



**ACN 106 609 143**

## Notice of General Meeting, Explanatory Memorandum, Prospectus and Proxy Form

**General meeting to be held at Level 21, 25 Bligh Street, Sydney at 9.00am (Sydney time) on Wednesday, 20 February 2013**

**Shareholders who are unable to attend the general meeting are encouraged to complete and return the enclosed proxy form by 9.00am (Sydney time) on Monday, 18 February 2013**

**THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION.**

The Directors recommend shareholders read this document in full before making any decision in relation to the resolutions to be considered at the general meeting.

An independent expert's report is set out in Schedule 7 to this document. The independent expert has concluded that the Acquisition is fair and reasonable to the Company's non-associated shareholders.

This document is also a prospectus for the purposes of Chapter 6D of the Corporations Act 2001 (Cwlth) in relation to the Placement.

If you are in any doubt as to how to deal with this document, you should consult your legal, financial or other professional adviser as soon as possible.

## **Explanatory Memorandum**

This Explanatory Memorandum is provided to Shareholders to explain the Resolutions to be put to Shareholders at the Meeting to be held at Level 21, 25 Blich Street, Sydney at 9.00am (Sydney time) on Wednesday, 20 February 2013.

The Directors recommend Shareholders read this document in full before making any decision in relation to the Resolutions.

## **Prospectus**

This document is also a prospectus for the purposes of Chapter 6D of the Corporations Act in relation to the Placement. Those Shares will be issued by the making of offers that do not need disclosure to investors under Chapter 6D of the Corporations Act pursuant to section 708 of the Corporations Act. No application form for Shares is attached to this document and application forms will only be provided to persons for whom offers can be made that do not need disclosure to investors under Chapter 6D of the Corporations Act pursuant to section 708 of the Corporations Act. This document expires as a prospectus on 10 February 2014, 13 months after the date of this document.

This document satisfies the disclosure requirements of section 710 of the Corporations Act.

This document is dated 11 January 2013 and a copy was lodged with ASIC on that date. Neither ASIC nor ASX take any responsibility for the content of this document.

This document has not been, and will not be, lodged, filed or registered with any regulatory authority under the securities laws of any country other than Australia.

No action has been taken to register or qualify Shares in any jurisdiction outside Australia. In particular, the Shares have not been, and will not be, registered under the US Securities Act 1933 ("**Securities Act**"), and may not be offered or sold in the United States of America or to, or for the account or benefit of, US Persons (as defined in Regulation S under the Securities Act) unless the Shares are registered under the Securities Act, or an exemption from the registration requirements of the Securities Act is available.

The distribution of this document outside Australia may be restricted by law and therefore persons who come into possession of this document outside Australia should seek advice on and observe any such restrictions. Any failure to comply with such restrictions may constitute a violation of applicable securities laws.

## **Publicly-available information**

This document is intended to be read in conjunction with the publicly-available information in relation to the Company which has been notified to ASX. Investors should have regard to the publicly-available information in relation to the Company before making a decision on whether or not to invest in the Company.

## **References to the number of Shares and Options**

As part of the Transaction the Company proposes to consolidate the number of Shares and the number of Options on issue on a 1 for 10 basis ("**Consolidation**"). Unless the contrary intention appears (for example, where the word "currently" is used), all references to the number of Shares and Options in this document are on a post-Consolidation basis.

## **Definitions**

Terms used in this document are defined in section 8 of this document.

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## 1 Chairman's Letter

Dear Shareholder

The purpose of the general meeting being convened by the Directors is to seek Shareholder approval for, amongst other things, the change in the scale of K2 Energy Limited's ("**Company**") activities by continuing to invest in MEARS Technologies, Inc. ("**MEARS**") by acquiring all of the MEARS Securities that it does not already own in a transaction structure known in the United States of America as a reverse triangular merger.

MEARS is seeking to design, develop and license semiconductor technologies and manufacturing solutions for integrated circuits (transistors and computer chips).

MEARS Silicon Technology™ ("**MST**"), a nano engineered silicon material, is intended to deliver a range of potential benefits to chip manufacturers including:

- improved transistor performance;
- lower power consumption;
- lower gate leakage; and
- lower costs.

MEARS' technologies also extend to potential applications in the area of solar energy technology. The Company already holds a 50% interest in the worldwide rights to those technologies.

MEARS has spent the last 10 years and approximately US\$65 million developing MST and is now seeking to enter the commercialisation phase of the development of its technologies. The MEARS business plan targets the signing of its first licence agreement in 2013. To achieve this objective, in the past 12 months MEARS has appointed a new management team with considerable semiconductor industry experience. Further information regarding MEARS, its patents and its commercialisation plan are set out in section 4.1 of this document.

Shareholders can rightly ask the question why would a highly prospective United States corporation agree to merge with the Company and thereby become listed on ASX? MEARS has considered for some time a public listing, so as to increase its shareholder base. The Company is one of MEARS' largest shareholders and has been very supportive of MEARS, contributing over \$5 million to MEARS fund raisings and its solar research technologies since 2010. Listing on ASX is regarded as a stepping stone to the possible consideration of a NASDAQ listing at the appropriate time.

Should the Acquisition and the Placement be concluded, the Company will have an interest in 100% of MEARS' chip and solar intellectual property and in excess of \$7.5 million cash.

To ensure that Shareholders are fully informed, the Company engaged the Independent Expert, Leadenhall Corporate Advisory, to assess whether the Acquisition is fair and reasonable to non-associated Shareholders. The Independent Expert has concluded that the Acquisition is fair and reasonable to non-associated Shareholders.

Your Directors believe that if MEARS is successful in commercialising its MST, the rewards to Shareholders could be significant.

Your Directors support the Transaction and have no hesitation in recommending that Shareholders vote in favour of the Resolutions.

This document contains important information about the Transaction, including the reasons to vote for and against the Transaction (see section 3.2 of this document), the conditions precedent to Completion of the Transaction (see section 3.1(f) of this document) and the risks associated with approving or voting against the Resolutions and investing in Shares (see section 6 of this document). Please read this document in full before making your decision and voting on the Resolutions. I also encourage you to seek legal, financial or other professional advice before making any investment decision in relation to your Shares.

Your Directors encourage you to vote at the Meeting. If you wish for the Transaction to proceed, it is important that you vote in favour of the Resolutions.

Yours faithfully

A handwritten signature in black ink, appearing to read 'S.M. Gazal', with a stylized flourish at the end.

S.M. Gazal  
Chairman

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## **2 Investment Highlights**

### **2.1 Overview of the Company**

The Company is an Australian public company listed on ASX.

The Company and its controlled entities currently have an investment in MEARS, own the worldwide rights to all intellectual property covering solar energy applications developed by MEARS, and have oil and gas interests in the United States of America, via its unitholding in Trey Resources.

### **2.2 Overview of the Transaction**

#### **(a) Acquisition**

MEARS is an engineered materials company incorporated in the State of Delaware in the United States of America which focuses on the development and commercialisation of products based on its proprietary electronic materials platform.

The Company proposes to change the scale of its activities by continuing to invest in MEARS by acquiring all of the MEARS Securities that it does not already own in a transaction structure known in the United States of America as a reverse triangular merger.

Further information regarding MEARS is set out in section 4.1 of this document and further information regarding the Acquisition is set out in sections 3 and 7 of this document.

#### **(b) Placement**

The Company is seeking to raise capital by placing up to 33,333,334 Shares with sophisticated and professional investors to raise between \$7.5 and \$10 million (before transaction costs). This document is also a prospectus in relation to the Placement.

The Company has appointed Foster Stockbroking to represent the Company in relation to the Placement.

The funds raised from the Placement will be used to:

- fund the commercialisation plan that is proposed by MEARS for the further development of its technologies;
- pay the costs of the Transaction; and
- otherwise contribute to working capital expenses.

Further information regarding the Placement is set out in sections 3 and 7 of this document.

### **2.3 Oil and gas interests**

The Company currently has a 17% interest in Trey Resources, a company which holds interests in oil and gas assets in the United States of America.

During the September 2012 quarter Trey Resources acquired additional oil and gas assets in Texas.

The Company may have the opportunity to invest further in Trey Resources in the future. The Company will consider its options if and when such an opportunity arises.

Further information regarding Trey Resources is set out in section 4.2 of this document.

## **2.4 Key investment risks**

Potential investors should be aware that there are risks associated with investing in the Company, including risks associated with the Company's business and risks associated with investing in the stock market generally. Some risks are beyond the control of the Company and its directors and management and may have a material impact on the Company's financial performance or position and hence on the value of an investment in the Company.

Before deciding whether to acquire Shares, potential investors should carefully consider the risk factors that could affect the future performance and position of the Company. Investors should also consult their legal, financial or other professional adviser before deciding whether to acquire Shares.

Some of the key risks of investing in the Company are described in section 6 of this document and include the following:

- commercialisation risks;
- MEARS' dependency on key personnel;
- intellectual property protection;
- financing risks; and
- general risks associated with conducting business and investing in listed securities.

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## 3 Details of the Transaction

### 3.1 Overview of the Transaction

#### (a) Introduction

The Company is a major shareholder of MEARS, currently holding 8% of the share capital in MEARS (with warrants that, if exercised, would bring its fully diluted interest up to approximately 17% before the proposed MEARS rights issue). The Company has also advanced approximately US\$1 million to MEARS pursuant to a bridge loan, the terms of which are summarised in section 7.15 of this document. MEARS will be undertaking a one for two rights issue of MEARS Shares at a price of US\$0.25 each. The Company is also an investor and partner in MEARS' solar photovoltaic activities as outlined below.

The Company proposes to change the scale of its activities by continuing to invest in MEARS by acquiring all of the MEARS Securities that it does not already own in a transaction structure known in the United States of America as a reverse triangular merger. The Directors and the directors of MEARS have negotiated a transaction to effect this change.

The key components to the Transaction are as follows:

- the Company will acquire all of the MEARS Securities that it does not already own for a consideration comprising 80,000,000 Shares (subject to adjustment);
- so that the Company can execute the commercialisation plan that is proposed by MEARS, the Company will seek to raise capital by placing Shares with sophisticated and professional investors to raise between \$7.5 and \$10 million (before transaction costs); and
- the Company will change its name to "MEARS Technologies Limited".

The Transaction will only proceed if all of the Resolutions (other than Resolution 14) are passed by Shareholders at the Meeting and the Placement is successfully completed. The passing of Resolution 14, which concerns changing the name of the Company to "MEARS Technologies Limited", is conditional on all other Resolutions being passed by Shareholders and will not affect whether the Transaction proceeds.

For the purposes of the Transaction, the Company and MEARS entered into the Memorandum of Agreement on 19 October 2012, the key terms of which are set out in Schedule 4 to this document. The Company, the Acquisition Company and MEARS have also entered into an Agreement and Plan of Merger under Delaware law, the terms of which are summarised in Schedule 5 to this document.

#### (b) Adjustments to the consideration for the Acquisition

The Company has agreed to acquire all of the MEARS Securities that it does not already own in a transaction structure known in the United States of America as a reverse triangular merger for a consideration comprising 80,000,000 Shares subject to adjustment ("**Merger Shares**").



The Company, the Acquisition Company and MEARS have agreed that the Merger Shares will be adjusted as follows:

- if between 4 December 2012 and Completion (“**Interim Period**”) any new Shares or equity securities convertible into Shares are issued by the Company, the Company will adjust up the absolute number of Merger Shares so that the ratio of 800,000,000 / 244,057,151 (“**Merger Ratio**”) is maintained. In that ratio 244,057,151 reflects the number of Shares on issue on 4 December 2012;
- any reduction in the number of Shares outstanding by way of a capital reduction or consolidation during the Interim Period will result in the Company adjusting down the absolute number of Merger Shares so that the Merger Ratio is maintained; and
- any fund raising completed directly by MEARS during the Interim Period will result in the Company adjusting up the absolute number of Merger Shares by an amount equal to the quotient obtained by dividing (i) the quotient obtained by dividing the dollar value of the funds raised denominated in US\$ divided by 1.02 by (ii) \$0.03.

MEARS will be undertaking a one for two rights issue of MEARS Shares at a price of US\$0.25 each, to raise up to a total of US\$1,541,585.50 (“**MEARS Rights Offer**”). The MEARS Rights Offer is not underwritten. On the assumption that the MEARS Rights Offer is fully subscribed prior to Completion, the number of Shares the Company will issue and allot to MEARS Securityholders as part of the Acquisition will increase to 85,037,861. The Company is not intending to participate in the MEARS Rights Offer.

(c) **Overview of MEARS**

MEARS is an engineered materials company incorporated in the State of Delaware in the United States of America which focuses on the development and commercialisation of products based on its proprietary electronic materials platform. MEARS seeks to generate new material designs and assemble atoms into structures so as to open the door to engineered materials with a spectrum of possible properties that can become the core of a new generation of electronic devices.

MEARS is currently pursuing opportunities in the silicon-based global semiconductor industry seeking to licence proprietary reengineered silicon products that reduce power consumption, improve performance and reduce manufacturing costs, thereby delivering benefits to manufacturers and electronic device end-users.

(d) **Placement**

Simultaneous with completion of the Acquisition, the Company is seeking to raise capital by placing up to 33,333,334 Shares with certain sophisticated and professional investors to raise between \$7.5 and \$10 million (before transaction costs, including brokerage and legal costs, which are estimated to be between \$560,000 and \$660,000 assuming a raising of \$7.5 million).

The Company has appointed Foster Stockbroking to represent the Company in relation to the Placement.

The funds raised from the Placement will be used for the purposes set out in the table below.

<b>Use of funds</b>	<b>Approximate amount based on a Placement of \$7.5 million (\$)</b>	<b>Approximate amount based on a Placement of \$10 million (\$)</b>
Fund the commercialisation plan that is proposed by MEARS (details of which are set out in section 4.1(d) of this document)	5,400,000	5,400,000
Pay the costs of the Transaction	625,000	750,000
Contribute to working capital expenses	1,475,000	3,850,000

(e) **Appointment of additional Directors**

At the date of this document, the Directors of the Company are Mr Sam Gazal, Mr Robert (Ken) Gaunt and Dr Robert Mears. The Merger Agreement requires the election of Mr John Gerber, Mr Erwin Trautmann, Mr Rolf Stadheim and Dr Rinn Cleavelin as directors of the Company with effect from Completion. These new directors will be casual appointments to the Board until they are re-elected by Shareholders at the next annual general meeting of the Company.

Details of the qualifications and experience of Mr John Gerber, Mr Erwin Trautmann, Mr Rolf Stadheim and Dr Rinn Cleavelin are set out in section 4.3 of this document.

(f) **Conditions to Completion**

Completion of the Transaction is subject to a number of conditions precedent as set out in the Merger Agreement, including:

- approval by Shareholders and MEARS Shareholders;
- the Placement being completed;
- holders of 100% (or such lesser percentage as may be agreed to by the Company) of the MEARS warrants having entered into a Warrant Exchange Agreement or been notified that their warrants will terminate immediately prior to completion of the Acquisition if not exercised by such time;
- official quotation of the Shares issued to MEARS Securityholders as consideration for the Acquisition on ASX;
- MEARS being reasonably satisfied that the Company has no material liabilities other than those disclosed in its financial statements; and
- any other regulatory approvals.

Either party may terminate the Memorandum of Agreement and the Merger Agreement if Completion does not occur on or before Friday 1 March 2013 (“**Deadline**”) by reason of the failure of any condition precedent (unless the failure results primarily from a breach by the party seeking to terminate of any representation, warranty or covenant contained in the Merger Agreement). The Deadline may be extended by mutual agreement of the Company, the Acquisition Company and MEARS.

(g) **Effect of the Transaction on capital structure**

The effect of the Transaction on the capital structure of the Company is set out in the table below.

Holder	Shares currently on issue	Shares on issue post Acquisition and consolidation		Shares on issue post Acquisition, Placement and consolidation	
		Shares	%	Shares	%
<b>Current Shareholders</b>	244,057,151	24,405,715	22.3	24,405,715	18.2
<b>MEARS Securityholders</b>	-	85,037,861	77.7	85,037,861	63.3
<b>Subscribers under the Placement</b>	-	-	-	25,000,000	18.6
<b>Total</b>	244,057,151	109,443,576	100	134,443,576	100

The above table:

- reflects the proposed consolidation of Shares on issue on a 1 for 10 basis. Further information regarding the proposed consolidation is set out in section 7.12 of this document; and
- assumes the maximum number of Shares are issued to MEARS Securityholders and includes columns (“Shares on issue post Acquisition and consolidation”) setting out the impact of the Acquisition prior to completion of the Placement of \$7.5 million. Should an amount of \$10 million be raised pursuant to the Placement, an additional 8,333,334 Shares would be issued.

Note that the Company currently has on issue 6,000,000 Options. These Options will remain on issue following Completion (unless exercised before that time). As a result of the proposed consolidation, the number of Options on issue will decrease to 600,000. The terms of these Options are summarised in section 7.18 of this document.

(h) **Effect of the Transaction on the financial position of the Company**

The Transaction will have the following effects on the financial position of the Company based on the assumptions contained in the Investigating Accountant’s Report:

- cash will increase from less than \$1 million to approximately \$8 million if an amount of \$7.5 million is raised pursuant to the Placement. This amount would increase by approximately \$2.3 million if an amount of \$10 million was raised pursuant to the Placement;

- share capital will increase by approximately \$32 million should an amount of \$7.5 million be raised pursuant to the Placement or \$34.375 million if an amount of \$10 million is raised pursuant to the Placement; and
- the Company will own 100% of MEARS rather than holding an investment in MEARS and providing a bridge loan to MEARS.

Further information regarding the effect of the Transaction on the financial position of the Company is set out in section 5 of this document.

(i) **Background and reasons for the Transaction**

The Company has already made a significant investment in MEARS, as set out below:

- on 8 March 2010 the Company announced to ASX that it had secured the worldwide rights to all intellectual property covering solar energy applications developed by MEARS, with MEARS entitled to 50% of the earnings from the commercialisation of the solar technology. As part of the acquisition of these rights, the Company made an investment of US\$1 million in MEARS by way of a convertible note and agreed to fund further research and development at a rate of US\$1 million per year until 2014;
- on 5 July 2010 the Company announced that the head of MEARS, Dr Robert Mears, had agreed to become a Director;
- on 23 July 2010 the Company announced to ASX a non-renounceable pro rata offer to raise approximately \$3.29 million for the purpose of strengthening the Company's balance sheet and funding future working capital requirements, and thereby improving its ability to continue investing in MEARS;
- on 31 January 2011 the Company announced that it had increased its convertible note investment in MEARS from US\$1 million to US\$1.45 million;
- on 29 July 2011 the Company announced to ASX that it had committed to invest an additional US\$250,000 for additional MEARS Shares and that the convertible note had been converted into equity in MEARS. As a result of these transactions, the Company held over 5% of the share capital in MEARS as well as warrants that had been issued by MEARS;
- in its Annual Report for the financial year ended 30 June 2011 the Company disclosed that it would increase its interest in MEARS to at least 7.4%;
- a presentation by Dr Mears at the Annual General Meeting of the Company held on 22 November 2011 disclosed that the Company held 8% of the share capital in MEARS (with warrants, if exercised, that could bring its fully diluted interest up to approximately 17% before the proposed MEARS rights issue);
- on 4 April 2012 the Company announced to ASX that it and MEARS had executed a non-binding Memorandum of Agreement which provides that the parties must use their best endeavours to negotiate the proposed acquisition by the Company of all of the issued share capital in MEARS which it does not already own. This announcement also indicated that

MEARS was in the process of raising US\$2 million to fund the company through its next stage of commercialisation of its chip technology, with the Company conditionally agreeing to commit US\$1 million to the fund raising. Following that investment, it was agreed that Mr Sam Gazal, the Chairman of the Company, would become a director of MEARS;

- on 15 May 2012 the Company announced to ASX that it had completed a placement of approximately 31.333 million Shares to sophisticated and professional investors for the purpose of raising \$940,000 before costs. The proceeds of the placement were to be applied to fund the Company's further investment in MEARS and provide the Company with additional working capital; and
- on 21 May 2012 the Company announced to ASX a share purchase plan seeking to raise a maximum of \$1,880,000, the proceeds of which were again to be applied to fund the Company's further investment in MEARS and to provide the Company with additional working capital.

The Transaction is a positive opportunity for the Company to continue this investment and can be considered an evolution of the Company's primary activity, being investing in MEARS.

The Company engaged the Independent Expert, Leadenhall Corporate Advisory, to assess whether the Acquisition is fair and reasonable to non-associated Shareholders. The Independent Expert has concluded that the Acquisition is fair and reasonable to non-associated Shareholders.

(j) **Options**

The Merger Agreement requires that the Company obtain all necessary consents, approvals or other authorisations and effected all of the registrations, filings and notices which are required such that the Company may issue to Dr Robert Mears and Mr Erwin Trautmann and other key management personnel of the Company and the Acquisition Company, without the need for any further actions other than approval by the Board, Options to purchase or acquire up to an amount of Shares equal to 10% of the fully-diluted Shares (such amount to be determined as of immediately following Completion but after giving effect to and including the issuance of the Shares to MEARS Securityholders and the Shares issued under the Placement).

(k) **Indicative timetable**

Subject to the satisfaction of all of the conditions precedent, the Company anticipates completion of the Transaction in accordance with the following timetable.

Dispatch of Notice of General Meeting, Explanatory Memorandum, Prospectus and Proxy Form	Friday, 11 January 2013
Last date and time by which Proxy Forms must be received	9.00am (Sydney time) on Monday, 18 February 2013

Date and time for eligibility to vote at the Meeting	7.00pm (Sydney time) on Monday, 18 February 2013
Meeting A trading halt to be requested from commencement of trade on the date of the Meeting	9.00am (Sydney time) on Wednesday, 20 February 2013
If Shareholders approve the Transaction all Shares will be suspended from trading on ASX until the Company re-complies with the requirements of Chapters 1 and 2 of the Listing Rules	Wednesday, 20 February 2013
Completion of the Transaction and issue of Shares under the Acquisition and Placement  No securities will be issued pursuant to the Transaction (including issues of securities to MEARS Securityholders, related parties of the Company or anyone that ASX considers that the securities are being issued to as part of the Transaction) until the Company has re-complied with Chapters 1 and 2 of the Listing Rules	Thursday, 7 March 2013

The above timetable is indicative only. The actual timetable will depend on factors outside the control of the Company, including the time at which the conditions precedent are satisfied. The Company has the right to vary the timetable set out above subject to the approval of such variation by MEARS and ASX where required. Any variation to the timetable set out above will be announced to ASX.

## 3.2 Reasons to vote for and against the Transaction

### (a) Reasons to vote for the Transaction

The key reasons to vote in favour of the Transaction are set out below:

- the Company will own 100% of MEARS and therefore be entitled to 100% of any future revenue from MEARS solar activities;
- the Company will own 100% of the MST and therefore should the MST be successfully commercialised, the Company will have greater exposure to any revenue generated from this technology;
- it will allow the Company's investors to invest in a company which controls 100% of the MST;
- it will provide the combined group with a greater ability to raise capital to accelerate the commercialisation of the MEARS technologies, by virtue of the Company owning 100% of each technology and being listed on ASX;
- the Independent Expert has concluded that the Acquisition is fair and reasonable to non-associated Shareholders; and

- the Company's cash position will be improved following the Placement.

(b) **Reasons to vote against the Transaction**

The key reasons to vote against the Transaction are set out below:

- current Shareholders will have their interests in the Company diluted since the Acquisition is being wholly funded by the issue of new Shares and the Placement will also involve the issue of new Shares;
- the operating expenses of the Company will increase as a direct result of owning 100% of the MST and the consequential expenditure required to further develop that technology; and
- the Company will become more exposed to the risks associated with MEARS' business – see section 6.2 of this document.



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## 4 Profile of MEARS, Trey Resources, New Directors and Corporate Governance

### 4.1 MEARS

#### (a) Overview

MEARS is an electronic materials company with technology applicable to the semiconductor industry. It holds over 100 granted patents over this technology which is intended to improve the performance of silicon based computer chips. Development of the technology commenced in 2001, and approximately \$65 million has been expended to date. MEARS has recently entered the commercialisation phase of the development of its MST.

The Company currently has the exclusive worldwide rights to MEARS Solar Technology and MEARS is entitled to 50% of the earnings from any commercialisation of this technology.

MEARS headquarters are currently in Newton, Massachusetts in the United States of America (near Boston) and is intending to relocate to Silicon Valley (California, United States of America) in 2013.

#### (b) History

In 2001 Dr Robert Mears, a pioneer in the fields of photonics, computational materials science and nanofabrication technologies founded MEARS in Boston, United States of America to pursue commercial applications for such materials.

While still a Ph.D. student, Dr Mears pioneered optical fibre rare-earth doped lasers and amplifiers, including the erbium-doped fibre amplifier (“**EDFA**”) (US Patent US4955025). The invention of the EDFA in the mid-1980s was a significant industry event because it was the key enabling technology behind the current growth of global communications bandwidth.

The reengineering of silica optical fibre fundamentally changed the optical properties of the material, thereby removing the bottleneck of having to convert an optical signal back into an electronic signal every few kilometres. The EDFA enabled the capacity (bandwidth) of optical communications systems to be increased by a factor of a thousand.

#### (c) MST

The MEARS proprietary electronic materials platform is based on a new class of patent protected engineered materials MEARS refers to as MEARS Silicon Technology™ (“**MST**”) materials. The objective of this technology is that MST™ materials can be designed and engineered to offer unique physical properties that make them potentially valuable in certain applications. These materials have engineered electrical or other characteristics fundamentally different to those subsisting naturally in a given material.

MST CMOS is an ultra-thin film of reengineered silicon that improves the conductive “channel” in a transistor. CMOS is Complementary Metal-Oxide-Semiconductor which is the technology used to construct integrated circuits, including microprocessors (computer chips) and microcontrollers. It is based on an engineered silicon lattice structure that has special electrical properties. These properties potentially



address a number of key device engineering challenges the industry currently faces as it tries to move towards smaller microprocessors.

MEARS believes MST CMOS can potentially be of substantial value to the semiconductor industry by delivering multiple benefits through a single technology that requires relatively minor modifications to the current industry standard CMOS manufacturing flow.

The MST CMOS delivers multiple, simultaneous benefits including:

(i) **Increased mobility**

Improved in-plane carrier transport could lead to increased drive current. These benefits are believed to be applicable to a variety of integrated circuit (“IC”) types including microprocessors, DRAM, SRAM, flash, and other memory ICs, and radio frequency (RF) and mixed-signal devices. Drive and effective current increases of 10%-20% and improved mobility at high and low fields have already been demonstrated during third party evaluations. The performance improvements can also be traded-off for reduced static power, providing up to a 60% static power reduction.

(ii) **Reduced leakage**

Gate leakage is when the charge carriers (electrons and holes) are pulled away from the centre of a semi-conductor junction. Gate leakage reduction by impeding unwanted current flow in the vertical direction has already been demonstrated during third party evaluations.

(iii) **Reduced variability**

Reduced variability is a greater consistency and reliability of CMOS product. The improved channel doping delivers additional and increasingly important benefits in the form of variability reduction.

(iv) **‘Silicon-on-Silicon’ - additive benefits**

MST CMOS is a ‘Silicon-on-Silicon’ solution that provides multiple benefits through a single and relatively simple modification to the standard CMOS manufacturing flow; one that can be used across multiple product categories and generations. MEARS believes that quick and widespread MST CMOS adoption may be possible once it is accepted as a proven solution, even more so since it may be combined with other scaling and enhancement technologies already in use to add to and extend their benefits.

(v) **High benefit / cost ratio**

MST CMOS lends itself to further enhancement and customization, as the layer design can be optimized for specific applications based on performance priorities and cost targets. With a low fabrication process flow cost for the single film insertion, MST CMOS potentially delivers a high benefit to cost ratio across multiple products.

(vi) **Fab life extension**

Measured as a cost adder per wafer, MST CMOS provides a stronger value proposition than the leading current enhancement and scaling options. The MST CMOS technology offers a cost effective alternative to device manufacturers who are looking to extend the life of their current fabrication infrastructure.

(d) **MST commercialisation plan**

MEARS aims to become a leading materials semiconductor intellectual property (“IP”) supplier with its IP used in digital electronic products.

The MEARS business model involves the designing and licensing of IP rather than the manufacturing and selling of actual semiconductor materials or products. The evaluation of MEARS IP is already being conducted with some of the world’s leading semiconductor companies. MEARS intends that where commercial licensing agreements are signed, these parties would utilize MEARS material technology to create enhanced semiconductors, and pay MEARS a royalty on every chip or wafer produced. No commercial licencing agreements have yet been signed but the MEARS business plan seeks to target the signing of its first licencing agreements in 2013.

As MEARS target customers include the world’s largest semiconductor manufacturers, regular royalty payments would provide reliable cash flows. The aim is to develop a broad base of customers so that MEARS is not overly reliant on any one company or consumer product for its future revenue.

(e) **Solar technologies**

In March 2010 the Company secured the exclusive worldwide rights to the MST for all solar energy applications from MEARS.

The MST potentially addresses one of the major limiting factors for Photovoltaic (“PV”) solar cell technology and solar power generation, being the efficiency limits of silicon PV cells. A key efficiency parameter can potentially be lifted using MST and furthermore the amount of silicon required can potentially be reduced over time, potentially making PV cells both more efficient and less expensive.

The MST involves the production of altered or “nano-doped” layers of silicon that can be inserted into the manufacture of silicon solar PV wafers. The process lends itself to application in existing silicon wafer manufacturing processes.

During the 2012 financial year, the Company’s solar research program progressed with MEARS. The aim of the research is to develop more efficient silicon based cells utilising MST. A new design was developed and fabricated during the year to seek to overcome recombination issues encountered in the earlier version. Whilst recombination issues of electrons remain, elipsometry measurements indicate a significant increase in optical absorption using MST film. As a result, the Company has begun the next phase for this technology and is approaching major international solar groups to collaborate in its future development and commercialisation.

(f) **Patents**

MEARS has an extensive IP portfolio which has been established to protect the technology it has developed.

MEARS IP portfolio includes 111 granted patents of which 54 are United States of America patents, 21 are Taiwanese patents, 9 are Great Britain patents, 8 are Chinese patents, 7 are European Patent Office patents, 5 are Australian patents, 4 are Japanese patents and 3 are Canadian patents, and MEARS has further patents pending.

The core MEARS patents cover both the physical structure of the technology and also the process to manufacture the engineered silicon material.

(g) **Funding of business plan**

As noted above MEARS have expended approximately US\$65 million since 2001 in developing its technologies to the current state of development.

At present the current focus of MEARS is to achieve the commercialisation phase of the MST technology by entering into a licence agreement with a major technology company. While seeking to do so MEARS has been less focused on research and development expenditure and more focused on proving up the benefits of the technologies already developed as a basis for discussions and negotiation with potential licensees.

On the basis of the current activities being undertaken by MEARS current cash expenditures are in the range of \$400,000 to \$500,000 per month and are expected to continue at approximately that level until the first licence is negotiated.

Following the Transaction, the Company will have enough working capital to carry out its objectives.

On the basis of the current business plan the Directors of the Company are satisfied that the proceeds of the Placement of between approximately \$7.5 million and \$10 million will be adequate to meet the short and medium term requirements of the Company.

There can be no certainty that the business plan for the commercialisation of MEARS' technologies will proceed as currently anticipated or that the Company will not require further funding to develop that business plan to a point where it is financially self-sufficient.

## 4.2 **Trey Resources**

The Company is a unitholder in Trey Resources, which has oil and gas interests in the United States of America, predominately in Oklahoma. It has some existing wells producing modest amounts of oil and gas.

In the September 2012 quarter, Trey Resources acquired additional oil and gas assets in Texas which included a number of wells producing small amounts of oil and gas. This acquisition by Trey Resources was funded using a combination of cash and the issue of additional units in Trey Resources. The Company's unit holding remains the same with its current percentage holding being approximately 17% of the now expanded Trey Resources.

Trey Resources has secured a US\$35 million debt facility to enable it to fund drilling into the lease areas it owns.

### 4.3 New directors

Details of the qualifications and experience of Mr John Gerber, Mr Erwin Trautmann, Mr Rolf Stadheim and Dr Rinn Cleavelin, being the persons who are expected to be appointed to the Board at Completion, are set out below.

(a) **Mr John Gerber | BSE Princeton University, MA Harvard University**

Mr Gerber is Managing Partner for Four Points where he leads the investment capital group, real estate special project activities, and venture capital investments for the companies and their partners. Over the last 10 years, Mr Gerber and his partners have closed more than 40 capital transactions with an aggregate value of more than \$1.8 billion. Mr Gerber is also a director and CEO of two early stage technology companies – Nephromics, LLC and Aggamin Pharmaceuticals, LLC – one an intellectual property licensing biotech company, working in partnership with Harvard University, Techne/R&D Systems and Merck, that has licensed its preeclampsia diagnostic technology to Siemens, Roche, J&J and Beckman Coulter (the first diagnostic test came out in Europe in 2011) and the other a therapy device company, working in partnership with Harvard University, that is developing the first therapy capable of treating preeclampsia, a currently untreatable pregnancy disease in a multi-billion dollar per annum market (the proof-of-concept is complete, and the first in-human trial is expected in 2013).

(b) **Mr Erwin Trautmann | BSCE University of Mannheim**

Mr Trautmann has over 30 years of experience in the semiconductor industry. He has held various executive positions at Fortune 500 companies and possesses extensive experience in project management, product development and business leadership. He has overseen the creation of new product lines, and implemented innovative technology including the training programs necessary for international deployment.

Previously, Mr Trautmann was a Senior Vice President at KLA-Tencor responsible for the worldwide Service Division with a \$400 million plus revenue base. The division generated service revenue with the globally installed OEM tool base, with applications engineering and with yield consulting services. KLA-Tencor is a supplier of process control and yields management solutions for the semiconductor and related nanoelectronics industries.

Mr Trautmann held various executive positions at Texas Instruments Inc. (“**Texas Instruments**”). As Program Manager, he was responsible for the technology development and fan-out of major design nodes. This technology deployment was mission critical for wafer-fabs in the United States of America, Europe, Japan, Taiwan and Singapore. At the peak, more than 200 design, product and technology engineers, deployed worldwide, reported into the program.

As Texas Instruments Vice President, Mr Trautmann held P&L responsibility for three major product lines with annual revenue exceeding \$1.6 billion. He also held the position as VP for Quality and Reliability. This worldwide responsibility included customer service, product qualifications and reliability engineering.

(c) **Mr Rolf Stadheim | BA University of Wisconsin, JD University of Chicago**

Mr Stadheim is a Founder and senior partner of Stadheim & Gear Ltd. (“**Stadheim & Gear**”), a leading patent and intellectual property licensing and enforcement practice, engaging primarily on a contingent fee basis with a focus on representing universities. Over the past two decades Stadheim & Gear successfully assisted dozens of universities in patent licensing and enforcement and in contract compliance.

Mr Stadheim has been a patent litigation attorney for over 40 years.

(d) **Dr Rinn Cleavelin | MS, PhD Texas Tech University**

Dr Cleavelin has more than 34 years of experience in the areas of semiconductor processing, development, and management. He held the position as Chief Operating Officer for International SEMATECH in Austin, Texas until returning to Texas Instruments in Silicon Technology Development in June of 2002. During his career, he has had the opportunity to lead several significant programs at Texas Instruments, which included the start-up of three wafer fabs and the leadership role in the process development of several DRAM, EPROM, and Flash EEPROM products. He has also had the leadership role in the development of several new process technologies and tools in the areas of ion implantation, thermal processing, surface preparation, defect detection, and metrology working with equipment suppliers worldwide. One of the surface preparation tools, the FSI Excalibur, won an R&D 100 award in 1988.

In 1997 Dr Cleavelin accepted a position at International SEMATECH as the Director of Front End Processing where he initiated several programs to further the scaling of planar CMOS technology. In 2000, he was named Chief Operating Officer of International SEMATECH responsible for all technical programs and the Advanced Technology Development Facility (ATDF). In July 2002 he returned to Texas Instruments in the Silicon Technology Development (“**SiTD**”) where he was the Manager for Devices and Manufacturing for External R&D. In this role he oversaw and coordinated SiTD’s research and development activities in the areas of Devices and Manufacturing at external organizations such as International SEMATECH, Interuniversity MicroElectronics Center, Semiconductor Research Corporation, LETI and several directly funded university activities.

After retiring from Texas Instruments in November 2007, Mr Cleavelin became a consultant. He has also served as member of SIA’s National Technology Roadmap for semiconductors materials and bulk processes technical working group. Dr Cleavelin holds 23 United States of America patents and has served as a member of SIA’s National Technology Roadmap for semiconductors materials and bulk processes technical working group.

#### **4.4 Corporate Governance**

The Company has adopted corporate governance policies and practices consistent with the Listing Rules and the principles of the ASX Corporate Governance Council (as applicable and appropriate for the Company).

The corporate governance policies and practices of the Company will not change following Completion.

(a) **The Board**

Should the Transaction proceed the Board will consist of two executive Directors (Dr Robert Mears and Mr Erwin Trautmann) and five non-executive Directors (Mr Sam Gazal, Mr Robert Gaunt, Mr John Gerber, Mr Rolf Stadheim and Dr Rinn Cleavelin).

The Board is responsible for the overall corporate governance of the Company including its strategic direction, establishing goals for management and monitoring the achievement of these goals. The primary responsibilities of the Board include responsibility for:

- oversight of the Company, including its control and accountability systems;
- appointing and removing the Chief Executive Officer (or equivalent);
- ratifying the appointment and, where appropriate, the removal of the Chief Financial Officer (or equivalent) and the company secretary;
- input into and final approval of management's development of corporate strategy and performance objectives;
- reviewing and ratifying systems of risk management and internal compliance and control, codes of conduct, and legal compliance;
- monitoring senior management's performance and implementation of strategy, and ensuring appropriate resources are available;
- approving and monitoring the progress of major capital expenditure, capital management, and acquisitions and divestitures; and
- approving and monitoring financial and other reporting.

Issues of substance affecting the Company are considered by the full Board with advice from external advisers, as required.

A Director must declare any conflict of interest, when it arises and must not participate in discussions or resolutions pertaining to any matter in which the Director has a material personal interest (unless the Corporations Act permits otherwise).

(b) **Committees**

To assist in the execution of its responsibilities, the Board has established an audit committee and will establish a remuneration and nomination committee following Completion.

Each committee will have written mandates and operating procedures, which are to be reviewed on a regular basis. The effectiveness of each committee will be constantly monitored.

(c) **Management**

Should the Transaction proceed the Board will establish a framework for the management of the combined group, including a system of internal control, a business risk management process and appropriate ethical standards.



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## 5 Financial Information

### 5.1 Introduction

This section contains a summary of the historical financial information and pro-forma historical financial information for MEARS and the Company (collectively the “**Financial Information**”).

The Financial Information is presented in an abbreviated form insofar as it does not include all of the disclosures required by Australian Accounting Standards applicable to annual financial reports prepared in accordance with the Corporations Act. The Financial Information has been prepared in accordance with the recognition and measurement principles of applicable Australian Accounting Standards. The significant accounting policies upon which the Financial Information is based is set out in section 5.3 of this document.

The Directors have considered ASIC Regulatory Guide 170, and having regard to the requirements of that Regulatory Guide, have concluded that the Company cannot include prospective financial information in this document.

### 5.2 Overview

The Financial Information comprises the following:

- **MEARS**
  - Statement of Net Assets as at 30 June 2012.
- **Company**
  - Pro-forma Consolidated Balance Sheet of the Company as at 30 June 2012;
  - Pro-forma Consolidated Statement of Comprehensive Income of the Company for the financial year ended 30 June 2012; and
  - Pro-forma Consolidated Statement of Changes of Equity for the financial year ended 30 June 2012.

The Financial Information should be read together with the Investigating Accountant’s Report (see section 5.6 below), the risk factors set out in section 6 of this document and the other information contained in this document.

There are no material differences between US Generally Accepted Accounting Principles and Australian International Reporting Standards relevant to the accounts of the Company and MEARS as at 30 June 2012.

### 5.3 Significant accounting policies

The significant accounting policies for the Company are contained in Schedule 6 to this document in the Investigating Accountant’s Report dated 11 January 2013 prepared by Stirling International.

MEARS expenses research and development costs to operations as incurred. Research and development costs consist of personnel costs for the design, development, testing and enhancement of its technology and certain other allocated costs such as depreciation and other facilities related expenditures.



Since its incorporation, MEARS has expended in approximately US\$65 million, including a significant amount spent on research and development, all of which has been expensed. MEARS owns over 100 patents. No intellectual property is carried as an asset in MEARS' balance sheet.

#### 5.4 Statement of Net Assets of MEARS

	<b>Actual 30 June 2012 US\$</b>
<b>Current assets</b>	
Cash and cash equivalents	1,064,659
Trade and other receivables	200,238
Total current assets	<u>1,264,897</u>
<b>Non-current assets</b>	
Property, plant and equipment	8,313
Total non-current assets	<u>8,313</u>
<b>Total assets</b>	<u>1,273,210</u>
<b>Current liabilities</b>	
Trade and other payables	260,065
Convertible notes payable	1,625,770
Total current liabilities	<u>1,885,835</u>
<b>Total liabilities</b>	<u>1,885,835</u>
<b>Deficiency of assets</b>	<u>(612,625)</u>
<b>Equity</b>	
Issued capital and warrants	64,718,759
Subscription receivable	(187,500)
Accumulated losses	(65,143,884)
<b>Shareholders' deficiency</b>	<u>(612,625)</u>

## 5.5 Pro-forma financial information

Below are extracts of pro-forma financial information from the Investigating Accountant's Report contained in Schedule 6 of this document.

### (a) Pro-forma Consolidated Balance Sheet of the Company as at 30 June 2012

	Actual 30 June 2012	Pro-forma assuming Placement of \$7.5 million 30 June 2012	Pro-forma assuming Placement of \$10 million 30 June 2012
	\$	\$	\$
<b>Current assets</b>			
Cash and cash equivalents	967,272	8,925,439	11,300,439
Trade and other receivables	1,030,897	195,392	195,392
Total current assets	<u>1,998,169</u>	<u>9,120,831</u>	<u>11,495,831</u>
<b>Non-current assets</b>			
Other financial assets	2,701,146	779,078	779,078
Property, plant and equipment	-	8,112	8,112
Goodwill on consolidation	-	28,031,226	28,031,226
Total non-current assets	<u>2,701,146</u>	<u>28,818,416</u>	<u>28,818,416</u>
<b>Total assets</b>	<u>4,699,315</u>	<u>37,939,247</u>	<u>40,314,247</u>
<b>Current liabilities</b>			
Trade and other payables	184,764	928,065	928,065
Total current liabilities	<u>184,764</u>	<u>928,065</u>	<u>928,065</u>
<b>Total liabilities</b>	<u>184,764</u>	<u>928,065</u>	<u>928,065</u>
<b>Net assets</b>	<u>4,514,551</u>	<u>37,011,182</u>	<u>39,386,182</u>
<b>Equity</b>			
Issued capital	47,549,154	80,045,785	82,420,785
Reserves	2,621,100	2,621,100	2,621,100
Accumulated losses	<u>(45,655,703)</u>	<u>(45,655,703)</u>	<u>(45,655,703)</u>
<b>Total equity</b>	<u>4,514,551</u>	<u>37,011,182</u>	<u>39,386,182</u>

(b) **Pro-forma Consolidated Statement of Comprehensive Income of the Company for the financial year ended 30 June 2012**

	Actual 30 June 2012	Pro-forma assuming Placement of \$7.5 million 30 June 2012	Pro-forma assuming Placement of \$10 million 30 June 2012
	\$	\$	\$
Loss for the period	(1,052,250)	(1,052,250)	(1,052,250)
Income tax benefit/(expense)	-	-	-
Loss for the period after tax	(1,052,250)	(1,052,250)	(1,052,250)
Other comprehensive income	-	-	-
Total comprehensive income attributable to members of the entity	(1,052,250)	(1,052,250)	(1,052,250)

(c) **Pro-forma Consolidated Statement of Changes of Equity for the financial year ended 30 June 2012**

	Issued capital \$	Option reserve \$	Accumulated losses \$	Total \$
<b>Actual:</b>				
<b>Balance at 1 July 2011</b>	<b>46,686,559</b>	<b>2,621,100</b>	<b>(44,603,453)</b>	<b>4,704,206</b>
Total comprehensive income attributable to members of the entity	-	-	(1,052,250)	(1,052,250)
Issue of Shares	862,595	-	-	862,595
<b>Actual balance at 30 June 2012</b>	<b>47,549,154</b>	<b>2,621,100</b>	<b>(45,655,703)</b>	<b>4,514,551</b>
<b>Pro-forma adjustments:</b>				
Issue of Shares	25,621,631	-	-	25,621,631
Placement of \$7.5 million	7,500,000	-	-	7,500,000
Costs associated with issue of abovementioned Shares	(625,000)	-	-	(625,000)
<b>Pro forma balance at 30 June 2012</b>	<b>80,045,785</b>	<b>2,621,100</b>	<b>(45,655,703)</b>	<b>37,011,182</b>
<b>Pro-forma adjustments:</b>				
Issue of Shares (Placement of additional \$2.5 million)	2,500,000	-	-	2,500,000
Costs associated with issue of additional Shares	(125,000)	-	-	(125,000)
<b>Pro forma balance at 30 June 2012</b>	<b>82,420,785</b>	<b>2,621,100</b>	<b>(45,655,703)</b>	<b>39,386,182</b>

## 5.6 Review opinion

Set out in Schedule 6 to this document is the Investigating Accountant's Report dated 11 January 2013 prepared by Stirling International ("**Investigating Accountant**"). The Investigating Accountant's Report includes:

- the historical Consolidated Statement of Comprehensive Income of the Company for the financial year ended 30 June 2012;
- the historical Consolidated Balance Sheet of the Company as at 30 June 2012;
- the pro-forma Consolidated Balance Sheet of the Company as at 30 June 2012; and
- notes to the above financial information.

Based on its review, which is not an audit, the Investigating Accountant has stated that nothing has come to its attention that causes it to believe that:

- the historical financial information set out in this section 5 is not presented fairly in accordance with the accounting policies adopted by the Company as described in Note 3 to the Financial Information; and
- the pro-forma Consolidated Balance Sheet of the Company set out in section 5.5 of this document has not been compiled on the basis of the pro-forma transactions as detailed in Note 2(b) to the Financial Information.

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## 6 Risk Factors

### 6.1 Introduction

The Company, MEARS and their respective businesses are subject to a number of risk factors. They could be specific to the Company, MEARS and their respective businesses or be of a general nature. Individually, or in combination, these risk factors might affect the current or future operating or financial performance or position of the Company and any decision relating to Shares (including whether or not to vote for, against or abstain from voting on the Resolutions, and/or whether to buy, sell or hold Shares). There can be no guarantee that the Company or MEARS will achieve their stated objectives or that any forward looking statements will be achieved.

This section describes some, but does not purport to envisage all, of the risks associated with approving or voting against the Resolutions and investing in Shares. The order in which the risks are described below does not reflect either their relative likelihood or potential impact. Prior to determining how to vote on the Resolutions and/or whether to invest in Shares, Shareholders and prospective investors should carefully consider the following risk factors, read this document in its entirety, and consult their legal, financial or other professional adviser.

### 6.2 Specific risks

#### (a) Lack of operating history

MEARS commenced operations in 2001 with the bulk of the last 12 years being spent undertaking research and development of technologies without those technologies being developed to the point of commercialisation. Therefore, MEARS lacks experience in selling the technologies that it has developed over that time.

As a result, since the majority of Company's operations are those connected with MEARS, the Company should be considered a speculative investment. There is no guarantee that MEARS will achieve its objectives and its prospects of success are uncertain.

#### (b) Commercialisation risks

There can be no guarantee that, after further research and development, MEARS efforts to develop its technologies will be commercially successful.

Market acceptance of MEARS' technologies is uncertain. These uncertainties can be caused by:

- difficulties in marketing any of MEARS' technologies, including those associated with proving the capabilities of the technologies;
- inability to develop a viable business plan based on the technologies;
- the unwillingness of customers to adopt new technical solutions (for example, because the customers may not value or be willing to bear the cost of incorporating MEARS technologies into their products) and in particular, the unwillingness of customers to design MEARS' technologies into the products that they design and sell;

- even if a customer designs MEARS' technologies into its products, there is no guarantee that that product will be commercially successful over time or at all, or that MEARS will receive or continue to receive any revenue from that customer;
- differences in the analysis of data obtained from pilot or demonstration trials;
- delays in marketing any of MEARS' technologies; and
- the discovery and development of new competitive technologies.

Accordingly, there can be no assurance that MEARS' technologies will be successful in the market place, or that MEARS will receive any profits from the sale of its technologies. As a result, MEARS financial performance may be adversely affected.

(c) **Competition from other technologies**

There are a number of companies with nano-scaling technology for use in the semiconductor industry such as Strain, SOI and HKMG. Whilst these companies' technologies are potential competitors, MEARS believes its technology is commercially competitive. In addition, MEARS believes its MST film can be used in conjunction with these companies' technologies to enhance CMOS performance.

While the business plan of MEARS anticipates competition in relation to its technologies, it does not have the data or experience to accurately assess the impact of that competition on its business plan and prospects.

(d) **Cyclical nature of the semiconductor industry**

The semiconductor industry is highly cyclical and is characterised by constant and rapid technological change, rapid product obsolescence, price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry experienced a significant downturn during the recent global recession. These downturns have been characterised by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. Any future downturns could harm MEARS business and financial performance.

(e) **Protection of technology and intellectual property rights**

MEARS success will depend, in part, on its ability to obtain adequate and valid patent protection, maintain trade secret protection (confidentiality) and operate without infringing on the proprietary rights of third parties or having third parties circumvent MEARS' rights. No guarantee can be given that such protection will be successfully and validly obtained by MEARS, including the grant of patents currently applied for. The granting of a patent does not guarantee that the patent concerned is valid, that the rights of others are not infringed or that competitors will not develop technology to avoid MEARS' patented technology.

The patent positions of technology companies can be highly uncertain and frequently involve complex legal and factual questions. Therefore, neither the breadth of claims allowed in technology and process patents nor their enforceability can be predicted with certainty. There can be no assurance that any patents which MEARS may own or control will afford

MEARS commercially significant protection of its technology. While MEARS believes it has taken appropriate steps to protect its technology, the law may not adequately protect MEARS' rights in all places where MEARS does business, or enable MEARS' rights to be enforced adequately. There can be no assurance that the measures taken by MEARS have been, or will be, adequate to protect MEARS' technology.

MEARS' foreign patent protection is generally not as comprehensive as its United States of America patent protection and may not protect its intellectual property in some countries where its technologies may be used in the future.

The enforceability of a patent is dependent on a number of factors which may vary between jurisdictions. These factors include the validity of the patent and the scope of protection it provides. The validity of a patent depends upon factors such as the novelty of the invention, the requirement in many jurisdictions that the invention not be obvious in light of the prior art (including any prior use or documentary disclosure of the invention), the utility of the invention and the extent to which the patent specification clearly discloses the best method of performing the invention. The legal interpretation of these requirements often varies between jurisdictions. The scope of rights provided by a patent can also differ between jurisdictions. There can be no assurance that others will not seek to imitate MEARS' technologies, and in doing so, attempt to design their technologies in such a way as to circumvent MEARS' rights.

Infringement of MEARS' technologies, such as unauthorised copying, could enable third parties to benefit from its technologies without paying MEARS for doing so, which could harm MEARS' business. Monitoring unauthorised use of technology is difficult and costly. Although MEARS is not aware of any authorised use of its technologies in the past, it is possible that unauthorised use of its technologies may have occurred or may occur without its knowledge.

Additionally, the ability and costs of the legal process to provide efficient and effective procedures for dealing with actual or suspected infringements can vary considerably between jurisdictions. There is no guarantee that MEARS will be able to enforce its rights in any particular jurisdiction or even if it can, that the Company will have the funds and resources to enable MEARS to do so. Any litigation, whether as a plaintiff or defendant, may divert the efforts of MEARS senior management and key personnel, which could harm MEARS' business, whether or not such litigation results in a determination favourable to MEARS. Litigation also puts MEARS patents at risk of being invalidated or interpreted narrowly and its patent applications at risk of not being granted. Additionally, any enforcement of its patents may provoke third parties to assert counterclaims against MEARS.

(f) **Third party assertions of infringement of technology or intellectual property rights**

The semiconductor industry is characterised by vigorous protection and pursuit of intellectual property rights and positions, which has resulted in protracted and expensive litigation for many companies. Certain potential customers of MEARS have received and, particularly as a subsidiary of a public company, MEARS expects that in the future it may receive, communications from others alleging MEARS infringement of their patents, trade secrets or other intellectual property rights. Lawsuits resulting from such allegations could subject MEARS to significant liability for damages and invalidate its proprietary rights, though this has

not occurred to date. Any potential intellectual property litigation also could force MEARS to do one or more of the following:

- lose the opportunity to license its technology to others or to collect royalty payments based upon successful protection and assertion of MEARS' intellectual property against others;
- incur significant legal expenses;
- expend significant resources to develop non-infringing technology;
- pay substantial damages to the party whose intellectual property rights MEARS may be found to be infringing;
- attempt to obtain a license to the relevant intellectual property from third parties, which may not be available on reasonable terms or at all; or
- cross-licence its technology to a competitor to resolve an infringement claim, which could weaken the ability of MEARS to compete with that competitor.

Any significant impairment of MEARS' intellectual property rights from any litigation MEARS faces could harm its business and its ability to compete.

**(g) Reliance on third parties for testing**

MEARS relies on third parties for testing of MEARS technologies. MEARS depends on these third parties to test MEARS technologies in a timely manner that meets its standards for quality and cost. MEARS does not have long-term agreements with these third parties. If one or more of these third parties terminates its relationship with MEARS, or if MEARS encounters any problems with the testing, MEARS ability to commercialise its technologies in accordance with its commercialisation plan could be adversely affected.

**(h) Reliance on third party software development tools**

MEARS relies on third party software development tools to assist it to develop its technologies. To commercialise its technologies in a timely manner, or at all, MEARS needs software development tools that are sophisticated enough or technologically advanced enough to complete its development of the technologies. Unavailability of software development tools may result in delay or impede the commercialisation of the MEARS technologies.

**(i) Impairment of goodwill on consolidation**

It is expected that an amount of approximately \$28 million will be recognised in the balance sheet of the Company as goodwill on consolidation following Completion. The future value of goodwill on consolidation must be reassessed at each balance date of the Company and, to the extent that the assessed fair value of the investment in MEARS is less than the goodwill on consolidation, any deficiency would need to be the subject of impairment changes that would need to be written off through the income statement of the Company. The future carrying value of goodwill on consolidation will therefore be dependent on the ability of MEARS to achieve the commercialisation of its technologies. For further details see the Investigating Accountant's Report.



(j) **The Company is a holding company with no significant business operations of its own**

The Company is a holding company with no significant business operations of its own. The Company's subsidiaries conduct all of its operations and own substantially all of its assets. Dividends and cash from its subsidiaries will be the Company's principal sources of cash to fund operations. Accordingly, the Company's ability to fund operations is dependent on the earnings and the distribution of funds from its subsidiaries.

The Company's subsidiaries are separate and distinct legal entities. Any right the Company has to receive any assets of or distributions from any of its subsidiaries upon the bankruptcy, dissolution, liquidation or reorganization of any such subsidiary, or to realise proceeds from the sale of their assets, will be junior to the claims of that subsidiary's creditors, including trade creditors and holders of debt issued by that subsidiary.

(k) **Growth management**

MEARS anticipated growth may place a significant strain on the Company's managerial, operational and financial resources. To manage MEARS potential growth, the Company must improve its technical, operational and financial systems and expand, train and manage its employee base. There can be no assurance that the Company will be able to effectively manage the expansion of MEARS operations, that the Company's systems, procedures or controls will be adequate to support MEARS operations or that the Company's management will be able to achieve the expansion necessary to fully exploit the market opportunity for MEARS' technologies. Any inability to manage growth effectively could have a material adverse effect on MEARS' business and results of operations, and the financial performance and position of the Company.

(l) **Performance of MEARS' technologies**

The performance of MEARS' technologies is critical to its reputation and to its ability to achieve market acceptance of these technologies. Any failure could have a material adverse effect on MEARS business (including its representation and customer relationships) and results of operations and the financial performance and position of the Company.

(m) **Dependency on key personnel**

MEARS performance is substantially dependent on the talent and experience of its senior management and key technical personnel (including Dr Robert Mears). While MEARS has initiatives to mitigate this risk, the loss of the services of any of its senior management or other key employees could delay the development and commercialization of MEARS technologies. Any delay could have a material adverse effect on the MEARS business and results of operations and on the financial performance and position of the Company.

If any senior management or key technical personnel were to leave unexpectedly, MEARS could face substantial difficulty in hiring and retaining qualified successors on a cost-effective basis or at all, and could experience a loss in productivity during the search for any successor and while any successor is integrated into the MEARS business.

MEARS future success also depends on its ability to identify, attract, hire, train, retain and motivate highly skilled managerial, operations, sales, marketing and customer service personnel. If MEARS fails to attract, integrate, and retain the necessary personnel, its ability to maintain and grow its business could suffer significantly.

(n) **Additional financing requirements**

The Company will require additional working capital for the MEARS business so that MEARS can develop its technologies. There can be no assurance that the Company will be able to raise such capital on favourable terms (or at all) or, if it is able to raise the capital, that it will be able to utilise that capital efficiently. If the Company is unable to obtain or utilise such additional capital, the Company may be required to reduce the scope of MEARS business activities or forego an investment opportunity, which could adversely affect MEARS business and the financial position and performance of the Company. Further, the costs associated with such capital raising and the cost of capital itself may adversely impact on the financial performance of the Company.

(o) **Residual oil and gas activities**

The Company has a 17% interest in the units of Trey Resources, being a company which holds a diverse interest in oil and gas assets in the United States of America. The value of the Company's investment in Trey Resources could be adversely affected by any of the following factors (amongst others):

- lack of exploration success in future drilling;
- an adverse movement in oil and gas prices;
- exchange rate fluctuations;
- increases in operating expenses or drilling costs of future wells; and
- any future equity raisings by Trey Resources if the Company elects not to participate in such raisings on a pro-rata basis.

### **6.3 General risks**

(a) **Economic factors**

The performance of the Company will depend significantly on global economic conditions, including movements in inflation and interest rates, currency fluctuations, supply and demand and industrial disruption.

Since 2008, the global economy has experienced significant financial turmoil and upheaval characterised by volatility and declines in prices of securities and commodities, diminished credit availability, declining consumer and business confidence, inability to access capital markets, proliferation of insolvencies and rising unemployment rates. It is not clear how long the uncertain economic conditions will continue, how quickly the economy and employment will recover, and how much adverse impact it will have on the global economy. Changes in these conditions may impact MEARS' business and profitability via the prices that can be obtained for MEARS technologies or the demand for MEARS technologies.

(b) **Share price**

Investors should recognise that the price of Shares may fall as well as rise. Many factors will affect the price of Shares including local and international stock markets, general economic factors, accounting standards and practices, domestic and international economic conditions, investor sentiment, changes in government fiscal, monetary and regulatory policies and the occurrence of other local, state, national and international events, such as armed conflicts.

(c) **Legislation**

Australian and international government legislation is subject to review and change from time to time. Any such change is likely to be beyond the control of the Company and could adversely affect the Company's operations, financial performance and financial position.

MEARS' operations are subject to laws, regulatory restrictions and certain governmental directives, recommendations and guidelines relating to, amongst other things, occupational safety, anti-bribery, the use and handling of materials, prevention of illness and injury, environmental protection and hazardous substance control. There can be no assurance that future legislation will not impose further government regulation with which MEARS will be required to comply.

(d) **Past performance**

Past results are not necessarily indicative of future performance. No assurance can be made that profits will be achieved or that losses will not be incurred by the Company or Shareholders.

(e) **Liability and insurance risk**

The Company's insurance arrangements may not be adequate to protect the Company against all liabilities for losses arising from claims made against the Company by third parties. The liabilities/losses may arise from, but are not limited to, claims relating to public liability, environmental losses, property damage, product liability, business interruption and other risks that may arise in the course of its operations. If this occurs, the Company's financial performance and position could be materially affected.

(f) **Litigation and dispute risk**

From time to time, the Company may be involved in litigation in relation to issues such as contract, personal injury, employee disputes, intellectual property, environmental and other claims which may arise in the ordinary course of business. Any claim made against the Company may adversely impact upon the operational and financial performance and position of the Company, and may also negatively impact on the price of Shares. In addition, should the Company decide to pursue claims against a third party, including any party with whom the Company has entered into agreements, this process may incur significant management and financial resources, and a positive outcome for the Company cannot be guaranteed. Further, even if the Company is successful in obtaining a judgement against a third party, the Company may not be able to recover any monies from that party. If this occurs, the Company's financial performance and/or position could be materially affected.

(g) **Doing business internationally**

There are certain risks inherent in doing business on an international level, such as unexpected changes in regulatory requirements (including taxation), tariffs, customs, duties and other trade barriers, longer payment cycles, problems in collecting accounts receivable, political instability, war and other political risks, fluctuations in currency exchange risk, foreign exchange controls which restrict or prohibit repatriation of funds, technology exports and import restrictions or prohibitions, seasonal reductions in business activity and potentially adverse tax consequences, any of which could adversely impact on the success of MEARS present and future proposed international operations.

Companies doing business in foreign countries may be required to obtain operating licences in new and uncertain regulatory environments. Such licences could prove to be difficult to obtain and retain, depending on government policies, customers, changes in political leadership and other factors.

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## 7 Additional Information

### 7.1 Resolution 1 – Approval of the acquisition of additional MEARS Securities – Change of activities

Resolution 1 relates to the proposed acquisition by the Company of all of the MEARS Securities that it does not already own in a transaction structure known in the United States of America as a reverse triangular merger and the resulting change to the scale of the Company's activities.

#### (a) Listing Rule 11.1

Listing Rule 11.1 provides that if an entity proposes to make a significant change, either directly or indirectly, to the nature or scale of its activities, it must provide full details to ASX as soon as practicable. It must do so in any event before making the change. The following rules apply in relation to the proposed change:

- the entity must give ASX information regarding the change and its effect on future potential earnings and any other information that ASX asks for;
- if ASX requires, the entity must get the approval of holders of its ordinary securities and must comply with any requirements of ASX in relation to the notice of meeting. The notice of meeting must include a voting exclusion statement; and
- if ASX requires, the entity must meet the requirements in Chapters 1 and 2 of the Listing Rules as if the entity were applying for admission to the official list of ASX.

Listing Rule 11.3 permits ASX to suspend the quotation of the entity's securities until the entity has satisfied the requirements of Listing Rule 11.1.

Completion of the Transaction will cause a significant change in the scale of the Company's activities.

On 22 October 2012 the Company:

- notified ASX that it would be seeking the approval of Shareholders for the Transaction (including under Listing Rule 11.1); and
- applied to ASX for a determination as to whether ASX will require the Company to meet the requirements of Chapters 1 and 2 of the Listing Rules as though the Company were applying for admission to the official list of ASX.

On 8 November 2012 ASX notified the Company that it would require the Company to meet the requirements of Chapters 1 and 2 of the Listing Rules as though the Company were applying for admission to the official list of ASX. To meet the requirements of Chapters 1 and 2 of the Listing Rules, ASX also required the Company to prepare a prospectus.

No securities will be issued pursuant to the Transaction (including issues of securities to MEARS Securityholders, related parties of the Company or anyone that ASX considers that the securities are being issued to as part of the Transaction) until the Company has re-complied with Chapters 1 and 2 of the Listing Rules.

Securities to be issued pursuant to the Notice may be held in escrow as ASX restricted securities for a maximum of 24 months after the Company is reinstated to official quotation, if required by the Listing Rules.

(b) **Consequences of the Acquisition not proceeding**

If the Acquisition does not proceed:

- the Company will continue with its current business; and
- the Board will continue to look for additional corporate and commercial opportunities (although no guarantee can be made that any suitable opportunity will be found).

(c) **Consequences of passing this Resolution**

If Resolution 1 is passed, the Company will have obtained, in compliance with Listing Rule 11.1.2, Shareholder approval to the change in the scale of its activities to the extent described in the Explanatory Memorandum.

(d) **Recommendation**

The Board, other than Dr Robert Mears and Mr Sam Gazal, recommends that Shareholders vote in favour of Resolution 1. Dr Mears and Mr Gazal have an interest in Resolution 1 and refrain from making any recommendation as to how Shareholders should vote on the Resolution.

The passing of Resolution 1 is conditional upon, and subject to, Resolutions 2 to 13 inclusive being passed by Shareholders.

## 7.2 **Resolution 2 – Issue of Shares to MEARS Securityholders**

(a) **Listing Rule 7.1**

The issue of Shares to MEARS Securityholders will exceed the 15% limit under Listing Rule 7.1. Accordingly, the Directors are seeking Shareholder approval under Resolution 2 for the issue of Shares to MEARS Securityholders.

Listing Rule 7.1, known as the “15% rule”, limits the capacity of a company to issue securities without the prior approval of its shareholders. In broad terms, Listing Rule 7.1 provides that a company may not, in a 12 month period, issue securities equal to more than 15% of the total number of ordinary securities on issue at the beginning of the 12 month period unless the issue is first approved by a majority of disinterested shareholders or the issue otherwise comes within one of the exceptions to Listing Rule 7.1.

Resolution 2 proposes to issue up to 85,037,866 Shares to MEARS Securityholders on the terms set out in Schedule 2 to this document in consideration for the transfer to the Company by MEARS Securityholders of the MEARS Securities that it does not already own.

In accordance with Listing Rule 7.3, the Company advises that:

- the maximum number of Shares the Company is to issue to MEARS Securityholders pursuant to Resolution 2 is 85,037,866;
- the Shares will be issued and allotted on Completion, which will occur not later than one month after the date of the Meeting;
- the Shares will not be issued for cash and will not raise any funds as the Shares are to be issued as consideration for the acquisition of the MEARS Securities from MEARS Securityholders;
- the deemed price of Shares issued to MEARS Securityholders is \$0.30 per Share;
- each MEARS Securityholder as at the Completion date will be issued Shares; and
- the terms of the Shares are summarised in Schedule 2 to this document.

(b) **Consequences of passing this Resolution**

If Resolution 2 is passed, the issue of Shares to MEARS Securityholders will not be counted as part of the 15% rule, and the Company will therefore retain the right to issue Shares under the 15% rule for any subsequent requirements that may arise.

(c) **Recommendation**

The Board, other than Dr Robert Mears and Mr Sam Gazal, recommends that Shareholders vote in favour of Resolution 2. Dr Mears and Mr Gazal have an interest in Resolution 2 and refrain from making any recommendation as to how Shareholders should vote on the Resolution.

The passing of Resolution 2 is conditional upon, and subject to, Resolution 1 and Resolutions 3 to 13 inclusive being passed by Shareholders.

### **7.3 Resolution 3 – Issue of Shares to Dr Robert Mears**

Since some of the Shares that will be issued to MEARS Securityholders (in exchange for MEARS Securities) will be issued to a director of the Company, being Dr Robert Mears (or his nominee), Shareholder approval is sought under Listing Rules 10.1 and 10.11 and rule 3.12(c) of the Constitution.

Resolution 3 proposes the issue and allotment of up to 2,004,944 Shares to Dr Mears (or his nominee) in exchange for MEARS Securities held by or on behalf of him.

(a) **Listing Rule 10.1**

Listing Rule 10.1 provides that a company must ensure that neither it, nor any of its subsidiaries, acquires a substantial asset from, or disposes of a substantial asset to, any of the following persons without the approval of shareholders:

- a related party;



- a subsidiary;
- a substantial shareholder, being a person who, together with the person's associates, hold a relevant interest, or had a relevant interest at any time in the 6 months before the relevant transaction, in at least 10% of the total votes attached to the voting securities in the company;
- an associate of a person referred to in the three bullet points above; or
- a person whose relationship to the company or a person referred to in the four bullet points above is such that, in ASX's opinion, the transaction should be approved by securityholders of the company.

An asset is substantial if its value, or the value of the consideration for it is, or in ASX's opinion is, 5% or more of the equity interests of the company as set out in the latest accounts given to ASX under the Listing Rules.

A "related party" includes a director, an entity controlled by a director and spouses, parents and children of a director. A related party also includes any person who came within any of these classifications in the preceding 6 months or in respect of which there are reasonable grounds to believe that that person will fall within such a classification in the future.

Dr Mears, as a Director, is a related party of the Company and the value of:

- the MEARS Securities being acquired from Dr Mears by the Company as part of the Transaction; and
- the Shares being issued to Dr Mears in exchange for those MEARS Securities,

exceeds 5% of the equity interests of the Company as set out in the latest accounts given to ASX under the Listing Rules. Therefore, approval in accordance with Listing Rule 10.1 is being sought under Resolution 3.

Listing Rule 10.10 requires that a report on the transaction be obtained from an independent expert stating whether the transaction is fair and reasonable to shareholders whose votes are not to be disregarded.

The Independent Expert's Report prepared by Leadenhall Corporate Advisory is set out in Schedule 7 to this document. The Independent Expert's Report was prepared in respect of Listing Rule 10.1 and the Independent Expert concluded that the Transaction is fair and reasonable to non-associated Shareholders.

A copy of the Independent Expert's Report is available on the Company's website ([www.k2energy.com.au](http://www.k2energy.com.au)) and if requested by a Shareholder, the Company will send to the Shareholder a copy of the report at no cost to the Shareholder.



(b) **Listing Rule 10.11**

Listing Rule 10.11 provides that unless one of the exceptions in Listing Rule 10.12 applies, an entity must not issue or agree to issue equity securities to any of the following persons without the approval of holders of ordinary securities:

- a related party; or
- a person whose relationship with the entity or a related party is, in ASX's opinion, such that approval should be obtained.

Dr Mears, as a Director, is a related party of the Company. Therefore, approval in accordance with Listing Rule 10.11 is being sought under Resolution 3.

In accordance with Listing Rule 10.13, the Company advises that:

- the person who will be issued Shares if Resolution 3 is passed is Dr Robert Mears, a Director (or his nominee);
- the maximum number of Shares the Company is to issue to Dr Mears (or his nominee) is 2,004,944;
- the Shares will be issued and allotted on Completion, which will occur no later than one month after the date of the Meeting;
- the Shares will not be issued for cash and will not raise any funds as the Shares are to be issued as consideration for the acquisition of the Mears Securities;
- the deemed price of Shares issued to Dr Mears (or his nominee) is \$0.30 per Share; and
- the terms of the Shares are summarised in Schedule 2 to this document.

Please note that the Shares the subject of Resolution 3 are not in addition to those Shares proposed to be issued and allotted under Resolution 2.

(c) **Rule 3.12(c) of the Constitution**

Rule 3.12(c) of the Constitution provides that a Director or any person who for the purpose of section 9 of the Corporations Act would be regarded as a person associated with that Director ("**Associated Person**") may only participate (directly or indirectly) in an issue by the Company of shares where the Director or an Associated Person receives the prior approval of shareholders by special resolution at a general meeting where the notice convening the meeting has advised:

- the number of shares to be allotted to the Director or an Associated Person; and
- the precise terms and conditions of the issue,

and the Director and Associated Person abstain from exercising any voting rights on the resolution.

As a special resolution, Resolution 3 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Dr Mears is a Director and therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 3.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company is to issue to Dr Mears (or his nominee) is 2,004,944; and
- the terms of the Shares are summarised in Schedule 2 to this document.

(d) **Consequences of passing this Resolution**

If Resolution 3 is passed, the Company will have obtained, in compliance with Listing Rules 10.1 and 10.11 and rule 3.12(c) of the Constitution, Shareholder approval for the issue of Shares to Dr Mears (or his nominee) as described in the Explanatory Memorandum.

(e) **Recommendation**

The Board, other than Dr Mears, recommends that Shareholders vote in favour of Resolution 3. Dr Mears has an interest in Resolution 3 and refrains from making any recommendation as to how Shareholders should vote on the Resolution.

The passing of Resolution 3 is conditional upon, and subject to, Resolutions 1 and 2 and Resolutions 4 to 13 inclusive being passed by Shareholders.

## **7.4 Resolution 4 – Issue of Shares to Mr Sam Gazal**

Since some of the Shares that will be issued to MEARS Securityholders (in exchange for MEARS Securities) will be issued to a director of the Company, being Mr Sam Gazal (or his nominee), Shareholder approval is sought under Listing Rule 10.11 and rule 3.12(c) of the Constitution.

Resolution 4 proposes the issue and allotment of up to 128,057 Shares to Mr Gazal (or his nominee) in exchange for the MEARS Securities held by or on behalf of him.

(a) **Listing Rule 10.11**

A description of Listing Rule 10.11 is set out in section 7.3(b) of this document.

Mr Gazal, as a Director, is a related party of the Company. Therefore, approval in accordance with Listing Rule 10.11 is being sought under Resolution 4.

In accordance with Listing Rule 10.13, the Company advises that:

- the person who will be issued Shares if Resolution 4 is passed is Mr Sam Gazal, a Director (or his nominee);
- the maximum number of Shares the Company is to issue to Dr Mears (or his nominee) is 128,057;

- the Shares will be issued and allotted on Completion, which will occur no later than one month after the date of the Meeting;
- the Shares will not be issued for cash and will not raise any funds as the Shares are to be issued as consideration for the acquisition of the Mears Securities;
- the deemed price of Shares issued to Mr Gazal (or his nominee) is \$0.30 per Share; and
- the terms of the Shares are summarised in Schedule 2 to this document.

Please note that the Shares the subject of Resolution 4 are not in addition to those Shares proposed to be issued and allotted under Resolution 2.

(b) **Rule 3.12(c) of the Constitution**

A description of rule 3.12(c) of the Constitution is set out in section 7.3(a) of this document.

As a special resolution, Resolution 4 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Mr Gazal is a Director and therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 4.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company is to issue to Mr Gazal (or his nominee) is 128,057; and
- the terms of the Shares are summarised in Schedule 2 to this document.

(c) **Consequences of passing this Resolution**

If Resolution 4 is passed, the Company will have obtained, in compliance with Listing Rule 10.11 and rule 3.12(c) of the Constitution, Shareholder approval for the issue of Shares to Mr Gazal (or his nominee) as described in the Explanatory Memorandum.

(d) **Recommendation**

The Board, other than Mr Gazal, recommends that Shareholders vote in favour of Resolution 4. Mr Gazal has an interest in Resolution 4 and refrains from making any recommendation as to how Shareholders should vote on the Resolution.

The passing of Resolution 4 is conditional upon, and subject to, Resolutions 1, 2 and 3 and Resolutions 5 to 13 inclusive being passed by Shareholders.

## **7.5 Resolution 5 – Issue of Shares to Mr John Gerber**

Since some of the Shares that will be issued to MEARS Securityholders (in exchange for MEARS Securities) will be issued to a proposed Director, being Mr John Gerber (or his nominee), Shareholder approval is sought under rule 3.12(c) of the Constitution.

Resolution 5 proposes the issue and allotment of up to 4,818,319 Shares to Mr Gerber (or his nominee) in exchange for MEARS Securities held by or on behalf of him.

### **(a) Rule 3.12(c) of the Constitution**

A description of rule 3.12(c) of the Constitution is set out in section 7.3(a) of this document.

As a special resolution, Resolution 5 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Mr Gerber is a proposed Director (see section 3.1(e) of this document) and therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 5.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company is to issue to Mr Gerber (or his nominee) is 4,818,319; and
- the terms of the Shares are summarised in Schedule 2 to this document.

### **(b) Consequences of passing this Resolution**

If Resolution 5 is passed, the Company will have obtained, in compliance with rule 3.12(c) of the Constitution, Shareholder approval for the issue of Shares to Mr Gerber (or his nominee) as described in the Explanatory Memorandum.

### **(c) Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 5.

The passing of Resolution 5 is conditional upon, and subject to, Resolutions 1 to 4 inclusive and Resolutions 6 to 13 inclusive being passed by Shareholders.

## **7.6 Resolution 6 – Issue of Shares to Mr Erwin Trautmann**

Since some of the Shares that will be issued to MEARS Securityholders (in exchange for MEARS Securities) will be issued to a proposed Director, being Mr Erwin Trautmann (or his nominee), Shareholder approval is sought under rule 3.12(c) of the Constitution.

Resolution 6 proposes the issue and allotment of up to 284,460 Shares to being Mr Trautmann (or his nominee) in exchange for the MEARS Securities held by or on behalf of him.

(a) **Rule 3.12(c) of the Constitution**

A description of rule 3.12(c) of the Constitution is set out in section 7.3(a) of this document.

As a special resolution, Resolution 6 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Mr Trautmann is a proposed Director (see section 3.1(e) of this document) and therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 6.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company is to issue to Mr Trautmann (or his nominee) is 284,460; and
- the terms of the Shares are summarised in Schedule 2 to this document.

(b) **Consequences of passing this Resolution**

If Resolution 6 is passed, the Company will have obtained, in compliance with rule 3.12(c) of the Constitution, Shareholder approval for the issue of Shares to Mr Trautmann (or his nominee) as described in the Explanatory Memorandum.

(c) **Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 6.

The passing of Resolution 6 is conditional upon, and subject to, Resolutions 1 to 5 inclusive and Resolutions 7 to 13 inclusive being passed by Shareholders.

## **7.7 Resolution 7 – Issue of Shares to Mr Rolf Stadheim**

Since some of the Shares that will be issued to MEARS Securityholders (in exchange for MEARS Securities) will be issued to a proposed Director, being Mr Rolf Stadheim (or his nominee), Shareholder approval is sought under rule 3.12(c) of the Constitution.

Resolution 7 proposes the issue and allotment of up to 1,475,310 Shares to Mr Stadheim (or his nominee) in exchange for the MEARS Securities held by or on behalf of him.

(a) **Rule 3.12(c) of the Constitution – Acquisition of securities by director – Mr Stadheim**

A description of rule 3.12(c) of the Constitution is set out in section 7.3(a) of this document.

As a special resolution, Resolution 7 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Mr Stadheim is a proposed Director (see section 3.1(e) of this document) and therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 7.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company is to issue to Mr Stadheim (or his nominee) is 1,475,310; and
- the terms of the Shares are summarised in Schedule 2 to this document.

**(b) Consequences of passing this Resolution**

If Resolution 7 is passed, the Company will have obtained, in compliance with rule 3.12(c) of the Constitution, Shareholder approval for the issue of Shares to Mr Stadheim (or his nominee) as described in the Explanatory Memorandum.

**(c) Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 7.

The passing of Resolution 7 is conditional upon, and subject to, Resolutions 1 to 6 inclusive and Resolutions 8 to 13 inclusive being passed by Shareholders.

## **7.8 Resolution 8 – Issue of Shares to Dr Rinn Cleavelin**

Since some of the Shares that will be issued to MEARS Securityholders (in exchange for MEARS Securities) will be issued to a proposed Director, being Dr Rinn Cleavelin (or his nominee), Shareholder approval is sought under rule 3.12(c) of the Constitution.

Resolution 8 proposes the issue and allotment of up to 109,706 Shares to Dr Cleavelin (or his nominee) in exchange for the MEARS Securities held by or on behalf of him.

**(a) Rule 3.12(c) of the Constitution – Acquisition of securities by director – Dr Cleavelin**

A description of rule 3.12(c) of the Constitution is set out in section 7.3(a) of this document.

As a special resolution, Resolution 8 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Dr Cleavelin is a proposed Director (see section 3.1(e) of this document) and therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 8.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company is to issue to Dr Cleavelin (or his nominee) is 109,706; and

- the terms of the Shares are summarised in Schedule 2 to this document.

(b) **Consequences of passing this Resolution**

If Resolution 8 is passed, the Company will have obtained, in compliance with rule 3.12(c) of the Constitution, Shareholder approval for the issue of Shares to Dr Cleavelin (or his nominee) as described in the Explanatory Memorandum.

(c) **Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 8.

The passing of Resolution 8 is conditional upon, and subject to, Resolutions 1 to 7 inclusive and Resolutions 9 to 13 inclusive being passed by Shareholders.

## 7.9 Resolution 9 – Grant of Options to Dr Robert Mears

Resolution 9 proposes the approval of the grant of up to 2,300,000 Options to Dr Mears (or his nominee). These Options will not be granted if Completion does not occur.

The primary purpose of the grant of the Options to Dr Mears is not to raise capital, but to form part of his remuneration package.

(a) **Listing Rule 10.11**

Listing Rule 10.11 provides that unless one of the exceptions in Listing Rule 10.12 applies, an entity must not issue or agree to issue equity securities (including options) to any of the following persons without the approval of holders of ordinary securities:

- a related party; or
- a person whose relationship with the entity or a related party is, in ASX's opinion, such that approval should be obtained.

A "related party" includes a director, an entity controlled by a director and spouses, parents and children of a director. A related party also includes any person who came within any of these classifications in the preceding six months or in respect of which there are reasonable grounds to believe that that person will fall within such a classification in the future.

Dr Mears, as a Director, is a related party of the Company. Therefore, approval in accordance with Listing Rule 10.11 is being sought under Resolution 9.

In accordance with Listing Rule 10.13, the Company advises that:

- the person who will be granted Options if Resolution 9 is passed is Dr Robert Mears, a Director;
- the maximum number of Options the Company is to grant to Dr Mears (or his nominee) is 2,300,000;
- the Options will be issued and allotted on Completion, which will occur no later than one month after the date of the Meeting;

- the Options will not be issued for cash and will not raise any funds as the Options are to be granted as part of Dr Mears' remuneration package;
- the exercise price of Options granted to Dr Mears (or his nominee) is \$0.30 per Option; and
- the terms of the Options are summarised in Schedule 3 to this document.

(b) **Listing Rule 7.1**

A description of Listing Rule 7.1 is set out in section 7.2(a) of this document.

If approval is given under Listing Rule 10.11, approval is not required under Listing Rule 7.1.

(c) **Rule 3.12(c) of the Constitution**

Rule 3.12(c) of the Constitution provides that a Director or any person who for the purpose of section 9 of the Corporations Act would be regarded as a person associated with that Director ("**Associated Person**") may only participate (directly or indirectly) in an issue by the Company of shares where the Director or an Associated Person receives the prior approval of shareholders by special resolution at a general meeting where the notice convening the meeting has advised:

- the number of shares to be allotted to the Director or an Associated Person; and
- the precise terms and conditions of the issue,

and the Director and Associated Person abstain from exercising any voting rights on the resolution.

As a special resolution, Resolution 9 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Dr Mears is a Director and the Options to be granted to him will entitle him to be issued Shares (subject to the terms of the Options). Therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 9.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company could issue to Dr Mears (or his nominee) if the Options granted to him are exercised is 2,300,000; and
- the terms of such Shares are summarised in Schedule 2 to this document.

(d) **Consequences of passing this Resolution**

If Resolution 9 is passed, the Company will have obtained, in compliance with Listing Rule 10.11 and rule 3.12(c) of the Constitution, Shareholder approval for:



- the grant of Options to Dr Mears (or his nominee) as described in the Explanatory Memorandum; and
- upon the exercise of the Options the issue of Shares to Dr Mears (or his nominee) as described in the Explanatory Memorandum.

(e) **Recommendation**

The Board, other than Dr Robert Mears, recommends that Shareholders vote in favour of Resolution 9. Dr Mears has an interest in Resolution 9 and refrains from making any recommendation as to how Shareholders should vote on the Resolution.

The passing of Resolution 9 is conditional upon, and subject to, Resolutions 1 and 8 inclusive and Resolutions 10 to 13 inclusive being passed by Shareholders.

## 7.10 Resolution 10 – Grant of Options to Mr Erwin Trautmann

Resolution 10 proposes approval of the grant of up to 2,500,000 Options to Mr Trautmann (or his nominee). These Options will not be granted if Completion does not occur.

The primary purpose of the grant of the Options to Mr Trautmann is not to raise capital, but to form part of his remuneration package.

(a) **Rule 3.12(c) of the Constitution**

Rule 3.12(c) of the Constitution provides that a Director or any person who for the purpose of section 9 of the Corporations Act would be regarded as a person associated with that Director (“**Associated Person**”) may only participate (directly or indirectly) in an issue by the Company of shares where the Director or an Associated Person receives the prior approval of shareholders by special resolution at a general meeting where the notice convening the meeting has advised:

- the number of shares to be allotted to the Director or an Associated Person; and
- the precise terms and conditions of the issue,

and the Director and Associated Person abstain from exercising any voting rights on the resolution.

As a special resolution, Resolution 10 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

Mr Trautmann is a proposed Director (see section 3.1(e) of this document) and the Options to be granted to him will entitle him to be issued Shares (subject to the terms of the Options). Therefore approval in accordance with rule 3.12(c) of the Constitution is being sought under Resolution 10.

In accordance with rule 3.12(c) of the Constitution, the Company advises that:

- the maximum number of Shares the Company could issue to Mr Trautmann (or his nominee) if the Options granted to him are exercised is 2,500,000; and

- the terms of such Shares are summarised in Schedule 2 to this document.

(b) **Consequences of passing this Resolution**

If Resolution 10 is passed, the Company will have obtained, in compliance with rule 3.12(c) of the Constitution, Shareholder approval for:

- the grant of Options to Mr Trautmann (or his nominee) as described in the Explanatory Memorandum; and
- upon the exercise of the Options the issue of Shares to Mr Trautmann (or his nominee) as described in the Explanatory Memorandum.

(c) **Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 10.

The passing of Resolution 10 is conditional upon, and subject to, Resolutions 1 to 9 inclusive and Resolutions 11, 12 and 13 being passed by Shareholders.

## 7.11 Resolution 11 – Issue of Shares under the Placement

The Company proposes to raise funds for the purposes set out in section 3.1(d) of this document. The Placement is intended to raise between \$7.5 and \$10 million (before transaction costs). Shareholder approval under Listing Rule 7.1 is required before the Company is able to issue and allot the Shares referred to in Resolution 11.

(a) **Listing Rule 7.1**

A description of Listing Rule 7.1 is set out in section 7.2(a) of this document.

In accordance with Listing Rule 7.3, the Company advises that:

- the maximum number of Shares the Company is to issue to under the Placement pursuant to Resolution 11 is 33,333,334;
- the Shares will be issued and allotted on Completion, which will occur no later than 3 months after the date of the Meeting;
- the Shares will be issued for a price to be determined by the Directors which shall be not less than \$0.30 per Share;
- the intended use of the funds raised is set out in section 3.1(d) of this document;
- the allottees will be subscribers to the Placement and the identity of the allottees is not known at this point in time; and
- the terms of the Shares are summarised in Schedule 2 to this document.

(b) **Consequences of passing this Resolution**

If Resolution 11 is passed, the issue of Shares under the Placement will not be counted as part of the 15% rule, and the Company will therefore retain the right to issue Shares under the 15% rule for any subsequent requirements that may arise.

(c) **Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 11.

The passing of Resolution 11 is conditional upon, and subject to, Resolutions 1 to 10 inclusive and Resolutions 12 and 13 being passed by Shareholders.

## 7.12 Resolution 12 – Consolidation of capital

Resolution 12 seeks Shareholder approval to consolidate the number of Shares and the number of Options on issue on a 1 for 10 basis (“**Consolidation**”).

The purpose of the Consolidation is to implement a more appropriate capital structure for the Company going forward, enable the Company to satisfy Chapters 1 and 2 of the Listing Rules and obtain re-quotations of the Shares on ASX.

(a) **Corporations Act**

Section 254H of the Corporations Act provides that a company may convert all or any of its shares into a larger or smaller number of shares by resolution passed at a general meeting.

(b) **Listing Rules**

The Company currently has on issue 6,000,000 Options which will remain on issue following Completion (unless exercised before that time).

Listing Rule 7.22.1 requires that the Options be consolidated in the same ratio as the ordinary capital and the exercise price must be amended in inverse proportion to that ratio. For that reason, the Company proposes to consolidate the number of Options on issue on a 1 for 10 basis and amend the exercise price in inverse proportion to that ratio.

(c) **Fractional entitlements**

Not all Shareholders will hold a number of Shares which can be evenly divided by 10. Similarly, not all Optionholders will hold that number of Options which can be evenly divided by 10. Where a fractional entitlement occurs, the Directors will round that fraction up to the nearest whole Share or Option.

(d) **Taxation**

It is not considered that any taxation implications will exist for Shareholders and Optionholders arising from the Consolidation. However, Shareholders and Optionholders are advised to seek their own tax advice on the effect of the Consolidation and neither the Company nor the Directors accept any responsibility for the individual taxation implications arising from the Consolidation.

(e) **Holding statements**

From the date of the Consolidation, all holding statements for the Shares and Options will cease to have any effect, except as evidence of entitlement to a certain number of Shares or Options on a post-Consolidation basis.

After the Consolidation becomes effective, the Company will arrange for new holding statements to be issued to Shareholders and Optionholders.

(f) **Effect on capital structure**

The effect which the Consolidation will have on the capital structure of the Company is set out in the table in section 3.1(g) of this document.

(g) **Indicative timetable**

An indicative timetable for the Consolidation is set out below.

The Company announces the Consolidation and sends out the Notice to Shareholders	Friday, 11 January 2013
The Company tells ASX that Shareholders have approved the Consolidation	Wednesday, 20 February 2013
Last day for trading in pre-consolidated Shares	Thursday, 21 February 2013
Trading in the consolidated Shares commence trading on a deferred statement basis	Friday, 22 February 2013
Last day for the Company to register transfers of Shares on a pre-consolidated basis	Thursday, 28 February 2013
The Company commences sending notices concerning the Consolidation to each Shareholder First day for the Company to register Shares on a post-consolidation basis and first day for the issue of holding statements to Shareholders	Friday, 1 March 2013
Deferred settlement ends Last day for the Company to send notices concerning the Consolidation to each Shareholder	Thursday, 7 March 2013

The above timetable is indicative only. The actual timetable will depend on factors outside the control of the Company. The Company has the right to vary the timetable set out above subject to the approval of such variation by MEARS and ASX where required. Any variation to the timetable set out above will be announced to ASX.

(h) **Consequences of passing this Resolution**

If Resolution 12 is passed:

- the number of Shares on issue will be consolidated on a 1 for 10 basis; and

- the number of Options on issue will be consolidated on a 1 for 10 basis and the exercise price will be amended in inverse proportion to that ratio.

As required by the Listing Rules, the Consolidation will take effect on the date which is the second Business Day after Resolution 12 is passed.

(i) **Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 12.

The passing of Resolution 12 is conditional upon, and subject to, Resolutions 1 to 11 inclusive and Resolution 13 being passed by Shareholders.

### 7.13 Resolution 13 – Modification of Constitution

To provide the Company with greater flexibility to have Directors from a range of backgrounds, including a greater number of Directors who are not residents of Australia, Resolution 13 seeks Shareholder approval to delete a rule in the Constitution which requires that a majority of the Directors for the time being in office be persons who are residents of Australia.

(a) **Rule to be repealed**

Rule 13.1(d) of the Constitution provides as follows:

*“A majority of the Directors for the time being in office must be persons who are residents of Australia. Any election or appointment of a Director or Directors (including any election or appointment by a single resolution or a single act of appointment of two or more Directors) which would have the effect of creating amongst the Directors for the time being a majority who are not persons who are residents of Australia shall be void.”*

(b) **Corporations Act**

Under section 136(2) of the Corporations Act, a Company must obtain member approval by a special resolution to modify its constitution.

Under section 201A(2), a public company (such as the Company) must have at least two directors that ordinarily reside in Australia.

(c) **Consequences of passing this Resolution**

If Resolution 13 is passed, the Company will be able to have a Board that consists of only two directors that ordinarily reside in Australia.

(d) **Recommendation**

The Board recommends that Shareholders vote in favour of Resolution 13.

The passing of Resolution 13 is conditional upon, and subject to, Resolutions 1 to 12 inclusive being passed by Shareholders.

## 7.14 Resolution 14 – Change of name

For the purpose of developing and commercializing MEARS' technologies following Completion, the Company proposes to change its name from "K2 Energy Limited" to "MEARS Technologies Limited".

### (a) Corporations Act

Under section 157(1) of the Corporations Act, a Company must obtain member approval by a special resolution to adopt a new name. As a special resolution, Resolution 14 must be passed by at least 75% of the votes cast by Shareholders entitled to vote on this resolution at the Meeting.

The name of the Company is included in the Constitution. Under section 136(2) of the Corporations Act, a Company must obtain member approval by a special resolution to modify its constitution.

The name change is subject to and will take effect when ASIC effects the change and alters the Company's registration details.

Accordingly, Resolution 14 seeks member approval to change the Company name and to modify the Constitution to reflect that name.

### (b) Consequences of passing this Resolution

If Resolution 14 is passed, the Company will change its name from "K2 Energy Limited" to "MEARS Technologies Limited" and modify the Constitution accordingly.

### (c) Recommendation

The Board recommends that Shareholders vote in favour of Resolution 14.

The passing of Resolution 14 is conditional upon, and subject to, Resolutions 1 to 13 inclusive being passed by Shareholders.

## 7.15 Bridge loan made to MEARS by the Company

Since March 2012 the Company has advanced approximately US\$1 million to MEARS pursuant to a bridge loan. The terms of the bridge loan are summarised below.

<b>Interest rate</b>	Year 1: 18% per annum (accruing) Years 2 to 4: 8% per annum (accruing and compounding), unless MEARS is in default, in which case the Year 1 interest rate applies
<b>Term</b>	One year
<b>Extension options</b>	The Company has the option in its sole discretion to extend the Term for up to three one-year extensions. The Company must notify MEARS of such extension(s) no less than 90 days prior to the end of the Term or its extension.
<b>Grant of warrants</b>	For every US\$2.25 of the bridge loan principal, the Company shall receive a 10 year warrant to purchase two MEARS Shares at a price of US\$2.25 per MEARS Share.

<b>Prepayment</b>	The bridge loan may be paid-off or prepaid at any time without penalty (principal amount plus interest) provided there is no “Event of Default”.
<b>Event of Default</b>	<p>Event of Default means:</p> <ul style="list-style-type: none"> <li>• default in the payment or performance of any obligation under the terms of the bridge loan, including failure to pay in full and when due any sum due under the terms of the bridge loan (within 10 days of the date such payment or obligation is due);</li> <li>• the liquidation, termination or dissolution of MEARS or it ceasing to carry on activity, its present business or the appointment of a receiver for its property;</li> <li>• the adjudication of bankruptcy or the insolvency of, or the making of an assignment or trust mortgage for the benefit of creditors by MEARS;</li> <li>• the institution of bankruptcy, reorganisation, arrangement, liquidation, receivership, moratorium or similar proceedings by or against MEARS and, if instated against MEARS, its consent thereto of the pendency thereof for 60 days;</li> <li>• admission by MEARS of the inability to pay its debts as they mature; or</li> <li>• the failure by MEARS to perform its obligations under the “Restrictive Covenant” described below.</li> </ul> <p>If an Event of Default occurs the principal and all accrued interest shall become due and payable immediately.</p>
<b>Restrictive Covenant</b>	<p>Until holder(s) representing 100% of any unpaid balance of the bridge loan are repaid in full or, alternatively, MEARS has received the prior written approval of such holder(s), MEARS shall not enter into any transaction to:</p> <ul style="list-style-type: none"> <li>• sell, assign, transfer, pledge or hypothecate any of its property or assets outside the ordinary course or activities of its business;</li> <li>• incur any debt (other than normal trade debt incurred in the conduct of normal business operations) that is senior to or on par with the bridge loan or that is secured by any asset of MEARS; or</li> <li>• change the control of MEARS such that all or substantially all of the individuals and entities who were beneficial owners of the capital stock of MEARS immediately prior to such transaction beneficially own, directly or indirectly, less than 50% of the outstanding securities (on an as-converted basis) entitled to vote generally in the election of directors of the resulting, surviving or acquiring corporation in such transaction.</li> </ul>
<b>Change of control</b>	<p>The principal and all accrued interest shall automatically become due and payable upon the closing of a change in control of MEARS.</p> <p>Change of control means:</p> <ul style="list-style-type: none"> <li>• a transaction in which all or substantially all of the individuals and entities who were beneficial owners of the</li> </ul>

	<p>capital stock of MEARS immediately prior to such transaction beneficially own, directly or indirectly, less than 50% of the outstanding securities (on an as-converted to common stock basis) entitled to vote generally in the election of directors of the resulting, surviving or acquiring corporation in such transaction; or</p> <ul style="list-style-type: none"> <li>• a sale of all or substantially all of the assets of property of MEARS.</li> </ul>
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## 7.16 Continuous disclosure obligations

The Company is a “listed disclosing entity” for the purposes of the Corporations Act. As such, it is subject to regular reporting and disclosure obligations which require it to disclose to ASX any information of which it is, or becomes, aware concerning the Company and which a reasonable person would expect to have a material effect on the price or the value of the Company’s securities.

As a disclosing entity under the Corporations Act, the Company states that:

- it is subject to regular reporting and disclosure obligations;
- copies of documents lodged with ASIC in relation to the Company may be obtained from, or inspected at, an ASIC office; and
- it will provide a copy of each of the following documents, free of charge, to any person on request:
  - the annual financial report of the Company for the financial year ended 30 June 2012;
  - any half-year financial report of the Company lodged with ASIC after the lodgement of that annual financial report and before the lodgement of a copy of this document with ASIC; and
  - all continuous disclosure notices given by the Company after the lodgement of that annual financial report and before the lodgement of a copy of this document with ASIC.

If persons require further information in relation to the Company, they are recommended to take advantage of the opportunity to inspect or obtain copies of the documents referred to above.

The following announcements have been lodged with ASX in respect of the Company since the lodgement of the annual financial report for the year ended 30 June 2012:

Date	Announcement
22 October 2012	MEARS Technologies Inc. Memorandum of Agreement
24 October 2012	Notice of Annual General Meeting
24 October 2012	Proxy Form Annual General Meeting
30 October 2012	Quarterly Cashflow Report
30 October 2012	Quarterly Cashflow Report



28 November 2012	Results of Meeting
5 December 2012	MEARS Technologies Agreement and Plan of Merger signed

## 7.17 Interests of Directors and other persons named in this document

Other than as set out in section 7.18 of this document or elsewhere in this document, no:

- Director or proposed Director;
- person named in this document as performing a function in a professional, advisory or other capacity in connection with the preparation or distribution of this document;
- promoter of the Company; or
- underwriter or financial services licensee named in this document as an underwriter or financial services licensee involved in Shares,

holds, or has held within two years before the date of this document, any interest in Shares or in the formation or promotion of, or in any property acquired or proposed to be acquired by, the Company in connection with its formation or promotion or Shares.

Other than as set out in sections 7.18 and 7.19 of this document or elsewhere in the document, no amounts have been paid or agreed to be paid and no benefits have been given or agreed to be given:

- to a Director, or proposed Director, to induce them to become, or to qualify as, a director of the Company; or
- for services provided in connection with the formation or promotion of the Company or Shares by any Director or proposed Director, any person named in this document as performing a function in a professional, advisory or other capacity in connection with the preparation or distribution of this document, any promoter of the Company, or any underwriter or financial services licensee named in this document as an underwriter or financial services licensee involved in Shares.

## 7.18 Details of Directors' interests

Directors' interests in Shares and Options as at the date of this document are:

Director	Shares*		Options*	
	Direct	Indirect	Direct	Indirect
Mr Sam Gazal	-	8,100,000	-	4,000,000
Mr Ken Gaunt	-	10,499,260	-	2,000,000
Dr Robert Mears	-	-	-	-

\* The number of Shares and Options contained in the Directors' interest table above reflect Share and Option numbers pre-consolidation.

In summary, the terms of the Options held indirectly by Mr Gazal and Mr Gaunt are as follows:

- each Option entitles the holder to one Share, subject to the terms and conditions of the Option;
- the exercise price of each Option is \$0.20;
- the Options must be exercised by 31 December 2014;
- if at any time prior to the exercise of any of the Options, there is a reconstruction (including a consolidation, subdivision, reduction or return) of the issued capital of the Company, the outstanding Options will be reorganised in the manner required by the Listing Rules;
- if the Company makes a bonus issue of securities, each outstanding Option confers on each option holder the right to receive on exercise of those outstanding Options an allotment of additional securities, which the Optionholder would have received if it had participated in that bonus issue; and
- the Options are not to be quoted on ASX.

In addition, as part of the Acquisition, Dr Mears and Mr Gazal (or their nominees) will acquire a maximum of 2,004,944 and 128,057 Shares respectively as consideration for MEARS Securities held by or on behalf of them. It is also proposed that Dr Mears (or his nominee) will be granted up to 2,300,000 Options (the terms of which are set out in Schedule 3 to this document). The primary purpose of the grant of the Options to Dr Mears is not to raise capital, but to form part of his remuneration package.

Over the last two years, the total aggregate of the remuneration paid or payable to Directors was as follows:

Director	Since 30 June 2012 (\$)	12 months ended 30 June 2012 (\$)	12 months ended 30 June 2011 (\$)
Mr Sam Gazal	12,490	59,950	140,464*
Mr Ken Gaunt	7,948	38,150	77,611**
Dr Robert Mears	-	35,000*	35,591***

\* Includes share option expense of \$88,000

\*\* Includes share option expense of \$44,000

\*\*\* Amount paid to MEARS

## 7.19 Details of advisers interests

Foster Stockbroking has acted at Sole Lead Manager and Bookrunner to the Placement. The Company has agreed to pay Foster Stockbroking as follows:

- a monthly retainer of \$7,500 for a total period of three months;
- a management fee of 1% of the gross amount raised through the Placement;
- a distribution fee of 4% of the gross amount raised through the Placement; and

- two million Options to be issued at the offer price of the Placement with a three-year expiry. The Options will only be issued at Completion.

Stirling International has acted as an Investigating Accountant and has prepared the Investigating Accountant's Report set out in Schedule 6 to this document. The Company has paid, or agreed to pay, approximately \$5,500 for preparing the Investigating Accountant's Report.

Leadenhall Corporate Advisory has acted as an Independent Expert and has prepared the Independent Expert's Report set out in Schedule 7 to this document. The Company has paid, or agreed to pay, approximately \$33,000 (including GST) for preparing the Independent Expert's Report.

## 7.20 Consents and liability of persons named in this document

Each of the parties referred to as consenting parties who are named below:

- has given, and has not before the lodgement of this document with ASIC withdrawn, its written consent to being named in this document in the form and context in which it is named;
- has not made any statement that is included in this document or on which a statement made in this document is based other than as specified the last two bullet points below;
- to the maximum extent permitted by law, expressly disclaims and takes no responsibility for any statements in or omissions from this document, other than the reference to its name and statements included in this document with the consent of those persons specified in the last two bullet points below;
- in the case of Stirling International has given, and has not before the lodgement of this document with ASIC withdrawn, its consent to the inclusion of Investigating Accountants' Report dated 11 January 2013 in Schedule 6 to this document and references to that Investigating Accountants' Report in the form and context in which they are included; and
- in the case of Leadenhall Corporate Advisory has given, and has not before the lodgement of this document with ASIC withdrawn, its consent to the inclusion of Independent Expert's Report dated 11 January 2013 in Schedule 7 to this document and references to that Independent Expert's Report in the form and context in which they are included.

Role	Consenting parties
Sole Lead Manager and Bookrunner	Foster Stockbroking
Investigating Accountant	Stirling International
Independent Expert	Leadenhall Corporate Advisory

None of the persons referred to above has caused or authorised the issue of this document. Accordingly, none of the persons referred to above makes any express or implied representation regarding, and has any responsibility for, any other statements or material in, or omissions from, this document. This applies to the maximum extent permitted by law and does not apply to any matter to the extent to which consent is given above.

## **7.21 Consent to lodgement**

Each Director and Mr John Gerber, Mr Erwin Trautmann, Dr Rinn Cleavelin and Mr Rolf Stadheim as proposed directors of the Company have consented to the lodgement of this document with ASIC.

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## 8 Glossary

The following defined terms are used throughout this document unless the contrary intention appears or the context requires otherwise.

**\$** means the lawful currency of Australia.

**Acquisition** means the acquisition by the Company of all of the MEARS Securities that it does not already own in a transaction structure known in the United States of America as a reverse triangular merger, as described in the Explanatory Memorandum.

**Acquisition Company** means K2 Merger Subsidiary, Inc.

**ASIC** means Australian Securities & Investments Commission.

**ASX** means ASX Limited (ACN 008 624 691) or Australian Securities Exchange, as appropriate.

**ASX Settlement Operating Rules** means the operating rules of the settlement facility provided by ASX Settlement Pty Limited (ACN 008 504 532).

**Business Day** means Monday to Friday inclusive, except New Year's Day, Good Friday, Easter Monday, Christmas Day, Boxing Day, and any other day that ASX declares is not a business day.

**Board** means the board of directors of the Company.

**CMOS** means complementary metal-oxide-semiconductor.

**Company** means K2 Energy Limited (ACN 106 609 143).

**Company Material Adverse Effect** means any material adverse change, event, circumstance or development with respect to, or material adverse effect on, the business, assets, liabilities, capitalisation, prospects, condition (financial or other), or results of operations of the Company.

**Company Register** means the share register of the Company and **Company Registry** has a corresponding meaning.

**Completion** means completion of the Transaction.

**Constitution** means the constitution of the Company.

**Corporations Act** means the Corporations Act 2001 (Cwlth).

**Director** means a director of the Company.

**Effective Time** means the time at which the Acquisition Company files the Certificate of Merger with the Secretary of State of the State of Delaware.

**Explanatory Memorandum** means the explanatory memorandum set out in this document.

**Financial Information** has the meaning given to it in section 5.1 of this document.

**Foster Stockbroking** means Foster Stockbroking Pty Limited (ACN 088 747 148).

**Independent Expert** means Leadenhall Corporate Advisory.

**Independent Expert's Report** means the report set out in Schedule 7 to this document.

**Investigating Accountant's Report** means the report set out in Schedule 6 to this document.

**Leadenhall Corporate Advisory** means Leadenhall Corporate Advisory Pty Ltd (ACN 114 534 619).

**Listing Rules** means the Listing Rules of ASX.

**MEARS** means MEARS Technologies, Inc.

**MEARS Material Adverse Effect** means any material adverse change, event, circumstance or development with respect to, or material adverse effect on, the business, assets, liabilities, capitalisation, prospects, condition (financial or other), or results of operations of MEARS.

**MEARS Securities** means:

- (a) MEARS Shares; and
- (b) warrants and options over MEARS Shares.

**MEARS Securityholders** means each person registered as a holder of MEARS Securities.

**MEARS Share** means a share of common stock of MEARS.

**MEARS Shareholder** means each person registered as a holder of MEARS Shares.

**Meeting** means the general meeting being convened by the Directors pursuant to the Notice.

**Memorandum of Agreement** means the Term Sheet Memorandum of Agreement dated 19 October 2012 between the Company and MEARS.

**Merger Agreement** means the Agreement and Plan of Merger dated 4 December 2012 between the Company, the Acquisition Company and MEARS.

**MST** means MEARS Silicon Technology™.

**Notice** means the notice of general meeting set out in Schedule 1 to this document.

**Option** means an option to acquire a Share.

**Optionholder** means each person registered as a holder of Options.

**Placement** means the placement of up to 33,333,334 Shares with certain sophisticated and professional investors, as described in the Explanatory Memorandum.

**Proxy Form** means the proxy form enclosed with this document.

**Resolution** means a resolution set out in the Notice.

**Share** means an ordinary share in the capital of the Company.

**Shareholder** means each person registered as a holder of Shares.

**Transaction** means the Acquisition and the Placement.

**Trey Resources** means Trey Resources 1, LLC.

**US\$** means the lawful currency of the United States of America.

# Schedule 1 – Notice of General Meeting

Notice is hereby given that a general meeting of Shareholders of the Company will be held at Level 21, 25 Bligh Street, Sydney at 9.00am (Sydney Time) on Wednesday, 20 February 2013.

## 1 Definitions

Terms used in this Notice are defined in section 8 of this document.

## 2 Business of meeting

### Resolution 1 – Approval of the acquisition of additional MEARS Securities – Change of activities

To consider and, if thought fit, pass the following resolution as an ordinary resolution:

*“That, subject to the passing of Resolutions 2 to 13 inclusive, for the purposes of Listing Rule 11.1.2 and for all other purposes, the Company is authorised to change the scale of its activities as described in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- any person who might obtain a benefit, except a benefit solely in the capacity of a holder of ordinary securities, if the Resolution is passed, and any associates of those persons; and
- because of the inter-conditionality of this Resolution with Resolutions 2 to 13 inclusive, any person whose votes cast on Resolutions 2 to 13 will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### Resolution 2 – Issue of Shares to MEARS Securityholders

To consider and, if thought fit, pass the following resolution as an ordinary resolution:

*“That, subject to the passing of Resolution 1 and Resolutions 3 to 13 inclusive, for the purposes of Listing Rule 7.1 and for all other purposes, the Company is authorised to issue and allot up to 85,037,866 Shares to MEARS Securityholders on the terms set out in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- any person who may participate in the proposed issue and any person who might obtain a benefit, except a benefit solely in the capacity of a holder of ordinary securities, if the Resolution is passed, and any associates of those persons; and



- because of the inter-conditionality of this Resolution with Resolution 1 and Resolutions 3 to 13 inclusive, any person whose votes cast on Resolution 1 and Resolutions 3 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 3 – Issue of Shares to Dr Robert Mears**

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

*“That, subject to the passing of Resolutions 1 and 2 and Resolutions 4 to 13 inclusive, for the purposes of Listing Rules 10.1 and 10.11 and rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to issue and allot to Dr Robert Mears (or his nominee) up to 2,004,944 Shares on the terms set out in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- Dr Robert Mears (or his nominee) and any of his associates; and
- because of the inter-conditionality of this Resolution with Resolutions 1 and 2 and Resolutions 4 to 13 inclusive, any person whose votes cast on Resolutions 1 and 2 and Resolutions 4 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 4 – Issue of Shares to Mr Sam Gazal**

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

*“That, subject to the passing of Resolutions 1, 2 and 3 and Resolutions 5 to 13 inclusive, for the purposes of Listing Rule 10.11 and rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to issue and allot to Mr Sam Gazal (or his nominee) up to 128,057 Shares on the terms set out in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- Mr Sam Gazal (or his nominee) and any of his associates; and
- because of the inter-conditionality of this Resolution with Resolutions 1, 2 and 3 and Resolutions 5 to 13 inclusive, any person whose votes cast on Resolutions 1, 2 and 3 and Resolutions 5 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 5 – Issue of Shares to Mr John Gerber**

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

*“That, subject to the passing of Resolutions 1 to 4 inclusive and Resolutions 6 to 13 inclusive, for the purposes of rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to issue and allot to Mr John Gerber (or his nominee) up to 4,818,319 Shares on the terms set out in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- Mr John Gerber (or his nominee) and any of his associates; and
- because of the inter-conditionality of this Resolution with Resolutions 1 to 4 inclusive and Resolutions 6 to 13 inclusive, any person whose votes cast on Resolutions 1 to 4 inclusive and Resolutions 6 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 6 – Issue of Shares to Mr Erwin Trautmann**

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

*“That, subject to the passing of Resolutions 1 to 5 inclusive and Resolutions 7 to 13 inclusive, for the purposes of rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to issue and allot to Mr Erwin Trautmann (or his nominee) up to 284,460 Shares on the terms set out in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- Mr Erwin Trautmann (or his nominee) and any of his associates; and
- because of the inter-conditionality of this Resolution with Resolutions 1 to 5 inclusive and Resolutions 7 to 13 inclusive, any person whose votes cast on Resolutions 1 to 5 inclusive and Resolutions 7 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 7 – Issue of Shares to Mr Rolf Stadheim**

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

*“That, subject to the passing of Resolutions 1 to 6 inclusive and Resolutions 8 to 13 inclusive, for the purposes of rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to issue and allot to Mr Rolf Stadheim (or his nominee) up to 1,475,310 Shares on the terms set out in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- Mr Rolf Stadheim (or his nominee) and any of his associates; and
- because of the inter-conditionality of this Resolution with Resolutions 1 to 6 inclusive and Resolutions 8 to 13 inclusive, any person whose votes cast on Resolutions 1 to 6 inclusive and Resolutions 8 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 8 – Issue of Shares to Dr Rinn Cleavelin**

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

*“That, subject to the passing of Resolutions 1 to 7 inclusive and Resolutions 9 to 13 inclusive, for the purposes of rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to issue and allot to Dr Rinn Cleavelin (or his nominee) up to 109,706 Shares on the terms set out in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

Dr Rinn Cleavelin (or his nominee) and any of his associates; and

- because of the inter-conditionality of this Resolution with Resolutions 1 to 7 inclusive and Resolutions 9 to 13 inclusive, any person whose votes cast on Resolutions 1 to 7 inclusive and Resolutions 9 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 9 – Grant of Options to Dr Robert Mears**

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

*“That, subject to the passing of Resolutions 1 to 8 inclusive and Resolutions 10 to 13 inclusive, for the purposes of Listing Rule 10.11 and rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to:*

- (a) grant to Dr Robert Mears (or his nominee) up to 2,300,000 Options on the terms set out in the Explanatory Memorandum; and*
- (b) upon the exercise of the Options, issue and allot to Dr Robert Mears (or his nominee) up to 2,300,000 Shares on the terms described in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- Dr Robert Mears (or his nominee) and any of his associates; and
- because of the inter-conditionality of this Resolution with Resolutions 1 to 8 inclusive and Resolutions 10 to 13 inclusive, any person whose votes cast on Resolutions 1 to 8 inclusive and Resolutions 10 to 13 inclusive will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 10 – Grant of Options to Mr Erwin Trautmann**

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

*“That, subject to the passing of Resolutions 1 to 9 inclusive and Resolutions 11, 12 and 13, for the purposes of rule 3.12(c) of the Constitution and for all other purposes, the Company is authorised to:*

- (a) *grant to Mr Erwin Trautmann (or his nominee) up to 2,500,000 Options on the terms set out in the Explanatory Memorandum; and*
- (b) *upon the exercise of the Options, issue and allot to Mr Erwin Trautmann (or his nominee) up to 2,500,000 Shares on the terms described in the Explanatory Memorandum.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- Mr Erwin Trautmann (or his nominee) and any of his associates; and
- because of the inter-conditionality of this Resolution with Resolutions 1 to 9 inclusive and Resolutions 11, 12 and 13, any person whose votes cast on Resolutions 1 to 9 inclusive and Resolutions 11, 12 and 13 will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

#### **Resolution 11 – Issue of Shares under the Placement**

To consider and, if thought fit, pass the following resolution as an ordinary resolution:

*“That, subject to the passing of Resolutions 1 to 10 inclusive and Resolutions 12 and 13, for the purposes of Listing Rule 7.1 and for all other purposes, the Company is authorised to issue and allot up to 33,333,334 Shares pursuant to the Placement at a price to be determined by the Directors, which shall be not less than \$0.30 per Share.”*

**Voting exclusion:** The Company will disregard any votes cast on this Resolution by:

- any person who may participate in the proposed issue and any person who might obtain a benefit, except a benefit solely in the capacity of a holder of ordinary securities, if the Resolution is passed, and any associates of those persons; and
- because of the inter-conditionality of this Resolution with Resolutions 1 to 10 inclusive and Resolutions 12 and 13, any person whose votes cast on Resolutions 1 to 10 inclusive and Resolutions 12 and 13 will be disregarded.

However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or

- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 12 – Consolidation of capital**

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

*“That, subject to the passing of Resolutions 1 to 11 inclusive and Resolution 13, for the purposes of section 254H of the Corporations Act and for all other purposes, approval is given for the issued capital of the Company to be consolidated on the basis that:*

- (a) every 10 Shares be consolidated into 1 Share; and
- (b) every 10 Options be consolidated into 1 Option, with the exercise price of the Options being amended in the inverse proportion to that ratio,

*and where this consolidation results in a fraction of a Share or Option being held by a Shareholder or Optionholder, the Directors be authorised to round that fraction up to the nearest whole Share or Option, with the consolidation taking effect on the date which is the second Business Day after this Resolution is passed.”*

**Voting exclusion:** Because of the inter-conditionality of this Resolution with Resolutions 1 to 11 inclusive and Resolution 13, the Company will disregard any votes cast on this Resolution by any person whose votes cast on Resolutions 1 to 11 inclusive and Resolution 13 will be disregarded. However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 13 – Amendment to Constitution**

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

*“That, subject to the passing of Resolutions 1 to 12 inclusive, for the purposes of sections 136(2) of the Corporations Act and for all other purposes, the Constitution be modified by repealing rule 13.1(d).”*

**Voting exclusion:** Because of the inter-conditionality of this Resolution with Resolutions 1 to 12 inclusive, the Company will disregard any votes cast on this Resolution by any person whose votes cast on Resolutions 1 to 12 inclusive will be disregarded. However, the Company need not disregard a vote if:

- it is cast by a person as proxy for a person who is entitled to vote, in accordance with the directions on the Proxy Form; or
- it is cast by the person chairing the meeting as proxy for a person who is entitled to vote, in accordance with a direction on the Proxy Form to vote as the proxy decides.

### **Resolution 14 – Change of name**

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

*“That, subject to the passing of Resolutions 1 to 13 inclusive, for the purposes of sections 136(2) and 157(1) of the Corporations Act and for all other purposes, the Company adopt “MEARS Technologies Limited” as the name of the Company and that the Constitution be modified accordingly.”*

### **3 Voting methods**

A Shareholder entitled to vote at the meeting may vote in either of two ways:

- by attending the meeting and voting either in person or by attorney, or in the case of corporate Shareholders, by corporate representative; or
- by appointing a proxy to attend and vote on their behalf, using the Proxy Form enclosed.

### **4 Voting in person**

Shareholders are asked to arrive at the venue 30 minutes prior to the time designated for the meeting to allow for registration for the meeting. A representative of a company attending the meeting must present satisfactory evidence of his or her appointment to attend on its behalf, unless previously lodged with the Company Registry.

### **5 Appointment of proxy or attorney**

- A Shareholder entitled to attend and vote may appoint a proxy to attend and vote for the Shareholder at the meeting and may, but need not, direct the proxy how to vote in relation to or on any Resolution.
- A Shareholder entitled to cast two or more votes is entitled to appoint not more than two proxies.
- A proxy can be an individual or a body corporate and need not be a Shareholder.
- The appointment of a proxy may specify the proportion or the number of votes that the proxy may exercise. Where more than one proxy is appointed, and if the appointment does not specify the proportion or number of the Shareholder’s votes each proxy may exercise, each proxy may exercise half of the votes.
- A Proxy Form must be signed by the Shareholder or the Shareholder’s attorney.
- Proxies given by corporations must be executed in accordance with the Corporations Act.
- To be effective, a Proxy Form (and the power of attorney, if any, under which it was signed or proof of the power of attorney to the satisfaction of the Board) must be:
  - sent by mail to the Company Registry (using the reply paid envelope included with this document), addressed to Boardroom Pty Limited, GPO Box 3993, Sydney NSW 2001, Australia;



- faxed to +61 2 9290 9655; or
- delivered by hand to Boardroom Pty Limited, Level 7, 207 Kent Street, Sydney NSW 2000, Australia,

so that they are received by no later than 9.00am (Sydney time) on Monday, 18 February 2013. A Proxy Form received after this time will be invalid.

- If you appoint an attorney to attend and vote at the meeting, a copy of the power of attorney or proof of the power of attorney to the satisfaction of the Board must be:
  - sent by mail to the Company Registry (using the reply paid envelope included with this document), addressed to Boardroom Pty Limited, GPO Box 3993, Sydney NSW 2001, Australia;
  - faxed to +61 2 9290 9655; or
  - delivered by hand to Share Registry - Boardroom Pty Limited, Level 7, 207 Kent Street, Sydney NSW 2000, Australia,

together with evidence of the due execution of the power of attorney as required by the Board, so that they are received by no later than 9.00am (Sydney time) on Monday, 18 February 2013.

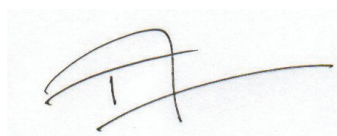
## **6 Shareholders entitled to vote**

For the purpose of the meeting, voting Shareholders will be taken to be those persons recorded in the Company's Register as holding Shares at 7.00pm (Sydney time) on Monday, 18 February 2013.

## **7 Further information**

This Notice should be read in conjunction with the Explanatory Memorandum.

By order of the Board



Terry Flitcroft  
Company Secretary  
K2 Energy Limited

Dated: 11 January 2013



# Schedule 2 – Terms of the Shares to be issued under the Acquisition and the Placement

Shares issued under the Acquisition and the Placement (“**New Shares**”) will be issued fully paid and will rank equally with existing Shares from the date of issue.

The rights and liabilities of the New Shares will be the same as those existing Shares and are as set out in the Constitution and, in certain circumstances, are regulated by the Corporations Act, Listing Rules, ASX Settlement Operating Rules and general law.

A summary of the significant terms attaching to New Shares is set out below. This summary is not exhaustive and is not a definitive statement of the terms of the New Shares. Such terms involve complex questions of law arising from the interaction of the Constitution, Corporations Act, ASX Listing Rules, ASX Settlement Operating Rules and general law.

## 1 Voting

Subject to the Constitution, at meetings of Shareholders:

- each Shareholder entitled to vote may vote in person, by proxy or attorney or, where the Shareholder is a body corporate, by proxy, attorney or representative;
- where two or more persons are registered as the holders of any Shares, anyone of the joint holders may vote either personally or by proxy, attorney or representative, in respect of the Shares as if that joint holder was solely entitled to the Shares. If more than one of the joint holders are present personally or by proxy, attorney or representative, the joint holder who is present whose name stands first in the Company Register in respect of the Shares is entitled alone to vote in respect of the Shares;
- on a show of hands, each Shareholder present has one vote;
- where a Shareholder has appointed two persons as proxies for that Shareholder, neither proxy may vote on a show of hands;
- if the person appointed as proxy has two or more appointments that specify different ways to vote on a resolution, the proxy must not vote on a show of hands; and
- on a poll, each Shareholder present has one vote for each fully paid Share held.

## 2 General meetings and notices

Each Shareholder is entitled to receive notice of, and, if they are entitled to vote at the meeting, attend and vote at, general meetings of the Company.

## 3 Dividends

The Board may from time to time determine that a dividend is payable to the Shareholders. The dividend is payable on all Shares pro rata to the total amount for the time being paid, but not credited as paid, in respect of the Shares as a proportion of the total of the amounts then paid and payable thereon, excluding amounts credited, and may be paid at a rate per annum in respect of a specified period.

The Board may declare one dividend on all shares or may declare at any one meeting of the Board two or more dividends so that each dividend is declared on any Shares to the exclusion of any other Shares but so that the amount payable out of the total of the amount of all dividends declared at the meeting on all Shares is subject as mentioned above in the aforesaid proportion.

The Board may from time to time pay to Shareholders on account of the next forthcoming dividend any interim dividend as in its judgment the position of the Company justifies.

No dividend is payable except out of the profits of the Company, and no dividend or other moneys payable on or in respect of a Share carries interest as against the Company.

#### **4 Winding Up**

If the Company is wound up, whether voluntarily or otherwise, the liquidator may divide among all or any of the contributories as the liquidator thinks fit in specie or in kind any part of the assets of the Company, and may vest any part of the assets of the Company in trustees upon any trusts for the benefit of all or any of the contributories as the liquidator thinks fit.

If thought expedient, any division may be otherwise than in accordance with the legal rights of the contributories and, in particular, any class may be given preferential or special rights or may be excluded altogether or in part, but in case any division otherwise than in accordance with the legal rights of the contributories is determined, any contributory who would be prejudiced by the division has a right to dissent and ancillary rights as if the determination were a special resolution passed pursuant to the Corporations Act relating to the sale or transfer of the Company's assets by a liquidator in a voluntary winding up.

#### **5 Transfer of Shares**

Subject to the Constitution, a Shareholder may transfer all or any Shares:

- in any manner required or permitted by the Listing Rules or ASX Settlement Operating Rules applying in relation to any computerised or electronic system established or recognised by the Listing Rules or the Corporations Act for the purpose of facilitating dealings in securities, including a transfer that may be effected pursuant to the ASX Settlement Operating Rules or other electronic transfer process; and
- by an instrument in writing in any usual or common form or in any other form that the Board approves.

The Company may in the Board's absolute discretion and without assigning any reason therefore, refuse to register or prevent or interfere with the registration of a transfer of Shares while it is not admitted to the official list of ASX, and when it is admitted to ASX the Company may only refuse to register or prevent or interfere with the registration of a transfer of Shares where permitted by any of the Listing Rules or the ASX Settlement Operating Rules.

#### **6 Issue of shares**

Subject to the Listing Rules, any share in the capital of the Company may be issued with preferred, deferred or other special rights, obligations or restrictions, whether in regard to dividends, voting, return of share capital, payment of calls or otherwise, as the Board may from time to time determine.

## **7 Alteration of capital**

The Company may from time to time by ordinary resolution:

- increase the share capital by such sum to be divided into shares of such amount as the resolution shall prescribe;
- consolidate and divide all or any of its share capital into shares of larger amount than its existing shares, or convert, or make the provision for the conversion of, all or any of its paid up shares into stock and re-convert, or make provision for the re-conversion of that stock into paid up shares of any denomination;
- subdivide its existing shares or any of them into shares of smaller amount; or
- cancel any shares which at the date of passing of the resolution in that behalf have not been taken or agreed to be taken by any person or which have been forfeited and diminish the amount of its share capital by the amount of the shares so cancelled,

provided always that all of the Shares shall be of the same nominal value.

## **8 Reduction of capital**

The Company may by special resolution reduce its share capital and any capital redemption reserve fund or any share premium account in any manner and with and subject to any incident authorised and consent required by law and without limiting the foregoing may do all or any of the following:

- extinguish or reduce the liability of any of its shares in respect of share capital not paid up;
- cancel any paid up capital which is lost or unrepresented by available assets; or
- pay off any paid up share capital which is in excess of the needs of the Company.

## **9 Variation of rights**

The Company may only modify or vary the rights attaching to any class of shares with the consent in writing of the holders of at least 75% of the issued shares of the class or the sanction of a special resolution passed at a meeting of the holders of the issued shares of that class.

## Schedule 3 – Terms of the Options to be granted to Dr Mears and Mr Trautmann

- 1 The exercise price per Option will be a fixed price of \$0.30. Each Option exercised entitles the holder of the Option (“**Optionholder**”) to be issued with one new Share.
- 2 The Options will:
  - (a) be unlisted;
  - (b) be restricted from exercise until after 28 February 2016; and
  - (c) will expire on 28 February 2018.
- 3 The Options will vest progressively at the rate of one quarter for each completed year of the Optionholder’s employment from 1 March 2013 (“**Commencement Date**”) (for the avoidance of doubt this means that if on 1 March 2015 an Optionholder is still employed by the Company they will have an entitlement to 50% of the Options).
- 4 Once vested the Options shall be exercisable anytime from three years after Commencement Date until their expiry five calendar years after the Commencement Date (for the avoidance of doubt this means that if on 1 March 2016 an Optionholder is still employed by the Company they will have an entitlement to 75% of the Options, all of which are exercisable).
- 5 Should the Optionholder resign or choose to leave the employment of the Company (or a wholly owned subsidiary of the Company) or the Optionholder’s employment be terminated by the Company (or a wholly owned subsidiary of the Company), the Optionholder will have 30 days from the date he leaves the Company (or a wholly owned subsidiary of the Company) to exercise any or all Options which have been issued to him prior to that date, subject to these Options having vested and having reached the date at which they have become exercisable prior to the date at which the Optionholder leaves the Company. All Options which have been issued to the Optionholder but have not vested and reached the date at which they have become exercisable, together with all Options which are to be issued to the Optionholder, prior to date the Optionholder leaves the Company, will automatically expire and the Optionholder will have no further rights to any of these Options. For the avoidance of doubt this means if the Optionholder resigns or leaves or is terminated on or before 28 February 2016 the Optionholder will have no entitlement to any Options.
- 6 The Options will not be transferable and the Optionholder must not dispose of, or purport to dispose of, the Options or any interest in the Options. This item does not affect the Optionholder or the executor of the estate of the Optionholder exercising the Options in accordance with these terms if the Optionholder dies or is terminated due to ill health.
- 7 If the Company is subject to a takeover bid, and the bidder obtains a relevant interest in 50% or more of the voting shares of the Company, then notwithstanding item 2(b) of above the Optionholder may exercise the Options but only after the takeover bid becomes unconditional and before the end of the offer period and before the Company ceases to be on the official list of ASX.

- 8 If there is a reorganisation of capital of the Company (whether before or during the period during which the Optionholder can exercise the Options) then the rights of the Optionholder (including the number of Options to which the Optionholder is entitled or the exercise price of the Options) will be changed to the extent necessary to comply with the Listing Rules applying to a reorganisation of capital at the time of the reorganisation.
- 9 The Company must give to the Optionholder, in accordance with the Listing Rules, notice of any new issue of securities before the record date for determining entitlements to the new issue. An Optionholder may not participate in any new issue of securities without exercising the Options held by the Optionholder.
- 10 The Options do not confer any right to a change in the exercise price or a change to the number of underlying securities over which they can be exercised except as provided for in item 8 above and item 11 below.
- 11 In the event that prior to the date of exercise of the Options a pro rata bonus issue is made to the holders of fully paid Shares (other than an issue in lieu or in satisfaction of dividends or by way of a dividend reinvestment plan), upon exercise of the Options, the entitlement to be issued fully paid ordinary shares upon exercise of the Options will be adjusted to include the number of bonus shares that would have been issued to the holder of the Options as if the Options held had been exercised prior to the record date for the bonus issue. Notwithstanding any adjustment to the entitlement to be issued fully paid ordinary shares upon exercise of the Options that results from a bonus issue, the exercise price in respect of the Options will not change.
- 12 Any calculations or adjustments which are required to be made under items 8 or 11 above will be made by the auditors of the Company for the time being and will, in the absence of manifest error, but subject to item 13 below, be final and binding on the holder of the Options.
- 13 If the Board in its absolute discretion determines that an adjustment prescribed by items 8 or 11 above (or the fact that no adjustment is prescribed in respect of a particular reconstruction) would not be fair and equitable to the Optionholder and the Shareholders, having regard to the circumstances of the particular capital reconstruction or bonus issue and the capital structure of the Company at that time, then the Board may, subject to the Listing Rules, substitute another adjustment, provided that the Board reasonably considers that the substitute adjustment is fair and equitable.
- 14 The Company will notify the Optionholder of any adjustments under items 8 or 11 above to the exercise price or the number of Options within seven days of the date of the adjustment.
- 15 Any taxation obligations arising from the issue of the Options shall be to the account of the Optionholder.

# Schedule 4 – Key terms of the Memorandum of Agreement

Please note that the Memorandum of Agreement has been superseded by the Merger Agreement with respect to the subject matter thereof.

## 1 Parties

Company and MEARS

## 2 Merger

Subject to the terms and conditions contained herein, the Company and MEARS hereby agree to merge into one entity (the “**Merged Entity**”) utilizing the Company’s current listing on ASX, whereby the Company will issue as merger consideration a total of 800,000,000 Shares (“**Merger Shares**”) to acquire all of the issued and outstanding common shares, warrants and options over common shares in MEARS.

Upon completion of the transaction, the name of the Merged Entity will be changed to “MEARS Technologies Limited” or such other name as agreed between the parties as being appropriate for the purposes of developing and commercializing MEARS’ technologies under the Merged Entity, especially as they relate to the semiconductor industry.

The transaction is subject to all requisite approvals from MEARS and the Company shareholders, the raising of new capital, official quotation on ASX of the Merger Shares within one business day of their issue, MEARS being reasonably satisfied that the Company has no material liabilities other than those disclosed in the Company’s financial statements for FY12, any other regulatory approvals and certain other terms and conditions referred to below.

## 3 Fund raising

The Parties agree that completion of the Merger is subject to the completion of a fund raising by the Company in the minimum amount of \$7.5 million in new capital (before all reasonable merger costs including brokerage, legal, etc. estimated to be \$560,000 to \$660,000), via the issue of ordinary shares subscribed in the Merged Entity simultaneous with the Closing of the Merger (as defined in section 4 of this Schedule 4), at a minimum “pre-money” value of at least \$30 million for the Merged Entity (“**Fund Raising**”). MEARS and the Company may by mutual agreement accept a lower “pre-money” value for the Merged Entity.

The Company has engaged Foster Stockbroking to represent the Company in the Fund Raising and Stuart Foster, the Chief Executive Officer of Foster Stockbroking, will be actively involved in leading the Fund Raising.

## 4 Closing and timing

The Parties and Foster Stockbroking will use best efforts to complete the Fund Raising and conclude the Merger (the “**Closing**”) no later than December 31, 2012 but in no case later than March 1, 2013 (the “**Merger Deadline**”). The Merger Deadline may be extended by mutual agreement of the Boards of the Company and MEARS respectively.

## 5 Pro-forma merger offer

On the assumption that completion of the full MEARS Bridge Fund Raising (referred to in section 12 of this Schedule 4) occurs prior to the merger transaction, thereby resulting in an adjustment to the number of Merger Shares (referred to in section 11 of this Schedule 4), the Company consideration of 850,378,611 Merger Shares will be offered to holders of each class and series of

common shares, warrants and options over common shares in MEARS. The offer document must be in a form approved by the Board of Directors of MEARS.

## 6 Company pre-merger capital structure

Shares	244,057,151
31 December 2014 Options exercisable at \$0.20	6,000,000

## 7 Company share consolidation

The Parties agree that as part of the merger transaction, the number of Shares outstanding may need to be consolidated on a basis yet to be determined, subject to the advice of Foster Stockbroking, in which case the number of Merger Shares will be adjusted accordingly.

## 8 Warrants, options and stock purchase programs

Foster Stockbroking has advised the Parties that for capital raising purposes, it is preferable for the capital structure of the Merged Entity to comprise ordinary shares, absent pre-merger warrants, options, or other stock purchase programs. This will require MEARS to seek the approval of holders of common shares and equity securities convertible into common shares (other than the Company) to accept Merger Shares as consideration for their equity securities convertible into common shares (including all warrants, options, any outstanding bridge loan and other securities), in number recommended by the Board of Directors of MEARS. The Company will own 100% of MEARS upon completion of the Merger, with no other securities in MEARS in existence at that time.

## 9 Management incentive plan for Merged Entity

Within three months of the date of completion of the Merger, the Merged Entity will formally establish an incentive plan for senior management of the Merged Entity.

## 10 Merged Entity board, management and governance

The Board, management, and governance structure of the Merged Entity will be established according to the best practices of companies generally listed on ASX. The Board members of the Merged Entity will be selected by the Company Board and the MEARS Board on a pro rata basis according to the Merger Ratio in section 11 of this Schedule 4. The initial management team of the Merged Entity will be selected by the MEARS Board. The contracts, however, for the each of the initial management team members must be unanimously approved by the Merged Entity Board. The Merged Entity is expected to conduct its business from offices in Sydney, the San Francisco area, and possibly Boston.

## 11 Adjustment to number of merger shares

During the period commencing on the date of this Agreement and until completion of the Merger ("**Interim Period**"), the Parties acknowledge that the number of Merger Shares will be adjusted as follows:

- a) any new issue of ordinary shares or equity securities convertible into new ordinary shares by the Company, will result in the Company adjusting up the absolute number of Merger Shares so that the ratio of 800,000,000 / 244,057,151 ("**Merger Ratio**") is maintained;
- b) any reduction in the number of ordinary shares outstanding in the capital of the Company by way of a capital reduction or consolidation of shares will result in the Company adjusting down the absolute number of Merger Shares so that the Merger Ratio is maintained (for example, a one for ten share consolidation by the Company will result in a reduction in the number of Merger Shares from 800,000,000 to 80,000,000); and



- c) any fund raising completed directly by MEARS during the Interim Period (for example, the MEARS Bridge Fund Raising in section 12 of this Schedule 4), will result in the Company adjusting up the absolute number of Merger Shares in an amount of shares calculated by dividing the dollar value of that fund raising denominated in US dollars by \$0.03 per Share using an exchange rate of US\$1.02:\$1.00.

## **12 MEARS Bridge Financing**

The MEARS Bridge Fund Raising will constitute a one for two rights issue of common shares in the capital of MEARS at a price of US\$0.25 each, to raise up to a total of US\$1,541,585.50, of which a minimum raise of US\$1,000,000 is to be jointly underwritten in the proportions of 50% by Foster Stockbroking and 50% by a group of MEARS shareholders approved by the Board of MEARS (including members of the Board). Prior to final completion and the taking up of any shortfall of the minimum raise of US\$1,000,000 (if any) by the underwriters, MEARS will first offer any shortfall back to the MEARS shareholders on a pro-rata basis.

## **13 Merger costs**

The Merged Entity shall pay for any and all Foster Stockbroking fees relating to the Fund Raising and the MEARS Bridge Fund Raising, whereby:

- a) MEARS will retain and be responsible for the cost of its own legal and financial advisors in relation to the proposed merger transaction; and
- b) the Company will retain and be responsible for the cost of its own legal and financial advisors in relation to the proposed merger transaction, the cost of the Fund Raising and MEARS' reasonable travel costs for fund raising road show(s).

## **14 Termination**

This Agreement shall automatically terminate and be made void with no force or effect, unless agreed otherwise in MEARS Board's sole discretion, if any one of the following events occurs:

- a) MEARS has not received a formal underwriting commitment of at least US\$500,000 from Foster Stockbroking and executed binding Subscription Agreements for the minimum US\$1,000,000 MEARS Bridge Fund Raising on or before November 1, 2012 with the only condition being the Company and MEARS shareholder approval of the Merger based upon this Agreement;
- b) any portion of the entire amount of the Required New Capital at the required "pre-money" value is not closed and the Merger thereby not consummated on or before the Merger Deadline for any reason;
- c) the Company does not receive the necessary shareholder approval to consummate the Merger; or
- d) MEARS does not receive the necessary shareholder approval to consummate the Merger.

## **15 Bridge loan extension**

Subject to the holders of Promissory Notes with a face value in the amount of approximately US\$0.58 million extending the maturity date of their Promissory Notes by six months, the Company shall also extend the maturity date of its Promissory Note with a face value in the amount of US\$1 million by six months from April 4, 2013 to October 4, 2013.



**16 Public announcements**

The timing and content of any public announcements about this Agreement shall require the mutual approval of both Parties.

**17 Binding agreement**

Subject to the approvals referred to herein, this Agreement is intended to constitute the binding agreement of the parties hereto; provided, however, that MEARS' obligations hereunder shall be subject to approval of the definitive acquisition agreement by the Board of MEARS.

**18 Confidentiality**

The parties shall execute a mutually acceptable Confidentiality Agreement which shall remain in force outside this Agreement.

# Schedule 5 – Key terms of the Merger Agreement

## 1 Parties

Company, Acquisition Company and MEARS

## 2 Merger

### *Merger*

Upon and subject to the terms and conditions of the Merger Agreement, the Acquisition Company shall merge with and into MEARS at the Effective Time. From and after the Effective Time, the separate corporate existence of the Acquisition Company shall cease and MEARS shall continue as the surviving corporation.

### *Completion*

At Completion:

- the Acquisition Company shall file with the Secretary of State of the State of Delaware the Certificate of Merger; and
- the Company shall issue the Shares to MEARS Securityholders.

### *Conversion of MEARS Securities*

At the Effective Time:

- each MEARS Share (other than MEARS Shares owned beneficially by the Company or the Acquisition Company, Dissenting Shares (as defined below) and MEARS Shares held in MEARS' treasury) shall be converted into and represent the right to receive such number of Shares as is set forth on the Conversion Schedule;
- each option over MEARS Shares ("**MEARS Options**") (other than MEARS Options owned beneficially by the Company or the Acquisition Company and MEARS Options the holders of which have not executed and delivered to MEARS an Option Exchange Agreement providing that such Options have been converted into the right to receive Shares) shall be converted into and represent the right to receive such number of Shares as is set forth on the Conversion Schedule;
- each warrant over MEARS Shares ("**MEARS Warrant**") (other than MEARS Warrants owned beneficially by the Company or the Acquisition Company and MEARS Warrants the holders of which have not executed and delivered to MEARS a Warrant Exchange Agreement providing that such MEARS Warrants have been converted into the right to receive Shares) shall be converted into and represent the right to receive such number of Shares as is set forth on the Conversion Schedule; and
- each MEARS Share held in the MEARS' treasury immediately prior to the Effective Time and each MEARS Share, MEARS Option and MEARS Warrant owned beneficially by the Company or the Acquisition Company shall be cancelled and retired without payment of any consideration therefor.

### ***Dissenting Shares***

“Dissenting Shares” means MEARS Shares held as of the Effective Time by a MEARS Shareholder who has not voted such MEARS Shares in favour of the adoption of the Merger Agreement and with respect to which appraisal shall have been duly demanded and perfected in accordance with section 262 of the Delaware General Corporation Law and not effectively withdrawn or forfeited prior to the Effective Time.

Dissenting Shares shall not be converted into or represent the right to receive Shares, unless the person holding such Dissenting Shares shall have forfeited his, her or its right to appraisal under the Delaware General Corporation Law or properly withdrawn, his, her or its demand for appraisal.

### ***Fractional Shares***

If the number of MEARS Shares, MEARS Options or MEARS Warrants held by a person is such that the aggregate entitlement of that holder to Shares is not a whole number, then the entitlement in each case must be rounded down to the nearest whole number.

### ***MEARS Warrants***

As of the Effective Time and subject to a lower percentage being agreed, the Company agrees that any outstanding MEARS Warrants not subject to a Warrant Exchange Agreement, if any (the “**Assumed Company Warrants**”), whether vested or unvested, shall have the right to receive upon exercise, such number of Shares as is set forth on the Conversion Schedule, at such exercise price as is set forth on the Conversion Schedule.

The Company shall take all corporate action necessary to reserve for issuance a sufficient number of Shares for delivery upon exercise of the Assumed Company Warrants assumed in accordance with the Merger Agreement and to ensure that such Shares, when delivered upon the exercise of Assumed Company Warrants, shall be freely tradable on ASX and not subject to any restrictions on sale, assignment or transfer.

### ***MEARS Options***

Any MEARS Option not subject to an Option Exchange Agreement as of 10 business days prior to Completion shall be terminated immediately prior to the Effective Time.

### ***Board of Directors***

The Board of Directors of the Company and MEARS immediately following the Effective Time shall consist of seven directors and the initial directors of the MEARS shall be John Gerber, Rinn Cleavelin, Rolf Stadheim, Robert Mears, Robert Gaunt, Sam Gazal and Erwin Trautmann.

## **3 Covenants**

### ***Completion efforts***

Each of the parties shall use its reasonable best efforts to take all actions and to do all things necessary, proper or advisable to consummate the transactions contemplated by the Merger Agreement.

### ***Governmental and third-party notices and consents***

Each party shall use its reasonable best efforts to obtain, at its expense, all waivers, permits, consents, approvals or other authorisations from governmental entities, and to effect all registrations, filings and notices with or to governmental entities, as may be required for such party to consummate the transactions contemplated by the Merger Agreement and to otherwise comply with all

applicable laws and regulations in connection with the consummation of the transactions contemplated by the Merger Agreement.

MEARS shall use its reasonable best efforts to obtain, at its expense, all such waivers, consents or approvals from third parties, and to give all such notices to third parties, as are required in connection with the Merger Agreement and the Merger under any agreements with MEARS.

### ***Shareholder approval***

As promptly as practicable after the execution of the Merger Agreement, the parties shall prepare the written proxy or information statement ("**Disclosure Statement**").

MEARS, acting through its Board of Directors, shall include in the Disclosure Statement the unanimous recommendation of its Board of Directors that the MEARS Shareholders vote in favour of the adoption of the Merger Agreement and the approval of the Merger.

Notwithstanding the foregoing, the obligation set forth in the foregoing sentence shall not apply (and the Board of Directors shall be permitted to modify or withdraw any such recommendation previously made) if the Board of Directors of MEARS reasonably concludes, after consultation with its outside legal counsel, that the fiduciary duties of the Board of Directors under applicable law prohibit it from fulfilling the obligations in the foregoing sentence.

The Company shall use reasonable best efforts to obtain from the Shareholders at a special meeting of the Shareholders, the approval of the issuance of the Shares to MEARS Securityholders and any other approvals required by the Company to perform its obligations under the Merger Agreement.

The Company, acting through its Board, shall include in the Notice and Explanatory Memorandum the unanimous recommendation of its Board that the Shareholders vote in favour of the approval of the issuance of Shares in the Merger. Notwithstanding the foregoing, the obligation set forth in the foregoing sentence shall not apply (and the Board shall be permitted to modify or withdraw any such recommendation previously made) if the Board of the Company reasonably concludes, after consultation with its outside legal counsel, that the fiduciary duties of the Board under applicable law prohibit it from fulfilling the obligations in the foregoing sentence.

### ***Financing***

The Company shall use reasonable best efforts to secure at least \$7,500,000 in gross proceeds from third parties in exchange for the issuance of Shares in an amount to be determined based on a pre-money valuation of the Company of at least \$30,000,000 (or such lower amount mutually agreed-upon by the Boards of Directors of both parties) (such sale and issuance, the "**Merger Financing**" and the shares to be issued in the Merger Financing, the "**Merger Financing Shares**").

### ***MEARS Options and MEARS Warrants***

MEARS shall take such actions as may be required to cause all MEARS Options not subject to an Option Exchange Agreement as of 10 business days prior to Completion to be terminated immediately prior to the Effective Time. MEARS shall use reasonable best efforts to cause all holders of MEARS Warrants to execute a Warrant Exchange Agreement with respect to all such Company Warrants. For any MEARS Warrants not subject to a Warrant Exchange Agreement as of 10 business days prior to Completion and pursuant to the terms of which MEARS has the unilateral authority to require that such MEARS Warrant be exercised or else will terminate prior to Completion, MEARS shall terminate such MEARS Warrants effective immediately prior to Completion. MEARS Warrants not subject to a Warrant Exchange Agreement and not terminated prior to Completion shall be treated as set out above.

### ***Indemnification***

The Company shall not, for a period of six years after Completion, take any action to alter or impair any exculpatory or indemnification provisions now existing in the Certificate of Incorporation or By-laws of MEARS for the benefit of any individual who served as a director or officer of MEARS at any time prior to Completion (an “**Indemnified Executive**”), except for any changes which may be required to conform with changes in applicable law and any changes which do not affect the application of such provisions to acts or omissions of such individuals prior to Completion.

From and after Completion, the Company agrees that it will, and will cause MEARS to, indemnify and hold harmless each Indemnified Executive against any costs or expenses (including attorneys’ fees), judgments, fines, losses, claims, damages, liabilities or amounts paid in settlement incurred in connection with any claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative, arising out of or pertaining to matters existing or occurring at or prior to Completion, whether asserted or claimed prior to, at or after Completion, to the fullest extent permitted under Delaware law (and the Company and the MEARS shall also advance expenses as incurred to the fullest extent permitted under Delaware law, provided the Indemnified Executive to whom expenses are advanced provides an undertaking to repay such advances if it is ultimately determined that such Indemnified Executive is not entitled to indemnification).

For a period of six years after Completion, the Company shall cause MEARS to maintain (to the extent available in the market) in effect a directors’ and officers’ liability insurance policy covering those persons who are currently covered by MEARS’ directors’ and officers’ liability insurance policy with coverage in amount and scope at least as favourable to such persons as MEARS’ existing coverage; provided, that in no event shall the Company or MEARS be required to expend in excess of 150% of the annual premium currently paid by MEARS for such coverage.

### ***Listing of Shares***

The Company shall make application to ASX for the Shares to be issued to MEARS Securityholders to be listed on ASX immediately following the Completion, such that the Shares shall be freely tradable on ASX immediately following Completion.

### ***Promissory notes***

Subject to the holders of promissory notes issued by MEARS with a face value in the amount of approximately US\$0.58 million extending the maturity date of their promissory notes by six months, the Company shall also extend the maturity date of its promissory note with a face value in the amount of US\$1 million by six months from 4 April 2013 to 4 October 2013.

### ***Equity awards***

The Company shall obtain all necessary consents, approvals or other authorisations and effected all of the registrations, filings and notices which are required such that the Company may issue to Robert Mears and Erwin Trautmann and other key management personnel of the Company and MEARS, without the need for any further actions other than approval by the Board of Directors of the Company, options to purchase up to an amount of shares equal to 10% of the fully-diluted Shares (such amount to be determined as of immediately following Completion but after giving effect to and including the issuance of the Merger Financing Shares).

#### 4 **Conditions to consummation of the merger**

##### ***Conditions to each party's obligations***

The respective obligations of each party to consummate the Merger are subject to the Merger Agreement and the Merger receiving the approval of Shareholders and MEARS Shareholders.

##### ***Conditions to obligations of the Company and the Acquisition Company***

The obligation of each of the Company and the Acquisition Company to consummate the Merger is subject to the satisfaction (or waiver by the Company) of the following additional conditions:

- MEARS shall have obtained (and shall have provided copies thereof to the Company) all of the waivers, permits, consents, approvals or other authorizations, and effected all of the registrations, filings and notices which are required on the part of MEARS, except for any which if not obtained or effected would not have a MEARS Material Adverse Effect or a material adverse effect on the ability of the parties to consummate the transactions contemplated by the Merger Agreement;
- the representations and warranties of MEARS in the Merger Agreement shall be true and correct as of the date of the Merger Agreement and shall be true and correct as of Completion as though made as of Completion, except to the extent that the inaccuracy of any such representation or warranty is the result of events or circumstances occurring subsequent to the date of the Merger Agreement and any such inaccuracies, individually or in the aggregate, would not have a MEARS Material Adverse Effect or a material adverse effect on the ability of the parties to consummate the transactions contemplated by the Merger Agreement; provided that the representations and warranties regarding MEARS' capitalization shall be true and correct as of Completion of the Acquisition, except for immaterial inaccuracies;
- MEARS shall have performed or complied with in all material respects its agreements and covenants required to be performed or complied with under the Merger Agreement as of or prior to Completion;
- no legal proceeding shall be pending or threatened in writing wherein an unfavourable judgment, order, decree, stipulation or injunction would (i) prevent consummation of the transactions contemplated by the Merger Agreement, or (ii) cause the transactions contemplated by the Merger Agreement to be rescinded following consummation, and no such judgment, order, decree, stipulation or injunction shall be in effect; and
- holders of 100% (or such lesser percentage as may be agreed to by the Company) of the MEARS Warrants shall have either entered into a Warrant Exchange Agreement or been notified that their MEARS Warrant will terminate immediately prior to Completion if not exercised by such time.

##### ***Conditions to obligations of MEARS***

The obligation of MEARS to consummate the Merger is subject to the satisfaction of the following additional conditions:

- the Shares issued to MEARS Securityholders shall have been approved for listing on ASX, subject only to official notice of issuance and customary pre-quotation listing conditions, and upon issuance, the Shares shall be freely transferable and tradable on ASX and not subject to any restriction on sale, assignment or transfer;



- the due execution and delivery of transaction documents for the Merger Financing, which shall provide that the closing of the Merger Financing shall become automatically effective, without any additional action required, as of Completion (other than conditions of an administrative nature as would usually be imposed by ASX to permit quotation of Shares on ASX);
- subject to them consenting to act, the below directors shall have been elected as of Completion as the directors of the Company and MEARS: John Gerber, Rinn Cleavelin, Rolf Stadheim, Robert Mears, Robert Gaunt, Sam Gazal and Erwin Trautmann; provided, however, that Erwin Trautmann shall continue to serve as a director for so long as he is Chief Executive Officer of the Company;
- subject to ASIC altering the details of the Company's registration, the Company shall have changed its name to MEARS Technologies Limited as of Completion;
- the Company shall have effected all of the registrations, filings and notices which are required on the part of the Company, except for any which if not obtained or effected would not have a Company Material Adverse Effect or a material adverse effect on the ability of the parties to consummate the transactions contemplated by the Merger Agreement;
- the representations and warranties of the Company in the Merger Agreement shall be true and correct as of the date of the Merger Agreement and shall be true and correct as of Completion as though made as of Completion, except to the extent that the inaccuracy of any such representation or warranty is the result of events or circumstances occurring subsequent to the date of the Merger Agreement and any such inaccuracies, individually or in the aggregate, would not have a Company Material Adverse Effect or a material adverse effect on the ability of the parties to consummate the transactions contemplated by the Merger Agreement provided that the representations and warranties regarding the Company's capitalization shall be true and correct as of Completion of the Acquisition, except for immaterial inaccuracies;
- each of the Company and the Acquisition Company shall have performed or complied with in all material respects its agreements and covenants required to be performed or complied with under the Merger Agreement as of or prior to Completion;
- no legal proceeding shall be pending or threatened in writing wherein an unfavourable judgment, order, decree, stipulation or injunction would (i) prevent consummation of the transactions contemplated by the Merger Agreement or (ii) cause the transactions contemplated by the Merger Agreement to be rescinded following consummation, and no such judgment, order, decree, stipulation or injunction shall be in effect; and
- no event or circumstances shall have occurred which would have a Company Material Adverse Effect on the consolidated financial position of the Company and its subsidiaries since the date of, and as disclosed in the Company's Annual Report to Shareholders for the fiscal year ended 30 June 2012, nor shall any other event or circumstances have occurred since that date or become likely to occur which would have a Company Material Adverse Effect, which is disclosed, in either case:
  - in the prospectus or any supplementary prospectus issued by the Company in connection with the Merger;

- in the Half-year Financial Report of the Company and its subsidiaries for the period ended 31 December 2012; or
- by the Company or any Directors,

but excluding any event or circumstances which occur directly as a result of any action required by the Merger Agreement, or as a result of the acquisition of MEARS by the Company, including without limitation the Merger Financing.

## 5 Termination

The parties may terminate the Merger Agreement prior to Completion, as provided below:

- the parties may terminate the Merger Agreement by mutual written consent;
- the Company may terminate the Merger Agreement by giving written notice to MEARS in the event MEARS is in breach of any representation, warranty or covenant contained in the Merger Agreement, and such breach (i) individually or in combination with any other such breach, would cause certain conditions set forth in the Merger Agreement not to be satisfied and (ii) is not cured within 20 days following delivery by the Company to MEARS of written notice of such breach;
- MEARS may terminate the Merger Agreement by giving written notice to the Company in the event the Company or the Acquisition Company is in breach of any representation, warranty or covenant contained in the Merger Agreement, and such breach (i) individually or in combination with any other such breach, would cause certain conditions set forth in the Merger Agreement not to be satisfied and (ii) is not cured within 20 days following delivery by MEARS to the Company of written notice of such breach;
- the Company may terminate the Merger Agreement by giving written notice to MEARS if between 30 June 2012 and Completion there has occurred a change, event, circumstance or development which, individually or in the aggregate, has had, or could reasonably be expected to have in the future, a MEARS Material Adverse Effect, provided that changes, events, circumstances or developments will not be taken into account in determining whether there has been or will be a MEARS Material Adverse Effect to the extent they are attributable to actions by or on behalf of the Company;
- MEARS may terminate the Merger Agreement by giving written notice to the Company if between 30 June 2012 and Completion there has occurred a change, event, circumstance or development which, individually or in the aggregate, has had, or could reasonably be expected to have in the future, a Company Material Adverse Effect, provided that changes, events, circumstances or developments will not be taken into account in determining whether there has been or will be a Company Material Adverse Effect to the extent they are attributable to actions by or on behalf of MEARS;
- any party may terminate the Merger Agreement by giving written notice to the other parties at any time after the stockholders of MEARS and/or the Company have voted on whether to approve the Merger Agreement and the merger in the event the Merger Agreement and the merger failed to receive the approval of Shareholders or MEARS Shareholders;



- the Company may terminate the Merger Agreement by giving written notice to MEARS if Completion shall not have occurred on or before 1 March 2013 by reason of the failure of any condition precedent (unless the failure results primarily from a breach by the Company or the Acquisition Company of any representation, warranty or covenant contained in the Merger Agreement); or
- MEARS may terminate the Merger Agreement by giving written notice to the Company if Completion shall not have occurred on or before 1 March 2013 by reason of the failure of any condition precedent (unless the failure results primarily from a breach by MEARS of any representation, warranty or covenant contained in the Merger Agreement).

## **6 Press releases and announcements**

No party shall issue any press release or public announcement relating to the subject matter of the Merger Agreement without the prior written approval of the other parties; provided, however, that any party may make any public disclosure it believes in good faith is required by applicable law, regulation or stock market rule (in which case the disclosing party shall use reasonable efforts to advise the other parties and provide them with a copy of the proposed disclosure prior to making the disclosure).

## **7 Entire Agreement**

The Merger Agreement constitutes the entire agreement among the parties and supersedes any prior understandings, agreements or representations by or among the parties, written or oral, with respect to its subject matter (including, without limitation, the Memorandum of Agreement).

## **8 Governing law**

All matters arising out of or relating to the Merger Agreement and the transactions contemplated by the Merger Agreement shall be governed by and construed in accordance with the internal laws of the State of Delaware without giving effect to any choice or conflict of law provision or rule (whether of the State of Delaware or any other jurisdiction) that would cause the application of laws of any jurisdictions other than those of the State of Delaware.

## **9 Submission to Jurisdiction**

Each party:

- submits to the jurisdiction of any state or federal court sitting in the State of Delaware in any action or proceeding arising out of or relating to the Merger Agreement;
- agrees that all claims in respect of such action or proceeding may be heard and determined in any such court;
- waives any claim of inconvenient forum or other challenge to venue in such court;
- agrees not to bring any action or proceeding arising out of or relating to the Merger Agreement in any other court; and
- waives any right it may have to a trial by jury with respect to any action or proceeding arising out of or relating to the Merger Agreement.

## **10 Conversion Schedule**

### ***Shares***

Subject to the terms and conditions of the Merger Agreement and subject to adjustment as set forth in the Conversion Schedule, the Company shall issue 800,000,000 Shares to acquire all of MEARS Securities.

### **Adjustment**

The number of Shares issued to MEARS Securityholders shall be adjusted according to the following to the extent applicable:

- if MEARS receives any additional funds from the MEARS Rights Offer described in section 3.1(b) of this document prior to Completion, the absolute number of Shares shall be increased by an amount equal to the quotient obtained by dividing (i) the quotient obtained by dividing the dollar value of the funds raised denominated in US dollars divided by 1.02 by (ii) \$0.03;
- if the Company issues any Shares or equity securities convertible into new Shares above the existing 244,057,151 Shares (“**Additional Shares**”), the absolute number of Shares shall be increased so that the ratio of (i) 800,000,000 plus any increase in Shares the first bullet point above divided by (ii) 244,057,151 plus the number of Additional Shares equals 3.277821 (the “**Merger Ratio**”);
- if the Company reduces the number of Shares outstanding by way of a capital reduction or consolidation, the absolute number of Shares shall be reduced so that the ratio of (i) the total number of Shares divided by the total number of Shares equals the Merger Ratio.

Accordingly, the aggregate number of Shares to be issued will equal the following product:

$$\text{MS} = \frac{(800,000,000 + X) \text{ times}}{(1 + (\text{ABOS} \div 244,057,151)) \text{ times}} \times \frac{\text{BOSC}}{(\text{ABOS} + 244,057,151)}$$

where:

MS = Aggregate Number of Shares to be issued to MEARS Securityholders as consideration for the Merger

ABOS = Number of Additional Shares issued before a consolidation or capital reduction

BOSC = Number of Shares outstanding after a consolidation or capital reduction

X = (A ÷ ER ÷ MSP)

ER = 1.02

A = Amount of capital (in US\$) raised by MEARS via the MEARS Rights Offer

MSP = 0.03

If any MEARS Warrants are not exchanged pursuant to Warrant Exchange Agreements or terminated and the Company elects in its sole discretion to waive its closing requirement that holders of 100% of the MEARS Warrants shall have either entered into a Warrant Exchange Agreement or been notified that their MEARS Warrant will terminate immediately prior to Completion if not exercised by such time, the number of Shares to be issued shall be reduced by the number of Shares that would have otherwise been issued to purchase applicable MEARS Warrants at the values calculated by the formulas below.

### **Allocation of Shares**

The Shares, as may be adjusted above, shall be allocated among outstanding MEARS Shares, MEARS Warrants and MEARS Options according to an established conversion schedule using the following formulas (the “**Conversion Schedule**”).

$$\mathbf{MSC = (MS - MSW - MSO)}$$

where:

MSC = Number of Shares issued to holders of MEARS Shares

MSW = Number of Shares issued to holders of MEARS Warrants

MSO = Number of Shares issued to holders of MEARS Options

$$\mathbf{MSW = (BSV \div MSP)}$$

where:

BSV = Black Scholes Value attributed to MEARS Warrants exchanged for Shares

MSP = 0.03

$$\mathbf{MSO = (BSV \div MSP)}$$

where:

BSV = Black Scholes Value attributed to MEARS Options exchanged for Shares

MSP = 0.03

The Black Scholes Value ("BSV") attributed to any MEARS Warrants or MEARS Options exchanged for merger shares shall be calculated as follows:

$$\mathbf{BSV = SN(d_1) - Ke^{(-rt)}N(d_2)}$$

(as applied to each series of MEARS Warrants and MEARS Options)

where:

S = MSP

t = time until expiration of MEARS Warrant or MEARS Option

K = strike price

r = 0.31%

N = cumulative standard normal distribution e = 2.7183

$$d_1 = \frac{\ln\left(\frac{S}{K}\right) + \left(r + \frac{\sigma^2}{2}\right)t}{\sigma\sqrt{t}}$$

$$d_2 = d_1 - \sigma\sqrt{t}$$

$\sigma$  = 67.5%

ln = natural logarithm

# Schedule 6 – Investigating Accountants’ Report



**STIRLING INTERNATIONAL**  
CHARTERED ACCOUNTANTS

11 January 2013

The Board of Directors  
K2 Energy Limited  
Level 2  
27 Macquarie Place  
SYDNEY NSW 2000

Dear Sirs

**Investigating Accountants' Report on Historical and Pro-forma Financial Information**

***Introduction***

Stirling International (Stirling) has been engaged by the Directors of K2 Energy Limited (K2 Energy or Company) to prepare this Investigating Accountants' Report (Report) for inclusion in a Notice of General Meeting, Explanatory Memorandum and Prospectus (Prospectus) to be issued by K2 Energy on or about 11 January 2013.

Expressions defined in the Prospectus have the same meaning in this Report.

***Historical and Pro-forma Financial Information***

You have requested Stirling to prepare an Investigating Accountants' Report covering the following financial information set out on pages 95 to 107 of the Prospectus:

- the historical Consolidated Statement of Comprehensive Income of the Company for the year ended 30 June 2012;
- the historical Consolidated Balance Sheet of the Company as at 30 June 2012;
- the pro-forma Consolidated Balance Sheets of the Company as at 30 June 2012, based on the assumption that the transactions contemplated in the Prospectus and as detailed in Note 2(b) to the financial information had been completed as at 30 June 2012; and
- notes to the financial information  
(collectively the historical and pro-forma financial information).

The historical financial information for the year ended 30 June 2012 has been extracted from the audited financial statements of the Company, which were audited by Stirling. Our audit of the Company was conducted in accordance with Australian Auditing Standards to provide reasonable assurance whether the financial statements were free from material misstatement. The audit opinion issued by Stirling to the members of the Company relating to the financial statements for the year ended 30 June 2012 was unqualified, however without qualification to the audit opinion attention was drawn to inherent uncertainty regarding recoverability of the investment in Mears Technologies Inc. (Mears) and a bridge loan to Mears.

The pro-forma financial information has been derived from the historical financial information, assuming completion of the pro-forma adjustments as at 30 June 2012.

Mears accounts as at 30 June 2012 were reviewed by Kahn, Litwin, Renza & Co, Ltd (KLR) and figures used in this report were derived from those accounts.

The Directors of the Company are responsible for the preparation and presentation of the historical and pro-forma financial information, including the determination of the pro-forma adjustments.

The historical and pro-forma financial information is presented in an abbreviated form insofar as it does not include all of the disclosures required by Australian Accounting Standards applicable to annual financial reports prepared in accordance with the Corporations Act 2001.

Level 4, 285 Clarence Street Sydney NSW 2000 Australia  
PO Box Q182 Sydney NSW 1230 ABN 65 085 182 822  
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### **Scope**

We have conducted our review of the historical and pro-forma financial information in accordance with Australian Standard on Review Engagements ASRE 2405 'Review of Historical Financial Information Other than a Financial Report' in order to state whether, on the basis on the procedures described, anything has come to our attention that causes us to believe that K2 Energy's historical and pro-forma financial information is not presented fairly, in all material respects, in accordance with K2 Energy's accounting policies as detailed in Note 3 to the financial information. ASRE 2405 requires us to comply with the requirements of the applicable code of professional conduct of a professional accounting body.

We have made such inquiries and performed such procedures as we, in our professional judgment, consider necessary to the circumstances including:

- a review of workpapers, accounting records and other documents pertaining to balances in existence at 30 June 2012;
- a review of the assumptions used to compile the pro-forma Consolidated Balance Sheet;
- a comparison of consistency in application of the recognition and measurement principles in Australian Accounting Standards (including Australian Accounting Interpretations) and the accounting policies adopted by the Company disclosed in the financial information; and
- inquiry of Directors and others.

A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and therefore these procedures do not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion on the historical and pro-forma financial information.

### **Conclusion**

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that:

- a) the historical financial information set out on pages 95 to 107 of the Prospectus is not presented fairly in accordance with the accounting policies adopted by the Company as described in Note 3 to the financial information, and
- b) the pro-forma Consolidated Balance Sheet of the Company set out on page 95 of the Prospectus has not been compiled on the basis of the pro-forma transactions as detailed in Note 2(b) to the financial information.

### **Emphasis of Matter**

Without qualification to the above conclusion attention is drawn to the following matter. The pro-forma Consolidated Balance Sheet includes goodwill on consolidation of \$28,031,226. As mentioned at note 9 the future carrying value of goodwill on consolidation will be dependent upon the future success of the commercialization of the Mears technology.

### **Subsequent Events**

Apart from the matters dealt with in this Report, and having regard for the scope of our Report, no other material transactions or events outside of the ordinary business of the Company have come to our attention that would require comment on, or adjustments to, the information contained in the historical and pro-forma financial information, or would cause such information to be misleading or deceptive.

### **Independence and Disclosure of Interest**

Stirling does not have any interest in the outcome of the Prospectus other than the preparation of this Report for which normal professional fees will be received. Consent to the inclusion of the Investigating Accountants' Report in the Prospectus in the form and context in which it appears has been given. At the date of this Report this consent has not been withdrawn.

Yours faithfully

Peter Turner  
Partner

## Annexure

### Consolidated Balance Sheet

		Actual 30 June 2012 \$	Pro Forma \$7.5 million 30 June 2012 \$	Pro Forma \$10 million 30 June 2012 \$
	Note			
<b>CURRENT ASSETS</b>				
Cash and cash equivalents	5	967,272	8,925,439	11,300,439
Trade and other receivables	6	1,030,897	195,392	195,392
<b>Total Current Assets</b>		<b>1,998,169</b>	<b>9,120,831</b>	<b>11,495,831</b>
<b>NON CURRENT ASSETS</b>				
Other financial assets	7	2,701,146	779,078	779,078
Property, plant and equipment	8	-	8,112	8,112
Goodwill on consolidation	9	-	28,031,226	28,031,226
<b>Total Non Current Assets</b>		<b>2,701,146</b>	<b>28,818,416</b>	<b>28,818,416</b>
<b>TOTAL ASSETS</b>		<b>4,699,315</b>	<b>37,939,247</b>	<b>40,314,247</b>
<b>CURRENT LIABILITIES</b>				
Trade and other payables	10	184,764	928,065	928,065
<b>Total Current Liabilities</b>		<b>184,764</b>	<b>928,065</b>	<b>928,065</b>
<b>TOTAL LIABILITIES</b>		<b>184,764</b>	<b>928,065</b>	<b>928,065</b>
<b>NET ASSETS</b>		<b>4,514,551</b>	<b>37,011,182</b>	<b>39,386,182</b>
<b>EQUITY</b>				
Issued capital	11	47,549,154	80,045,785	82,420,785
Reserves	12	2,621,100	2,621,100	2,621,100
Accumulated losses		(45,655,703)	(45,655,703)	(45,655,703)
<b>TOTAL EQUITY</b>		<b>4,514,551</b>	<b>37,011,182</b>	<b>39,386,182</b>

The Consolidated Balance Sheet should be read in conjunction with the accompanying notes.

The actual Consolidated Balance Sheet as at 30 June 2012 has been extracted from the consolidated financial statements of K2 Energy.

The pro forma Consolidated Balance Sheet as at 30 June 2012 has been compiled based on the Consolidated Balance Sheet as at 30 June 2012 and the reviewed accounts of Mears as at 30 June 2012 adjusted for the pro forma transactions outlined in Note 2(b).

## Consolidated Statement of Comprehensive Income

	Actual 30 June 2012 \$	Pro Forma \$7.5 million 30 June 2012 \$	Pro Forma \$10 million 30 June 2012 \$
Loss for the period	(1,052,250)	(1,052,250)	(1,052,250)
Income tax benefit/(expense)	-	-	-
Loss for the period after tax	(1,052,250)	(1,052,250)	(1,052,250)
Other comprehensive income	-	-	-
Total comprehensive income attributable to members of the entity	<u>(1,052,250)</u>	<u>(1,052,250)</u>	<u>(1,052,250)</u>

The actual Consolidated Statement of Comprehensive Income for the year ended 30 June 2012 has been extracted from the consolidated financial statements of K2 Energy.

The pro forma Consolidated Statement of Comprehensive Income for the year ended 30 June 2012 has been compiled based on the Consolidated Statement of Comprehensive Income for the year ended 30 June 2012 adjusted for the pro forma transactions outlined in Note 2(b).

The pro-forma Consolidated Statement of Comprehensive Income does not include the losses incurred by Mears. The reviewed accounts for Mears show the loss for the year ended 31 December 2011 amounted to US\$4,714,071 (A\$4,599,991 approximately) and US\$2,960,455 (A\$2,888,812 approximately) for the 6 months to 30 June 2012.

At 30 June 2012 no adjustment has been made for the loss incurred by Mears because it had not been acquired as at that date.

## Consolidated Statement of Changes of Equity

	Issued Capital \$	Option Reserve \$	Accumulated Losses \$	Total \$
<b>Actual:</b>				
<b>Balance at 1 July 2011</b>	<b>46,686,559</b>	<b>2,621,100</b>	<b>(44,603,453)</b>	<b>4,704,206</b>
Total comprehensive income attributable to members of the entity	-	-	(1,052,250)	(1,052,250)
Issue of Shares	862,595	-	-	862,595
<b>Actual Balance at 30 June 2012</b>	<b>47,549,154</b>	<b>2,621,100</b>	<b>(45,655,703)</b>	<b>4,514,551</b>
<b>Pro Forma Adjustments:</b>				
Issue of shares	25,621,631	-	-	25,621,631
Placement of \$7.5 million	7,500,000	-	-	7,500,000
Costs associated with issue of abovementioned shares	(625,000)	-	-	(625,000)
<b>Pro forma balance at 30 June 2012</b>	<b>80,045,785</b>	<b>2,621,100</b>	<b>(45,655,703)</b>	<b>37,011,182</b>
<b>Pro Forma Adjustments:</b>				
Issue of shares (Placement of additional \$2.5 million)	2,500,000	-	-	2,500,000
Costs associated with issue of additional shares	(125,000)	-	-	(125,000)
<b>Pro forma balance at 30 June 2012</b>	<b>82,420,785</b>	<b>2,261,100</b>	<b>(45,655,703)</b>	<b>39,386,182</b>

The actual Consolidated Statement of Changes of Equity for the year ended 30 June 2012 has been extracted from the consolidated financial statements of K2 Energy.

The pro forma Consolidated Statement of Changes of Equity for the year ended 30 June 2012 has been compiled based on the Consolidated Statement of Changes of Equity for the year ended 30 June 2012 adjusted for the pro forma transactions outlined in Note 2(b).



## Summary of Significant Accounting Policies

### 1. Reporting Entity

K2 Energy is a company domiciled in Australia. The consolidated financial statements of the Company as at and for the year ended 30 June 2012 comprise the Company and its controlled entities (together referred to as the Consolidated Entity). The Consolidated Entity owns the worldwide rights to all intellectual property covering solar energy applications developed by Mears, has an investment in and has provided a bridge loan to Mears and has oil and gas interests in the USA, via its shareholding in Trey Resources 1 LLC.

### 2(a). Basis of Preparation

#### *Statement of Compliance*

The financial report is a general purpose financial report, which has been prepared in accordance with Australian Accounting Standards (AASBs) (including Australian Interpretations) adopted by the Australian Accounting Standards Board and the Corporations Act 2001. The financial report of the Consolidated Entity and the financial report of the Company comply with International Financial Reporting Standards and Interpretations adopted by the International Accounting Standards Board.

#### *Basis of Measurement*

The consolidated financial statements have been prepared on the historical cost basis.

#### *Functional and Presentation Currency*

The consolidated financial statements are presented in Australian dollars, which is the Company's functional currency.

#### *Use of Judgments and Estimates*

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. In particular, information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is described in the following areas: Impairment and Financial instruments.

### 2(b). Assuming Full Subscription pursuant to a Placement

The pro-forma financial information has been prepared from information extracted from the audited consolidated balance sheet and statement of changes in equity as at 30 June 2012 and statement of comprehensive income for the year to 30 June 2012 and the reviewed accounts of Mears as at 30 June 2012, adjusted for the following transactions as if they had taken place on 30 June 2012:

Transactions relating to shares of K2 Energy reflect the proposed consolidation of shares on issue on a 1 for 10 basis as set out in section 7.12 of the Prospectus.

The issue of up to 85,037,866 shares at an issue price of \$0.30 per share as consideration for all the shares of Mears not owned by K2 Energy, the issue of 25,000,000 (minimum) / 33,333,334 (maximum) shares at an issue price of \$0.30 per share to raise \$7.5 million (minimum) / \$10 million (maximum) pursuant to a placement and 3,675,750 shares at an issue price of \$0.03 per share in July 2012 which raised \$110,273 (pre 10 for 1 consolidation). The fair value of the existing investment in Mears is dependent on a planned rights issue, the outcome of which is unknown. Therefore, for the purpose of preparing the pro-forma report the fair value of the existing investment in Mears is assumed to remain unchanged. Expenses associated with the placement and merger (including legal, accounting, listing and administrative fees as well as printing, travel and other expenses) which are estimated to be between \$625,000 to \$750,000, have been directly off set against share capital. This issue is contingent upon a number of conditions precedent as set out in the Merger Agreement.

The Merger Agreement provides that a minimum amount of \$7.5 million and a maximum amount of \$10 million is to be raised pursuant to a placement, as a condition precedent to the merger. The Pro Forma consolidated balance sheets assume amounts of either \$7.5 million or \$10 million are raised.

### 3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements and have been applied consistently by all entities in the Consolidated Entity.

#### a. Basis of Consolidation

##### *Controlled entities*

Controlled entities are entities controlled by the Company. Control exists when the Company has power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of controlled entities are included in the consolidated financial statements from the date that control commences until the date that control ceases. Investments in controlled entities are carried at their cost of acquisition in the Company's financial statements.

##### *Transactions eliminated on consolidation*

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

#### b. Income Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured.

The following specific recognition criteria must also be met before revenue is recognised:

##### *Interest*

Control of the right to receive the interest payment.

#### c. Goods and Services Tax

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense. Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the relevant taxation authority is included as a current asset or liability in the balance sheet. Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, the relevant taxation authority are classified as operating cash flows.

#### d. Foreign Currency

Transactions in foreign currencies are translated to the respective functional currencies of controlled entities at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary transactions denominated in foreign currencies that are stated at historical cost are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at the foreign exchange rates ruling at the date the fair value was determined. Foreign exchange differences arising on translation are recognised in the income statement.

##### *Financial statements of foreign operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, generally are translated to the functional currency at foreign exchange rates ruling at the reporting date. The revenues and expenses of foreign operations are translated to the functional currency at rates approximating the foreign exchange rates ruling at the dates of transactions. Foreign currency differences arising from translation of controlled entities with a different functional currency to that of the Consolidated Entity are recognised in the foreign currency translation reserve (FCTR). When a foreign operation is disposed of, in part or in full, the relevant amount of its FCTR is transferred to profit or loss.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a foreign operation and are recognised directly in equity in the FCTR.

#### e. Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with an original maturity of three months or less.

#### f. Provisions

A provision is recognised in the balance sheet when the Consolidated Entity has a present legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.



## **i. Exploration, Evaluation and Development Expenditure**

Exploration, evaluation and development expenditure incurred is accumulated in respect of each identifiable area of interest. These costs are carried forward only if they relate to an area of interest for which rights of tenure are current and in respect of which:

- (i) such costs are expected to be recouped through successful development and exploitation or from sale of the area; or
- (ii) exploration and evaluation activities in the area have not, at balance date, resulted in booking economically recoverable reserves, and active operations in, or relating to, this area are continuing.

Accumulated costs in respect of areas of interest which are abandoned are written off in full against profit in the year in which the decision to abandon the area is made.

A regular review is undertaken of each area of interest to determine the appropriateness of continuing to carry forward costs in relation to that area of interest.

Amortisation is charged against individual wells based on a well life of 5 years where reserve estimates are not yet available. Amortisation is not charged on costs carried forward in respect of areas of interest in the development phase until production commences.

## **j. Restoration**

Provisions for future environmental restoration are recognised where there is a present obligation as a result of exploration, development, production, transportation or storage activities having been undertaken, and it is probable that an outflow of economic benefits will be required to settle the obligation. The estimated future obligations include the costs of removing facilities, abandoning wells and restoring the affected areas.

The provision for future restoration costs is the best estimate of the present value of the expenditure required to settle the restoration obligation at the reporting date, based on current legal requirements and technology. Future restoration costs are reviewed annually and any changes in the estimate are reflected in the present value of the restoration provision at the end of the balance sheet date, with a corresponding change in the cost of the associated asset.

The amount of the provision for future restoration costs relating to exploration, development and production facilities is capitalized and depleted as a component of the cost of those activities.

The unwinding of the effect of discounting on the provision is recognised as a finance cost.

## **k. Goodwill**

Goodwill represents the excess of the cost of the acquisition over the Consolidated Entity's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquiree. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

## **l. Employee Benefits**

### *Wages, salaries and annual leave*

Liabilities for employee benefits for wages, salaries and annual leave expected to settle within 12 months of the year end represent present obligations resulting from employees' services provided up to reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that the Consolidated Entity expects to pay as at reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

### *Share based payments*

The Company had granted options to certain directors and employees. The fair value of options and shares granted was recognised as an expense with a corresponding increase in equity. The fair value was measured at the date the options or shares were granted taking into account market based criteria and expensed over the vesting period after which the employees become unconditionally entitled to the options and shares. The fair value of the options granted is measured using the Black-Scholes method, taking into account the terms and conditions attached to the options. The fair value of the performance shares granted is measured using the weighted average share price of ordinary shares in the Company, taking into account the terms and conditions attached to the shares. The amount recognised as an expense is adjusted to reflect the actual number of options and shares that vest except where forfeiture is due to market related conditions.

## **m. Receivables**

Trade and other receivables are stated at amortised cost less impairment losses (see accounting policy (g)).

## **n. Taxation**

Income tax expense in the income statement for the periods presented comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences are not provided for the initial recognition of goodwill and other assets or liabilities in a transaction that affects neither accounting nor taxable profit, or differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future.

**o. Payables**

Trade and other payables are stated at amortised cost.

**p. Finance income and expense**

Interest income is recognised as it accrues in the income statement using the effective interest method.

**q. Earnings per share**

The Consolidated Entity presents basic and diluted earnings per share (EPS) for its ordinary shares. Basic EPS is calculated by dividing the net loss attributable to equity holders of the parent for the financial period, after excluding any costs of servicing equity (other than ordinary shares) by the weighted average number of ordinary shares of the Company, adjusted for any bonus issue.

Diluted EPS is calculated using the basic EPS earnings as the numerator. The weighted average number of shares used as the denominator is adjusted by the after-tax effect of financing costs associated with the dilutive potential ordinary shares and the effect on revenues and expenses of conversion to ordinary shares associated with dilutive potential ordinary shares adjusted for any bonus issue.

**r. Segment Reporting**

An operating segment is a component of The Consolidated Entity that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of The Consolidated Entity's other components if separately reported and monitored. An operating segment's operating results are reviewed regularly by the Board of Directors to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the Board of Directors include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate head office results.

**s. Ordinary shares**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any income tax benefit.

**t. New Standards and Interpretations not yet adopted**

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2012 reporting period. None of these are expected to have a significant effect on the consolidated financial statements of the Consolidated Entity except for AASB 9 Financial Instruments, which becomes mandatory for the Consolidated Entity's 2016 consolidated financial statements and could change the classification and measurement of financial assets. The Consolidated Entity does not plan to adopt this standard early and the extent of the impact has not been determined.

**u. Other financial assets**

Financial assets in the scope of AASB 139 Financial Instruments: Recognition and Measurement are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transactions costs. The Consolidated Entity determines the classification of its financial assets after initial recognition and, when allowed and appropriate, re-evaluates this designation at each financial year-end.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Consolidated Entity commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets under contracts that require delivery of the assets within the period established generally by regulation or convention in the marketplace.

*(i) Financial assets at fair value through profit or loss*

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on investments held for trading are recognised in profit or loss.

*(ii) Held-to-maturity investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Consolidated Entity has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. Investments that are intended to be held-to-maturity, such as bonds, are subsequently measured at amortised cost. This cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount.

This calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in profit or loss when investments are derecognised or impaired, as well as through amortisation process.

*(iii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

*(iv) Available-for-sale investments*

Available-for-sale investments are those non-derivative financial assets that are designated as available-for-sale or are not classified as any of the three preceding categories. After initial recognition available-for-sale investments are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is recognised in profit or loss.

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments with no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument that is substantially the same; discounted cash flow analysis and option pricing models.

**v. Research and Development**

Expenditure during the research phase of a project is recognised as an expense when incurred. Development costs are capitalised only when technical feasibility studies identify that the project will deliver future economic benefits and these benefits can be measured reliably. Development costs have a finite life and are amortised on a systematic basis matched to the future economic benefits over the useful life of the project.



## 4. FINANCIAL RISK MANAGEMENT

### Overview

The Company and Consolidated Entity have exposure to the following risks from the use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Company's and the Consolidated Entity's exposure to each of above risks, their objectives, policies and processes for measuring and managing risk, and the management of capital. Further quantitative disclosures are included throughout these consolidated financial statements. The Board of directors has overall responsibility for the establishment and oversight of the risk management and monitors operational and financial risk management throughout the Consolidated Entity. Monitoring risk management includes ensuring appropriate policies and procedures are published and adhered to. The Management reports to the Audit Committee.

The Board aims to manage the impact of short-term fluctuations on the Company's and the Consolidated Entity's earnings. Over the longer term, permanent changes in market rates will have an impact on earnings.

The Company and the Consolidated Entity are exposed to risks from movements in exchange rates, commodity prices and interest rates that affect revenues, expenses, assets, liabilities and forecast transactions. Financial risk management aims to limit these market risks through ongoing operational and finance activities.

Exposure to credit, commodity prices, foreign exchange and interest rate risks arises in the normal course of the Company's and the Consolidated Entity's business. Derivative financial instruments are not used to hedge exposure to fluctuations in foreign exchange rates, interest rates or commodity prices.

The Audit Committee oversees adequacy of the company's risk management framework in relation to the risks faced by the Company and the Consolidated Entity.

#### *Credit Risk*

Credit risk is the risk of financial loss to the Company or the Consolidated Entity if a customer, controlled entity or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's and the Consolidated Entity's receivables from customers.

#### *Trade and other receivables*

The Company's and Consolidated Entity's exposure to credit risk is influenced mainly by the geographical location and characteristics of individual customers. The Consolidated Entity does not have a significant concentration of credit risk with a single customer.

Policies and procedures of credit management and administration of receivables are established and executed at a regional level.

In monitoring customer credit risk, the ageing profile of total receivables balances is reviewed by management by geographic region on a monthly basis.

The Company and the Consolidated Entity have established an allowance for impairment that represents their estimate of incurred losses in respect of trade and other receivables.

#### *Liquidity Risk*

Liquidity risk is the risk that the Consolidated Entity will not be able to meet its financial obligations as they fall due. The Consolidated Entity's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Consolidated Entity's reputation.

The Consolidated Entity monitors cash flow requirements and produces cash flow projections for the short and long term with a view to optimising return on investments. Typically, the Consolidated Entity ensures that it has sufficient cash on demand to meet expected operational net cash flows for a period of at least 30 days, including the servicing of financial obligations. This excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters.

#### *Market Risk*

Market risk is the risk that changes in market prices such as foreign exchange rates, commodity prices interest rates and equity prices will affect the Company's and the Consolidated Entity's net loss or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

#### *Currency Risk*

The Consolidated Entity undertakes its exploration and production transactions denominated in US currency and is exposed to currency risk on the value of its exploration assets and sales and purchases that are denominated in United States dollars (USD).

None (2011- none) of the Consolidated Entity's revenues and over 74% (2011-58%) of costs are denominated in currencies other than AUD. Risk resulting from the translation of assets and liabilities of foreign operations into the Consolidated Entity's reporting currency is not hedged

### *Interest Rate Risk*

The Consolidated Entity is exposed to interest rate risks in relation to the return earned on its funds on deposit and invested. The Consolidated Entity does not have short or long term debt, and therefore risk is minimal.

### *Capital Management*

The Consolidated Entity's objectives when managing capital are to safeguard its ability to continue as a going concern, to provide returns to shareholders, to provide benefits to other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Board aims to maintain and develop a capital base appropriate to the Consolidated Entity. In order to maintain or adjust the capital structure, the Consolidated Entity can issue new shares. The Board of directors undertakes periodic reviews of the Consolidated Entity's capital management position to assess whether the capital management structure is appropriate to meet the Consolidated Entity's medium and long-term strategic requirements. Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements. There were no significant changes in the Consolidated Entity's approach to capital management during the year.

	Actual 30 June 2012	Pro Forma \$7.5 million 30 June 2012	Pro Forma \$10 million 30 June 2012
<b>5. Cash Assets</b>			
Cash at bank	<u>967,272</u>	<u>8,925,439</u>	<u>11,300,439</u>
Movements in cash:			
Balance as at 30 June 2012		967,272	967,272
3,675,750 shares issued at 3 cents per share (pre 10 for 1 consolidation) (\$66,000 collected in June 2012)		44,273	44,273
25,000,000 shares (\$7.5 million placement) / 33,333,334 shares (\$10 million placement) issued at 30 cents per share pursuant to a placement		7,500,000	10,000,000
Mears cash acquired upon acquisition	1,038,894	1,038,894	
Costs associated with the placement		<u>(625,000)</u>	<u>(750,000)</u>
Pro forma at 30 June 2012		<u>8,925,439</u>	<u>11,300,439</u>

Mears intends to undertake a rights issue to raise between \$US1m and \$US1.5m. No adjustment has been made in this report for the amount raised as the amount to be raised would approximate expenditure incurred by Mears since 30 June 2012.

### **6. Trade and Other Receivables**

#### **Current**

Other debtors	22,813	180,755	180,755
Bridge loan	1,008,084	-	-
Restricted investment	-	14,637	14,637
	<u>1,030,897</u>	<u>195,392</u>	<u>195,392</u>

- Other debtors as at June 2012 include accrued interest on the Bridge loan which is due on maturity of the loan and other amounts that are non-interest bearing and generally on 30 day terms
- The bridge loan to Mears bears interest at 18% pa and the loan together with interest accrued is repayable 12 months after the funds were advanced. Repayment of the loan will not be required by K2 Energy should the merger be completed. Should the merger not proceed, recoverability of the loan is dependent on Mears ability to repay the loan.



<b>7. Other Financial Assets</b>	Actual 30 June 2012	Pro Forma \$7.5 million 30 June 2012	Pro Forma \$10 million 30 June 2012
Shares in unlisted company (Mears)	1,922,068	-	-
Investment in Limited Liability Company	779,078	779,078	779,078
	<u>2,701,146</u>	<u>779,078</u>	<u>779,078</u>

## **8. Property, Plant and Equipment**

Office equipment	<u>-</u>	<u>8,112</u>	<u>8,112</u>
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## **9. Goodwill on consolidation**

Goodwill on consolidation	<u>-</u>	<u>28,031,226</u>	<u>28,031,226</u>
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### Acquisition of Mears

#### Consideration

Issue of 85,037,866 shares @ 30 cents per share	-	25,511,358	25,511,358
Fair Value of previously held interest*	-	1,922,068	1,922,068
Fair Value of identifiable net assets**	<u>-</u>	<u>597,800</u>	<u>597,800</u>
Goodwill on consolidation	<u>-</u>	<u>28,031,226</u>	<u>28,031,226</u>

\* AASB 3 requires any previously acquired interest in the acquiree to be fair valued at the time of gaining control of the acquiree and any gain or loss on fair value to be recognized in the income statement.

The fair value of the existing investment in Mears is dependent on the outcome of the planned rights issue. Because the outcome is not known at this stage the directors have assumed that there will be no change in the fair value and if a change was to occur it would not be material.

\*\* A statement of the net assets of Mears as at 30 June 2012 is shown at section 5.4 of the Prospectus. The fair value of identifiable net assets to be acquired is based on the net assets of Mears as reflected as at that date. The actual net assets to be acquired will be determined based on the net asset position of Mears as at the date of completion of the merger.

As detailed in the Prospectus, since its incorporation Mears has expended approximately US\$65 million all of which has been expensed. Mears owns 111 granted patents of which 54 are United States of America patents and has further patents pending. Goodwill on consolidation will be reassessed at each balance date of the Company for impairment. The future carrying value of goodwill on consolidation will be dependent upon the future success of the commercialization of the Mears technology.

## **10. Trade and Other Payables**

Accruals	118,764	372,534	372,534
Share Purchase Plan receipts (partial receipts collected in June 2012)	66,000	-	-
Bridge Loan	<u>-</u>	<u>555,531</u>	<u>555,531</u>
	<u>184,764</u>	<u>928,065</u>	<u>928,065</u>

The bridge loan represents amounts due to third parties by Mears. It bears interest at 18% pa and the loan together with interest accrued is repayable 12 months after the funds were advanced.

## 11. Contributed Equity

(a) Issued Capital	\$7.5m raised Number	\$7.5m raised \$	\$10m raised Number	\$10m raised \$
Balance at 30 June 2012	24,038,140	47,549,154	24,038,140	47,549,154
Pro forma adjustments:				
Issue of shares prior to merger	367,575	110,273	367,575	110,273
Issue of shares pursuant to merger	85,037,861	25,511,358	83,333,334	25,511,358
Issue of shares pursuant to placement	25,000,000	7,500,000	33,333,334	10,000,000
Less costs associated with placement	-	(625,000)	-	(750,000)
Pro forma at 30 June 2012	<u>134,443,576</u>	<u>80,045,785</u>	<u>142,776,910</u>	<u>82,420,785</u>

The merger and placement is subject to shareholder approval of K2 Energy shareholders. A maximum of 85,037,866 shares are to be issued to acquire all those shares and options/warrants not already owned in Mears by K2 Energy.

The Merger Agreement provides that a minimum amount of \$7.5 million and a maximum amount of \$10 million is to be raised pursuant to a placement as a condition precedent to the merger. The Pro-forma consolidated balance sheets assume that amounts of \$7.5 million or \$10 million is raised.

### (b) Options

	Number
Issue of options prior to 30 June 2012	<u>600,000</u>
Pro forma at 30 June 2012	<u>600,000</u>

At 30 June 2012 there were 6 million existing options (pre 10 for 1 consolidation) on issue. The options are exercisable at a price of 20 cents each and will expire on 31 December 2014. Each option entitles the holder, when exercised, to one Share in the capital of K2 Energy.

Shares and share options held by directors are disclosed in section 7.18 of the Prospectus.

12. Reserves	Actual 30 June 2012	Pro Forma \$7.5 million 30 June 2012	Pro Forma \$10 million 30 June 2012
Share option reserve	<u>2,621,100</u>	<u>2,621,100</u>	<u>2,621,100</u>

### Nature and purpose of reserve

The share based payment reserve is used to recognise the fair value of options issued.

## 13. Events Subsequent to Balance Date

Other than as contained in the 2012 Financial Accounts, the directors are not aware of any matter or circumstance that has arisen since the end of the financial year to the date of this report that has significantly affected or may affect:

- (i) The operations of the company and the entities that it controls
- (ii) The results of those operations
- (iii) The state of affairs of the company in subsequent years.

Subsequent to the end of the financial year Trey Resources 1, LLC has acquired additional oil and gas assets in Texas for which it paid cash and issued additional units in Trey Resources 1, LLC as part consideration. K2 Energy's unit holding remains the same with its percentage holding being approximately 17% of the now expanded Trey Resources 1, LLC.

#### **14. Contingent Liabilities and Commitments**

The Consolidated Entity is not aware of any contingent liabilities, which existed as at the end of the financial year or have arisen as at the date of this report, other than as contained in the 2012 Financial Accounts

#### **15. Related Party Disclosures**

##### ***Ultimate Parent***

K2 Energy Limited is the ultimate Australian parent company.

##### ***Other Related Party Transactions***

There are no related party transactions, other than as contained in the 2012 Financial Accounts

##### ***Equity holdings of key management personnel***

Directors interest in shares and options held by directors are disclosed in section 7.18 of the Prospectus.

## Schedule 7 – Independent Expert’s Report

# **K2 ENERGY LIMITED**

Proposed Acquisition of Mears Technologies, Inc.

Independent Expert's Report  
and Financial Services Guide

11 January 2013



**LEADENHALL**  
corporate advisory

**Valuations and Transaction Specialists**

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ABN 11 114 534 619

11 January 2013

The Independent Director  
K2 Energy Limited  
Level 2, Kyle House  
27 Macquarie Place  
Sydney NSW 2000

Dear Director,

## **Independent Expert's Report for K2 Energy Limited**

### **1. Introduction**

K2 Energy Limited (“**K2**”) is a public company listed on the Australian Securities Exchange (“**ASX**”) that was originally formed to invest in oil and gas exploration in the United States of America (“**US**”). More recently K2 has invested in Mears Technologies, Inc. (“**Mears**”).

Mears is an unlisted US based company that has developed and patented a nano engineered silicon material. The material allows silicon chips to operate at lower temperatures and consume less power than alternative chip materials.

On 22 October 2012, K2 announced that it had reached an agreement on merger terms with Mears whereby K2 will acquire all of the equity in Mears that it does not already own (“**The Proposed Transaction**”). K2 is to issue approximately 85 million new shares as consideration for Mears, with the final number depending on the proceeds of a rights issue that Mears is presently conducting. The shares to be issued will be shares in a combined K2 and Mears which we have defined as the (“**Proposed Merged Entity**”).

Further details of the Proposed Transaction are set out in Section 1 of our detailed report.

### **2. Purpose of the Report**

The director of K2 that is not associated with Mears (“**Independent Director**”) have engaged Leadenhall Corporate Advisory Pty Ltd (“**Leadenhall**”) to prepare an independent expert's report, setting out whether in Leadenhall's opinion the Proposed Transaction is fair and reasonable to K2 shareholders that are not associated with Mears securityholders (“**Shareholders**”). This report is to be included in the notice of meeting that will be sent to Shareholders regarding the Proposed Transaction.

Further details of the purpose of this report are provided in Section 2 of our detailed report.

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

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**Leadenhall Corporate Advisory Pty Ltd.**

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other than for the acts or omissions of financial services licensees. A.F.S. Licence No: 293586.



### 3. Basis of Evaluation

In order to assess whether the Proposed Transaction is fair and reasonable we have:

- assessed whether the Proposed Transaction is fair by determining whether the value of the consideration offered is equal to, or less than, our assessed Fair Market Value of the interest in Mears to be acquired; and
- assessed it as reasonable if it is fair, or despite not being fair the advantages to Shareholders outweigh the disadvantages. We have therefore analysed the advantages and disadvantages to Shareholders of undertaking the Proposed Transaction.

### 4. Conclusion

#### *The Proposed Transaction is Fair*

The Proposed Transaction is fair because the Fair Market Value of the interest in Mears to be acquired by K2 is above the Fair Market Value of the consideration offered.

#### **Value of Mears**

We have valued 100% of the equity in Mears to be in the range from US\$40 million to US\$45 million on a minority interest basis. We have estimated the Fair Market Value of Mears using the discounted cash flow method and an analysis of recent trading in Mears shares.

In applying the discounted cash flow methodology, we applied a post-tax discount rate in the range of 30% to 35% to discount Mears' projected after tax cash flows to their present value; and then calculated a terminal value based on the expected long-term growth rate of future cash flows.

Due to the start-up nature of Mears' business we have projected a period of continuing high growth followed by a period of decline thereafter, which results in a 24 year forecast period for Mears. The discounted cash flow analysis resulted in a value for 100% of the equity in Mears in the range from US\$37 million to US\$56 million on a minority interest basis.

Further details on the assumptions adopted are provided in Section 7.1 of our detailed report. Due to the uncertainty surrounding the assumptions in the model, particularly surrounding the forecasted volume of sales, we have highlighted the impact of alternative assumptions on the value of Mears in a sensitivity analysis. The sensitivity analysis indicates that the value for Mears can vary significantly depending on the assumptions adopted; therefore care should be taken by Shareholders in forming a view regarding the key value drivers.

The value of Mears based on the most recent round of financing was US\$44 million which represents a minority interest value. This occurred in October 2011. The company has advanced its plans towards commercialisation since that time. As a result of this transaction evidence, combined with our discounted cash flow analysis, we adopted a range of US\$40 million to US\$45 million for 100% of the equity in Mears.

As K2 already owns 8% of the shares in Mears as well as number of warrant to subscribe for new Mears shares the value of this existing ownership interest needs to be deducted from the value of 100% of Mears in evaluating the effective consideration. After deducting the value of the interest in Mears already owned by K2 and translating into Australian dollars, the value of the remaining interest in Mears to be acquired becomes \$35 million to \$39 million.

#### **Value of Consideration Offered**

The consideration offered by K2 is approximately 85 million shares in the Proposed Merged Entity, with the exact number depending on the take up of a rights issue that Mears is currently undertaking. We have determined the Fair Market Value of the Proposed Merged Entity by adding the value of K2's other investments to the value of Mears, with \$6.5 million added for the worldwide rights to solar power applications of Mear's technology, and \$1.0 million to \$1.2 million added for the remaining oil and gas interests. This leads to a value per K2 share (after a proposed 1 for 10 consolidation) of \$0.43 to \$0.48, somewhat higher than recent trading in K2's shares at around \$0.25 to \$0.30 (equivalent after a proposed 1 for 10 consolidation). However we note that trading in K2 shares has been very illiquid recently, according we have adopted a range of \$0.35 to \$0.41, which implies a proposed consideration of \$30 million to \$35 million. This range is also consistent with a proposed capital raising K2 is currently undertaking.



### Conclusion on Fairness

We set out below a comparison of the Fair Market Value of the interest in Mears to be acquired with the proposed consideration:

**Table 1: Comparison of the interest in Mears to be acquired with the proposed consideration**

		Low \$'000	High \$'000
Fair Market Value of interest in Mears to be acquired	(Section 7.4)	35,000	40,000
Fair Market Value of the proposed consideration	(Section 8.4)	30,000	35,000

Source: Leadenhall analysis

As the proposed consideration is below the fair market value of the interest in Mears to be acquired the Proposed Transaction is fair.

### *The Proposed Transaction is Reasonable*

We have defined the Proposed Transaction as being reasonable if it is fair, or if despite not being fair, the overall advantages of the proposal outweigh its disadvantages from the perspective of Shareholders. We have therefore considered the advantages and disadvantages to Shareholders of the Proposed Transaction.

### Advantages

The main advantages of the Proposed Transaction to Shareholders are:

- **Fairness** – the Proposed Transaction is fair.
- **Scale** – the increased scale will allow K2 to spread its listing costs over a wider base and to potentially enjoy better terms with employees, suppliers and financiers.
- **Liquidity** – the increased value should lead to an increase in market capitalisation, which may in turn improve the level of liquidity in K2 shares.
- **Full ownership of technology** – with ownership of rights Mears' technology for solar and computer chip applications in one entity it will be possible to focus on what has the best opportunities for success and if needed change priorities.

### Disadvantages

The main disadvantages of the Proposed Transaction to Shareholders are:

- **Increased risk** - after the Proposed Transaction, Shareholders will be heavily exposed to the success or failure of the Mears business, which is still in the start-up phase and thus carries a significant level of risk.
- **Potential for future dilution** - it is possible that the Proposed Merged Entity will run out of cash before it is able to generate sufficient revenues to meet its ongoing costs. This could lead to the need to raise future capital which may dilute K2's shareholders in the future.

### Conclusion on reasonableness

Since the Proposed Transaction is fair, it is also reasonable.





**Opinion**

In our opinion, the Proposed Transaction is fair and 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.

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

Yours faithfully

A handwritten signature in blue ink, appearing to read 'Richard Norris'.

Richard Norris  
**Senior Adviser**

A handwritten signature in blue ink, appearing to read 'Hamish Blair'.

Hamish Blair  
**Director**

**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 “**ours**” 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.

This FSG includes information about:

- who we are and how we can be contacted;
- the services we are authorised to provide;
- remuneration that we and/or our employees and any associates receive in connection with the general financial product advice;
- any relevant associations or relationships we have; and
- our complaints handling procedures and how you may access them.

**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:

- interests in managed investments schemes (excluding investor directed portfolio services); and
- securities (such as shares and debentures).

We provide financial product advice by virtue of an engagement to issue a report in connection with a financial product of another person. Our report will include a description of the circumstances of our engagement and the person 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.

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**Leadenhall Corporate Advisory Pty Ltd.**

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other than for the acts or omissions of financial services licensees. A.F.S. Licence No: 293586.



### **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 and set out in the report that we have been engaged to provide. Leadenhall is entitled to receive a fixed fee of \$33,000 (incl. GST) for preparing this report.

Except for the fees referred to above, neither Leadenhall, nor any of its Directors, 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**

All our employees receive a salary. Our employees are eligible for bonuses based on overall productivity but not directly in connection with any engagement for the provision of a report.

### **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  
Level 1, 31 Franklin Street  
Adelaide SA 5000

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.

11 January 2013



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## 1. Terms of the Proposed Transaction

Mears is a US based technology company that has developed a patent protected nano engineered silicon material. This material allows silicon chips to operate at lower temperatures and consume less power than alternative chip materials. Mears has recently changed its focus from research and development to concentrate on commercialisation of its technology.

K2 is an Australian company which is listed on the ASX that has:

- an 8% interest in Mears ordinary shares;
- warrants that if exercised would bring its holding in Mears to 17% on a fully diluted basis before the proposed rights issue;
- a \$1 million loan to Mears, with interest accruing at 18% per annum;
- worldwide rights to solar energy applications of the technology developed by Mears; and
- an investment in the oil and gas industry via a 17% holding in Trey Resources 1 LLC (“**Trey Resources**”).

On 22 October 2012, K2 announced that it had reached an agreement on merger terms with Mears. An agreement and plan of merger was subsequently signed on 4 December 2012. The key transaction steps proposed are:

- Mears will undertake a 1 for 2 rights issue at US\$0.25 per share.
- There will be a 1 for 10 consolidation of K2 shares.
- K2 will undertake a capital placement to raise between \$7.5 million and \$10 million. Based on the market soundings of K2’s broker we understand this is currently expected to be at \$0.30 per share (equivalent to \$0.03 before the consolidation).
- K2 will acquire all of the existing outstanding shares, options and warrants in Mears that it does not already own, for consideration of 80 million new K2 shares. The purchase consideration for Mears is to be adjusted as described in section 3.1(b) of the Notice of Meeting, Explanatory Memorandum and Prospectus. The adjustment primarily takes account of any additional capital raised by Mears through its rights issue.
- K2 will change its name to Mears Technologies Limited.

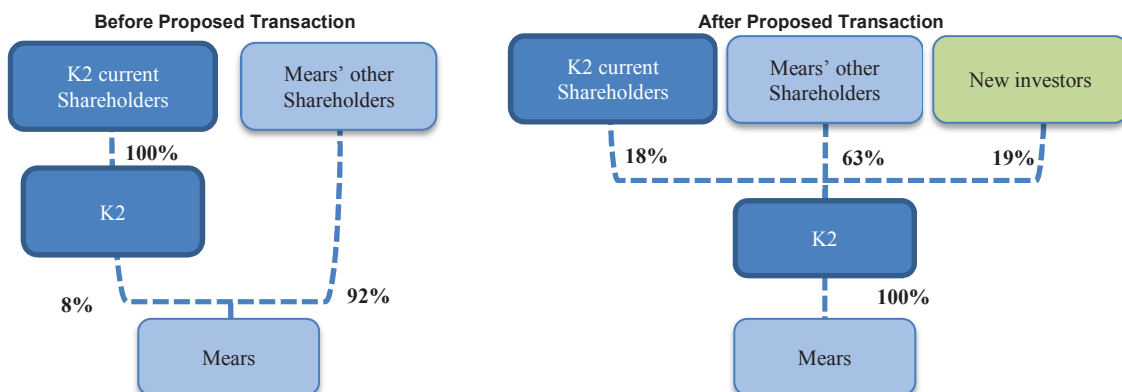
If the Proposed Transaction proceeds, Mears will merge with a wholly owned subsidiary of K2. We have referred to this combined group of K2 and Mears as the Proposed Merged Entity.

As a result of these transactions, K2’s current shareholders will hold approximately 18% of the Proposed Merged Entity, with the exact percentage depending on the take-up of Mears’ rights issue and K2’s capital placement. The Proposed Transaction remains subject to a number of conditions including:

- shareholder approval;
- completion of the proposed capital raising; and
- relevant regulatory approvals.

The existing and proposed corporate structures of K2 and Mears are outlined below.

**Figure 1: Impact on Corporate Structure of the Proposed Transaction**



Source: Leadenhall Analysis

Note: Assumes 25 million K2 shares issued under proposed placement



## 2. Scope of the Report

### 2.1. Purpose of the Report

ASX Listing Rule 10.1 requires a listed entity to obtain shareholders' approval before it acquires a substantial asset from a related party. An asset is considered to be substantial if its value, or the consideration being paid for it, is 5% or more of the equity in the listed entity, as set out in its latest accounts lodged with the ASX.

The equity of K2 on 30 June 2012 was \$4.5 million, as set out in the company's Annual Report lodged with the ASX on 28 September 2012. The last traded price of K2 before 24 December 2012 was \$0.022, which is equivalent to \$0.22 after the proposed 1 for 10 consolidation.

Dr Robert Mears is a director of K2 and the value of the Mears securities being acquired from Dr Mears as part of the Proposed Transaction exceeds 5% of the equity of K2 (as does the value of the K2 shares being issued to Dr Mears in exchange for those Mears securities). Accordingly, the Proposed Transaction is an acquisition of a substantial asset from a related party. As a result, the Proposed Transaction must be approved by K2 shareholders that are not associated with the transaction. ASX Listing Rule 10.10 requires that the Notice of Meeting sent to shareholders advising them of such a transaction must include a report on the transaction from an independent expert. The independent expert's report must state whether the transaction is fair and reasonable to the non-associated shareholders.

The Independent Director has engaged Leadenhall to prepare an independent expert's report in accordance with Listing Rule 10.10 stating whether the Proposed Transaction is fair and reasonable to Shareholders. This report is to accompany the Notice of Meeting to be sent to shareholders of K2 in order to assist Shareholders in their decision whether to vote for, or against, the Proposed Transaction.

### 2.2. Basis of Evaluation

The ASX Listing Rules do not define the term 'fair and reasonable' and provide no guidance on what should be considered when assessing whether a proposed transaction is fair and reasonable. However, guidance on what an independent expert should consider and how 'fair and reasonable' should be defined is contained in Regulatory Guide 111: Content of expert reports ("RG111") issued by the Australian Securities and Investment Commission. RG 111 states that in the context of related party transactions requiring an independent expert's report as a result of ASX Listing Rule 10, there should be separate assessments of whether the transaction is 'fair' and whether it is 'reasonable'. We have therefore considered the concepts of "fairness" and "reasonableness" separately as discussed below.

#### *Fairness*

RG 111 defines a related party transaction as being fair if the value of the financial benefit to be provided by the company to the related party is equal to or less than the value of the consideration being provided to the company. Accordingly, Leadenhall has assessed whether the Proposed Transaction is fair by comparing the value of Mears to the value of the proposed consideration. We have assessed the values of Mears and the proposed consideration at their 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 arms' 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.*

This definition of Fair Market Value is consistent with the definition in RG 111 at paragraph 57.

Special value is defined as the amount a specific purchaser is willing to pay in excess of Fair Market Value. Such specific purchasers 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; these synergies should be included in Fair Market Value. Special value is typically not considered in forming an opinion on the Fair Market Value of an asset and our valuations of Mears and the proposed consideration do not include any special value.



### **Reasonableness**

In accordance with RG 111, 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. To assess the reasonableness of the Proposed Transaction we have considered the following significant factors recommended by RG 111:

- the financial situation and solvency of K2;
- opportunity costs;
- the alternative options available to K2 and their likelihood of occurring;
- K2's bargaining position;
- whether there is selective treatment of any security holder, particularly Dr Mears;
- any special value of the transaction to K2; and
- the liquidity of the market in K2's securities.

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

### **2.3. Individual Investors' Particular Circumstances**

We have evaluated the Proposed Transaction for Shareholders as a whole and have not considered its effect on the particular circumstances of individual investors. Due to their particular 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 different conclusions from ours on whether the Proposed Transaction is fair and reasonable. If in doubt investors should consult an independent financial adviser.

### **2.4. Limitations and Reliance on Information**

Leadenhall's opinion is based on current economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over a relatively short period of time. Any such changes subsequent to the issue of this report could change our opinion. In preparing this report we have considered the information set out in Appendix 2. We have undertaken limited analysis and enquiry in relation to this information. However, our procedures and enquiries do not include verification work nor constitute an audit in accordance with Australian Auditing Standards. This report should be read in conjunction with the declarations outlined in Appendix 4.



### 3. Profile of the Semiconductor Industry

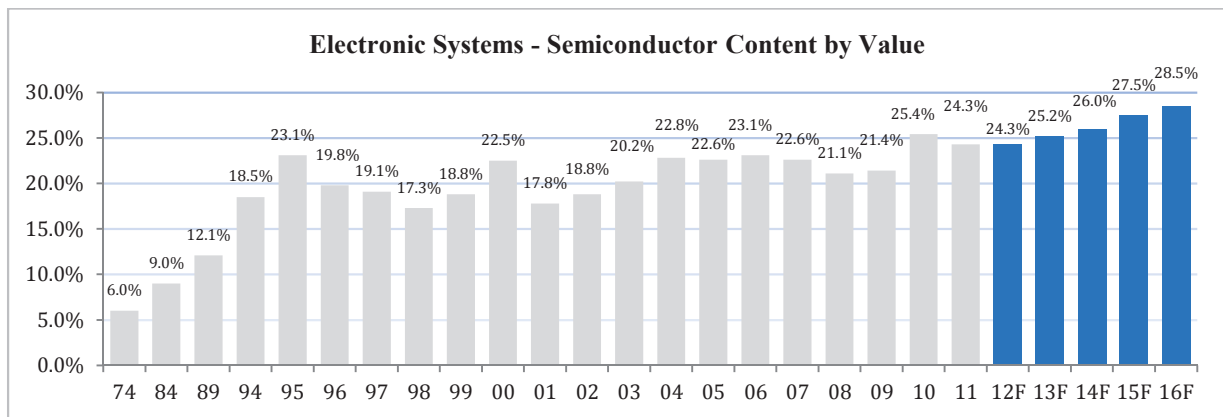
#### 3.1. Semiconductors

Semiconductors are the foundation of modern electronics, with semiconductor based integrated chips making up approximately 80% of the industry. Integrated chips are the core of innovative technological devices such as smartphones, tablets, flat-screen monitors and television sets, sophisticated cars, aircraft and many medical devices.

A semiconductor is a material that has intermediate conductivity between a conductor and an insulator, with unique physical properties that lay somewhere between the two. The engineering importance of semiconductors results from the fact that they can be conductors as well as insulators. A distinct property of semiconductors is their increasing conductivity with increasing temperature; as opposed to metals, within which conductivity decreases with increasing temperature. Due to the conductive properties of a semiconductor being able to be modified by varying conditions like temperature and impurity content, semiconductors are very useful devices for amplification of signals, switching, and energy conversion.

As can be seen in Figure 2 below, the proportion of semiconductors in electronic systems has increased steadily over the past few decades. Accounting for approximately only 6% of electronic systems' value in 1974, it has grown to about 24% in 2011, with expectations of this proportion increasing further to reach almost 29% by the year 2016.

**Figure 2: Semiconductor Content by Value**

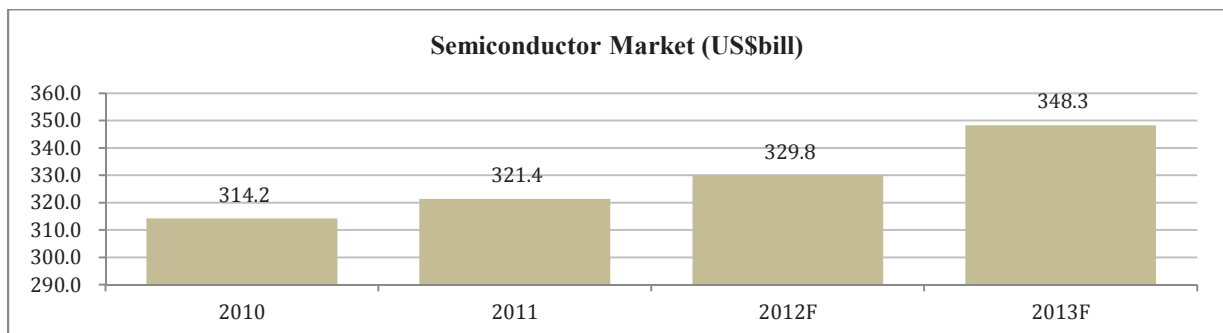


Source: IC Insights – The McLean Report, SIA

#### 3.2. Industry Overview

The global semiconductor industry is the aggregate collection of companies engaged in the design and fabrication of semiconductor devices. The industry developed around 1960, when the production of semiconductors became a viable business. It has since grown to be a US\$321 billion dollar industry in the year 2011. As is evident in the below graph, the current expectation is for the semiconductor industry to reach revenues of almost US\$350 billion by the year 2013.

**Figure 3: Semiconductor Market**



Source: IC Insights – The McLean Report, SIA





The largest segments within the semiconductor industry are data processing, communications, consumer electronics, and the automotive and industrial sectors. Data processing, communications and consumer electronics have historically accounted for the majority of semiconductor revenues, with future growth expected to be driven primarily by the automotive and industrial segments.

The global semiconductor market is fuelled by technological developments, with strong growth prospects in countries such as India, Russia and Brazil, with China the main growth centre. At present, it is estimated that consumption in China accounts for more than 40% of global semiconductor revenues, and is expected to reach 50% by 2015.

The global semiconductor industry can be broadly classified into two categories:

- Integrated Device Manufacturers that design, manufacture and sell integrated circuits. These include chipmakers such as Intel, Samsung and STMicroelectronics.
- Companies that design and sell chips (referred to as fabless companies) but outsource the manufacturing of the chips to foundry companies. Qualcomm, NVIDIA and AMD are a few of the major companies in this sector.

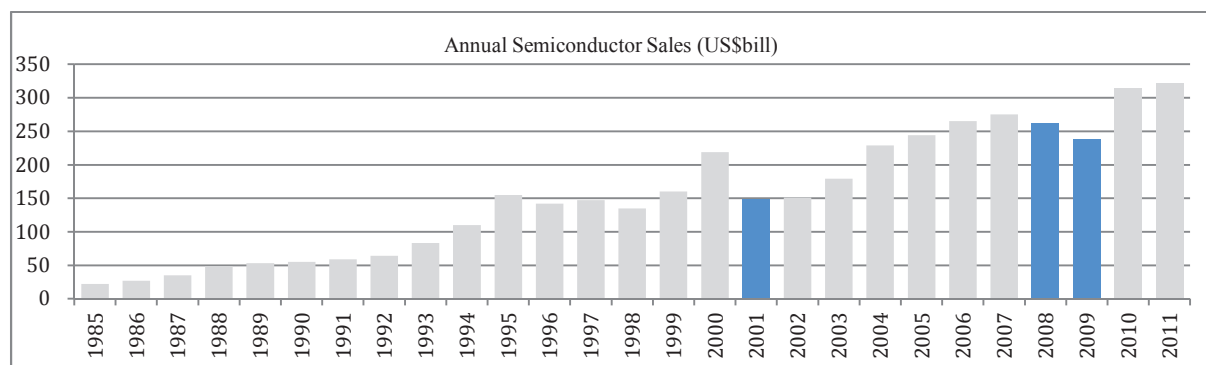
In addition, the industry also has foundry companies like TSMC and UMC, who manufacture chips that are designed by their customers. There are also companies in the industry such as ARM Holdings, a UK company listed on the London Stock Exchange, who license their technology to integrated chip manufacturers and receive royalty income for the use of their intellectual property.

Key suppliers to the industry are known as 'Equipment semiconductor companies', providing the systems used to manufacture semiconductors, integrated circuits and related products. Due to the high costs associated with manufacturing plants, semiconductor companies have quite high fixed cost of goods sold components compared to the variable costs. The raw material required to produce a semiconductor is silicon, which is the fundamental component of sand.

### 3.3. Industry Growth

As evident in the figure below, the industry has grown at a healthy rate over the past 40 years, with global sales increasing at an average compound annual growth rate ("CAGR") of about 9% p.a., despite several downturns in the economy including the effects of the internet bubble in 2001 and the financial crisis of 2008 and 2009.

Figure 4: Global Annual Semiconductor Sales



Source: IC Insights – The McLean Report, SIA

Figure 4 also highlights the correlation of the semiconductor industry's performance with that of the global economic environment. A significant portion of semiconductor industry revenue is derived from high value luxury products such as smartphones, tablets and cars. A sharp drop in semiconductor sales can be seen when the internet bubble burst in 2001 and again during the financial crisis of 2008 and 2009 (highlighted in the graph above).

### 3.4. Geographic Spread of Production and Sales

Integrated chips account for over 80% of semiconductor sales worldwide. The table below shows that the Asia-Pacific market (including China) accounts for over 50% of revenues generated through the sale of integrated chips, with this portion expected to increase further in the coming years primarily due to the increasing demand from the Chinese economy.



**Table 2: Integrated Chip Market by Region**

Region	2006 (%)	2010 (%)	2011 (%)	2012F (%)
Americas	20%	19%	20%	20%
<b>Asia-Pacific</b>	<b>48%</b>	<b>55%</b>	<b>56%</b>	<b>56%</b>
Europe	16%	12%	12%	11%
Japan	16%	14%	12%	12%
<b>Total Integrated Chip Market</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: IC Insights - The McLean Report - June/July Update

Global semiconductor producers are dominated by companies located in the US, South Korea, Japan, Taiwan, Singapore and the European Union, with about 75% of worldwide manufacturing capacity and research and development activities located in the US. However, production in the US is expected to decrease in coming years as a result of the increasing demand from the Asia-Pacific market as mentioned above, as well as challenges faced by the US such as higher costs of production and government restrictions on certain types of semiconductors due to their potential dual use in military applications. According to a fact sheet prepared by the Semiconductor Industry Association, 82% of US semiconductor sales are outside the US.

Low concentration of competition exists in the semiconductor industry beyond the two largest participants, with the top ten companies accounting for approximately 51.4% of global industry revenue, and the top 50 accounting for just over 80% as displayed in the table below.

**Table 3: Top Ten Semiconductor Manufacturers**

Rank	Company	Type	Country	2011	2011
				Revenue	Market
				USDMill	Share %
1	Intel Corporation	IDM	USA	49,292	15.4%
2	Samsung Electronics	IDM	South Korea	33,282	10.4%
3	Taiwan Semi Manuf Corp	Foundry	Taiwan	14,600	4.6%
4	Toshiba Semiconductor	IDM	Japan	10,877	3.4%
5	Texas Instruments	IDM	USA	12,194	3.8%
6	Renesas Electronics	IDM	Japan	9,415	2.9%
7	STMicroelectronics	IDM	South Korea	7,555	2.4%
8	Qualcomm	Fabless	France, Italy	9,488	3.0%
9	Hynix	IDM	USA	9,251	2.9%
10	Micron Technology	IDM	USA	8,123	2.5%
<b>Top 10 Total</b>				<b>164,077</b>	<b>51.4%</b>
Top 25 Total				221,724	69.4%
Top 50 Total				256,303	80.2%
Total				319,500	100.0%

Source: IC Insights - The McLean Report - June/July Update

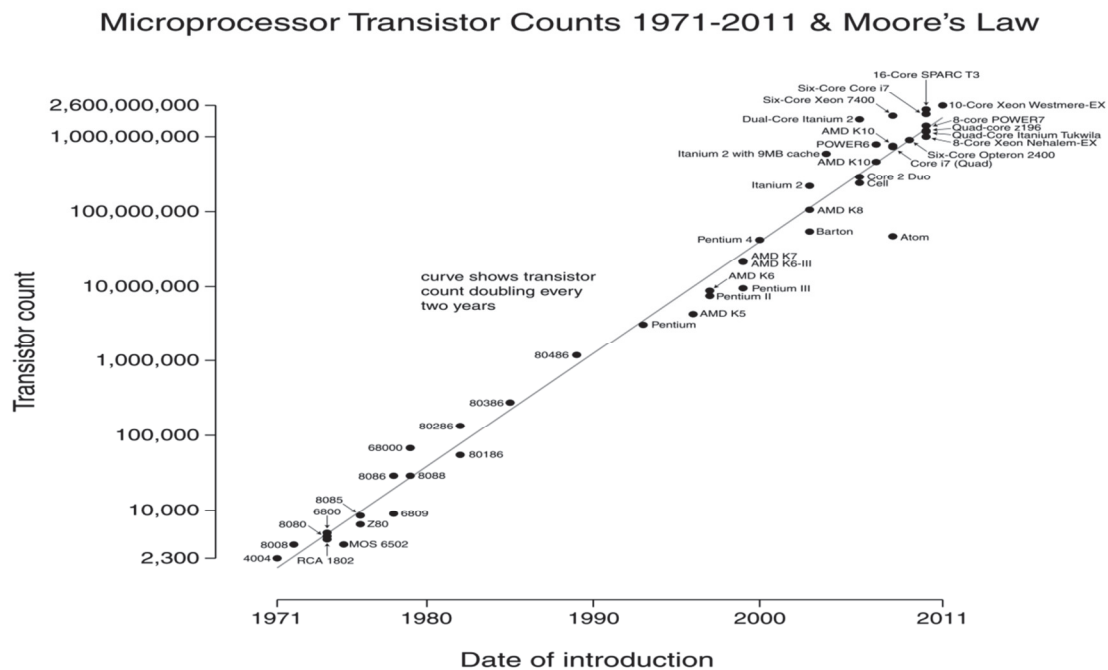


### 3.5. Cost Structure

Semiconductor manufacturing companies incur high fixed costs, due to the significant investment in research and development and manufacturing facilities required. The high level of fixed costs leads to high volumes of production required in order to achieve viable margins.

The variable costs of semiconductor manufactures include consumables, spare parts, clean room garments, power and raw materials. To combat increases in these costs, manufacturers have focussed on increasing the number of transistors that can be fitted onto a given size of silicon wafer. A decrease in chip size not only reduces effective cost but increases operating speeds and reduces heat and power usage. The ability to continually reduce the size of transistors has been impressive, as shown on the following figure:

Figure 5: Microprocessor Transistor Counts & Moore's Law



Source: Wikipedia

### 3.6. Barriers to Entry

The barriers to entry in the semiconductor industry are high and include:

- the high degree of specialisation requires significant investment in research and development, with the existence of patents to protect intellectual property being a main point of competition;
- the need for highly skilled qualified staff and the limited number of specialists in the field;
- the long lead times and upfront investment in setting up the appropriate infrastructure; and
- a lack of access to the latest proprietary technology and the fast pace of technological change within the industry can deter the entry of competitors.

Due to these barriers to entry, and in particular the requirement of capital to keep up with the high pace of innovation within the industry, companies are increasingly specialising in individual elements of the value chain - such as Integrated Device Manufacturers and fabless companies.



### 3.7. Integrated Chip Capacity, Size and Technological Innovation

Given the continuous demand for smaller electronic systems requiring semiconductor components and the healthy growth expectation of the industry over the next few years, investments to increase the installed capacity and reduce the physical size of the semiconductor will be required. An analysis of the installed capacities from 2010 to 2012 in the figure below shows a move to smaller sizes and diameters.

Table 4: Integrated Chip Relative Capacity Market Share

Feature Size	Capacity Market Share		
	2010	2011	2012
≥ 400nm	16.8%	15.4%	14.2%
< 400nm - ≥ 200nm	10.8%	10.9%	10.2%
< 200nm - ≥ 120nm	15.5%	14.9%	13.4%
< 120nm - ≥ 80nm	10.5%	8.7%	7.4%
< 80nm - ≥ 60nm	15.5%	10.9%	7.6%
< 60nm - ≥ 40nm	17.7%	22.2%	22.5%
< 40nm	13.2%	16.9%	24.7%
<b>Total</b>	100.0%	100.0%	100.0%

Source: IC Insights - The McLean Report - June/July Update

According to a report written by PWC in 2012 on semiconductors titled '*Faster, greener, smarter – reaching beyond the horizon in the world of semiconductors*', experts have predicted that semiconductor production technology would soon reach its physical limits, beyond which physical shrinking would no longer be possible. In other words; the size of the semiconductor cannot continue to decrease indefinitely. Steve Appleton, CEO of Micron Technologies, was quoted recently stating "Innovation is slowing down regarding the ability to shrink device geometries, but not in the application of the technologies". The growth of this industry is therefore dependent to a degree on the ability to continue to develop technological innovations that increase energy efficiency.



## 4. Profile of Mears

### 4.1. Activities

Mears is a US based technology company that has developed a patent protected nano engineered silicon material which is intended to improve the performance of silicon based products such as integrated circuits (computer chips) and photovoltaic solar panels. Since 2001, approximately \$65 million has been spent in developing its technologies to the current state.

Mears has recently entered the commercialisation phase of the development of its Mears Silicon Technology ("MST"). MST is intended to deliver a range of potential benefits to computer chip manufacturers including:

- improved transistor performance;
- lower power consumption;
- lower gate leakage; and
- lower manufacturing costs.

Mears has an extensive intellectual property portfolio which has been established to protect the technology it has developed. Mears' intellectual property portfolio includes 111 granted patents across eight countries, with further patents pending. The core Mears patents cover the physical structure, the process to manufacture and the application of the engineered silicon material technology.

Mears' activities also extend to potential applications for MST in the area of photovoltaic solar panels. Mears' headquarters are currently in Newton, Massachusetts in the US, with intentions to relocate to Silicon Valley, California in 2013.

### 4.2. History

Mears was founded in 2001 in Boston by Dr Robert Mears, a pioneer in the fields of photonics, computational materials science and nanofabrication technologies, with plans of pursuing commercial applications for such materials. Dr Mears pioneered optical fibre rare-earth doped lasers and amplifiers, including the erbium-doped fibre amplifier; the invention of which was the key enabling technology behind the current growth of global communication bandwidth.

At present, the current focus of Mears is to achieve the commercialisation phase of the MST by entering into licence agreements with major technology companies. The evaluation of Mears' intellectual property is already being conducted by four of the top ten of the world's leading semiconductor companies; however no commercial licencing agreements have yet been signed. Mears' current business plans are to sign its first licencing agreements in 2013.

### 4.3. Management and Personnel

The board and key management personnel of Mears include:

- **Erwin Trautman**, Chief Executive Officer, Board Director.  
Mr. Trautmann has over 30 years of experience in the semiconductor industry. He has held various executive positions at Fortune 500 companies and possesses extensive experience in project management, product development and business leadership. Mr. Trautmann formerly served as Senior Vice President at KLA-Tencor and as Vice President at Texas Instruments with global responsibilities.
- **Dr. Robert Mears**, President, Chief Technology Officer, Board Director, Founder.  
Dr. Mears is a recognized pioneer and leading expert in nano-scale material science and engineering. In the mid-1980's, Dr. Mears re-engineered silica optical fiber by adding atoms of erbium (a rare earth element) to silica to invent the Erbium Doped Fiber Amplifier, a transformative technology for long-distance optical networks. A decade ago, Dr. Mears shifted his focus to the semiconductor industry, where he identified a similar scaling problem on the horizon. Dr. Mears founded Mears in 2001 to leverage his unique insights in the engineering of new materials. As CTO, and supported by a talented R&D team, Dr. Mears developed the Mears MST Platform and MST CMOS, its first commercial application. Dr. Mears has authored or co-authored approximately 250 publications and patents and is an Emeritus Fellow of Pembroke College, Cambridge, England.



- **Dr. Rinn Cleavelin**, Board Director, Chair Technical Advisory Board.  
Dr. Cleavelin has more than 34 years of experience in the areas of Semiconductor Processing, Development, and Management. He held the position as Chief Operating Officer for International SEMATECH in Austin, TX until returning to Texas Instruments Inc. in Silicon Technology Development in June of 2002. During his career, he had the opportunity to lead several significant programs at Texas Instruments including the startup of three wafer fabrication plants and the leadership role in the process development of several computer memory products. He has also had the leadership role in the development of several new process technologies and tools in the areas of ion implantation, thermal processing, surface preparation, defect detection, and metrology working with equipment suppliers worldwide.
- **Ron Cope**, Chief Operating Officer.  
Mr. Cope brings to Mears Technologies more than 35 years of experience in various technical and operational positions with a proven record of success at both large Fortune 500 companies and venture capital backed technology start-ups. Mr. Cope formerly served as VP of Operations & General Manager for SyChip-Murata. Prior to SyChip-Murata, Mr. Cope held Executive and Sr. Management positions at Texas Instruments, National Semiconductor, VLSI Technology, Hitachi Semiconductor and other high-tech companies.

#### 4.4. Capital Structure and Shareholders

As at the date of this report, Mears had the following securities on issue:

- 12.3 million fully paid ordinary shares;
- 9.2 million warrants outstanding, with exercise prices between \$2.25 and \$7.49 and expiry dates ranging from one to ten years from the date from this report; and
- 2.9 million options outstanding, with exercise prices between \$0.17 and \$16.73 and expiry dates ranging from three months to ten years from the date of this report.

Mears' top five shareholders are shown in the table below:

**Table 5: Mears Top 5 Shareholders**

Shareholder	Number of shares	% holding of ordinary shares
Vulpes Testudo Fund	1,119,592	9.1%
K2 Energy Limited	987,612	8.0%
Richard Anthony Magides	929,593	7.5%
Pismo, LLC	682,150	5.5%
Growing Well Partners, LLC	678,441	5.5%
<b>Total Shares currently on Issue</b>	<b>12,332,685</b>	<b>100%</b>

Source: K2 Management

As previously noted, K2 currently owns 8.0% of the shares in Mears, and via the warrants has the opportunity to subscribe for additional shares in Mears. If all K2's warrants were exercised (at a cost of US\$5.3 million in total), K2 would own 17% of the shares in Mears (prior to the dilutionary impact of Mears' proposed capital raising).

There are no existing associations between the current shareholders of Mears that, when aggregated post transaction, would result in a relevant interest in K2 greater than 20%. Accordingly, no shareholder is likely to control or have significant influence over K2 after the Proposed Transaction.



#### 4.5. Competitive Position

The table below sets out a strengths, weaknesses, opportunities and threats analysis (“SWOT”) for Mears.

Table 6: SWOT Analysis of Mears

Strengths	Weaknesses
<ul style="list-style-type: none"><li>• An extensive intellectual property portfolio which has been established to protect the technology. Mears has developed and currently holds 111 patents.</li><li>• Current patent protected engineered materials, referred to as MST which is about to enter commercialisation.</li><li>• A strong management team with extensive experience in the semiconductor industry.</li></ul>	<ul style="list-style-type: none"><li>• Lack of operating history.</li><li>• Limited capital for potential future investments.</li><li>• Reliance on third parties for testing of Mears’ technologies and a lack of long term agreements with these third parties.</li><li>• Dependency on key personnel.</li></ul>
Opportunities	Threats
<ul style="list-style-type: none"><li>• Rapid growth in the global electronics industry which may lead to increased demand for Mears’ products.</li><li>• Potential applications for the MST technology.</li><li>• Solar industry benefits from recent nuclear incidents in Japan (although current developments have reduced this opportunity).</li></ul>	<ul style="list-style-type: none"><li>• Market not accepting of Mears’ technologies and an inability to commercialise Mears’ technologies.</li><li>• Competition from other technologies.</li><li>• Breach of patent protection and possible lawsuits relating to the infringement of intellectual property rights which are common in the semiconductor industry.</li></ul>

Source: Leadenhall analysis



#### 4.6. Financial Performance

The audited statement of financial performance for Mears for the six months ended 30 June 2012 and the 12 months ended 31 December 2011 is set out below.

**Table 7: Statement of Financial Performance for Mears**

	12 months ended 31 December 2011 (USD '000s)	6 months ended 30 June 2012 (USD '000s)
Funded research and development revenue	1,090	408
Direct cost	(909)	(378)
Indirect cost	(181)	(30)
<b>Gross profit</b>	-	-
<b>Operating expenses</b>		
Research and development	(1,722)	(830)
General and administrative	(3,064)	(1,037)
Selling and marketing	(436)	(113)
<b>Total operating expenses</b>	<b>(5,222)</b>	<b>(1,980)</b>
<b>Loss from operations</b>	<b>(5,222)</b>	<b>(1,980)</b>
<b>Other income (expense)</b>		
Interest income	14	3
Interest expense	(622)	(983)
Other income	64	-
Gain (loss) on disposal of equipment	1,064	-
<b>Total other income (expense)</b>	<b>520</b>	<b>(980)</b>
Income taxes	(12)	-
<b>Net loss</b>	<b>(4,714)</b>	<b>(2,960)</b>

Source: K2 management

In relation to the above financial performance, we note that Mears is still in the development stage and is devoting substantially all of its efforts toward product research and development and is therefore yet to record a profit.

Research and development costs consist of personnel costs for the design, development, testing and enhancement of its technology and certain other allocated costs such as depreciation and other facilities related expenditures.

We note the historical results are not indicative of the future, given Mears is expecting to commercialise technology currently in the development phase, and therefore a significant increase in revenue and profitability is expected by the company in the foreseeable future.





#### 4.7. Financial Position

The audited and unaudited financial position of Mears as at 30 June 2012 and 30 June 2011 is set out below.

**Table 8: Statement of Financial Position of Mears**

	30 June 2011 Unaudited (USD '000s)	30 June 2012 Audited (USD '000s)
Cash and cash equivalents	815	1,065
Trade and other receivables	243	200
<b>Total current assets</b>	<b>1,058</b>	<b>1,265</b>
Property, plant and equipment	40	8
<b>Total non-current assets</b>	<b>40</b>	<b>8</b>
<b>Total assets</b>	<b>1,098</b>	<b>1,273</b>
Trade and other payables	217	260
Convertible notes payable	-	1,626
<b>Total liabilities and total current liabilities</b>	<b>217</b>	<b>1,886</b>
<b>Net assets</b>	<b>881</b>	<b>(613)</b>

Source: K2 management

In relation to Mears' financial position, we note a significant portion of the assets of the business are represented by cash, which was funded from a series of equity financings. Mears is still an early stage business and has no other significant assets or liabilities other than its convertible notes.

Since its incorporation, Mears has expended approximately \$65 million including a significant amount spent on research and development, all of which has been expensed. Mears owns over 100 patents however no intellectual property is carried as an asset in Mears' balance sheet.

The convertible notes payable amount includes the \$1 million loan from K2 to Mears.



## 5. Profile of K2

### 5.1. Operations

K2 was formed in 2003 as Tomahawk Energy Limited, to invest in oil and gas exploration in the US, before merging with K2 Energy Limited in 2006 and changing its name. In 2010 K2 sold its oil and gas assets to Trey Resources for a 30% interest in that company. It also entered into a transaction to licence Mears' technology for solar power in the same year. K2 now has three areas of interest as noted below.

#### *Investment in Mears*

A description of Mears is provided in Section 4 above. K2's investment in Mears includes:

- 987,612 common shares (or 8% of the total shares currently outstanding).
- Warrants to acquire an additional 3,120,359 shares in Mears at \$2.25 per share over the next nine years. If all outstanding warrants over Mears shares were exercised, K2 would have a 16.8% interest in Mears before the rights issue.
- A \$1 million bridge loan, with interest accruing at 18% per annum.

#### *Trey Resources*

K2 has a 17% ownership interest in Trey Resources, a US based oil and gas business. Trey Resources' assets are predominantly in Oklahoma and Texas, producing approximately 100 barrels of oil equivalent ("BOE") per day. It has proved reserves of 1.5 million BOE. The company has recently secured a US\$35 million loan facility to fund additional drilling. Trey Resources currently generates a small positive cash flow from operations, which is expected to increase significantly over the next three years.

#### *Solar Technologies*

K2 has the worldwide rights to all solar energy applications of Mears' silicon technology. K2 believes that it will be possible to increase the efficiency in photovoltaic cells through use of Mears' patented technology. At the same time, it is expected that less silicon will be needed to manufacture the cells, reducing the cost of production. However, research and development is still ongoing to resolve some technical difficulties. K2 has agreed to pay Mears 50% of all profits from sale of solar power products using Mears' technologies, after recovering research, development and commercialisation costs.

### 5.2. Capital Structure and Shareholders

As at the date of this report, K2 had the following securities on issue:

- 244 million fully paid ordinary shares; and
- 6 million options outstanding, with an exercise price of \$0.20 expiring on 31 December 2014.

K2's top five shareholders are shown in the table below:

**Table 9: K2 Top 5 Shareholders**

Shareholder	Number of shares	% holding of ordinary shares
Asia Union Investments Pty Ltd	19,000,000	7.8%
Golden Words Pty Ltd	12,401,703	5.1%
Mr Trevor Kennedy & Mrs Christina Kennedy & Mr Daniel Kennedy <Golden Eggs Superfund A/C>	10,641,023	4.4%
Adajac Pty Ltd	8,333,333	3.4%
Edwards Meadows Pty Limited	8,100,000	3.3%
<b>Total Shares currently on Issue</b>	<b>244,057,151</b>	<b>100%</b>

Source: K2 Annual Report



### 5.3. Financial Position

The financial position of K2 as at 30 June 2010, 2011 and 2012 is set out below:

**Table 10: Consolidated Balance Sheet for K2 (Audited)**

As at 30 June	2010 AUD (\$'000's)	2011 AUD (\$'000's)	2012 AUD (\$'000's)
Cash and cash equivalents	948	2,235	967
Trade and other receivables	14	13	1,031
<b>Total current assets</b>	<b>962</b>	<b>2,248</b>	<b>1,998</b>
Financial assets	1,881	2,701	2,701
<b>Total non-current assets</b>	<b>1,881</b>	<b>2,701</b>	<b>2,701</b>
<b>Total assets</b>	<b>2,843</b>	<b>4,949</b>	<b>4,699</b>
Trade and other payables	179	245	184
<b>Total liabilities and total current liabilities</b>	<b>179</b>	<b>245</b>	<b>184</b>
<b>Net assets</b>	<b>2,664</b>	<b>4,704</b>	<b>4,515</b>

Source: K2 Annual Reports

Cash increased during the year ended 30 June 2011 as a result of a \$3.7 million capital raising via an entitlement issue. The additional cash was subsequently spent pursuing the development of the solar technologies, and an additional investment in Mears.

Trade and other receivables at 30 June 2012 primarily relates to the \$1 million bridge loan from K2 to Mears, which bears interest at 18% per annum.

Financial assets relate to K2's investments in Mears and Trey Resources at book value. The increase from 30 June 2010 to 30 June 2011 relates to an additional investment in Mears.



#### 5.4. Financial Performance

The financial performance of K2 for the three years ended 30 June 2012 is summarised below:

**Table 11: Consolidated Income Statement for K2 (Audited)**

For the Year Ended 30 June	2010 \$'000	2011 \$'000	2012 \$'000
Interest received	89	214	87
Administration and corporate	(277)	(393)	(216)
Depreciation and amortisation	(2)	-	-
Directors fees	(155)	(137)	(126)
Foreign exchange gain / (loss)	(63)	(203)	54
Share option expense	-	(132)	-
Research and development	(519)	(1,192)	(851)
<b>Loss before tax</b>	<b>(927)</b>	<b>(1,843)</b>	<b>(1,052)</b>
Tax benefit	-	-	-
<b>Net loss for continuing operations</b>	<b>(927)</b>	<b>(1,843)</b>	<b>(1,052)</b>
Discontinued operations	(2,895)	-	-
<b>Net loss for the year</b>	<b>(3,822)</b>	<b>(1,843)</b>	<b>(1,843)</b>
Basic and diluted loss per share (cents)	(2.93)	(0.95)	(0.49)

Source: K2 Annual Reports

Over the three years presented above K2 has been focussed on continuing research and development in relation to using Mears' technologies for photovoltaic cells. It has yet to commercialise any products, thus the only income relates to interest from cash balances and the bridging loan to Mears.

The loss on discontinued items in 2010 relates to US based oil and gas activities that were transferred to Trey Resources in that year.



## 6. Valuation Methodology

### 6.1. Available Valuation Methodologies

To estimate the Fair Market Value of Mears and the consideration payable, 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 earnings method;
- asset based methods;
- analysis of share market trading; and
- industry specific rules of thumb.

Each of these methods is appropriate in certain circumstances and often more than one approach is applied, at least as a secondary cross-check to a primary method. The choice of methods depends on 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 the availability of the required information. A detailed description of these methods and when they are appropriate is provided in Appendix 3: Valuation Methodologies.

### 6.2. Selection of Valuation Methodologies – Mears

In selecting an appropriate valuation methodology to value Mears, we have considered the following factors:

- a limited number of transactions in Mears shares have taken place in recent years;
- Mears' products are at an early stage of commercialisation and the company has yet to establish a pattern of earnings. A capitalised earnings approach would therefore not be appropriate;
- Mears is not an asset based business thus an asset based approach is not relevant; and
- we are not aware of any relevant industry specific rules of thumb.

Accordingly we are of the opinion that the most appropriate methodology to value Mears is the discounted cash flow method with an analysis of recent transactions as a cross-check.

### 6.3. Selection of Valuation Methodologies – Proposed Consideration

The proposed consideration is represented by 80 million shares (subject to adjustment for further capital raisings) in the Proposed Merged Entity. In selecting an appropriate valuation methodology to value the Proposed Merged Entity, we have considered the following factors:

- the main asset of the Proposed Merged Entity will be Mears, which is to be valued separately;
- since the announcement of the Proposed Transaction the market has been informed about K2's intention to merge with Mears. Thus, to the extent the market believes the transaction will complete, market trading in K2's shares reflects the market's assessment of the Proposed Merged Entity. However, we note that there are very low volumes of market trading in K2's shares; and
- the Proposed Merged Entity will be loss making due to the early stage of commercialisation of Mears' technology.

Accordingly we are of the opinion that the most appropriate methodology to value the Proposed Merged Entity is an asset based method (where the major asset is the Proposed Merged Entity's investment in Mears which we have separately valued using a discounted cash flow methodology as noted above), with an analysis of recent transactions in K2's shares as a cross-check.



## 7. Valuation of Mears

### 7.1. Discounted Cash Flow

As discussed in Section 6 above, we have applied the discounted cash flow methodology to determine the Fair Market Value of the interest in Mears to be acquired by K2 if the Proposed Transaction occurs. We have also analysed the most recent transactions in Mears' shares to evaluate the reasonableness of the assessed value. The discounted cash flow methodology requires:

- an analysis of projected cash flows;
- determination of an appropriate discount rate; and
- an analysis of a terminal value.

These are discussed below.

#### *Projected Cash Flows*

The first step is to determine the future cash flow to be generated by the business. The directors of Mears have prepared a detailed business plan for FY13 to FY21 ("**the Explicit Forecast Period**"). Leadenhall has discussed the assumptions behind these forecasts with K2's management and considered the risks associated with achieving them, in order to assess the likelihood of them being realised. We have then prepared a financial model based on these assumptions. The key assumptions adopted in the preparation of our projected cash flows are discussed below:

#### **Revenue**

##### *Chips*

The revenues forecast for the chip segment are underpinned by the assumption that the chips will be priced competitively and will be accepted by the market. Four of the top ten chip manufacturers in the world are currently either trialling Mears' technology or are in discussions with Mears' management; therefore revenue has been based on the successful signing of two of these companies in the year 2013. The assumed royalty rate included in the forecasts has been based on the royalty rates other comparable companies in the industry receive; with an example being ARM Holdings, which receives a royalty of between 1% to 2% for the licensing of their intellectual property, and is currently listed on the London Stock Exchange with a market capitalisation of approximately US\$10.7 billion at the date of this report.

##### *Solar*

The business plan did not include any revenue from the application of MST to solar energy, therefore we have prepared an alternative scenario based on an estimated market of approximately \$96.8 billion in the year 2014 as per data released from Solarbuzz; a company specialising in solar market research and analysis. This market is forecast to grow at a rate of 5% per annum, with Mears expected to generate a profit in this industry by the year 2016. We have estimated Mears to achieve market penetration of 20% by the year 2021 based on discussions with Mears management and after considering the number of industry participants they are currently in discussions with regarding their technology.

As per the current agreement in place between Mears and K2, all research and development expenses incurred by K2 in the advancement of the solar technology are required to be recouped by K2 before Mears is entitled to a 50% share of profit generated from the solar energy segment. This recoupment has been included in the forecast, with the entire research and development component being recovered by K2 within the second year of the solar technology generating revenue.

#### **Expenses**

Due to the manufacturing of the actual chip and solar technologies being outsourced to foundry companies, cost of goods sold are relatively low when compared to revenue forecasts. However due to incentives and commissions expected to be given to incentivise early acceptance of Mears' products, cost of goods sold have been forecast higher in the early years of the forecast period, with improving gross margins expected once more customers have been signed.



In the early years of the Explicit Forecast Period, silicon engineering and engineering services make up the majority of operating expenses expected to be incurred by Mears. As the projected take up of Mears' products by the market increases, the ratio of these types of expenses decreases, with general and administration expenses becoming the most significant operating expense from 2018, due to the higher volume of sales generated.

### Investment in Research and Development

#### *Chips*

The chips segment is currently in its final development stage and is already being trialled by major market participants. Approximately US\$65 million has been incurred to date in the development of the chips, with negligible capital expected to be required in the future in relation to the development of the product.

#### *Solar*

The solar technology is still currently being developed by Mears, however it is anticipated the product will be ready for market in approximately two years, with only US\$1 million expected to be required further in relation to developing the technology. Although the technology is still in the development stage, Mears has been in discussions with potential partners to work together to resolve minor issues that currently exist.

As mentioned previously, due to the agreement in place between Mears and K2, the historical and future expenses incurred for the development of the solar technology will be paid for by K2. This amount is required to be recovered by K2 from future profits, before Mears is entitled to their 50% profit share; therefore this effect has been included in the forecast revenues, and no costs have been included in Mears' cash flows.

### Tax Losses

The business has not recorded a profit historically and has therefore accumulated a tax loss balance that may be used to offset against future tax payable. Subject to satisfying relevant US taxation regulations, the unused tax losses may be carried forward to future years and applied against future tax payable when the business begins to generate a profit. Due to the degree of uncertainty we have not included carried forward tax losses in our assumed cash flows.

### Scenarios

Based on the future cash flows of Mears being highly dependent on the commercial success of its products; we developed cash flows for three alternative scenarios and applied a probability to their occurrence, to calculate probability weighted cash flows. The three scenarios were based on the following assumptions and the probabilities assigned to each scenario for the valuation included in this report are presented in the below table.

**Table 12: Alternative Scenarios**

Scenario		Probability Weighting
Base Case	Cash flows were based on the business plan provided by Mears, under the assumption of the chips segment being a commercial success and the solar technology failing to make a profit	40%
High Case	Cash flows for the chips segment were based on the business plan provided by Mears, with additional assumptions made regarding the success of the solar technology as mentioned previously	20%
Low Case	Cash flows were based on the assumption that both the chips and solar technology segments failed to generate a profit	40%

Source: Leadenhall analysis

The effect on the enterprise value of Mears of altering the probabilities assigned to each scenario has been included in a sensitivity analysis included below.



## Adjustments to Enterprise Value

In order to calculate the equity value of 100% interest in Mears from the enterprise value calculated from the discounted cash flow, we have added the value of cash held by Mears, and deducted the value of any debt on its balance sheet as at the valuation date.

The amount of cash required to be added to the enterprise value of Mears includes the cash expected to be raised in the rights issue (since this will occur prior to the Proposed Transaction proceeding).

The value of the bridging loan has been deducted from the enterprise value of Mears, as well as the value of convertible notes, in determining the value of the equity in Mears.

## Reasonableness of Assumptions

We have not undertaken a review of the projections in accordance with AUS 804 – The Audit of Prospective Financial Information and do not express an opinion on the reasonableness of the assumptions or their achievability.

In relation to prospective financial information, Leadenhall has been provided with projected financial information for Mears. We have reviewed the main assumptions underpinning the projections for Mears, undertaken analytical procedures and held discussions with K2's management to consider whether the projections are reasonable when taken as a whole for valuation purposes.

Except for the uncertainty surrounding the forecasted growth in volume of sales and prices, which has been reflected in the discount rate applied to the projected cash flows, nothing has come to our attention to suggest the assumptions on which the projections are based have not been prepared on a reasonable basis.

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 may be different from the prospective financial information of Mears referred to in this report since anticipated events frequently do not occur as expected and the variation may be material. The achievement of the prospective financial information is dependent on the outcome of the assumptions. Accordingly we give no assurance that any forecast results will be achieved and we express no opinion as to whether the prospective financial information will be achieved. Consequently any future variation between the actual results and any prospective financial information utilised in this report may affect the valuation conclusions included in this report.

## Discount Rates

To determine the Fair Market Value of Mears, it is necessary to determine an appropriate discount rate to apply to the projected cash flows. A discount rate is applied which discounts future earnings based on the level of risk in the business and the degree of risk in achieving the forecasts. We have expressed the selected discount rate as a nominal after tax cost of equity.

In determining the appropriate discount rate, we have considered the relative riskiness associated with the forecast cash flows and the typical rates of return required by venture capitalists for investments with similar technical and commercial risks to Mears as shown in the table below.

**Table 13: Studies into the Required Rate of Return for Venture Capitalists**

	Source	Final Stage	Bridge / IPO
Stern School of Business	1	35-50%	25-35%
Harvard Business School	2	20-26%	16-23%
London Business School	3	20-34%	17-23%
<b>Average</b>		<b>25-37%</b>	<b>19-27%</b>

Sources:

1. Valuing Young, Start-up and Growth Companies: Estimation issues and Valuation Challenges, Aswath Damodaran, Stern School of Business, New York University, May 2009.
2. Insights from the American Venture Capital Organisation, Harvard Business School, 1991.
3. Venture Capital in the United Kingdom, The London Business School, April 1994.





Based on our analysis above and the relative risks attached to the projected cash flow, we have selected a post-tax discount rate in the range of 30% to 35%, which we have used to discount Mears' probability weighted projected after tax cash flows to their present value. Applying these discount rates to the after tax forecast cash flows from 2013 to 2021 discussed above (the Explicit Forecast Period) gives a present value in the range from \$22 million to \$32 million.

### Terminal Value

The terminal value represents the value of cash flows beyond the Explicit Forecast Period. Terminal values are commonly calculated based on the expected long-term growth rate of future cash flows. However, due to the start-up nature of Mears' business, we have projected a period of continuing high growth immediately following the Explicit Forecast Period, followed by a period of decline thereafter.

### High Growth Phase

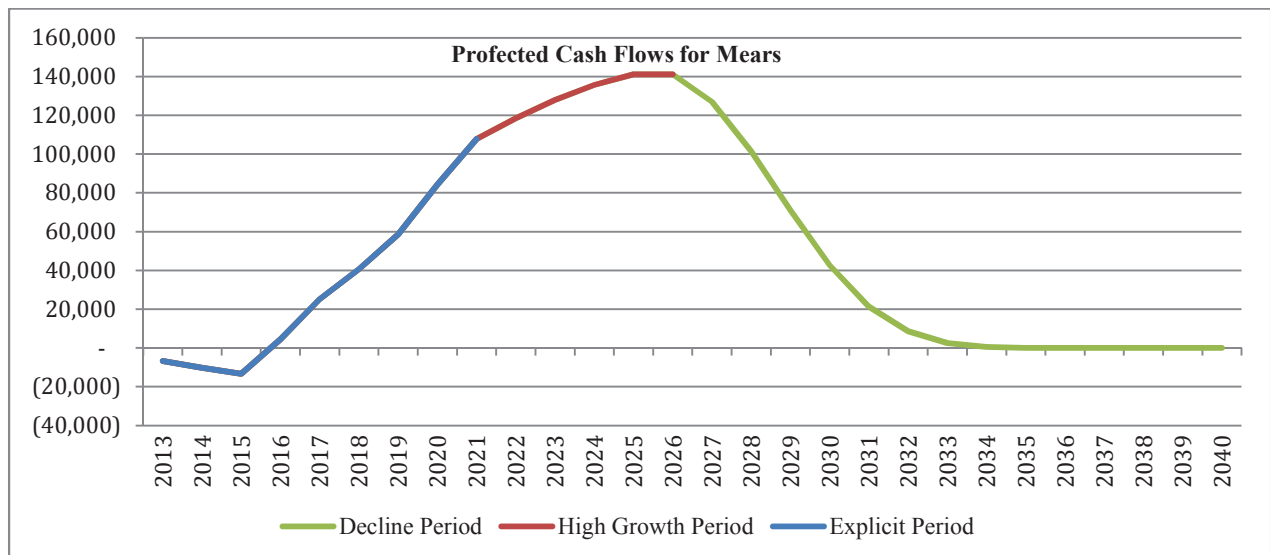
Due to the expected commercialisation of the chips segment in 2013 and the solar technology in the following years, the cash flows of the business are assumed to grow significantly over the Explicit Forecast Period. We assume expect cash flows will continue to grow as the business enters into the growth phase of its lifecycle and expands its market share, beyond the Explicit Forecast Period. We have therefore assumed that the growth phase will continue for a period of five years and the growth in free cash flows will decline from 10% per annum at the start of this period to zero growth in the year 2026.

### Decline Phase

As a result of potential new technologies being developed at some stage in the future, there is a risk that Mears' cash flows will eventually decrease, unless the company is able to remain at the forefront of its field. Due to this potential risk, we have assumed that cash flows will decline to zero over the ten years subsequent to the end of the high growth phase (i.e. from 2026 onwards), resulting in a 24 year lifespan for the Mears MST.

On the basis of these assumptions, the projected cash flow profile is as shown in the figure below.

Figure 6: Projected cash flows over the expected life of Mears



Source: Leadenhall analysis

### Conclusion

Based on the assumptions set out above, the present value of the after tax cash flows from year 2022 to year 2040 (i.e. the terminal value of the business) is in the range from \$26 million to \$40 million. Due to the uncertainty surrounding these assumptions we have highlighted the impact of alternative assumptions in a sensitivity analysis set out below.



### *Discount for Lack of Control*

In order to estimate the value of a minority interest in Mears, it is necessary to apply a discount for lack of control to the value of 100% of the equity interest in the business. This discount takes into account the lack of control that a minority interest has in the affairs of the company, which is the case for existing Shareholders once the Proposed Transaction has been completed, as no individual shareholder will have control over Mears.

In determining an appropriate discount to determine the value of a minority interest in Mears, we have considered the following:

- Australian studies indicate the premiums required to obtain control of companies range between 20% and 40% of the portfolio holding values. A minority interest discount is the inverse of a premium for control and generally ranges between 15% and 30%; and
- it is unlikely that the company will pay a dividend in the near future until the business is profitable and can fund future growth with internally generated resources. A lack of dividends will lead to a relatively high discount for lack of control.

Having regard to the empirical evidence, and the specific factors in relation to Mears, in our opinion a discount for lack of control towards the upper end of the range is appropriate. We are of the view that a discount of 25% is required to be deducted from the 100% value for Mears to calculate the value for an interest in Mears on a minority basis.

### *DCF – Valuation Conclusion of Mears*

Based on the analysis above, in order to determine the value of Mears to the Shareholders in K2, we have assessed the 100% equity value of Mears to be in the range from USD\$37.2 to USD\$55.9 million on a minority basis as set out in the table below:

**Table 14: Calculation of Equity Value of Mears**

	Low US\$'000	High US\$'000
Value of Explicit Forecast Period cash flows	21,763	32,045
Terminal value	25,963	40,359
<b>Enterprise value</b>	<b>47,726</b>	<b>72,403</b>
Add: Cash	2,483	2,483
Deduct: Net debt	(1,626)	(1,626)
<b>Equity value on a control basis</b>	<b>48,583</b>	<b>73,260</b>
Less: discount for lack of control – 25%	(12,146)	(18,315)
<b>100% equity value in Mears on a minority basis</b>	<b>36,437</b>	<b>54,945</b>

Source: Leadenhall analysis

The assessed value of Mears on a minority basis shown in the table above reflects the value of Mears to the existing K2 Shareholders after the Proposed Transaction.

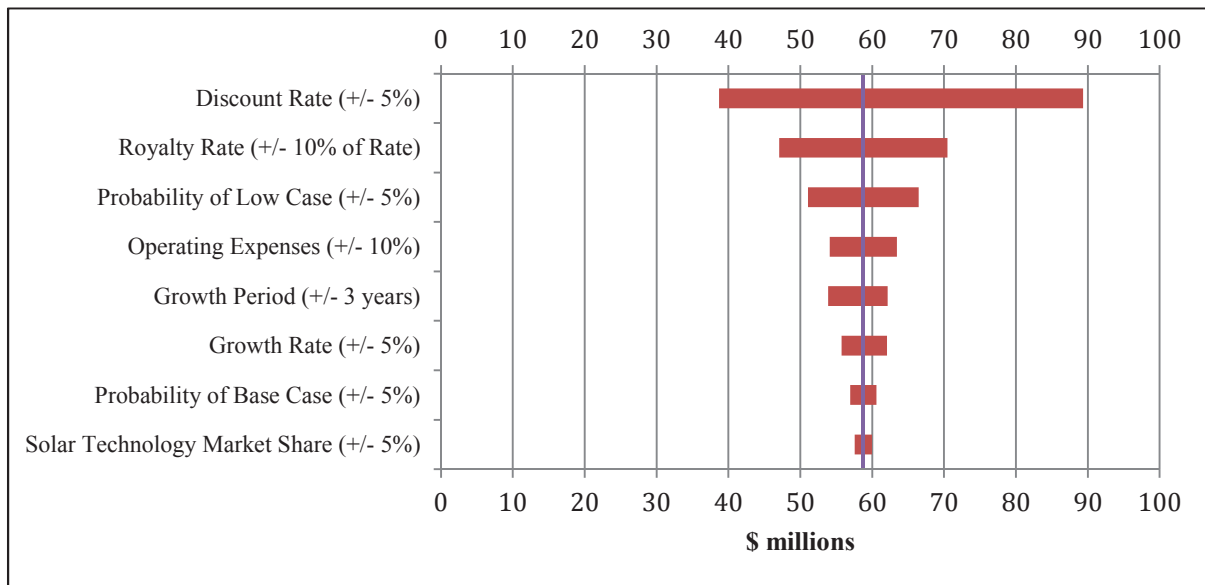
The outcome set out above is based on probability weighted cash flows. The outcome for any scenario would be significantly different to the result presented above.



### Sensitivity Analysis

As significant judgement is involved in determining an appropriate value, it is useful to identify the key value drivers of a business and conduct a sensitivity analysis on each of the value drivers individually. In determining the value of Mears, we have varied the following key value drivers to determine the potential impact on the value of Mears. Care should be taken in interpreting this sensitivity analysis. The analysis treats each change in the specific assumption in isolation to the others, whereas in many cases changes may be interdependent, with associated changes having cumulative or mitigating impacts. We have summarised the outcome based on the mid-point discount rate of 32.5% in the figure below.

Figure 7: Sensitivity Analysis – Impact on the Enterprise Value of Mears from Changes in Key Assumptions



Source: Leadenhall analysis

Note: Sensitivity of base case and low case takes adjusts high case correspondingly as the total probability must sum to 100%.

The sensitivity analysis above indicates that the value for Mears can vary significantly depending on the assumption adopted. The figure above shows that the value of Mears is more sensitive to certain key assumptions, such as the discount rate, and less sensitive to others. Therefore care should be taken by Shareholders in forming a view regarding the key value drivers.



## 7.2. Analysis of Recent Transactions

The most recent transaction in Mears shares was the issue of Series F convertible preference shares for US\$4.50 each in October 2011. At the time of the issue a capital reconstruction was already planned and investors informed that each Series F convertible share would convert into two ordinary shares, giving an effective purchase price of US\$2.25 per ordinary share.

As mentioned earlier Mears is undertaking a 1 for 2 rights issue at US\$0.25 per Mears share, giving Mears shareholders the right to subscribe for 1 share at US\$0.25 for every 2 shares held. The price of \$0.25 is lower than the value per share; hence failure to exercise their rights will be dilutive, incentivising participation.

The issue of the Series F convertible preference shares took place before the 1 for 2 rights issue at US\$0.25 was planned. This would normally lead to a value post rights of US\$1.58 per share (being US\$4.50 per two Mears common shares pre right, plus 1 rights share at US\$0.25, divided by 3 shares post rights). However, due to the exercise prices of the existing warrants and options outstanding in Mears not being repriced, their value decreases following the rights issue (as they become further out of the money). The rights issue therefore effectively creates a transfer of value from Mears option and warrant holders to Mears shareholders who take up their rights. As there are a significant number of warrants and options the transfer effect is reasonably significant, as set out below.

**Table 15: Analysis of Recent Transactions in Mears Shares**

	Units	Assessed values	Notes
Value per share implied by Series F issue	(US\$)	2.25	1
Multiply by: shares on issue	('000)	12,333	2
Value of common shares	(US\$'000)	27,749	
Value of options and warrants before dilution	(US\$'000)	14,465	3
<b>Total equity value before rights issue</b>	<b>(US\$'000)</b>	<b>42,213</b>	
Cash expected to be raised by rights issue	(US\$'000)	1,418	4
<b>Total equity value after rights issue</b>	<b>(US\$'000)</b>	<b>43,631</b>	
Implied value per share after rights issue	(US\$)	1.83	5
Multiply by: shares on issue post rights issue	('000)	18,005	6
<b>Implied capitalisation post rights issue</b>	<b>(US\$'000)</b>	<b>32,915</b>	
Implied value of options after dilution	(US\$'000)	10,717	7
<b>Total equity value after rights issue</b>	<b>(US\$'000)</b>	<b>43,631</b>	

Source: Leadenhall analysis

Notes:

1. As noted above the price paid for Series F convertible preference shares implied a price per ordinary share of US\$2.25.
2. Prior to the rights issue there were 12.3 million Mears shares on issue.
3. The total value of options and warrants, based on an ordinary share price of US\$2.25, calculated using the Black Scholes option pricing model. The other key inputs to the model were based on the amounts used by Mears to allocate the shares to be issued by K2 as a result of the Proposed Transaction among the holders of various Mears instruments. The key assumption was a volatility of 67%.
4. Cash of US\$0.25 multiplied by the number of rights expected to be exercised, as described in note 6 below.
5. US\$1.83 is the price per share required for the total value of shares and options after the rights issue to total the value calculated above of US\$43.6 million.
6. K2 has stated that it will not exercise its rights. As the rights price is significantly below our assessed share value we have assumed all other rights will be exercised, leading to the issue of an additional 5.7 million shares. The additional 5.7 million shares is calculated by deducting the number of shares held by K2 (988k) from the total number of shares outstanding in Mears (12,333k), and dividing by two to reflect the exercised rights.
7. The total value of options and warrants implied by a share price of US\$1.83, using the Black Scholes option pricing model with all other inputs the same as those described in note 3 above is US\$10.7 million.



The above analysis indicates that the Series F convertible preference share raising, subsequent to the dilutive effect of the rights issue, implies a value for the equity in Mears of approximately \$43.6 million. This includes the value of the outstanding options and warrants over Mears shares.

We undertook a sensitivity analysis on the key inputs, being the volatility of the price of Mears shares and the pre rights issue price, to the above calculation as follows:

**Table 16: Sensitivity Analysis of Total Equity Value after Rights Issue (US\$ Million)**

Per share value before rights issue	Volatility				
	54%	60%	67%	74%	80%
\$1.80	32.0	33.1	34.1	35.1	36.0
\$2.03	36.6	37.7	38.8	39.9	40.9
\$2.25	41.2	42.5	43.6	44.7	45.8
\$2.48	46.0	47.3	48.5	49.7	50.8
\$2.97	56.6	58.0	59.4	60.6	61.8

Source: Leadenhall analysis

As demonstrated in the above table, the value of the equity in Mears was most sensitive to the per share value before the rights issue, with a 25% decrease in share value from \$2.25 resulting in a decrease in equity value of almost 28%, compared to the impact from a 24% decrease in volatility which only reduced the equity value by 6%.

We note that the above analysis is based on minority interests in Mears shares; hence the resultant value is also on a minority basis (i.e. it excludes a premium for control).

### 7.3. Conclusion on Value of 100% Interest in Mears on a Minority Basis

The valuations that resulted from the discounted cash flow methodology and analysis of recent transactions for 100% of the equity interest in Mears on a minority basis are presented in the table below.

**Table 17: Comparison of Valuation Methods**

Valuation Method		Low US\$'000	High US\$'000
Discounted cash flow	(Section 7.1 above)	36,437	54,945
Analysis of recent transactions	(Section 7.2 above)	43,631	43,631
<b>Midpoint</b>		<b>40,034</b>	<b>49,288</b>
<b>Selected range</b>		<b>40,000</b>	<b>45,000</b>

Source: Leadenhall analysis

We have applied professional judgement to the above valuations to select a range for the valuation of 100% of the equity interest in Mears to be between US\$40 million and US\$45 million.

We note that the above alternative valuation methods are comparable due to a discount for lack of control being applied to the results from the discounted cash flow presented in Section 7.1 above, and the transactions included in the analysis in Section 7.2 above already being on a minority basis. Therefore both valuation methods have resulted in a valuation for 100% of the equity interest in Mears on a minority basis.

The value range set out above is an equity value calculated after deducting the debt payable from Mears to K2 and includes Mears share of solar business.



#### 7.4. Value of Interest to be Acquired

As K2 already owns 8% of the outstanding shares in Mears, plus a significant number of warrants, the value of these instruments needs to be deducted from the value of a 100% interest in the equity of Mears to assess the value of the interest in Mears to be acquired if the Proposed Transaction proceeds.

We set out in the table below the value of the interest in Mears to be acquired based on a value for 100% of Mears in the range from \$40 million to \$45 million.

**Table 18: Valuation of Interest in Mears to be Acquired**

	Notes	Low US\$'000	High US\$'000
Total equity value on a minority basis		40,000	45,000
Implied value of options and warrants	1	9,559	11,160
<b>Total value of common shares</b>		<b>30,441</b>	<b>33,840</b>
Divided by: total number of shares ('000)	2	18,005	18,005
<b>Value per share (US\$)</b>		<b>1.69</b>	<b>1.88</b>
Multiplied by: shares held by K2 ('000)		988	988
Value of K2 shareholding		1,670	1,856
Value of K2 warrants	3	1,574	1,869
<b>Total value of K2's current interest in Mears</b>		<b>3,244</b>	<b>3,725</b>
<b>Total value of interest to be acquired (USD)</b>	4	<b>36,756</b>	<b>41,275</b>
Exchange Rate (USD:AUD)	5	0.954	0.954
<b>Total Value of Interest to be Acquired (AUD)</b>		<b>35,066</b>	<b>39,376</b>

Source: Leadenhall analysis

Notes:

1. Based on a share price of \$1.69 to \$1.88 calculated using the Black-Scholes option pricing formula.
2. The number of shares is based on the expectation that the proposed rights issue is fully subscribed, other than the rights of K2.
3. The value of warrants was calculated using the Black Scholes option pricing model, based on the share price of \$1.69 to \$1.88.
4. The value of the interest to be acquired is the total equity value less the value of K2's current interest in Mears.
5. We have used a rate 0.954 to translate the equity value from USD to AUD, as per rates provided by the RBA on 20 December 2012

Based on the analysis set out above we have selected a range from \$35 million to \$40 million for the interest in Mears to be acquired by K2 if the Proposed Transaction proceeds.



## 8. Valuation of Consideration

### 8.1. Background

If the Proposed Transaction is approved, K2 will issue new shares to acquire the outstanding shares, options and warrants in Mears that it does not already own. The number of shares to be issued depends on the take-up of Mears proposed rights issue. If no rights are taken up, K2 will issue 80 million new shares. If all rights (other than those issued to K2) are taken up, K2 will issue 84.6 million new shares. The 4.6 million additional K2 shares reflect the additional cash subscribed of US\$1.4 million to Mears under the rights issue.

As the rights are in-the-money based on our valuation of Mears set out in Section 7 above, we have set out our analysis assuming the rights are fully taken up. However, we note that if the rights are not taken up it would not have a significant impact on our assessment.

The consideration is therefore up to 84.6 million shares in the Proposed Merged Entity (which is represented by K2 after the Proposed Transaction - i.e. with a 100% ownership interest in Mears). We have determined the Fair Market Value of 84.6 million shares in the Proposed Merged Entity using the net assets on a going concern basis method, with a cross-check by reference to recent trading in K2 shares.

### 8.2. Net Assets

We set out below our assessment of the Fair Market Value of the consideration, based on the net asset value of the Proposed Merged Entity.

**Table 19: Net Asset Based Valuation of Consideration**

	Low \$'000	High \$'000
Cash	600	600
Mears (100% interest on a minority basis)	38,160	42,930
Mears debt payable to K2	1,000	1,000
Trey Resources (17% interest)	1,000	1,200
Solar Technology	6,500	6,500
<b>Equity value including options</b>	<b>47,260</b>	<b>52,230</b>
Options	36	36
<b>Value of 100% of issued shares</b>	<b>47,224</b>	<b>52,194</b>
Divided by: Total number of shares ('000)	109,040	109,040
<b>Value per share (\$)</b>	<b>\$0.43</b>	<b>\$0.48</b>
Multiplied by: Shares to be issued ('000)	84,634	84,634
<b>Value of consideration</b>	<b>36,655</b>	<b>40,512</b>

Source: Leadenhall analysis

We discuss below the Fair Market Value of each of the net assets owned by the Proposed Merged Entity.

#### **Cash**

K2 currently has cash of approximately \$600,000. The cash in Mears, including the expected proceeds from its rights issue, is included in the value attributed to Mears.

We have not included the impact of the proposed capital raising by K2 in our analysis. However, this will not impact our conclusions significantly.





### **Mears**

In Section 7 above we valued 100% of the equity in Mears (including the value attributable to warrants and options) at US\$40 million to US\$45 million on a minority basis. As K2 will own all of the equity in Mears after the Proposed Transaction, with no warrants or other contingent claims on equity outstanding, we have included this full amount in the assessed Fair Market Value of the Proposed Merged Entity. This amount was translated into Australian dollars at the exchange rate of 0.954 as at 20 December 2012.

### **Mears Debt Payable to K2**

The valuation of Mears was calculated after deducting \$1 million in relation to the bridge loan from K2. As the bridge loan will be offset on consolidation within the Proposed Merged Entity, we have added this amount back.

### **Trey Resources**

K2 has a 17% holding in Trey Resources, with a book value of \$880,000. Trey Resources recently acquired Texas based Sierra Oil and Gas LP in exchange for equity and cash. In order to assess the recent transaction Trey Resources obtained a fairness opinion from Canaccord Genuity Inc. which included a valuation of Trey Resources after the proposed transaction to acquire Sierra. The valuation of 100% of Trey Resources contained in the fairness opinion implies a value for K2's interest in Trey Resources that is somewhat higher than the book value. However, after considering appropriate discounts for lack of control and lack of marketability to reflect K2's minority interest we have adopted a valuation of \$1.0 million to \$1.2 million, which is a premium to book value. This is consistent with the development of Trey Resources' operations since the initial investment.

### **Solar Technology**

The valuation of Mears discussed in Section 7 above includes 50% of the future profits from solar applications for Mears' technology, as this is what K2 has currently agreed to pay to Mears. The upfront development costs and the other 50% of future profits are not included in the cash flows in Section 7. The Proposed Merged Entity would be entitled to 100% of the profits from solar application of MST, therefore we have added the value of the solar related cash flows that K2 is presently entitled to. The present value of the forecast cash flows for solar technology that K2 is currently entitled to is \$6.5 million, based on a discount rate of 35% (the upper end of the rates as discussed in Section 7 above to reflect the higher risk related to the solar applications for MST) and a discount for lack of control of 25%.

### **Options**

K2 currently has 6 million options, exercisable at \$0.20 (\$2.00 after the 1 for 10 consolidation) on issue. These options are exercisable at any time up to 31 December 2014. K2 also intends to issue 2 million options to Foster Stockbroking upon completion of the Proposed Transaction. These options will have an exercise price of \$0.30 (after the 1 for 10 consolidation) and will be exercisable up to 31 December 2016. We have valued all of these options at a total of \$36,000 using the Black-Scholes option pricing model.

We note that a significant number of options are to be issued to Dr Robert Mears and Mr Erwin Trautman. However, these options vest progressively over several years and are effectively part of the remuneration package for these individuals. The costs of remuneration have been included in the value of Mears and thus no further adjustment is required to take account of these options.

### **Number of Shares**

K2 currently has 244.1 million shares on issue, which will reduce to 24.4 million shares post consolidation. As discussed above, it is expected to issue a further 84.6 million shares to complete the Proposed Transaction. Thus the total number of shares in the Proposed Merged Entity will be 109 million post share consolidation, before considering the proposed capital raising.

As noted above, we have not included the impact of the proposed capital raising by K2 in our analysis. However, this will not materially-impact our conclusions.

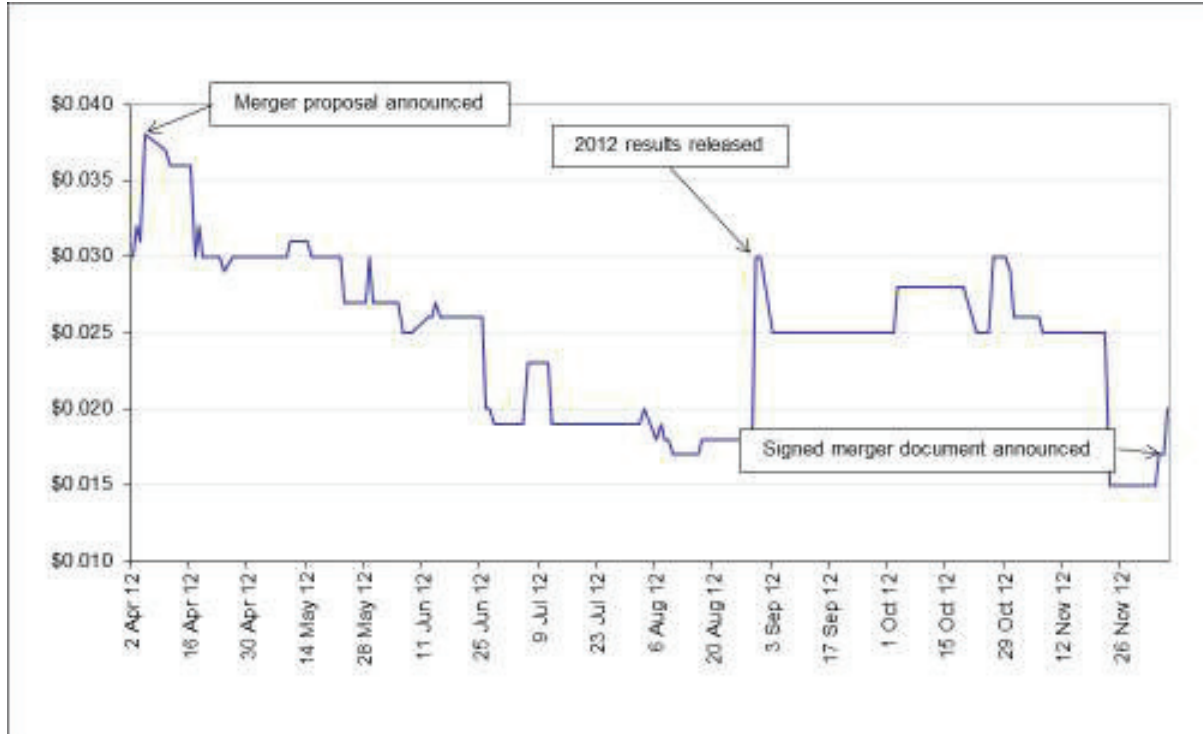




### 8.3. Analysis of Share Trading

Market trading in K2 shares since the announcement of the Proposed Transaction would indicate the market's view of post transaction value per share if the market expects the deal to complete. We have therefore analysed trading in K2 shares since the announcement of the Proposed Transaction in April 2012, as set out in the following chart.

Figure 8: Analysis of Market Trading in K2 Shares



Source: Capital IQ

The chart above shows that K2 shares have generally traded in the \$0.020 to \$0.030 range since the announcement of the merger. This equates to a range of \$0.20 to \$0.30 after the proposed 1 for 10 share consolidation. The volume weighted average price for the period since the initial announcement was \$0.025.

We understand that K2 currently expects to raise capital at \$0.30 per share in conjunction with executing the Proposed Transaction, which is at the upper end of the recent market trading in K2 shares. As the proposed capital raising will only occur if the Proposed Transaction is approved, the uncertainty regarding the completion of the transaction that may be implied by share market trading in K2 is not likely to affect the pricing of the capital raising. As a result we have adopted a range of \$0.25 to \$0.30 per share for the Proposed Merged Entity, based on an analysis of market trading in K2 shares.

Table 20: Share Trading Based Valuation of Consideration

	Low \$'000	High \$'000'
Value per Share (\$)	\$0.25	\$0.30
Multiplied by: Shares to be Issued ('000)	84,634	84,634
<b>Value of Consideration</b>	<b>21,159</b>	<b>25,390</b>

Source: Leadenhall analysis



#### **8.4. Conclusion on Value of Consideration**

In Section 8.2 we assessed the consideration payable by K2 at \$36.7 million to \$40.5 million, based on assessment of the net asset value of K2. In Section 8.3 we assessed the proposed consideration at \$21 million to \$25 million, based on recent trading in K2 shares. We place more weight on the former, especially given the somewhat illiquid nature of K2 shares in recent trading. As a result we have selected a range of \$30 million to \$35 million as representing the Fair Market Value of the consideration to be paid by K2 if the Proposed Transaction proceeds.



## 9. Evaluation

### 9.1. Fairness

In order to assess whether the Proposed Transaction is fair we have compared our assessed Fair Market Value of the interest in Mears to be acquired with the proposed consideration to be paid as set out in Table 21 below.

**Table 21: Comparison of the Interest in Mears to be acquired with the Proposed Consideration**

		Low \$'000	High \$'000
Fair Market Value of interest in Mears to be acquired	(Section 7.4)	35,000	40,000
Fair Market Value of the proposed consideration	(Section 8.4)	30,000	35,000

Source: Leadenhall analysis

Since the value of the interest in Mears to be acquired is above the range of the value of the proposed consideration, the Proposed Transaction is fair to Shareholders.

### 9.2. Reasonableness

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

#### *Advantages*

We set out below the main advantages to Shareholders of approving the Proposed Transaction:

##### **Increased scale**

After the Proposed Transaction, K2 will have a substantially larger business than it has at present. Thus the ongoing costs of maintaining a listed entity will be spread over a larger base. As a larger company K2 may be able to enjoy additional benefits such as attracting employees, better terms with suppliers and financiers etc.

##### **Increased liquidity**

The Proposed Merged Entity is likely to have a market capitalisation significantly in excess of the current market capitalisation of K2. The increased market capitalisation of the Proposed Merged Entity may attract greater analyst coverage which would enhance the profile of the Proposed Merged Entity with institutional investors. These factors could result in increased liquidity and greater trading depth than K2 would have on a standalone basis.

##### **Full ownership of MST**

If the Proposed Transaction is undertaken the ownership of all rights to MST (chips and solar) will be consolidated within one entity. This will allow K2 to focus its resources on the area with most benefit, whereas at present there may be incentives for K2 to inappropriately focus on one sector to the detriment of another.



### ***Disadvantages***

We set out below the main disadvantages to Shareholders of approving the Proposed Transaction:

#### **Increased risk**

K2's current business is predominantly one of passive investment, with some diversification achieved through investments in the unrelated activities of Mears and Trey Resources. After the Proposed Transaction, Shareholders will be heavily exposed to the success or failure of the Mears business, which is still in the start-up phase and thus carries a significant level of risk. While it is possible the Mears business will be a success and generate significant returns to Shareholders it is also possible that the business will fail.

#### **Potential for future dilution**

Mears' business is still in the start-up phase and it has yet to achieve commercial adoption for any of its products. It is therefore possible that the Proposed Merged Entity will run out of cash before it is able to generate sufficient revenues to meet its ongoing costs. This could lead to the need to raise future capital which may dilute K2's shareholders in the future.

### ***Conclusion on Reasonableness***

Since the Proposed Transaction is fair it is also reasonable.

### **9.3. Opinion**

The Proposed Transaction is fair and 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

Table 22: Glossary

Term	Meaning
AIFRS	Australian equivalent to international financial reporting
ASX	Australian Securities Exchange
AUD	Australian Dollar
BOE	Barrels of Oil Equivalent
CAGR	Compound Annual Growth Rate
Corporations Act	The Corporations Act 2001
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortisation
Explicit Forecast Period	FY13 to FY21
Fair Market Value	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 arms' 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
FOS	Financial Ombudsman Service
FSG	Financial Services Guide
FY	Financial year
Independent Directors	The directors of K2 that are not associated with Mears
K2	K2 Energy Limited
Leadenhall	Leadenhall Corporate Advisory Pty Ltd
Mears	Mears Technologies, Inc.
MST	Mears Silicon Technology
NPAT	Net profit after tax
Proposed Merged Entity	The merged entity comprising 100% of K2 and Mears after the Proposed Transaction
Proposed Transaction	K2's offer to acquire the interest in Mears that it does not already own.
RBA	Reserve Bank of Australia
RG111	Regulatory Guide 111: Content of Expert Reports
Shareholders	K2 shareholders that are not associated with Mears securityholders
SWOT	Strengths, weaknesses, opportunities and threats
Trey Resources	Trey Resources 1 LLC
US	United States of America
USD	US Dollar
WACC	Weighted Average Cost of Capital



## Appendix 2: Sources of Information

In preparing this report we have had access to the following principal sources of information:

- Capital IQ
- [www.mearstechnologies.com](http://www.mearstechnologies.com)
- [www.K2energy.com.au](http://www.K2energy.com.au)
- K2 Energy Limited Notice of General Meeting, Explanatory Memorandum, Prospectus and Proxy Form
- Financial Statements for K2 (2010-2012)
- Financial Statements for Mears (2011-2012)
- Business Plan for FY13 to FY21 provided by Mears
- CNET News; Moore's Law: The rule that really matters in tech, Stephen Shankland
- MOSFET Performance and Scalability Enhancement by Insertion of Oxygen Layers; Article released by the Department of Electrical Engineering and Computer Sciences, University of California, Berkeley
- B.G. Yacobi, Semiconductor Materials: An Introduction to Basic Principles, Springer 2003
- PWC, January 2012; Faster, greener, smarter – reaching beyond the horizon in the world of semiconductors
- [www.wikipedia.com](http://www.wikipedia.com)
- [www.arm.com](http://www.arm.com)
- 
- Semiconductor Industry Association Industry Fact Sheet –  
[http://www.sia-online.org/clientuploads/One Pagers/Semiconductor Overview July 2012.pdf](http://www.sia-online.org/clientuploads/One%20Pagers/Semiconductor%20Overview%20July%202012.pdf)  
[http://www.sia-online.org/clientuploads/One Pagers July 2012/Export Controls FINAL.pdf](http://www.sia-online.org/clientuploads/One%20Pagers%20July%202012/Export%20Controls%20FINAL.pdf)
- <http://www.bbc.co.uk/news/business-18980476>: July 2012; Apple chip designer Arm Holdings in 23% profits boost
- <http://spectrum.ieee.org/semiconductors>
- <http://iopscience.iop.org>; Journal of Semiconductors
- Mr. Vikrant Chaudhari, October 2000; Library Project: Industry Analysis, Company: Intel Corporation, Industry: Semiconductors
- SIRCA Risk Measurement Service
- Bloomberg ([www.bloomberg.com](http://www.bloomberg.com))

In addition, we have had discussions and correspondence with certain directors and executives of K2 and Mears, in relation to the above information and to current operations and prospects.



### Appendix 3: 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; and
- 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; and
- an estimate of terminal value.

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.

A terminal value reflects the value of cash flows that will arise beyond the explicit forecast period. This is commonly estimated using either a constant growth assumption or a multiple of earnings (as described under capitalisation of future maintainable earnings below). This terminal value is then discounted to current day terms and added to the net present value of the forecast cash flows.

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; or
- 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 forecasts of cash flow are not available and cannot be determined; or
- 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; and
- 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. In Australia this has been called the comparable transaction methodology. 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; or
- 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; and
- 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); or
- 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; or
- 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 4: Qualifications, Declarations and Consents

### Responsibility and Purpose

This report has been prepared only for the benefit of Shareholders for the purpose of assessing the fairness and reasonableness of the Proposed Transaction.

It therefore cannot be used for any purpose other than as described above unless Leadenhall has provided written consent. Other than as specifically identified elsewhere in this report, neither the whole nor any part of this report nor any reference thereto may be included in or with or attached to any document (including electronically), circular, resolution, letter or statement, or released externally to any other party without the prior written consent of Leadenhall as to the form and context in which it appears.

### No responsibility to third parties

We are not responsible to you, 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 – Accuracy and Completeness

The financial information supplied by K2, as set out in Appendix 2, is the prime basis of this engagement. In preparing our analysis we have relied upon the accuracy and completeness of the information provided to us and we have assumed it has been prepared in accordance with applicable accounting standards and the Corporations Act. We have assumed that there is no information or documentation that has been withheld from Leadenhall that potentially may have a material effect on our conclusions. We have not performed anything in the nature of an audit, review or financial due diligence on the information provided for this report.

### Prospective Information – Provision and Responsibility

In relation to prospective financial information, we have relied upon the information as detailed in Appendix 2, without verification by us of historical, budgeted or forecast information. K2 is responsible for this financial information.

Statements and opinions contained in this report are given in good faith but, in the preparation of this report, Leadenhall has relied upon the completeness of the information provided by K2 and its officers, employees, agents or advisors which Leadenhall believes, on reasonable grounds, to be adequate, reliable, complete, accurate and not misleading for the purpose of this report.

### Prospective Information – Procedures Undertaken

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 K2's personnel.

These procedures and enquiries did not include verification work nor constitute an audit or a review engagement in accordance with Australian Auditing Standards. Based on these procedures and enquiries, Leadenhall considers that there are reasonable grounds to believe that the prospective financial information for K2 and Mears included in this report has been prepared on a basis that is reasonable for valuation purposes.

### Prospective Information – Not Audited or Verified

Leadenhall does not imply, nor should it be construed, that it has carried out any form of audit or verification on the information and records supplied to us. Drafts of our report were issued to K2 for confirmation of factual accuracy. We have accepted the information at face value, and have not attempted to test its veracity. Whilst we believe the statements made in this report are accurate, no warranty of accuracy or reliability is given by Leadenhall or its affiliated companies and their respective officers and employees.



### **Prospective Information – No Assurance on Achievability**

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. Accordingly we give no assurance that any forecast results will be achieved and consequently any future variation between the actual results and any prospective financial information utilised in this report may affect the valuation conclusions included in this report.

In relation to the prospective financial information, actual results may be different from the prospective financial information of K2 and Mears referred to in this report since anticipated events frequently do not occur as expected and the variation may be material. The achievement of the prospective financial information is dependent on the outcome of the assumptions. Accordingly, we express no opinion as to whether the prospective financial information will be achieved.

### **Qualifications**

The employees of Leadenhall principally involved in the preparation of this report were Richard Norris, BA (Hons), ACA, M.App.Fin, F.Fin, Hamish Blair, B.Comm (Hons), M.Comm, FCA, F.FinSIA and Daniela Crollini, BBus (Acct).

### **Market Conditions**

The opinion of Leadenhall is based on prevailing market, economic and other conditions at the date of this report. Conditions can change over relatively short periods of time. Any subsequent changes in these conditions could impact upon value either positively or negatively.

### **Indemnities**

In recognition that Leadenhall may rely on information provided by K2 and its officers, employees, agents or advisors, K2 has agreed that it will not make any claim against Leadenhall to recover any loss or damage which K2 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 K2 and its officers, employees, agents or advisors or the failure by K2 and its officers, employees, agents or advisors to provide Leadenhall with any material information relating to this report.

### **APES 225**

This report has been prepared in accordance with APES 225 Valuation Services issued by the Accounting Professional and Ethical Standards Board Limited.