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Kim Booth MHA
Parliament House
HOBART TAS 7000

Dear Kim,

RE: SALE OF HOBART AIRPORT

In response to your request, the following valuation of the Hobart Airport from a prospective buyer's perspective as at December 2007 is set out below. The rationale behind the valuation process is explained and some of the FAQs are pre-emptively addressed.

The Hobart Airport business is conducted by Hobart International Airport Pty Limited (HIAPL), which at the time was a wholly owned subsidiary of Tasmanian Ports Corporation Pty Ltd (TPC).

The sale involved the sale by TPC of all its shares in HIAPL.

Ascertaining a value for the shares in HIAPL according to standard valuation principles involves the following steps

1. Determine the maintainable EBITDA (earnings before interest tax depreciation and amortisation).
2. Apply a P/E ratio or earnings multiple to determine the value of the business.
3. Determine a value for other assets and liabilities which a new owner of HIAPL will assume.
4. The value of the shares in HIAPL will be 2. plus 3.

The valuation that follows is based on the 2007 financial statement for HIAPL. Prospective buyers for HIAPL shares would have had access to more detailed information provided by the seller.

Maintainable EBITDA

Turnover for HIAPL in 2007 was $17.8m. After adding back depreciation and finance costs EBITDA was $11.3m giving an EBITDA margin of 63%. The EBITDA margin in 2006 was 60%.

It always a little difficult to determine from a statutory set of accounts which amounts of income and expenses are one off items and need to be excluded from a calculation of maintainable earnings.

Also because major capital works were completed during the year the full effects were not reflected in the 2007 earnings.

So it is not unreasonable to assume maintainable annual turnover of $20m as at Dec 2007 with an EBITDA margin of 64%. This gives an EBITDA of $12.8m.

Earnings Multiple

To determine the value of a particular investment an investor applies his required rate of return to the maintainable earnings expected from that investment. The earnings multiple is simply the inverse of the rate of return.

The rate of return will largely be determined by the riskiness of the investment and by returns for comparable investments.

Sydney Airport is majority owned by an ASX listed entity Macquarie Airports (MAP). The annual turnover for the airport for the year ended 30th September 2007 was $552m and the EBITDA was $439m. In February 2007 MAP bought a further 15.1% interest in Sydney Airport for $662.6m which valued a 100% interest at $4,388m, at a time when EBITDA was approximately $439m. In other words a rate of return of 10% was used, or an earnings multiple of 10.

The Queensland Government too has recently sold its 12.4% stake in Brisbane Airport for $289.4m. This implies an enterprise value of $2,333m. The latest financial statements for 2007 revealed an EBITDA of $253m. Hence an earnings multiple of 9 or 10 was used to value the Brisbane Airport.

Hobart Airport as a business inherently carries more risk than Sydney and Brisbane Airports. Yields (or rates of return) on commercial investments are higher in Tasmania compared to major mainland capital cities.

Hence an earnings multiple of 7 is reasonable for Hobart Airport. Applying this multiple to the maintainable earnings of $12.8m gives a value for the Hobart Airport business of $89.6m.

Adjustment for other assets and liabilities

When the sale of a business is effected by a transfer of the shares, the value of other assets and liabilities remaining with a Company needs to be taken into account. The final contract for the sale of HIAPL shares is listed at http://www.tenders.tas.gov.au/domino/tenders.nsf/all-v/F5A0D45002C824C0CA25734F00240ED2. The contract sets out an adjustment process whereby if the assets and liabilities at Completion Date differ from the values in the Schedule to the contract which presumably were the amounts revealed in the due diligence process, then an adjustment will occur. The current assets (cash at bank, debtors etc) plus the prepaid expenses were roughly equivalent to the liabilities (creditors, employee benefits etc). The liabilities here excludes the loans of $39m which were treated differently (see below).

Loans of $39m owing by HIAPL to its parent TPC and to Tasmanian Public Finance Corporation (TPFC) were required to be discharged at Completion Date by the Buyer. As a consequence the agreed purchase price for HIAPL shares paid by the Buyer as per the Contract was reduced by $39m at settlement.

Hence the same approach will be followed with this valuation. The value of the HIAPL shares will assume that the loans of $39m will be discharged at Completion Date and that the other current liabilities of HIAPL are offset by its current assets and prepayments.

Applying an earnings multiple to maintainable earnings gives a value for the 'airport business'. But there may be other assets (let's call them non business assets at this stage) owned by HIAPL which will remain with the Company.

The area of the Airport land (all leased subject to a 99 year lease from the Commonwealth) comprises 570ha.Approximately 25ha is the land subject to the current DFO proposal and other proposed commercial developments and a further 180ha is undeveloped at this stage but suitable for future commercial development. A kerbside valuation of $100,000 per ha on the 25ha area and $50,000 per ha on the 180ha give a value on the unused land of $11.5m.

Additional Comments

A common criticism of the above approach is that the valuation fails to recognise the potential of the investment. The pre-emptive response is as follows

- The basis for the valuation is maintainable earnings, not current or future earnings but maintainable earnings. If current costs can be curbed or turnover increased by adjusting prices, then this should be reflected in maintainable earnings. Because the Government was grooming HIAPL for sale one would normally expect the profit and loss statement to have been tidied up to maximise maintainable earnings. The information package presumably circulated to potential buyers, will allow a more accurate figure for maintainable earnings as at Dec 2007 if there is doubt.
- It is indeed probable that future development on the airport site will produce a greater income stream in the future. But it will require further investment and cannot be included in any valuation. To earn $1 pa in rent will require possibly $10 in capital expenditure by the new owner. To the extent that there is future potential for the site, then this should be reflected in the value of the yet undeveloped commercial land. And this is why this land was isolated from the business assets and valued separately.
- A prospective buyer may envisage greater growth for the Hobart Airport asset compared to other airports around Australia and may be prepared to accept a higher earnings multiple (i.e. less income yield) in return for a higher capital growth over time. But it is not immediately evident why earnings multiple greater than 10 used in respect of Sydney and Brisbane airports would be chosen.
- With a price of $350m the airport is only giving its new owners a 3.7% income return on an ungeared basis. A benchmark return (capital and income) on such an infrastructure investment would be 15%, hence if the income return is only 3.6% then the capital return needs to be 11.4%. It is indeed possible to achieve higher rates of returns with gearing and a different ownership structure but this is outside the scope of this valuation report.

Value of HIAPL shares

A fair and reasonable value of the airport business is therefore$89.6m which together with the value of the undeveloped land of $11.5m gives a total value of $101.1m.

Yours sincerely

JOHN LAWRENCE