (EMRP)	7.25%	7.75%	7.25%	7.75%
Size premium ( $\alpha_{size}$ )	3.00%	3.00%	2.50%	2.50%
Specific risk premium ( $\alpha_c$ )	0.00%	0.00%	0.00%	0.00%
<b>Assessed cost of equity (<math>k_e</math>)</b>	<b>12.72%</b>	<b>14.10%</b>	<b>12.22%</b>	<b>13.60%</b>
Cost of debt ( $K_d$ )	6.50%	7.50%	5.00%	6.00%
Gearing ( $D/V$ )	30.00%	25.00%	30.00%	25.00%
Tax rate ( $t$ )	30.00%	30.00%	30.00%	30.00%
<b>Calculated WACC</b>	<b>10.27%</b>	<b>11.88%</b>	<b>9.60%</b>	<b>11.25%</b>
<b>Selected WACC</b>	<b>11.00%</b>		<b>10.25%</b>	

Source: Leadenhall analysis

Based on the assessed gearing level of 25% to 30%, we have therefore assessed a WACC of 11.0% for REX before the Proposed Transaction and a WACC of 10.25% after the transaction. We note that any reasonable alternate assumptions for the assessed WACC above would not alter our conclusions on the Proposed Transaction.

## APPENDIX 4: COMPARABLE COMPANIES

The following company descriptions are extracted from descriptions provided by S&P Capital IQ.

Company	Description
Air Canada	Air Canada provides domestic, U.S. transborder, and international airline services.
Air New Zealand Limited	Air New Zealand Limited provides passenger and cargo transportation services on scheduled airlines primarily in New Zealand, Australia, the Pacific Islands, the United Kingdom, Europe, Asia, and the United States.
Alaska Air Group, Inc.	Alaska Air Group, Inc., through its subsidiaries, provides passenger and cargo air transportation services.
Allegiant Travel Company	Allegiant Travel Company, a leisure travel company, provides travel services and products to residents of under-served cities in the United States.
Alliance Aviation Services Limited	Alliance Aviation Services Limited provides aviation services to tourism, resources, mining, education, government, corporate, and sporting sectors in Australia and internationally.
American Airlines Group Inc.	American Airlines Group Inc., through its subsidiaries, operates as a network air carrier.
Copa Holdings, S.A.	Copa Holdings, S.A., through its subsidiaries, provides airline passenger and cargo services.
Delta Air Lines, Inc.	Delta Air Lines, Inc. provides scheduled air transportation for passengers and cargo in the United States and internationally.
Deutsche Lufthansa AG	Deutsche Lufthansa AG operates as an aviation company in Germany and internationally.
easyJet plc	easyJet plc, together with its subsidiaries, operates as an airline carrier primarily in Europe.
Hawaiian Holdings, Inc.	Hawaiian Holdings, Inc., through its subsidiary, Hawaiian Airlines, Inc., engages in the scheduled air transportation of passengers and cargo.
International Consolidated Airlines Group, S.A.	International Consolidated Airlines Group, S.A., together with its subsidiaries, engages in the provision of passenger and cargo transportation services in the United Kingdom, Spain, Ireland, the United States, and rest of the world.
JetBlue Airways Corporation	JetBlue Airways Corporation, a passenger carrier company, provides air transportation services.
Qantas Airways Limited	Qantas Airways Limited provides passenger and freight air transportation services in Australia and internationally.
Ryanair Holdings plc	Ryanair Holdings plc, together with its subsidiaries, provides scheduled-passenger airline services in Ireland, the United Kingdom, Italy, Spain, Germany, and Other European countries.
Singapore Airlines Limited	Singapore Airlines Limited, together with subsidiaries, provides passenger and cargo air transportation services under the Singapore Airlines, SilkAir, and Scoot brands in East Asia, the Americas, Europe, South West Pacific, West Asia, and Africa.
SkyWest, Inc.	SkyWest, Inc., through its subsidiaries, operates a regional airline in the United States.

Source: S&P Capital IQ

<b>Company</b>	<b>Description</b>
Southwest Airlines Co.	Southwest Airlines Co. operates a passenger airline that provides scheduled air transportation services in the United States and near-international markets.
Spirit Airlines, Inc.	Spirit Airlines, Inc. provides low-fare airline services.
United Airlines Holdings, Inc.	United Airlines Holdings, Inc., through its subsidiaries, provides air transportation services in North America, Asia, Europe, Africa, the Pacific, the Middle East, and Latin America.
Virgin Australia Holdings Limited	Virgin Australia Holdings Limited engages in the operation of domestic and international passenger and cargo airline business in Australia.
Wizz Air Holdings Plc	Wizz Air Holdings Plc, together with its subsidiaries, provides passenger air transportation services on scheduled short-haul and medium-haul point-to-point routes across Europe and the Middle East. As of June 03, 2020, it operated a fleet of 122 aircraft that offered services for approximately 710 routes from 25 bases connecting 155 airports in 45 countries.

Source: S&P Capital IQ

## APPENDIX 5: COMPARABLE COMPANIES GEARING AND MULTIPLES

The gearing level and trading multiples for the comparable companies are set below:

Company	Gearing		Recent Gearing		EBITDAR Multiple		EBIT Multiple		NTA Multiple
	D/EV	D/EV	FY21	FY22	FY21	FY22	MC/UNTA		
Regional Express Holdings	-2%	4%	n/a	n/a	n/a	n/a	0.9x		
<b>Australian airlines</b>									
Qantas Airways Limited	32%	40%	11.9x	4.4x	nmf	11.8x	1.5x		
Virgin Australia Holdings	51%	47%	12.5x	7.3x	nmf	21.1x	0.4x		
Alliance Aviation Services	24%	-7%	6.3x	5.1x	11.5x	9.2x	2.2x		
<b>Median (excluding outliers)</b>	<b>32%</b>	<b>44%</b>	<b>11.9x</b>	<b>5.1x</b>	<b>11.5x</b>	<b>11.8x</b>	<b>1.5x</b>		
<b>Average (excluding outliers)</b>	<b>35%</b>	<b>44%</b>	<b>10.2x</b>	<b>5.6x</b>	<b>11.5x</b>	<b>14.0x</b>	<b>1.4x</b>		
<b>Average</b>	<b>35%</b>	<b>27%</b>	<b>10.2x</b>	<b>5.6x</b>	<b>11.5x</b>	<b>14.0x</b>	<b>1.4x</b>		
<b>International airlines - full service</b>									
Delta Air Lines, Inc.	21%	29%	9.2x	6.6x	nmf	9.4x	2.3x		
United Airlines Holdings, Inc.	35%	42%	10.6x	5.3x	nmf	9.8x	0.5x		
Singapore Airlines Limited	6%	58%	nmf	8.6x	nmf	nmf	0.6x		
American Airlines Group Inc.	56%	71%	13.3x	5.6x	nmf	12.9x	0.3x		
International Consolidated Airlines Group	20%	46%	5.5x	3.2x	nmf	6.2x	0.6x		
Deutsche Lufthansa AG	33%	48%	6.1x	3.1x	nmf	10.2x	0.4x		
Alaska Air Group, Inc.	9%	17%	5.7x	4.0x	18.4x	7.9x	1.5x		
Air Canada	43%	21%	5.8x	3.6x	nmf	9.7x	1.7x		
Copa Holdings, S.A.	16%	10%	7.3x	4.8x	24.9x	9.1x	1.1x		
Air New Zealand Limited	38%	79%	10.7x	5.0x	nmf	nmf	0.4x		
Hawaiian Holdings, Inc.	13%	38%	5.1x	3.2x	nmf	10.6x	0.4x		
<b>Median (excluding outliers)</b>	<b>33%</b>	<b>40%</b>	<b>6.7x</b>	<b>4.8x</b>	<b>21.6x</b>	<b>9.7x</b>	<b>0.6x</b>		
<b>Average (excluding outliers)</b>	<b>31%</b>	<b>37%</b>	<b>7.9x</b>	<b>4.8x</b>	<b>21.6x</b>	<b>9.5x</b>	<b>0.9x</b>		
<b>Average</b>	<b>26%</b>	<b>42%</b>	<b>7.9x</b>	<b>4.8x</b>	<b>21.6x</b>	<b>9.5x</b>	<b>0.9x</b>		
<b>International airlines - discount &amp; regional</b>									
Southwest Airlines Co.	0%	0%	9.1x	5.0x	23.8x	7.5x	3.5x		
Ryanair Holdings plc	2%	4%	nmf	8.5x	nmf	15.8x	2.5x		
Wizz Air Holdings Plc	-70%	32%	nmf	4.9x	nmf	9.8x	1.5x		
JetBlue Airways Corporation	16%	26%	7.0x	4.4x	nmf	9.4x	0.5x		
easyJet plc	-4%	7%	8.6x	3.0x	nmf	6.3x	1.2x		
Allegiant Travel Company	22%	26%	8.5x	6.3x	17.4x	10.3x	1.3x		
Spirit Airlines, Inc.	18%	50%	5.8x	4.4x	22.3x	11.1x	0.3x		
SkyWest, Inc.	51%	47%	5.7x	4.9x	16.5x	11.0x	0.3x		
<b>Median (excluding outliers)</b>	<b>18%</b>	<b>32%</b>	<b>7.7x</b>	<b>4.9x</b>	<b>19.8x</b>	<b>10.0x</b>	<b>1.2x</b>		
<b>Average (excluding outliers)</b>	<b>21%</b>	<b>36%</b>	<b>7.4x</b>	<b>5.2x</b>	<b>20.0x</b>	<b>10.2x</b>	<b>1.4x</b>		
<b>Average</b>	<b>4%</b>	<b>24%</b>	<b>7.4x</b>	<b>5.2x</b>	<b>20.0x</b>	<b>10.2x</b>	<b>1.4x</b>		

Source: S&P Capital IQ

## APPENDIX 6: CONTROL PREMIUM

The outbreak of COVID-19 and the consequential general decline in share prices is likely to have an impact on implied control premiums in the current environment. Although there is anecdotal evidence from previous economic downturns of control premiums being higher than the long-term average in times of economic distress, it is difficult to quantify the impact of the current environment on long-term estimates based on currently available data. We have therefore presented our analysis of control premiums prior to the outbreak of COVID-19 noting that any reasonable range of control premiums does not impact our conclusion on the Proposed Transaction.

### Background

As discussed above, the difference between the control value and the liquid minority value of a security is the control premium. The inverse of a control premium is a minority discount (also known as a discount for lack of control). A control premium is said to exist because the holder of a controlling stake has several rights that a minority holder does not enjoy (subject to shareholders agreements and other legal constraints), including the ability to:

- ◆ Appoint or change operational management
- ◆ Appoint or change members of the board
- ◆ Determine management compensation
- ◆ Determine owner's remuneration, including remuneration to related party employees
- ◆ Determine the size and timing of dividends
- ◆ Control the dissemination of information about the company
- ◆ Set strategic focus of the organisation, including acquisitions, divestments and any restructuring
- ◆ Set the financial structure of the company (debt / equity mix)
- ◆ Block any or all of the above actions

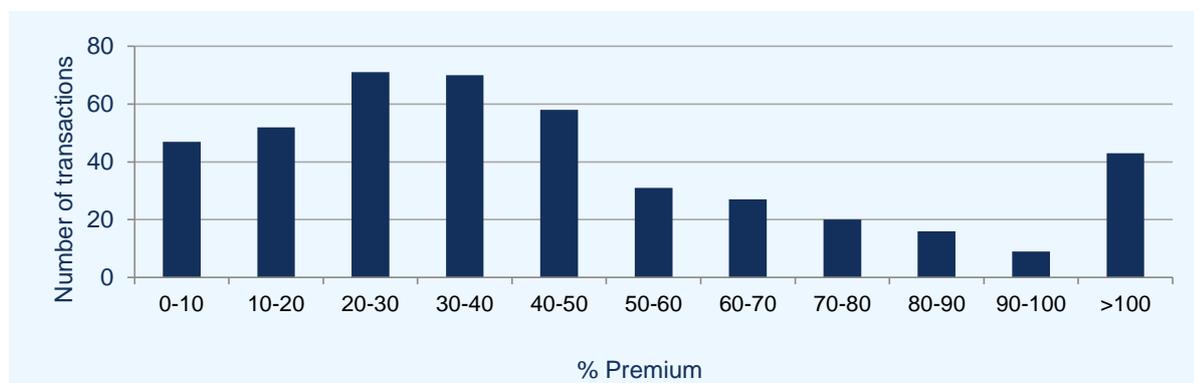
The most common approach to quantifying a control premium is to analyse the size of premiums implied from prices paid in corporate takeovers. Another method is the comparison between prices of voting and non-voting shares in the same company. We note that the size of the control premium should generally be an outcome of a valuation and not an input into one, as there is significant judgement involved.

## Takeover Premiums

### Dispersion of premiums

The following chart shows the spread of premiums paid in takeovers between 2007 and 2017. We note that these takeover premiums may not be purely control premiums, for example the very high premiums are likely to include synergy benefits, while the very low premiums may be influenced by share prices rising in anticipation of a bid.

**Figure 18: Takeover premium by size**



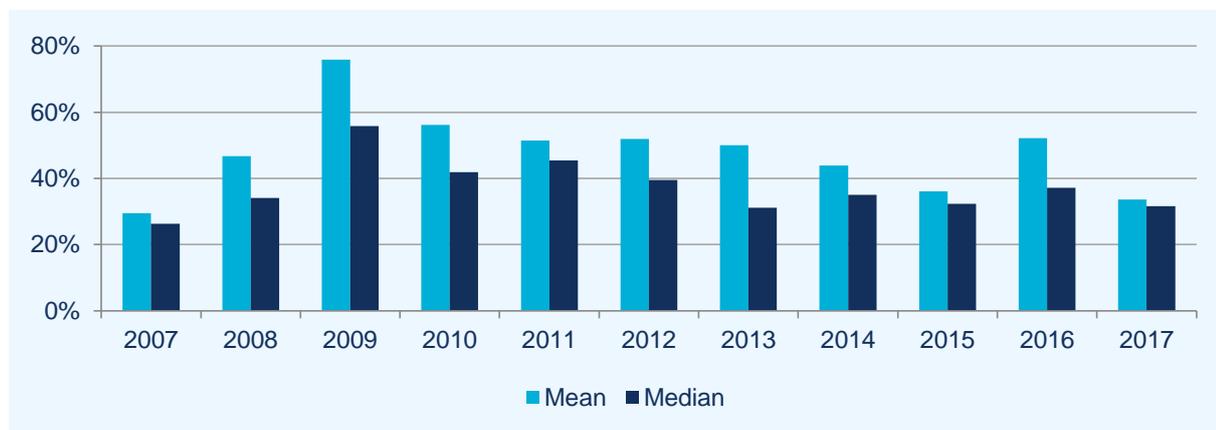
Sources: S&P Capital IQ, Leadenhall analysis

This chart highlights the dispersion of premiums paid in takeovers. The chart shows a long tail of high premium transactions, although the most common recorded premiums are in the range of 20% to 40%, with approximately 65% of all premiums falling in the range of 0% to 50%.

### Premiums over time

The following chart shows the average premium paid in completed takeovers compared to the price one month before the initial announcement.

**Figure 19: Average takeover premium (1 month)**



Sources: S&P Capital IQ, Leadenhall analysis

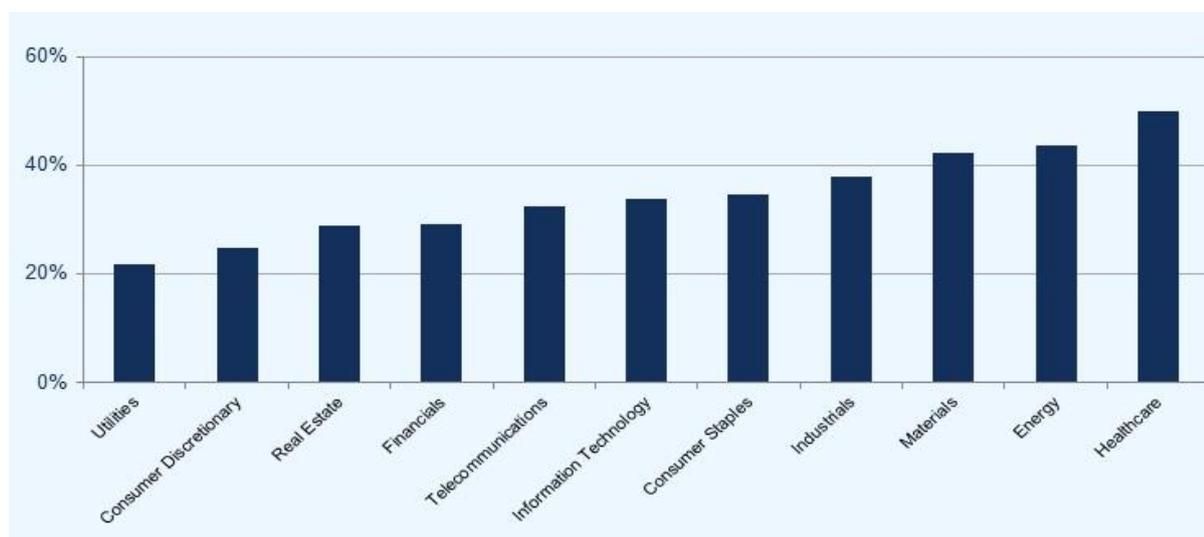
Note: The average premiums presented above exclude transactions with implied control premiums below zero and transactions which we consider to be outliers.

The chart indicates that while premiums vary over time, there is no clearly discernible pattern. The mean is higher than the median due to a small number of high premiums.

### Premiums by industry

The following chart shows the average takeover premium by industry, compared to the share price one month before the takeover was announced. Most industries show an average premium of 20% to 40%.

**Figure 20: Average takeover premium (2007 to 2017)**



Sources: S&P Capital IQ, Leadenhall analysis

Note: The average premiums presented above exclude specific transactions with implied control premiums below zero or over 100% which we consider to be outliers.

Key factors that generally lead to higher premiums being observed include:

- ◆ Competitive tension arising from more than one party presenting a takeover offer.
- ◆ Favourable trading conditions in certain industries (e.g. recent mining and tech booms).
- ◆ Significant synergistic special or strategic value.
- ◆ Scrip offers where the price of the acquiring entity's shares increases between announcement and completion.

## Industry Practice

In Australia, industry practice is to apply a control premium in the range of 20% to 40%, as shown in the following list quoting ranges noted in various independent experts' reports.

- ◆ Deloitte - 20% to 40%
- ◆ Ernst & Young - 20% to 40%
- ◆ Grant Samuel - 20% to 35%
- ◆ KPMG - 25% to 35%
- ◆ Lonergan Edwards - 30 to 35%
- ◆ PwC - 20% to 40%

The range of control premiums shown above is consistent with most academic and professional literature on the topic.

## Alternative View

Whilst common practice is to accept the existence of a control premium in the order of 20% to 40%, certain industry practitioners (particularly in the US) disagree with the validity of this conclusion. Those with an alternate viewpoint to the fact that very few listed companies are acquired each year as evidence that 100% of a company is not necessarily worth more than the proportionate value of a small interest. Those practitioners agree that the reason we see some takeovers at a premium is that if a company is not well run, there is a control premium related to the difference in value between a hypothetical well run company and the company being run as it is.

## Impact of Methodologies Used

The requirement for an explicit valuation adjustment for a control premium depends on the valuation methodology and approach adopted and the level of value to be examined. It may be necessary to apply a control premium to the value of a liquid minority value to determine the control value. Alternatively, in order to estimate the value of a minority interest, it may be necessary to apply a minority discount to a proportional interest in the control value of the company.

### Discounted cash flow

The discounted cash flow methodology generally assumes control of the cash flows generated by the assets being valued. Accordingly, such valuations reflect a premium for control. Where a minority value is sought a minority discount must therefore be applied. The most common exception to this is where a discounted dividend model has been used to directly determine the value of an illiquid minority holding.

### Capitalisation of earnings

Depending on the type of multiple selected, the capitalisation of earnings methodology can reflect a control value (transaction multiples) or a liquid minority value (listed company trading multiples).

### Asset based methodologies

Asset based methodologies implicitly assume control of the assets being valued. Accordingly, such valuations reflect a control value.

## Intermediate Levels of Ownership

There are a number of intermediate levels of ownership between a portfolio interest and 100% ownership. Different levels of ownership/strategic stakes will confer different degrees of control and rights as shown below.

- ◆ 90% - can compulsory purchase remaining shares if certain conditions are satisfied
- ◆ 75% - power to pass special resolutions
- ◆ 50% - gives control depending on the structure of other interests (but not absolute control)
- ◆ 25% - ability to block a special resolution
- ◆ 20% - power to elect directors, generally gives significant influence, depending on other shareholding blocks
- ◆ < 20% generally has only limited influence

Conceptually, the value of each of these interests lies somewhere between the portfolio value (liquid minority value) and the value of a 100% interest (control value). Each of these levels confers different degrees of control and therefore different levels of control premium or minority discount.

### 50%

For all practical purposes, a 50% interest confers a similar level of control to holdings of greater than 50%, at least where the balance of the shares are listed and widely held. Where there are other significant holders, such as in a 50/50 joint venture, 50% interests involve different considerations depending upon the particular circumstances.

Strategic parcels do not always attract a control premium. In fact, if there is no bidder, the owner may be forced to sell the shares through the share market, usually at a discount to the prevailing market price. This reflects the fact that the sale of a parcel of shares significantly larger than the average number of shares traded on an average day in a particular stock generally causes a stock overhang, therefore there is more stock available for sale than there are buyers for the stock and in order to clear the level of stock available, the share price is usually reduced by what is referred to as a blockage discount.

### 20% to 50%

Holdings of less than 50% but more than 20% can confer a significant degree of influence on the owner. If the balance of shareholders is widely spread, a holding of less than 50% can still convey effective control of the business. However, it may not provide direct ownership of assets or access to cash flow. This level of holding has a strategic value because it may allow the holder significant influence over the company's management, possibly additional access to information and a board seat.

### <20%

Holdings of less than 20% are rarely considered strategic and would normally be valued in the same way as a portfolio interest given the stake would not be able to pass any ordinary or special resolution on their own if they were against the interests of the other shareholders. Depending on the circumstances, a blockage discount may also apply.

As explained above, the amount of control premium or minority discount that would apply in specific circumstances is highly subjective. In relation to the appropriate level of control premium, Aswath Damodaran notes "the value of controlling a firm has to lie in being able to run it differently (and better)". A controlling shareholder will be able to implement their desired changes. However, it is not certain that a non-controlling shareholder would be able to implement changes they desired. Thus, following the logic of Damodaran and the fact that the strategic value of the holding typically diminishes as the level of holding decreases, the appropriate control premium for a non-controlling shareholder should be lower than that control premium for a controlling stake.

### Key Factors in Determining a Reasonable Control Premium

Key factors to consider in determining a reasonable control premium include:

- ◆ **Size of holding** – Generally, larger stakes attract a higher control premium
- ◆ **Other holdings** – The dispersion of other shareholders is highly relevant to the ability for a major shareholder to exert control. The wider dispersed other holdings are, the higher the control premium
- ◆ **Industry premiums** – Evidence of premiums recently paid in a given industry can indicate the level of premium that may be appropriate
- ◆ **Size** – medium sized businesses in a consolidating industry are likely to be acquired at a larger premium than other businesses
- ◆ **Dividends** – a high dividend pay-out generally leads to a low premium for control
- ◆ **Gearing** – a company that is not optimally geared may attract a higher premium than otherwise, as the incoming shareholder has the opportunity to adjust the financing structure
- ◆ **Board** – the ability to appoint directors would increase the control premium attaching to a given parcel of shares. The existence of independent directors would tend to decrease the level of premium as this may serve to reduce any oppression of minority interests and therefore support the level of the illiquid minority value
- ◆ **Shareholders' agreement** - the existence and contents of a shareholder's agreement, with any protection such as tag along and drag along rights offered to minority shareholders lowers the appropriate control premium.

## APPENDIX 7: VOLATILITY ANALYSIS

In selecting expected prospective volatility, we have considered the observed historical volatility of a range of comparable entities, as well as that of REX. We consider this approach preferable to relying on REX's historical volatility only, due to the significant uncertainty in any single observation. The historical volatility of companies with comparable operations to REX are set out in the table below.

**Table 31: Historical volatility of comparable companies**

Comparable Company Volatility					
Company	Market Cap (A\$m)	Annualised volatility (%)			
		3 Year	4 Year	5 Year	6 Year
<b><u>Australian airlines</u></b>					
Regional Express Holdings Limited	150	53%	49%	47%	44%
Qantas Airways Limited	8,089	41%	37%	36%	37%
Virgin Australia Holdings Limited	726	58%	53%	51%	48%
Alliance Aviation Services Limited	520	47%	46%	46%	56%
<b>Median</b>	<b>623</b>	<b>50%</b>	<b>48%</b>	<b>46%</b>	<b>46%</b>
<b>Mean</b>	<b>2,371</b>	<b>50%</b>	<b>46%</b>	<b>45%</b>	<b>46%</b>
<b><u>International airlines - full service</u></b>					
Delta Air Lines, Inc.	27,273	50%	45%	43%	41%
United Airlines Holdings, Inc.	13,967	63%	57%	53%	51%
Singapore Airlines Limited	10,422	30%	27%	25%	24%
American Airlines Group Inc.	8,087	64%	58%	54%	52%
International Consolidated Airlines	8,773	57%	51%	50%	47%
Deutsche Lufthansa AG	7,521	43%	40%	39%	38%
Alaska Air Group, Inc.	6,724	51%	46%	43%	42%
Air Canada	4,761	52%	49%	48%	46%
Copa Holdings, S.A.	2,892	59%	53%	52%	51%
Air New Zealand Limited	1,467	45%	41%	39%	38%
Hawaiian Holdings, Inc.	893	62%	57%	54%	53%
<b>Median</b>	<b>7,521</b>	<b>52%</b>	<b>49%</b>	<b>48%</b>	<b>46%</b>
<b>Mean</b>	<b>8,435</b>	<b>52%</b>	<b>47%</b>	<b>45%</b>	<b>44%</b>
<b><u>International airlines - discount &amp; regional</u></b>					
Southwest Airlines Co.	32,207	41%	38%	37%	36%
Ryanair Holdings plc	23,024	42%	38%	38%	37%
Wizz Air Holdings Plc	5,154	47%	43%	42%	41%
JetBlue Airways Corporation	4,645	53%	48%	46%	44%
easyJet plc	4,217	54%	49%	48%	46%
Allegiant Travel Company	2,977	54%	49%	47%	45%
Spirit Airlines, Inc.	2,443	73%	66%	62%	59%
SkyWest, Inc.	2,051	70%	64%	60%	58%
<b>Median</b>	<b>4,431</b>	<b>53%</b>	<b>48%</b>	<b>46%</b>	<b>45%</b>
<b>Mean</b>	<b>9,590</b>	<b>54%</b>	<b>49%</b>	<b>47%</b>	<b>46%</b>
<b><u>Airline indices</u></b>					
NYSE Arca Airline Index	N/a	47%	42%	39%	37%
STOXX Europe Total Market Airlines	N/a	39%	35%	36%	34%
<b>Median</b>	<b>4,761</b>	<b>52%</b>	<b>48%</b>	<b>46%</b>	<b>44%</b>
<b>Mean</b>	<b>7,782</b>	<b>52%</b>	<b>47%</b>	<b>45%</b>	<b>44%</b>

Source: Capital IQ as at 2 November 2020

In relation to assessing volatility we note:

- ◆ As REX would undergo a significant transformation (that has included significant organic growth, announcement and completion of highly strategic acquisitions and substantial capital raisings), we expect the future volatility of REX to decline compared to historical levels, other things being equal.
- ◆ Historical volatility is impacted by COVID 19 and therefore fairly high, especially for shorter periods.
- ◆ We anticipate COVID-19 volatility to persist for some time in the future.
- ◆ Generally small companies have higher volatilities than larger companies and REX is at the smaller end of the comparable companies.
- ◆ We believe a volatility of 45.0% is reasonable.

## APPENDIX 8: QUALIFICATIONS, DECLARATIONS AND CONSENTS

### Responsibility and purpose

This report has been prepared for REX's shareholders for the purpose of assessing the fairness and reasonableness of the Proposed Transaction. Leadenhall expressly disclaims any liability to any shareholder, or anyone else, whether for our negligence or otherwise, if the report is used for any other purpose or by any other person.

### Reliance on information

In preparing this report we relied on the information provided to us by REX being complete and accurate and we have assumed it has been prepared in accordance with applicable Accounting Standards and relevant national and state legislation. We have not performed an audit, review or financial due diligence on the information provided. Drafts of our report were issued to REX's management for confirmation of factual accuracy.

### Prospective information

To the extent that this report refers to prospective financial information, we have considered the prospective financial information and the basis of the underlying assumptions. The procedures involved in Leadenhall's consideration of this information consisted of enquiries of REX's personnel and analytical procedures applied to the financial data. These procedures and enquiries did not include verification work nor constitute an audit or a review engagement in accordance with Australian Auditing Standards, or any other standards. Nothing has come to our attention as a result of these enquiries to suggest that the financial projections for REX, when taken as a whole, are unreasonable for the purpose of this report.

We note that the forecasts and projections supplied to us are, by definition, based upon assumptions about events and circumstances that have not yet transpired. Actual results in the future may be different from the prospective financial information of REX referred to in this report and the variation may be material, since anticipated events frequently do not occur as expected. Accordingly, we give no assurance that any forecast results will be achieved. Any future variation between the actual results and the prospective financial information utilised in this report may affect the conclusions included in this report.

### Market conditions

Leadenhall's opinion is based on prevailing market, economic and other conditions as at the date of this report. Conditions can change over relatively short periods of time. Any subsequent changes in these conditions could impact upon the conclusion reached in this report.

As a valuation is based upon expectations of future results it involves significant judgement. Although we consider the assumptions used and the conclusions reached in this report are reasonable, other parties may have alternative expectations of the future, which may result in different valuation conclusions. The conclusions reached by other parties may be outside Leadenhall's preferred range

### Indemnities

In recognition that Leadenhall may rely on information provided by REX and their officers, employees, agents or advisors, REX has agreed that it will not make any claim against Leadenhall to recover any loss or damage which it may suffer as a result of that reliance and that it will indemnify Leadenhall against any liability that arises out of Leadenhall's reliance on the information provided by REX and their officers, employees, agents or advisors or the failure by REX and their officers, employees, agents or advisors to provide Leadenhall with any material information relating to this report.

### Qualifications

The personnel of Leadenhall principally involved in the preparation of this report were Dave Pearson, BCom., CA, CFA, CBV, ASA, M.App.Fin, Andrew Steere, BBus, CA, MCom, Grad Dip App.Fin, Richard Norris, BA (Hons), FCA, M.App.Fin, F.Fin, and Katy Lawrence, BCom., CA, Vicky Lau, BCom., CA.

This report has been prepared in accordance with "APES 225 – Valuation Services" issued by the Accounting Professional & Ethical Standards Board and this report is a valuation engagement in accordance with that standard and the opinion is a Conclusion of Value.

## **Independence**

Leadenhall has acted independently of REX. Compensation payable to Leadenhall is not contingent on the conclusion, content or future use of this report.

Leadenhall and its related entities do not have at the date of this report, and have not had within the previous two years, any business or professional relationship with REX, PAG or any related entities or any financial or other interest that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Proposed Transaction.

In the previous two years we have provided valuation advice to REX for impairment testing purposes in order to assist REX management in satisfying their financial reporting requirements. This work did not involve Leadenhall participating in setting the terms of, or any negotiations leading to, the Proposed Transaction.