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## Business in *Transition*

**Ian Stewart**  
Executive Director – Business Consulting  
Melbourne

**Australian business is facing challenge from numerous fronts at the moment. As we move into 2012 consider the following:**

- Falling global competitiveness for manufacturing and agriculture;
- Falling national productivity;
- Softness and unpredictability in the World economy;
- Volatility in finance markets;
- Increasing regulation;
- Introduction of transformational policies such as carbon pricing;
- Increased impact of technology; and
- Shortage of business capital

Not only that, there are long term social trends to be considered such as:

- Growth in multiculturalism;

- Greater participation in business leadership by women;
- Growth in the use of on-line technologies for conducting business and social interaction;
- Changing demographics in the business and consumer markets; and
- Changes to workplace flexibility

All of these factors are largely uncontrollable, but must be adapted to by individual businesses. Now is not the time for complacency where it can simply be assumed that what has worked in the past will continue to work into the future. Change is fast and unforgiving. To win in this environment, businesses must embrace change and competition and use them as the stimulus to evolve into being better than before.

The start of this is to recognise that there is the possibility that change exists and should be welcomed and embraced.

Old business models should be tested for relevance by challenging the assumptions upon which they have been built. Are those assumptions still valid now and will they be valid in five or ten years' time?

Next is a process of discovery to understand the business in greater depth. To find the gems that lie hidden in the detail that may provide an innovative solution or idea that leads to an evolution or transformation. This may be an efficiency gain that allows margins to be preserved or customer value adding benefits that help to make relationships long term and more profitable. This process should also aim to discover cross subsidies or other hidden drags on the business so that they can be eliminated. Such initiatives could be based on better use of technology or simply a great idea.

*(continued on page 2)*

## Business in Transition

(continued from page 1)

Consideration of cross border opportunities should also form a part of this review which should include a careful analysis of the respective merits of the various options that are available. Should manufacturing be based in China, India, Malaysia or Singapore or another region entirely? How can these growth markets be accessed? In depth knowledge and understanding of doing business in different jurisdictions gained from practical experience is essential to making the right decisions.

Armed with this information a revised business strategy can be formulated that is then validated with financial modelling.

At Pitcher Partners we have called this Business in Transition. It is a step by step approach to help business owners adapt their businesses into profitable and rewarding enterprises that will thrive in a challenging decade ahead.



Feature

# Gearing in super to buy

**Brad Twentyman**  
Director – Superannuation  
Melbourne

**A change in the rules in 2007 has opened the door for super funds to borrow money to invest in property assets and interest in this arrangement appears to be on the rise. This may be because it is now clearer what you can and can't do under the law, or because of the banks increased willingness to lend to super funds or as a result of the ongoing volatility in equity markets. In all likelihood however, it is due to combination of all of these factors.**

***So does it make sense to borrow to buy property in your super fund?***

In certain circumstances it probably does but it is important to consider the fundamentals of the investment and all legal requirements before signing any purchase contract.

### **Concessional tax rates**

As with all super fund investment returns, rental income and any gain on disposal of a property will be taxed at concessional rates being a maximum of 15%. If your super fund is in pension phase, you will pay no tax.

### **Access existing equity**

Direct property investments can impose a significant cash burden. It generally costs a lot to get into the market. By using your super fund you can access your existing balance as seed capital to finance the investment. Future contributions, which may also qualify for tax concessions, can be used to pay down debt.

### **Size & diversification**

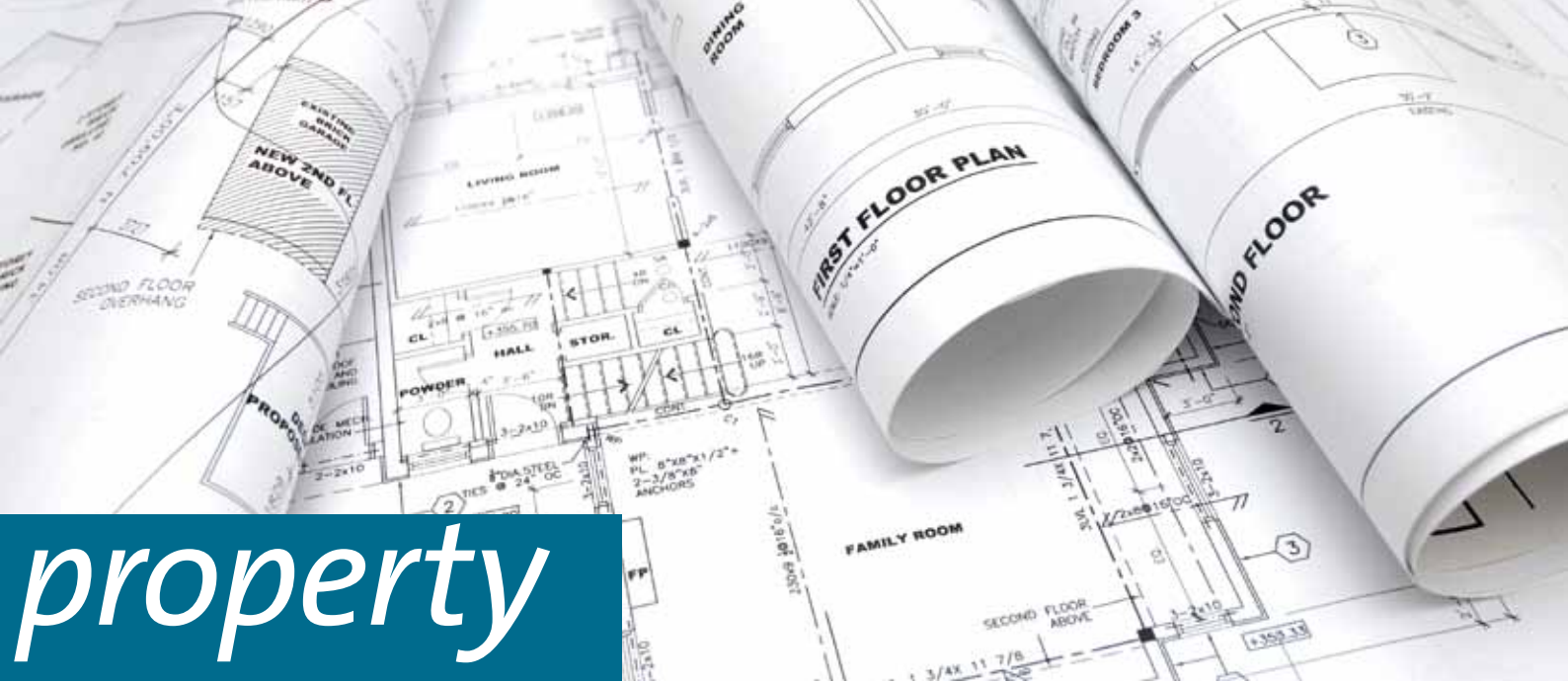
You are often limited as to the range and size of investments you can hold in a super fund. Contribution limits and the restrictions on member numbers effectively limits the speed with which your super fund can grow.

Being able to borrow to acquire property means your super fund can buy an asset it otherwise wouldn't be able to afford.

Similarly, borrowing to buy property may allow a level of diversification within your portfolio that you wouldn't otherwise be able to achieve.

### **Cash flow**

One of the key considerations in structuring a geared property investment in a super fund is cash flow within the fund. There are limits on the amount you can put into a super fund each year. As a result, it is crucial that the super fund has sufficient cash to meet repayment requirements and all costs associated with the investment as well as other ordinary outgoings such as minimum pension payments. The higher the proportion of the purchase price the fund borrows, the greater the pressure on the fund's cash flow.



# property

## Borrowing limits

Cash flow considerations place an effective limit on the level of borrowing you can commit to and banks set lending criteria that generally require the income generated from the property to exceed interest costs and other outgoings associated with the property. Combined, the maximum level of gearing is generally limited to 60% to 70% of the property value.

There is comparatively little value in negatively gearing within a super fund anyway. Any loss from the investment would generate a tax deduction for the super fund but as a super fund only pays a maximum of 15% tax and possibly nothing, the tax break the fund obtains from negative gearing is small compared to other structures that might be available, such as investing personally or through a trust.

## When it works best

Borrowing in a super fund works best when the investment is cash flow positive and profitable. This means the concessional rate of no more than 15% applies on the profit. From our experience, borrowing arrangements work best when a super fund borrows less than 60% of the property value.

## Counting the cost

Costs associated with a borrowing arrangement are likely to be larger than you expect. There is a legal structure requiring the property to be held on trust. Putting in place a trust structure typically costs between \$2,500 and \$5,000.

Banks will charge their own establishment fees, typically in the order of 0.8% of the amount financed. Interest rates may also be higher than rates applying on standard property investment loans, as the lender only has recourse against the property on default, although rates are becoming more competitive over time. Add to that other direct costs, such as stamp duty and government fees.

## Related party lending

If you have cash available in the family group, a related party can lend to the super fund provided the loan is on commercial terms. The advantage of related party lending is it may reduce costs by eliminating the fees charged by banks and by keeping interest payments in the family group.

Another popular structure is for a related party to borrow from a bank on standard property investment terms by giving security on existing assets and then on-lending to the super fund. This can avoid extra costs banks may look to charge.

## The structure

A special purpose 'custodian trust' holds the property for the super fund until the loan is repaid. The trust has no other role, the super fund retains beneficial ownership of the property and all income and expenses related to the property go through the super fund. There is no

requirement to prepare accounts or returns for the trust. When the loan is repaid, legal title passes to the super fund and no tax consequences generally arise.

The loan must be established on a limited recourse basis meaning the recourse in the event of default is limited to the property acquired with the borrowed funds and not to other super fund assets. Banks will generally require personal guarantees however.

## Limitations

A super fund can borrow to buy commercial or residential property, however a residential property could not generally be acquired if already owned by the family group. You must be borrowing to acquire a single asset or group of identical assets. This rule causes complexity if the property encompasses more than one title. Generally any development plans will also have to wait until the loan has been repaid.

## Summary

Borrowing to invest in property using your super fund over the longer term has the potential to significantly increase your retirement savings. But balanced against the positives of tax benefits and extra control are several risks, most significantly the risk that the super fund may get into a position where it cannot afford to meet repayments.

For more information please consult your local Pitcher Partners contact.

# Carbon Pricing

Ian Stewart, Executive Director – Business Consulting  
Melbourne

## *and your business*

With independent forecasts of a doubling of electricity prices over the next 5 years arising from carbon pricing and other factors related to the energy industry, the carbon pricing initiatives represent a significant challenge to the competitiveness of mid-market businesses in Australia.

### Why put a price on carbon emissions?

The economic community argue that the most efficient and cost effective method to change behaviour throughout the economy is to place a price on each tonne of carbon emitted. This creates a price signal that causes individuals and businesses to take action to avoid that cost.

In the plan proposed by the Government, the 500 or so biggest emitters in Australia of non-fuel related emissions will be the only organisations that will be required to purchase permits. These organisations are likely to be already reporting annual emissions so it is unlikely that any businesses not already involved will have any direct obligations. However, the effect of this scheme will be to pass much of the cost down the supply chain to the end consumer.

### How will the Carbon Tax work?

From 1 July 2012, liable entities in Australia will be required to purchase a permit at an initial fixed cost of \$23 per permit that will allow them to emit 1 tonne of Carbon Dioxide or equivalent emissions (CO<sub>2</sub>-e). This price will then increase by 2.5% plus CPI per annum for the following two years, resulting in an anticipated increase of between 5% and 6% each year.

In 2015, this will then move to an Emissions Trading Scheme (ETS) that will facilitate a variable price per permit as dictated by market forces.

At present, transport is excluded from the need to buy permits as the equivalent carbon cost is being put into effect by a reduction in the fuel tax credits of around 5 cents that are available to the industry. Rail, sea and air freight will suffer an immediate impact but road transport will

not be affected until 2014. Bio-fuels will not have a direct carbon price imposed nor will Agriculture. However both will suffer indirect cost increases with estimates indicating an effect on farm incomes of between 5 and 10 per cent.

### What is the Emissions Trading Scheme?

The introduction of an Emissions Trading Scheme (ETS) from 1 July 2015 will, in effect, move the Government from a fixed price and variable quantity of permits to a fixed quantity of permits at a variable price.

Other countries that operate an ETS are few and far between however the biggest is the European ETS which covers only power generation and energy-intensive industries. Obligations under Australia's ETS will be able to be met by acquiring qualifying international permits up to a limit of 50%. Interestingly, the spot price of a European permit, as at the time of writing this article is 9.83€ or \$13.07 AUD, a significant discount to the \$23 AUD quoted as the starting fixed price. This has possible ramifications for the Federal budget beyond 2015, should this situation not change.

Permits in the Australian ETS will be auctioned to the market by the Government, and the ETS will then also provide for a secondary market in which companies may trade permits with each other. The Government will then steadily reduce the number of issued permits each year to provide a 'cap' on the total emissions of the liable entities and thus reduce the overall emissions from the Australian economy. The rate of decline will be set five years in advance with the first period to 2019/2020 to be announced in the Budget released in May 2014.

### How will the funds be used?

More than half of the revenue raised from pricing carbon will be redirected towards households. The Government has proposed significant changes to personal income tax scales resulting in savings to lower income earners. It is important to note that business will not be compensated unless it is part of a specific industry scheme such as the electricity sector, food industry or foundries, and must adjust.

Businesses may benefit from a number of programs outlined by the Government including specific programs to support industries that will be placed at a disadvantage by the introduction of the carbon price. Through direct support and a number of grants schemes, the Government have stated that they intend to encourage businesses to move towards energy efficiency and to support research and development. However, the quantum of this assistance is very small in the context of the overall economy so we question its effectiveness in adequately supporting those businesses that face a challenge to their viability.

Support available to the middle market is extremely limited. However of interest is the \$1.2 billion Clean Technology Program that will provide support for manufacturers through the following three components:

- The Clean Technology Investment Program (\$800m over 7 years) will provide support to manufacturers for the investment of capital into energy-efficient plant and equipment and low pollution technologies.
- The Clean Technology – Food and Foundries Investment Program (\$200m over 6 years) will provide assistance to food processing, metal forging and

foundry industries as they will incur significant impacts due to their high energy costs and trade-exposed nature.

- The Clean Technology Innovation Program (\$200m over 5 years) will support business investment in research and development in the areas of renewable energy, low-pollution technology and energy efficiency.

The Government will also provide funding under the Jobs and Competitiveness Program that will be used to support emissions intensive and trade exposed businesses such as manufacturing. This program in essence is providing free permits to liable entities at varying levels depending upon their energy intensity. Because mid-market businesses are not liable to purchase permits they will not receive any of the benefits of this assistance and will be required to compete with both foreign competitors with no carbon cost and assisted larger businesses.

Combined with assistance to households and businesses, \$13 billion of funding will be directly invested into renewable energy through the newly formed Clean Energy Finance Corporation and the Australian Renewable Energy Agency. Both organisations will be responsible for the investment of funds into large-scale renewable energy production projects and assisting businesses to make improvements in energy efficiency in altering their processes to reduce emissions. Of particular interest will be the Clean Energy Finance Corporation as it will make investments in, or loans to, businesses involved in renewable energy technologies, energy efficiency and low-emissions technologies. While this could be perceived as Government picking winners, it fills an essential gap during this transitional period.

Also of interest to the property sector will be the Green Building Program that provides a bonus 50% tax deduction on capital expenditure resulting in improving buildings from below a 2 star rating to above a 4 star rating.

### How will it affect my business?

The impact on businesses that are not liable entities is summarised in the graphic below. In essence the impact will be determined by two things:

- The energy intensity of the supply chain and production processes of a business; and
- The ability of the business to pass on the cost.

With regard to the supply chain, any intensive exposure to energy use will drive up costs. The major parts of this will be electricity and transport although measures to include heavy road transport are delayed until 2014. Of significance will be the cost of construction because most building materials such as cement, steel, bricks and glass are highly energy intensive. Their costs can be expected to escalate well above the general level of inflation if they are sourced from domestic producers.

Businesses looking to pass through the cost increases will need to carefully consider their position in competitive markets including where they are subject to import competition or possibly substitution. In addition, contractual arrangements with customers could also limit the ability of a business to pass through cost increases. This could be particularly relevant in the case of long term contracts.

### What can I do to prepare?

Where energy costs are material, the business should:

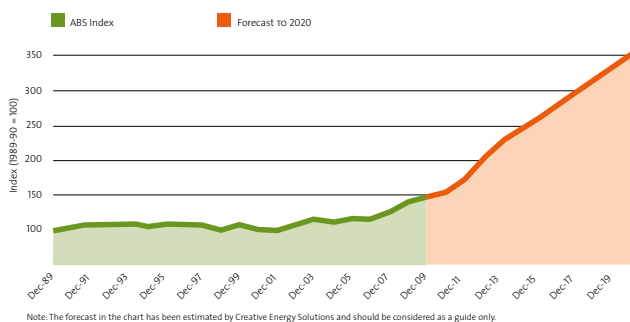
- Seek advice on how energy efficiency can be improved and cost reduced through price negotiation;
- Review the overall strategic plan to either maximise any opportunities that the carbon tax may bring or to limit the overall impact;
- Model the potential impacts of the carbon tax to consider the impact on profitability and cashflow and perform sensitivity analyses on the price of carbon;
- Consider eligibility for any assistance under any of the support programs. As a number of the programs have limited budgets, businesses should move quickly once the programs open; and
- Commence negotiations with suppliers and customers.

All businesses, should anticipate an initial period of broader economic uncertainty and activity levels but, unlike the introduction of the GST, there should not be any major distorting shifts in demand.

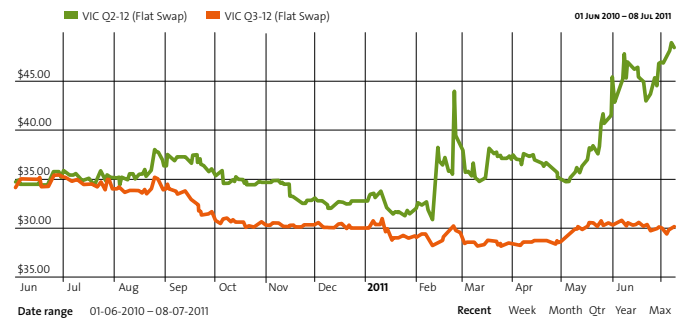
In summary, the introduction of a price on carbon brings with it the potential for transformation in the way we use energy but at the same time it could be a huge challenge for some sectors of our economy such as manufacturing in particular. For other industries, the proposed policies may provide opportunities to expand their products and services such as taking advantage of support for renewable energy investment or clean technology funding.

For more information please consult your local Pitcher Partners contact.

#### INCREASE IN ELECTRICITY COST FORECAST TO 2020



#### FORWARD PRICES FOR VIC



Graphs showing projected increase in electricity prices in Australia – Source M & C Energy Group

# Personal Property

Gess Rambaldi  
Partner – Business Recovery & Insolvency  
Melbourne

## Security Act...‘When will it commence?’

As you may well be aware, the Personal Property Securities Act 2009 (PPSA) was passed on 14 December 2009 and under the existing legislation, registrations were scheduled to commence by no later than 1 February 2012.

### What does the Act do?

The PPSA introduces rules that will govern how security interests are created and enforced, as well as determining priority between competing interests.

The PPSA provides a new framework and national online Register to deal with the securitisation of personal property interests. It allows for the registrations of charges on personal and business property including tangible assets (such as goods, crops and livestock, motor vehicles, paintings, machinery and debtors) as well as intangible assets (such as licenses, intellectual property, trademarks, and investment instruments). Personal property also includes interests under guarantees, hire purchase finance agreements, finance leases, debtor factoring as well as retention of title on goods supplied.

The PPSA legislation will result in significant changes to the registration of security interests over personal property. It will also radically change the notion of legal title over such property.

### Determination on Migration and Commencement Time

Until recently, it was feared that the effective commencement of the PPSA

would be delayed beyond its scheduled start date of on or before 1 February 2012. This delay was expected due to uncertainties associated with the migration of data from existing databases (eg. ASIC Register, Vehicle Security Registers in each state and territory etc) to the centralised database that will be administered by the Insolvency and Trustees Service of Australia (ITSA).

However, these concerns regarding date migration and registration processes appear to have now been mitigated and the framework is ready to be rolled out.

As a result, the Attorney General released a Determination on 21 November 2011 in detailing the migration time of 21 November 2011 and a registration commencement time of 30 January 2012.

Given that the start date for the Register is quickly approaching, it is important to stress that businesses should use the next month to their advantage, particularly if they have yet to get their affairs in order and protect their interests under the legislation.

### How will it affect my business?

Please consider the following suggestions to protect your interests under the PPSA:

1. Arrange a briefing about the PPSA;
2. Consider whether the PPSA will impact on your business;

3. Assess whether your trading terms and agreements are PPSA compliant, have been agreed to, adopted and signed off by your customers; and
4. Consider whether your business is ready to register your interests on the PPSA Register once it is up and running, and whether you have adequate internal systems and procedures in place.

### What can I do to prepare?

It is extremely important that businesses not only implement procedures to deal with the PPSA but also ensure that they train their own administration staff to recognise and register security interests over personal property.

There will be far reaching consequences for those individuals and businesses who fail to understand how the PPSA will affect them. Inaction will place their assets at risk.

#### Example:

*If your post PPSA interest in goods supplied under a retention of title has not been registered, then any other priority charge (eg bank charge) will take priority over those supplied goods even though title to those goods may not have passed.*

Businesses who have not already done so must seek the assistance of their lawyers and professional advisors to assist with the transition to this new regime or risk facing potentially harsh and expensive lessons.

For more information please consult your local Pitcher Partners contact.

## Client Profile

Able Industries Engineering ('Able') is a wholly Australian owned and operated company with over 35 years engineering experience in the manufacturing industry. The company this year won both the Manufacturing and Industrial Award and the Business of the Year Award at the annual Hobson's Bay Business Excellence Awards.



# Able Industries Engineering

Mark Harrison  
Partner – Business Advisory & Assurance  
Melbourne

Like many of Pitcher Partners clients', Able is a second generation family business whose evolution from a couple of young men doing basic sheet metal work to a complete metal fabrication and specialised engineering company, has been as satisfying to the firm as it undoubtedly has to its owners the Martyn family.

The story began in the 1950's with Bryan Martyn, a qualified fitter and turner working in the Victorian Railways, who moved on to selling machinery to companies like Able, but dreaming of one day owning a similar business. His hard work and natural ability at sales and marketing helped grow the fledgling business he bought into in 1977, into a sound and profitable engineering company with a reputation for turnkey solutions delivered in full, on time and on budget.

Over time all five of Bryan's children became involved in the business, three directly and two as silent partners. Stephen Martyn, Managing Director since 1999 has overseen the growth and expansion of the business during a difficult and volatile period in the company's history. At the time of his appointment, Pitcher Partners were asked to assist and provide recommendations to enhance company performance and sustainability which led to the re-structuring of the company and a subsequent three year period consolidating the business.

Since the re-structure, the business has grown and diversified and now offers fabrication and engineering services from concept through to production.

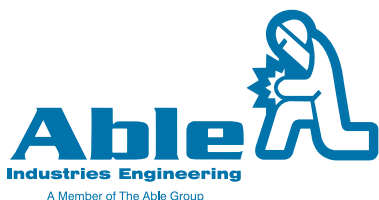
Their work for the Department of Defence has gained them an accreditation from the Australian Defence Force and the company's recognition as a defence supplier. The company has also developed a wide range of expertise across a number of project areas including defence, renewable energy, mining, rail, landmark construction and architectural fabrications.

When asked about one of their most satisfying achievements, Stephen has no hesitation in nominating the company's current flagship project, the Bushmaster, an armoured vehicle designed and built in Victoria, which is relied upon by the Australian Defence Force for operations in Iraq and Afghanistan amongst many other countries. Able manufactures a significant quantity of various components for all Bushmaster vehicles, including ballistic armour, communication racks, seat

mounts, rear steps, internal air-conditioning duct and external lockers and compartments. Stephen is proud of the fact that Able is contributing to enhancing the survival of Australian soldiers who are engaged in operations around the world, whilst travelling in the Bushmaster vehicles.

Stephen is proud of being an Australian manufacturer, and acknowledges that while there are challenges, if businesses focus on core strengths, develop specialised skills and add value to customers by being supportive and reliable there is a future for manufacturing in Australia. A recently undertaken strategic planning exercise with Pitcher Partners confirmed Able's focus and commitment to being an outstanding Australian manufacturer. This commitment was the foundation to winning this year's awards, and places Able in a position to continue to lead within the manufacturing sector.

Pitcher Partners congratulates Able on their win and is delighted to be working with an Australian business striving for excellence.



Stephen Martyn (MD, Able) accepting the awards.

Left to right: Michael Raffoul (Mayor, HBCC), Michael Martyn (Project Manager, Able), Sean Cartlidge (Commercial Manager, Able), Graham Lever (CFO, Able)

# What's New



For comments on this edition or if you wish to be removed from the *Contact* mailing list please email us at [editor@pitcher.com.au](mailto:editor@pitcher.com.au)

Seasons Greetings to all our clients and best wishes for a safe and happy 2012

## Congratulations

Pitcher Partners congratulates Susan Barton AM, Founder of The Lighthouse Foundation on winning the 2011 BrainLink Women of Achievement Award.

Pitcher Partners also congratulates Eastern Press for winning 11 awards in the Victorian Printing Industries' 2011 PICA Awards.

## Super Trade Mission to India

The Victorian Government will lead Australia's largest ever trade mission to India in February 2012. Over 100 companies across key strategic sectors including, education, ICT, aviation and aerospace, automotive, sustainable urban design, cleantech, food and beverage and tourism and life sciences, are expected to travel to India. The multi-sector mission will significantly strengthen the Australian trade relationship with India and generate substantial new opportunities for Victorian businesses, as well as additional exports and jobs.

Victorian companies from these sectors can find out more about this mission on the Victorian Government's Trade Engagement Program – India website. [www.trade.vic.gov.au/TMAP](http://www.trade.vic.gov.au/TMAP).

Clients of Pitcher Partners who join the delegation will be able to attend a specially tailored pre-mission 'Get Ready for India' business briefing. If you are interested in joining this mission please contact the Victorian Government. In

addition, please contact Rohini Kappadath, Head of Cross-Border Business to discuss potential opportunities for your business in India.

E: [Rohini.kappadath@pitcher.com.au](mailto:Rohini.kappadath@pitcher.com.au)  
T: (03) 8610 5000.

## Tax Diary

January, February & March 2012

### 15 January 2012

- Lodgement of income tax returns for taxable large/medium business taxpayers (companies, superannuation funds and trusts). Tax payments were due on 1 December 2011.

### 21 January 2012

- Lodgement and payment of the December monthly BAS/IAS.
- Lodgement and payment of Quarterly PAYG Instalment Statements for head companies of tax consolidated groups for the second quarter of the 2011/12 income year.

### 31 January 2012

- Quarterly TFN report for closely held trusts for TFNs quoted to a trustee by beneficiaries in the second quarter of the 2011/12 income year.

### 21 February 2012

- Lodgement and payment of the January monthly BAS/IAS.

### 28 February 2012

- Lodgement and payment of the second quarter 2011/12 BAS/IAS.
- Lodgement of income tax returns for all non-taxable large/medium business taxpayers (companies, partnerships, trusts and superannuation funds).
- Lodgement and payment of income tax returns for new registrant large/medium business taxpayers (companies, trusts and partnerships).
- Lodgement and payment of income tax returns for new registrant self-managed superannuation funds.

### 21 March 2012

- Lodgement and payment of the February monthly BAS/IAS.

### 31 March 2012

- Lodgement and payment of income tax returns for companies and superannuation funds with total income between \$2m and \$10m.
- Lodgement of income tax returns for individuals and trusts with a tax liability of \$20,000 or more.



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ACCOUNTANTS AUDITORS & ADVISORS

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