Toll Holdings Limited
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and subsidiaries

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12 October 2005

Mr William Hara
Legal Counsel and Group Company Secretary
Patrick Corporation Limited
Lot 3, Pier 8/9 Walsh Bay
23 Hickson Road
MILLERS POINT NSW 2000

Dear Mr Hara

Toll Holdings Limited takeover bid for Patrick Corporation Limited

We refer to your letter dated 10 October 2005.

Response to detailed questions

We set out on the following pages our response to each question.

Toll makes the comments on the following pages with respect to Toll Holdings Limited and the entities it controlled during the respective period of each question, but excluding Pacific National ("Toll"). We have not specifically included Pacific National ("PN") in our responses on the basis that Patrick Corporation Limited ("Patrick") has the same access as ourselves to the financial information of PN.

Toll's responses to the questions raised by Patrick Corporation Limited have been made with regard to materiality levels applicable to Toll.

There are several themes in your questions, which we make the following comments in respect of:

- **Acquisition Accounting**

  As noted in our response, Toll has provided an aggregate of $52 million (before tax) for acquisition related restructuring costs over the five years ended 30 June 2005. These provisions have been determined in accordance with Accounting Standards and are legitimate estimates of costs associated with restructuring following acquisitions. Toll's accounting policy is the same as Patrick's disclosed policy (although unlike Toll, Patrick does not disclose specific amounts) and Pacific National's accounting policy, which has been approved by the Patrick appointed directors. Toll has a successful track record in integrating acquisitions and improving the performance of those businesses through post acquisition performance improvement. This is illustrated in Toll's earnings and operating cash flow growth in Toll's Bidder's Statement.

Toll reserves its full rights in the event Patrick presents any Toll acquisition accounting in a misleading or deceptive way.

- **Toll NZ**

  Toll NZ is a publicly listed company which is 84% owned and controlled by Toll. As a separately listed company, there is full market disclosure in respect of Toll NZ, in addition to disclosures at the Toll level concerning Toll NZ. Accordingly, we believe the market is fully informed in respect of Toll NZ.

  It should be noted that Toll's A$165 million equity investment in Toll NZ in 2003 is now valued at in excess of A$550 million, based on Toll NZ's current share price and that no goodwill was recorded from Toll's acquisition of Tranz Rail Holdings Limited.

  Toll reserves its full rights in the event Patrick presents any Toll NZ accounting in a misleading or deceptive way.

- **Other**

  A number of your other questions suggest you may be looking to reclassify Toll's reported financial information in a manner inconsistent with accounting standards and accepted market practice. Again, Toll reserves its rights if Patrick presents any Toll information in a misleading or deceptive manner.

Toll's financial statements have been subject to audit every year and since Toll's shares were listed on the ASX and have received unqualified audit opinions. Toll NZ financial statements have also received unqualified audit opinions since the company was acquired by Toll.

Toll will shortly submit a number of questions to Patrick on aspects of its financial statements.

Yours sincerely
TOLL HOLDINGS LIMITED

Bernard McInerney
COMPANY SECRETARY

QUESTION 1

Will you advise the extent of pre-acquisition provisions recorded in the Toll Group accounts from 2001 to 2005, and please provide detailed information regarding the expenditures recorded against these provisions?

Toll response

Consistent with your comments in question 2, it is assumed that your reference to pre-acquisition provisions relates to provisions for restructure recognised as part of an acquisition of an entity or operation as referred to in AASB 1044 *Provisions, Contingent Liabilities and Contingent Assets*.

Toll's accounting policy with respect to provisions for restructuring costs is very transparent in our audited financial statements. Note 1(l)(iii) of the Toll financial statements for the year ended 30 June 2005 outlines our accounting policy. The notes to the financial statements separately identify the balance of the provision for restructuring costs at each balance date. The statement of cash flows separately identifies the payments that have been made in respect of restructuring costs in each financial period.

Provisions for restructure as part of an acquisition of an entity or a business totalling $52 million on a pre tax basis and including Toll NZ have been recognised by Toll during the period from 1 July 2000 to 30 June 2005.

Expenditure recorded against the provisions related largely to the restructuring of operations, including the rationalisation of employee numbers and in some instances the rationalisation of property holdings and fleet relivery costs.

All such restructuring provisions were initially recognised and subsequently accounted for in accordance with the guidance set out in accounting standard AASB 1044 (or accounting guidance applicable at the time of the acquisition if the acquisition occurred prior to the issue of AASB 1044).

QUESTION 2

We note in the 2004 Toll Holdings financial statements restructuring provisions on acquisition of subsidiaries of $9.3 million in regard to Mayne Express and $26.0 million in regard to Tranz Rail Holdings Limited. The effect of restructuring provisions on acquisition is to classify expenditure incurred after the acquisition as pre-acquisition expenditure the effect of which is to increase post acquisition earnings. Restructuring provisions at June 30 2005 are reported as $11.9 million which implies that Toll Holdings Earnings before interest and tax ("EBIT") have been boosted by at least $23.4 million as a result of this accounting treatment. Can you confirm that our analysis is correct? Additionally can you confirm that these are the only pre-acquisition provisions within the Toll Group over the period from 2000 to 2005? If not will you please provide details of other pre-acquisition provisions within the Toll Group?

Toll response

Your analysis is incorrect. The effect of restructuring provisions is to increase the cost of an acquisition by the amount of expenses incurred from restructuring identified at the time of the acquisition.

On 11 November 2002, the Toll Group recorded a provision of $9.3m (before tax) in relation to the acquisition of Mayne Express (which is part of the $52 million before tax aggregate provisions referred to in response to Question 1). This provision related the restructuring of operations, including rationalisation of employee numbers. Of this amount $8.9m (before tax) was charged against the provision during the year ended 30 June 2003. As at 30 June 2004 and 30 June 2005, a provision of $0.4m remained.

On the 10 October 2003, the Group recorded a provision of $26m (before tax) in relation to the acquisition of Tranz Rail Holdings Limited (which is part of the $52 million before tax aggregate provisions referred to in response to Question 1). This provision related the restructuring of operations, including the rationalisation of employee numbers. Of this amount $4.3m and $10.5m (both before tax) were charged against the provision during the years ended 30 June 2004 and 30 June 2005 respectively. As at 30 June 2005, a provision of $10.2m remained.

As stated above in our response to Question 1, all restructuring provisions recognised as part of an acquisition of an entity or operation and subsequent expenditure recorded against that provision have been accounted for in accordance with AASB 1044 (or earlier guidance). Accordingly, Toll's results have not been "boosted" as a result of this accounting treatment as the items charged against the restructuring provisions are non-recurring and non-operating costs specifically related to the acquisition of the respective businesses, and do not relate to the underlying business operations.

Refer to our response to question 1 for further details on provisions raised in relation to acquisitions between the period from 1 July 2000 to 30 June 2005.

QUESTION 3

Have there been instances in the Toll Group where pre-acquisition restructuring provisions have been adjusted to incorporate changed circumstances post acquisition? If so please provide details.

Toll response

There were no instances where Toll revised a provision for restructure recognised as part of an acquisition of an entity or operation as a result of changed circumstances post acquisition.

Furthermore, with the exception of a revision, which occurred in the year ended 30 June 2002, to an assessment of an executive termination payment arising from one acquisition, there have been no material adjustments to the restructuring provisions that were initially recognised. This one adjustment was accounted for in accordance with the accounting pronouncements applicable at the time.

QUESTION 4

Have any pre-acquisition provisions for redundancies within the Toll Group been applied other than in accordance with the original restructuring plan?

Toll response

No. All restructuring provisions, including those raised in relation to redundancies, have been charged against the restructuring provision in accordance with the original restructuring plan.

QUESTION 5

The items "Other provisions" in the 2005 accounts of Toll Holdings total $92 million. Please advise the nature of these provisions and whether any of them relate to amounts provided on acquisitions.

Toll response

Other provisions, as stated in Note 1(l)(iv) and (v) of the Toll financial statements for the year ended 30 June 2005, provides for items including workers compensation, payroll related items, bonuses, damages, pallets and stock losses.

As stated in Note 1(l)(iv) of the Toll financial statements for the year ended 30 June 2005, provisions for workers compensation using self-insurance are based on independent actuarial assessments. These assessments are completed bi-annually.

'Other provisions' does not include any restructuring provisions recognised as part of an acquisition of an entity or operation.

QUESTION 6

On the 9th August 2005 Toll Holdings and the Macquarie Goodman Group announced the sale and leaseback of five of Toll Holding's properties for $120 million. Can you please provide detailed information on the structure of this transaction, the details of the properties disposed and confirm that the properties were sold at market value and that the structure of the lease transaction reflects current market rental levels for the relevant properties?

Toll response

Toll's property sale and leaseback with Macquarie Goodman was not for $120 million.

As stated in Toll's media release of 9 August 2005 and the Macquarie Goodman release of the same date, Toll has entered into an arrangement for the sale of five properties, the sales value of which was $64 million. Of this sum $37 million, or two of the properties, was completed during the year ended 30 June 2005, with the balance to be settled in the year ending 30 June 2006. In addition to these sales it is expected that Macquarie Goodman in conjunction with Toll will manage a number of new sites, which when combined with the above sales will result in excess of $120 million of property being managed.

All properties sold by Toll are at market value and any leases entered into are on commercial terms and conditions.

Toll has accounted for these sale and leaseback transactions in accordance with the guidance set out in AASB 1008 *Leases*.

QUESTION 7

Following the sale of Webb Dock West what is the remaining carrying value of the assets in the Strang Stevedoring business?

Toll response

There are no assets with material carrying values in the Strang Stevedoring business.

QUESTION 8

Are there instances in the Toll Group where depreciation of assets is suspended as they are not in use? If so, can you please provide details?

Toll response

No. There have been no instances where Toll suspended the depreciation of assets not in use.

QUESTION 9

Toll Holdings 2004 annual report discloses at note 12 the fixed asset reconciliations. The sum total of these reconciliations for the year discloses the following:

Carrying amount at beginning of year	*462,752*
Additions	*162,393*
Disposal	*(36,732)*
Depreciation	*(102,355)*
Acquisitions through entity acquired	*500,164*
Net foreign currency differences on translation	*22,821*
Carrying amount at end of year	*1,009,043*

This reconciliation discloses $500.2 million as acquisitions through entities acquired in 2004. The annual report discloses two acquisitions in 2004, Tranz Rail Holdings Limited and Leonard & Dingley Limited, Note 32 of the 2004 report shows the fair value of the property, plant and equipment of these entities as follows:

Tranz Rail	*$476.122 million*
Leonard & Dingley	*$0.762 million*
Total	*$476.884 million*

We note the fixed asset acquisitions through entities acquired as per the Property, plant and equipment note amounts to $500.2 million which does not appear to reconcile to the amount of $476.884 million per the acquisition note by $23.3 million. Can you please provide an explanation as to why these amounts do not reconcile by $23.3 million, provide details of the assets represented by this $23.3 million and if applicable provide details of other entities acquired that have not been disclosed in the 2004 financial statements?

Toll response

The $23.3 million reconciling item represents fixed assets that were acquired as a result of the purchase of the remaining 50% interest not already held in Tranz Scenic 2001 Limited on 20 May 2004. Details of this acquisition are disclosed in the 2004 Toll NZ Limited financial statements (Note 24), and was not considered sufficiently material for separate disclosure in the Toll financial statements.

QUESTION 10

The 2005 AIFRS disclosures in the Toll Holdings financial statements disclose that interest bearing liabilities of $253.0 million at 30th June 2004 and $185.7 million at 30th June 2005 will be reclassified from non-current liabilities to current liabilities upon adoption of the Australian equivalents to International Financial Reporting Standards. The current policy being adopted by Toll Holdings is to include these liabilities as non-current as the group, they advise " … has historically been successful in rolling these debts for additional short terms". The current AASB 1040: Statement of Financial Position requires in summary that where the refinancing is not at the group's discretion, that is, there is no agreement to re-finance for a period greater than twelve months prior to the completion of the financial report, liabilities must be classified as current. Further, the 2004 financial statements note that a NZD $16.5 million loan was repaid and cancelled on 10th August 2004. In the 2004 financial statements this loan appears to have been classified as non-current, despite this repayment occurring shortly after year end. Considering the requirements of AASB 1040 please advise on what basis you believed the classification of these liabilities as current was appropriate.

Toll response

The analysis provided in this question is incorrect.

The reclassification reflects differing requirements between the current AGAAP (accounting standard AASB 1040) and AIFRS (accounting standard AASB 101).

For a liability to be classified as non current, AASB 1040 paragraph 4.5(b) requires the entity to be committed to an agreement to refinance prior to the time of <u>completion of the financial report</u>, whilst AASB 101 paragraph 63 requires such an agreement to be in existence <u>at reporting date</u>.

The differing requirements have resulted in the reclassification of debt between current and non current.

The loans held by Toll NZ at 30 June 2004 were borrowed under a term loan facility. This facility was classified as non current in accordance with AASB 1040 paragraph 4.5.

This facility was repaid and refinanced by Toll on 10 August 2004. The refinancing occurred shortly after year end following the Toll proposal being accepted by the Toll NZ Board.

This transaction, together with the fact that all debt facilities were disclosed as non-current liabilities at 30 June 2004, was fully disclosed in Note 13 of the Toll NZ financial statements for the year ended 30 June 2004. This disclosure was consistent with the Toll financial statements for the year ended 30 June 2004.

QUESTION 11

We have been unable to explain $29.1 million of Goodwill increases in the Toll Group balance sheet that occurs between 2001 and 2005. Please explain the increases and accounting entries which have given rise to this increase in Goodwill that have not arisen as a consequence of subsidiary acquisitions.

Toll response

We are unable to determine the basis for your $29.1 million of goodwill, however the increases in goodwill, other than for material acquisitions which were individually disclosed in the financial statements, relate to:

- acquisitions which occurred during the period 1 July 2000 to 30 June 2005 including BHP Stevedoring, R&H Transport, State Mail, International Corporate Relocations and SDC; and
- the revision to the executive termination payment referred to in question 3.

All such transactions and adjustments impacting the goodwill balance have been accounted for in accordance with AASB 1015 Acquisition of Assets and AASB 1013 Accounting for Goodwill.

QUESTION 12

We have attempted to calculate Toll's adjusted Debt Equity ratio for the previous 3 years, assuming liabilities include Preference Share capital and non-cancellable operating lease liabilities. Can you please confirm our calculation of the Toll Group's adjusted debt equity ratio is correct:

	2004 $'000	**2003** $'000	**2002** $'000
Toll Group equity	1,094,380	630,774	402,754
Less: Preference shares	(245,122)	-	-
Adjusted equity	849,258	630,774	402,754
Toll Group liabilities	1,080,489	806,427	747,003
Add: Preference shares	245,122	-	-
Add: Off balance sheet Liabilities	658,211	509,593	348,618
Adjusted liabilities	1,983,822	1,316,020	1,095,621

Adjusted Debt Equity Ratio	2.34	2.09	2.72

Toll response

The above calculation, which is based on total liabilities rather than interest bearing debt does not represent a Debt Equity Ratio. Any presentation of this information by Patrick as a Debt Equity ratio will plainly be misleading.

As you would be aware Toll's Reset Preference Shares, issued during the year ended 30 June 2004, were classified as equity in accordance with accounting standard AASB 1033 *Presentation and Disclosure of Financial Instruments.* Following the transition to AIFRS Toll's Reset Preference Shares will be reclassified from equity to interest bearing liabilities. This transitional adjustment is reflected in Toll's Financial Statements at 30 June 2005 and Toll's Bidder's Statement in respect of its takeover bid for Patrick Corporation Limited dated 15 September 2005.

With respect to leases, where Toll assumes substantially all the risks and benefits of ownership of leased assets, the respective asset and liability are capitalised. Where Toll does not assume substantially all the risks and benefits of ownership, the lease is accounted for as an operating lease and the payments made in respect of the lease are charged against profit over the accounting period(s) covered by the lease term. This treatment is in accordance with AASB 1008 and AASB 117 and accordingly no adjustment with respect to leases is required on transition to AIFRS. Additionally, Toll's operating lease commitments are disclosed in accordance with accounting requirements.

Accounting pronouncements provide no basis for reflecting operating lease commitments as liabilities and therefore presentation of this information as a liability of Toll is not only erroneous but clearly misleading.

QUESTION 13

In the year to 30 June 2005 Toll NZ recorded a net profit after tax of NZ $41.41 million compared with a loss of NZ $335.6 million in the previous year including big write-offs as the national rail network was sold back to the Government. Can you please provide details of the nature and extent of accounting provisions created and contributing to the losses recorded in the 2004 year?

Further please can you advise the extent to which the use of those provisions boosted profitability in the 2005 year?

Toll response

The rail track network was sold to New Zealand Government in accordance with Toll's intention at the time of the acquisition and it should be noted that no goodwill was recorded from Toll's acquisition of Tranz Rail Holdings Limited.

Net profit after tax of Toll NZ Limited improved from a loss of NZ$336 million in 2004 to a profit of NZ$41 million, whilst the operating profit from trading improved from NZ$36 million in 2004 to NZ$59 million in 2005. The operating profit increase was largely the result of revenue growth from new contracts and improved capacity and operating performance. Additionally, as disclosed in the Toll NZ Limited financial statements, the 2004 result was adversely impacted by individually significant revenues and expenses of NZ$380 million. These individually significant expense items included a loss on the sale of the rail network and associated assets of NZ$349 million and other adjustments such as a write down in the value of fixed assets of NZ$28 million, provisions for reorganisation costs of NZ$33 million and retirement leave of NZ$13 million. Individually significant revenue of NZ$63 million was recorded in relation to network encumbrances and land releases. Further details of these individually significant revenues and expenses are disclosed in the Toll NZ Limited financial statements for the year ended 30 June 2004.

The provisions described above have been recognised and subsequently accounted for in accordance with relevant New Zealand and Australian accounting pronouncements. Accordingly, Toll NZ's results have not been "boosted" as a result of this accounting treatment as the items charged against the provisions are non-recurring and non-operating costs specifically related to obligations that existed at the time the provision was recognised, and not the underlying business operations.

QUESTION 14

We note the 2004 Toll Holdings financial statements include a deferred revenue balance of $28.4 million. Are you able to please confirm the majority of this amount includes acquired deferred balances that arose on the sale and lease back of NZ rail assets in 1996? Further are you able to please confirm that the NZ annual revenues include approximately NZ$4.9 million which result from the amortisation of the NZ deferred revenue balance?

Toll response

The majority of the deferred revenue reflected in the 2004 Toll financial statements relates to the deferred gain recognised on the sale and leaseback of rolling stock equipment that Toll NZ (formerly Tranz Rail) entered into in December 1996. When the transaction occurred (which was some seven years prior to Toll acquisition) the deferred gain was recognised by the company and amortised over the period of the lease which expires in 2008.

The deferred gain results from the application of New Zealand and Australian GAAP that states that where a sale and leaseback transaction is entered involving a leaseback that is classified as an operating lease and the sale price is above fair value the excess of the sale price over the fair value must be deferred and amortised in proportion to the rental payments over the lease term.

At acquisition date, upon assessing the fair value of the assets and liabilities of the company, Toll noted that the lease terms were not based upon the fair value of the assets, and accordingly have continued to recognise the deferred gain.

In commercial terms, Toll regards the amortisation of the deferred gain on the lease as an offset to the excess lease rentals currently being incurred.

Taking into consideration the amortisation of the deferred gain Toll believes that the operating lease commitments as disclosed in Note 17 of the Toll NZ financials statements for the year ended 30 June 2005 are at fair value.

The amortisation of the deferred gain against the rental payments is not recorded as revenue but was netted off against the payment so as to record the expense at its fair value in both the Toll NZ Limited and Toll financial statements.

QUESTION 15

We have compared the information in Toll Holdings segment reporting in its financial statements to the information reported by Toll NZ, the results are summarised as follows:

	Toll Holdings Segment Reporting		Toll NZ Financials
	AUD	Approx NZD	NZD
2005	$"000	$"000	$"000
Ordinary Revenue	626,057	677,832	678,225
Other	1,857	2,011	1,177
Total	627,914	679,842	679,402
Expenses	568,305	615,304	619,902
Result (before interest, tax)	59,609	64,539	59,500
2004			
Ordinary Revenue	415,162	472,039	631,071
Other	375	426	63,323
Total	415,537	472,466	694,394
Expenses	373,967	425,200	658,735
Result (before interest, tax)	41,570	47,265	35,659

It would appear that the EBIT recognised by Toll Holdings in the 2005 year exceeds the amount reported by Toll NZ by approximately NZ$5.0 million, assuming that there are no other entities reported under this segment information that explain this difference. Please provide an explanation of what this difference represents.

Toll response

The reconciling item of approximately NZ$5m in Toll NZ's reported EBIT compared to that recognised on consolidation by Toll Holdings Limited is primarily due to certain costs incurred by Toll NZ in relation to pre-acquisition events including a legal case, indirect tax costs and fair value adjustments. The bulk of these adjustments were made before 31 December 2004 and were referred to in Toll's December 2004 Interim Results presentation made in February 2005.

QUESTION 16

The Toll NZ interim financial report to 31 December 2004 includes a revaluation of fixed assets of $196.3 million. The notes disclose that the effect of this revaluation on depreciation was an increase of $5.1 million. This suggests a depreciation rate of approximately 5% for what is supposedly already relatively well aged equipment. Can you please advise of the nature of the equipment, which was revalued and the assumed life of each major equipment type?

Toll response

All operating assets of the business were subject to revaluation including vessels, locomotives, rolling stock and passenger carriages.

The company commissioned an independent assessment of the assets including remaining useful lives of the assets which formed the basis of the revaluation.

As is the case with locomotives and rolling stock with any rail business, maintenance programs typically extend asset lives. Such programmes have been in place in Toll NZ.

The impact on depreciation arising from the revaluation reflects the remaining lives as independently assessed.

QUESTION 17

In the six month period ended 31 December 2003 Toll NZ Limited (formerly Tranz Rail) made a trading profit of NZ$11.8 million. Interest expense for the period amounted to NZ$15.0 million. We have reviewed the Toll Holdings financials for this period and it appears post acquisition amounts booked, converted to NZD were as follows:

	$NZ million
Trading profit, before AGAAP and other adjustments	*12.4*
Interest expense	*4.9*
Pre acquisition amounts can therefore be calculated as follows:	
Trading loss	*(0.6)*
Interest expense	*10.1*

We have utilised this information in the table below which analyses the trading profit and interest expense for the periods from 1 July 2001 to 30 June 2005.

Toll NZ Limited (formerly Tranz Rail)
Analysis on Trading Results and Interest

		Operating Profit from Trading $'000	**Daily profit (loss)** $'000	**Net Interest** $'000	**Daily Interest** $'000
Six months ended	*31-Dec-01*	15,206	83	(15,961)	(87)
Six months ended	*30-Jun-02*	11,606	64	(12,458)	(69)
Six months ended	*31-Dec-02*	11,207	61	(14,966)	(81)

Six months ended	*30-Jun-03*	28,840	159	(12,809)	(71)
Pre-acquisition to	*09-Oct-03*	(600)	(6)	(10,105)	(100)
Post-acquisition to	*31-Dec-03*	12,400	149	(4,920)	(59)
Six months ended	*30-Jun-04*	23,859	131	(11,393)	(63)
Six months ended	*31-Dec-04*	19,205	104	(10,139)	(55)
Six months ended	*30-Jun-05*	40,258	222	(8,989)	(50)

The analysis appears to disclose the following:

- *Toll NZ has not made a trading loss in any six month period, including the period in which Toll Holdings Ltd acquired Toll NZ;*
- *a preacquisition loss of NZD $600,000, was recorded for the period 1 July 2003 to 9 October 2003;*
- *significant post acquisition profit improvement in the periods 10 October 2003 to 31 December 2003 and 1 January 2004 to 30 June 2004. We note Toll's advice that the 1 January 2004 to 30 June 2004 result was impacted adversely by an NZ flood that occurred in February 2004;*
- *a significant increase in interest expense in the pre acquisition period, which is followed by decrease in the post acquisition period. The calculated daily interest amount pre-acquisition of $100,000 per day is 41% higher than the per day interest amount for the proceeding six months. The post acquisition component amounts to $59,000 per day, a decrease of 41%.*

In relation to our analysis if you could please respond to the following queries:

(i) *Explanation of the circumstances behind seasonal conditions that gave rise to the loss recorded in Toll NZ in the period proceeding Toll's acquisitions.*

(ii) *Why the Toll NZ interest expense peaked to such an extent in the period immediately proceeding Toll's acquisition, and*

(iii) *The circumstances that resulted in such an improved profit for period 10 October to 31 December 2003.*

Toll response

The major seasonal condition that gave rise to the loss in the period preceding Toll's acquisition was the reduction in freight volumes, in particular bulk dairy volumes, which are traditionally the lowest in Quarter 1.

A summary of historical quarterly trading results indicating that the July to September quarter is typically a low or loss earnings period for Tranz Rail Holdings Limited (since renamed Toll NZ Limited) can be found on page 24 of that company's annual report for the year ended 30 June 2003.

Toll NZ's interest expense peaked immediately prior to its acquisition by Toll as the company was not strong financially at the time and so was seen as a higher credit risk. As a result, Toll NZ incurred significant incremental funding costs, such as credit enhancement fees from the refinancing of the vessel Aratere, which occurred prior to the acquisition by Toll. Immediately following the acquisition, Toll NZ was able to restructure its financing using Toll facilities.

The circumstances that resulted in an improved profit for the period 10 October to 31 December 2003 immediately following Toll's acquisition included:

- significant cost reductions achieved from the restructuring of its operations, including rationalisation of employee numbers;
- improved stability in the company's operations leading to increased customer confidence; and
- normal seasonal trading volume increases in Quarter 2.

QUESTION 18

Toll Chief Operating Officer, Mark Rowsthorn said in the Toll NZ 04 / 05 interim report that Toll NZ's return on capital remains inadequate to support a sustainable level of new capital expenditure. Given the poor state of the NZ Rail system, please advise what level of capital expenditure will Toll be required to pay, directly or indirectly, in what periods, and how does it intend to fund these obligations? How does this obligation effect the future earnings of Toll NZ and Toll Holdings?

Toll response

Mr Rowsthorn in his Interim Report to Shareholders for the six months ended 31 December 2004 stated "the Company's return on capital remains inadequate to support a sustainable level of new capital expenditure and the success of rail is highly dependent on achieving the reforms necessary to improve infrastructure, lower costs and increase customer service"

Mr Rowsthorn has addressed how the business has begun to lower costs, improve infrastructure and customer service in his 2005 Chairman's statement for Toll NZ where he states:

> "Transition towards a more stable, sustainable and forward-looking rail business was evident in the solid ground made in securing new contracts and improving customer relationships. Examples were in bulk rail operations, where a new long-term contract was signed with Solid Energy and the introduction of coal shipments for Genesis were implemented. In addition, the contractual arrangement with Fonterra at Te Rapa establishes rail as the major transporter of dairy exports to port in the upper North Island over the next 20 years.
>
> Service improvements are only possible if the correct rolling stock profile is in place and Toll is moving towards this goal. The Company has been implementing a refurbishment and upgrade programme to its locomotive and rail wagon fleet, which is delivering improved capacity and operating performance. Whilst steady progress is being made in rail, we must continue to implement initiatives to significantly improve our rate of return on capital, in order to support new investment and to ensure long-term viability. "

During the year ended June 2005 the company transitioned responsibility for the rail track and infrastructure back to the New Zealand Government. The transaction with the Crown involves a commitment by the Crown to upgrade and maintain the rail track and infrastructure, whilst Toll NZ has committed to capital expenditure in rolling stock and locomotives and payment of access charges in relation to economically viable corridors. Full details of the Agreement with the Crown have been posted on the New Zealand Government website.

Under the agreement with the Crown, Toll NZ and the Crown are committed to improve the efficiency of rail in New Zealand and to facilitate the transfer of freight from road to rail.

The company is currently in discussions with the Crown in relation to long term investment strategies matched to a longer term viable access pricing regime such that all stakeholders maximise the benefit of investment. Significant improvements in Track and Track Infrastructure have been made in the last 14 months however significant opportunities for improvement still exist.

The company and the Crown both believe that an upgrade in rail infrastructure will lead to a reduction in maintenance costs and an increase in rail freight volumes as rail becomes more competitive with road both in terms of cost and service.

The company considers that the long term arrangements with the Crown will drive significant efficiencies in New Zealand's transport infrastructure, and at the same time deliver a satisfactory return on capital for Toll NZ, which when considered in the light of Toll's integrated model in New Zealand will deliver excellent earnings and shareholder returns over time.

Toll believes that the level of long term capital expenditure funding requirements of Toll NZ including capital amounts charged through access fees will be adequately met by internal cashflow generation and growth of the business.

QUESTION 19

Considering the performance of the Toll NZ rail and Freight business do you believe the carrying values of Toll NZ's rail and freight assets can be justified with regard to earnings and, if so, on what basis?

Toll response

As discussed in relation to Question 13, Toll NZ Limited's operating profit from trading improved from NZ$36 million in 2004 to NZ$59 million in 2005, largely the result of revenue growth from new contracts and improved capacity, greater cost efficiencies, continuing reduction in overheads and the benefits of integration. This improvement is evidenced by the EBIT margin expansion achieved during the 2005 financial year, as well as strong cash flow improvement.

Toll believes given the business performance since acquisition and based on the results of impairment testing performed in accordance with New Zealand and Australian GAAP and AIFRS it considers the carrying values of Toll NZ's rail and freight assets to be appropriately stated.

Toll is pleased with the overall performance of Toll NZ since the business was acquired in October 2003 and the business is generally in line with the acquisition plan.

Additionally, Toll notes that its A$165 million equity investment in Toll NZ (formerly Tranz Rail Holdings) is now valued at in excess of A$550 million based on Toll NZ's current share price on the New Zealand stock exchange.