



Toll Holdings Limited

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and subsidiaries

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13 October 2005

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

Toll Takeover Bid for Patrick Corporation Ltd

Toll poses the following questions following review of Patrick's Financial Statements as part of its ongoing due diligence of Patrick Corporation.

As the last audited financial statements of Patrick relate to 30 September 2004, and Virgin Blue relate to 31 March 2004 Toll is likely to have a number of follow up questions following the disclosure of more current financial information.

1. Patrick's Use of Acquisition Accounting/Restructuring Provisions

- (a) Patrick's financial statements until 2002 include a significant accounting policy in Note 1 that:

"A liability for restructuring costs is recognised as at the date of acquisition of an entity or part thereof when there is a demonstrable commitment to a restructuring of the acquired entity and a reliable estimate of the amount of the liability can be made."

The financial statements since 2002 include a similar policy in note 1 relating to Intangible assets and expenditure carried forward.

Accounting standard AASB 1044 sets out the requirements for the recognition and disclosure of restructuring provisions. In the absence of a specific accounting policy in the Patrick financial statements, can you please confirm the group's compliance with this accounting standard.

- (b) Pacific National's audited financial statements, signed by directors appointed by both Patrick and Toll, include provisions for restructuring costs. Can you please confirm whether the equity accounted profit contribution from Pacific National included in Patrick's consolidated financial statements is a direct translation of Pacific National's reported profit without adjustment (consistent with Toll's accounting treatment) or whether adjustments (such as reversing the impact of provisions for restructuring costs) have been made to Pacific National's reported results by Patrick?

- (c) We have attempted to reconcile the amounts included in Patrick's consolidated financial statements when it commenced to consolidate Virgin Blue (from 18 March 2005) with Virgin Blue's reported balance sheet at 31 March 2005. We note that there do not appear to be differences in account balances that we would expect to relate to trading activities, such as revenue received in advance, between these two dates. However, there are differences in property, plant & equipment, net debt, payables and net tax liabilities as highlighted below. Can you please explain the transactions that gave rise to these differences, particularly the higher balance of payables adopted for Patrick's consolidated financial statements as at 18 March 2005 compared to the actual balance at 31 March 2005, and whether any of these differences relate in any way to restructuring or accounting provisions of a similar type.

	PRK 18 Mar 05	VBA 31 Mar 05	Difference
Receivables	64.9	64.9	0.0
Inventories	1.3	1.3	0.0
Other Financial Assets	673.1	673.0	0.1
Property, Plant & Equipment	999.5	1,030.5	(31.0)
Intangibles	41.4	41.3	0.1
Other Assets	20.0	20.0	0.0
Payables	(175.7)	155.1	(20.6)
Interest Bearing Liabilities (net of cash)	(642.0)	(681.3)	39.3
Provisions	(65.8)	(65.8)	0.0
Revenue Received in Advance	(180.8)	(180.8)	0.0
Net Tax Liabilities	<u>(4.8)</u>	<u>(8.4)</u>	<u>3.6</u>
	<u>731.1</u>	<u>739.6</u>	<u>(8.5)</u>

2. Patrick's Use of Accruals and Capitalisation of Expenses

- (a) We note that Patrick has experienced a significant increase in its "other creditors and accruals", particularly relative to trade creditors, over the last 6 years as summarised below:

(\$m)	1999	200	2001	2002	2003	2004
Other creditors & accruals	20.8	52.9	59.6	92.1	110.3	121.5
Trade creditors	17.4	34.9	37.1	36.6	47.1	63.2

Can you please explain what is included in "other creditors and accruals" and why it has increased so significantly (particularly relative to trade creditors over the last 6 years)?

- (b) We also note that "other creditors and accruals" in Patrick's 2002 audited financial statements were \$92.1m, but this amount had increased to \$121.3m in the 2002 comparative column in the 2003 audited financial statements. The difference of \$29.2 million appears to have been reallocated from Employee benefits -current. Can you please explain the reasons for this reallocation?

- (c) Can you please explain Patrick's policy on expense capitalisation and the level and nature of capitalised expenses in its most recent published balance sheet?

3. Patrick's Gearing Position Including Off Balance Sheet Debt

- (a) As a result of the change in Virgin Blue's year end to 30 September following Patrick obtaining control, Virgin Blue has not published a full set of financial statements since its financial statements for the period ended 31 March 2004 – which is now 18 months old. We would expect that Virgin Blue's gearing level, including off balance sheet operating leases, would have increased substantially since this time due to the significant increase in the size of Virgin Blue's fleet. Please confirm that Patrick's target's statement will contain full disclosures in respect of Virgin Blue, including full details of Virgin Blue's off balance sheet liabilities, and all expenditure commitments, whether on or off balance sheet.
- (b) Please provide details of how Patrick's CRANES will be treated under AIFRS, in view of what may be considered to be their numerous debt-like features.
- (c) Patrick had adopted an economic interest concept in its release of financial results. Please provide an "economic interest" balance sheet and gearing ratios for the Patrick group including, where appropriate:
- capitalisation of off-balance sheet operating leases; plus
 - appropriate classification of Patrick's CRANES under AIFRS.

4. Extent to Which Patrick's Reported Profits Have Been Inflated by the Exclusion of Executive Option- Related Employee Compensation Expense

- (a) Patrick has been one of the most prolific issuers of executive share options in the Australian market. At 30 September 2004, 38.4m options were on issue, representing approximately 6% of Patrick's diluted ordinary share capital at that date and ranking as a percentage of issued capital behind only Macquarie Bank and Babcock & Brown amongst the ASX top 50.

As Patrick would be aware, companies will be required under AIFRS to expense the annual estimated cost of executive options issued each year so that their annual Statement of Financial Performance reflects all employee related compensation expense. Our analysis indicates that the annual impact of this requirement would approximate \$9m (or over 5% of 2005 after tax profit guidance provided by Patrick on 18 August 2005) per annum for each of the years between 2003 to 2005. Would you please either confirm or correct our analysis.

5. Patrick's Exposure to Asset Impairment Writedowns on circa \$800m in Goodwill under AGAAP and AIFRS

- (a) Patrick has substantial intangible assets, which we understand to comprise goodwill - \$740m at 31 March 2005, which we understand to have arisen principally in connection with its acquisition of its controlling interest in Virgin Blue. We expect that the goodwill figure will have increased further since 31 March 2005 due to further acquisitions of Virgin Blue shares under Patrick's takeover bid after that date.

As Patrick would be aware, companies will be required under AIFRS to conduct an annual impairment test on the carrying value of intangible items.

Can Patrick please advise:

- what recoverable amount testing of goodwill Patrick has conducted in accordance with existing AGAAP principles and Patrick's recoverable accounting policy, in which "the recoverable amount of an asset is the net present value of the amounts expected to be recovered through the cash inflows and outflows arising from existing use and subsequent disposal, discounted using market determined, risk adjusted discount rate" at 30 September 2005; and
- the extent of any writedowns which may have been required at 30 September 2005

Patrick's ability to satisfy such recoverable amount and impairment tests in relation to its goodwill balance, the majority of which relates to Virgin Blue, is of material interest given that it far exceeds the apparent level of Patrick's retained earnings, which were reported as at 31 March 2005 as \$386m. It would appear therefore that any current or future requirement for Patrick to make a sizeable write-down of the carrying value of the goodwill it has paid in acquiring its stake in Virgin Blue may impact its capacity to pay dividends to shareholders

6. AIFRS

- (a) The latest available Patrick accounts do not quantify the impact of the adoption of AIFRS from 1 October 2004. Please provide the reconciliation between AGAAP and AIFRS for the transition balance sheet at 1 October 2004.
- (b) Please also advise whether any assets on hand at 1 October 2004 or acquired since will fail the Impairment of Assets test pursuant to AASB 136.
- (c) We note that Patrick Corporation Limited is the sponsor of two defined benefit plans. Could you please advise the impact that these plans will have on the group's results given AIFRS requirements.


7. Other

- (a) We note that the 2004 statements of cash flows records dividends and distributions received of \$47.871m an increase of \$42.156m over the prior year. Please provide details of the \$47.871m received and comment whether they represent one off non recurring items and explain where they are reported in the statements of financial performance.
- (b) We note that Patrick Corporation Limited has a policy of increasing shareholders equity through freehold land revaluations. In particular we note that the balance sheet for the year ended 30 June 2004 was favourably impacted by such a revaluation. Can you provide details of the basis for the revaluation of \$24 million, being in excess of 30% of the value of the freehold land as recorded at the commencement of the 2004 financial year.

- (c) Patrick appears to generate revenues and earnings from “security trading” activities and “other” activities which for the 5 years to 30 September 2004 total approximately \$28million. Can you please provide specific details of your revenue recognition policies in relation to these activities and the major categories of revenue that comprise “other”.

We request that you provide by no later than **5.00pm** on **Monday 17 October 2005** a substantive response to each of the questions posed above or alternatively an assurance that each question will be substantively addressed in the forthcoming Patrick Target Statement.

Yours sincerely
TOLL HOLDINGS LIMITED


Bernard McNerney
Company Secretary