

Regular research papers and articles providing sector specific insights and issues analysis – Retail sector.

**August edition 2012 – Retail**

# Industry Intelligence Unit

Grant Thornton's Industry Intelligence Unit (IIU) blends the latest information and analysis of specific industries from publicly available sources (including the Australian Bureau of Statistics and the national press) with pragmatic, commercial and practical initiatives to improve stakeholder value.

## **Welcome to our latest edition of the Retail IIU.**

The end of the financial year provided continued refreshing news for retailers, following on from the previous six months results. The Australian Bureau of Statistics released the June 2012 retail numbers in early August 2012. The theme is still for cautious consumer confidence, with some sectors up and others remaining relatively flat. The seasonally adjusted estimate rose 0.5% in June 2012, consistent with April and May rises. The trend estimate also rose in June 2012 by 1.0% - this is the highest level of growth, although it remains underwhelming, that we have seen for two and a half years.

Despite this, there continue to be high-profile rationalisations and business failures occurring including Retravisation Southern, Pets Paradise and our recent appointment as Administrators of the WA based Wooldridges/Education Works. These have been attributed to the flat retail market in general. Whether the retail market is entirely responsible for business failures is questionable as continuing Federal political instability filters down into the retail sector.

Most of Australia's top 25 retailers reported flat sales in 2012 with profit margins continuing to be eroded by high rents and wage pressure. However, we see that the market may be more open for acquisitions. The recent Country Road

Our latest edition of the Retail IIU provides the following articles:

### **Retail industry snapshot from the Australian Bureau of Statistics**

with comments from with Simon Trivett (Partner, Audit & Assurance) and Gayle Dickerson (Partner, Recovery & Reorganisation).

### **The Australian Omni-channel Shopper**

from Gareth Jude - Retail Industry Executive at Telstra examines why the vast potential of the Omni-Channel world is untapped by Australian retailers.

**Fraud, the unknown, unknown** from Chris Watson (Associate Director, Forensic Consulting) looks at how to manage the risk of fraud and preventing a Clive Peeters scenario in your back yard.

acquisition of Witchery/Mimco could be the start of increased activity (albeit at a discount), which we expect to see more of in the next 12 to 24 months.

In the last month at Grant Thornton we hosted seminars where we heard from the authors of the Ipsos Mackay Report, Dr Rebecca Huntley and Dorothy Dudley. The Ipsos Mackay Report is Australia's premier syndicated qualitative research program, and has been running for 34 years. These presentations focused on consumer sentiment and shopping trends in 2012. The specific findings around consumer sentiment and how retailers, particularly bricks and mortar retailers, could address consumer concerns were insightful. Many consumers no longer find the shopping experience "fun". The Ipsos Mackay Report has further highlighted that retailers that focused on the fundamentals of customer service and creating the right customer experience were well placed

to succeed, even in a relatively flat retail market.

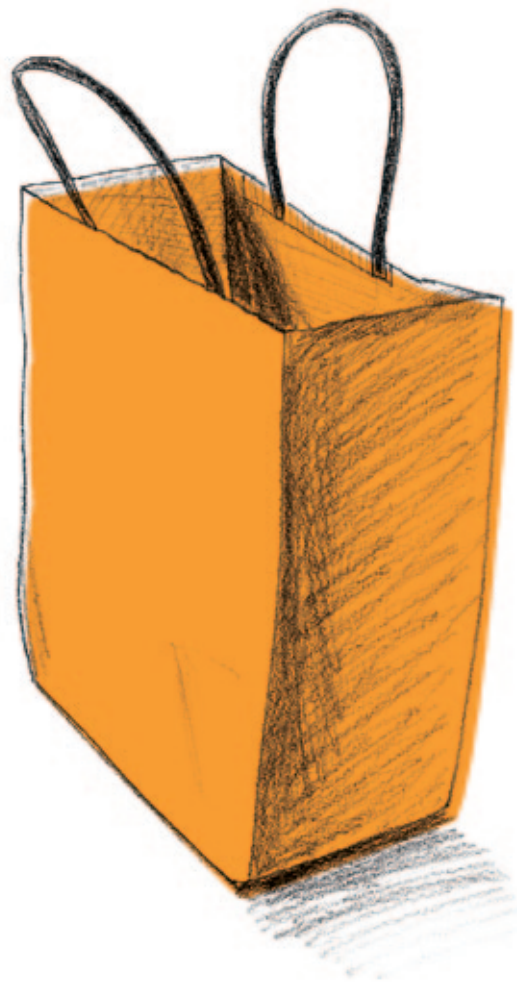
When we talk to successful retailers, we are finding that a common view taken by them is that whilst on-line shopping usually meets consumers' desire for value (even if this is only a perception) it still fails to deliver the same service and inspiration that a well run physical store can provide. It is often the customer service and experience that brings consumers back into the store time and again. Even if they are simply coming in-store for a price check, great service often results in a sale that would otherwise have been made on-line.

Many consumers have observed that some of the large retailers in Australia seemed to have lost their way recently with their delivery of service, something they used to be known for. Given salaries are a major cost to all bricks and mortar retailers, this expense line receives attention almost immediately in the drive

for responsibly delivering a return to the owners of the business. But it is not hard to see that if the service delivery is not present, then consumers will default to what they perceive as a better value proposition provided on-line.

We still see that some retailers are yet to fully appreciate that you need to drive both bricks and mortar and online to a happy marriage that can leverage and compliment each other to achieve higher sales than treating each distribution channel as a separate business.

Our regular contributor, Gareth Jude, Retail Executive at Telstra, who headlined the recent Retail World conference in Sydney and Melbourne, provides his insights and research on the Australian Omni-Channel retailer and how Australian retailers can utilize technology to improve customer interaction.



# Retail industry snapshot

The retail industry's mid-year results have exceeded industry analysts' forecasts, after a rise of 0.8% in May 2012, leading into a seasonally adjusted increase in June 2012 of 1.0%. The increases in May and June come on the back of consecutive increases in retail turnover from month to month of 0.5% in each of March and April. The result for June 2012 is the highest increase in retail sales we have seen in two and a half years.

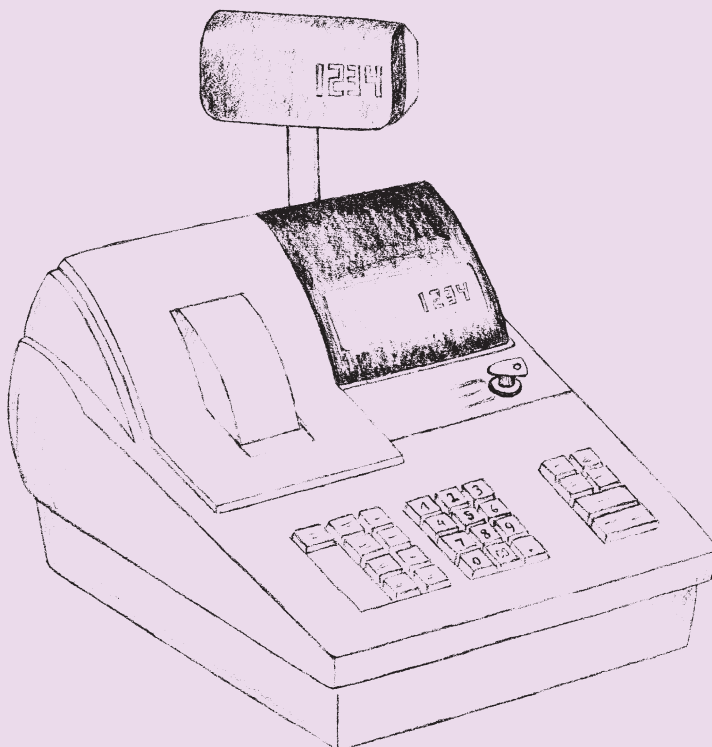
However, few analysts are forecasting anything other than flat growth over

the next 12 months in the sector. In addition, the environment surrounding these encouraging results continues to be uncertain. Retailers are not immune to the introduction of the new carbon tax, and we discuss later in this paper what we believe will be the impact of these changes.

These are the key macro-economic issues impacting retailers:

- Introduction of the carbon tax, which is creating uncertainty regarding the extent of the impact on individuals' and families' expenses

- The Household Assistance Package started in May 2012 providing initial payments and promising tax cuts for July 2012 and increased assistance from March 2013
- A strong Australian dollar, touching a four month high at the beginning of August
- European economic situation remains a concern
- More than 650 retail store closures planned since the beginning of the year, including major store closure programs by: Speciality Fashion Group, Billabong, Sleep City, Fletcher Jones, WOW Sight and Sound and Darell Lea
- RBA's decision to cut the cash rate by 0.25% in June and by 0.5% in May

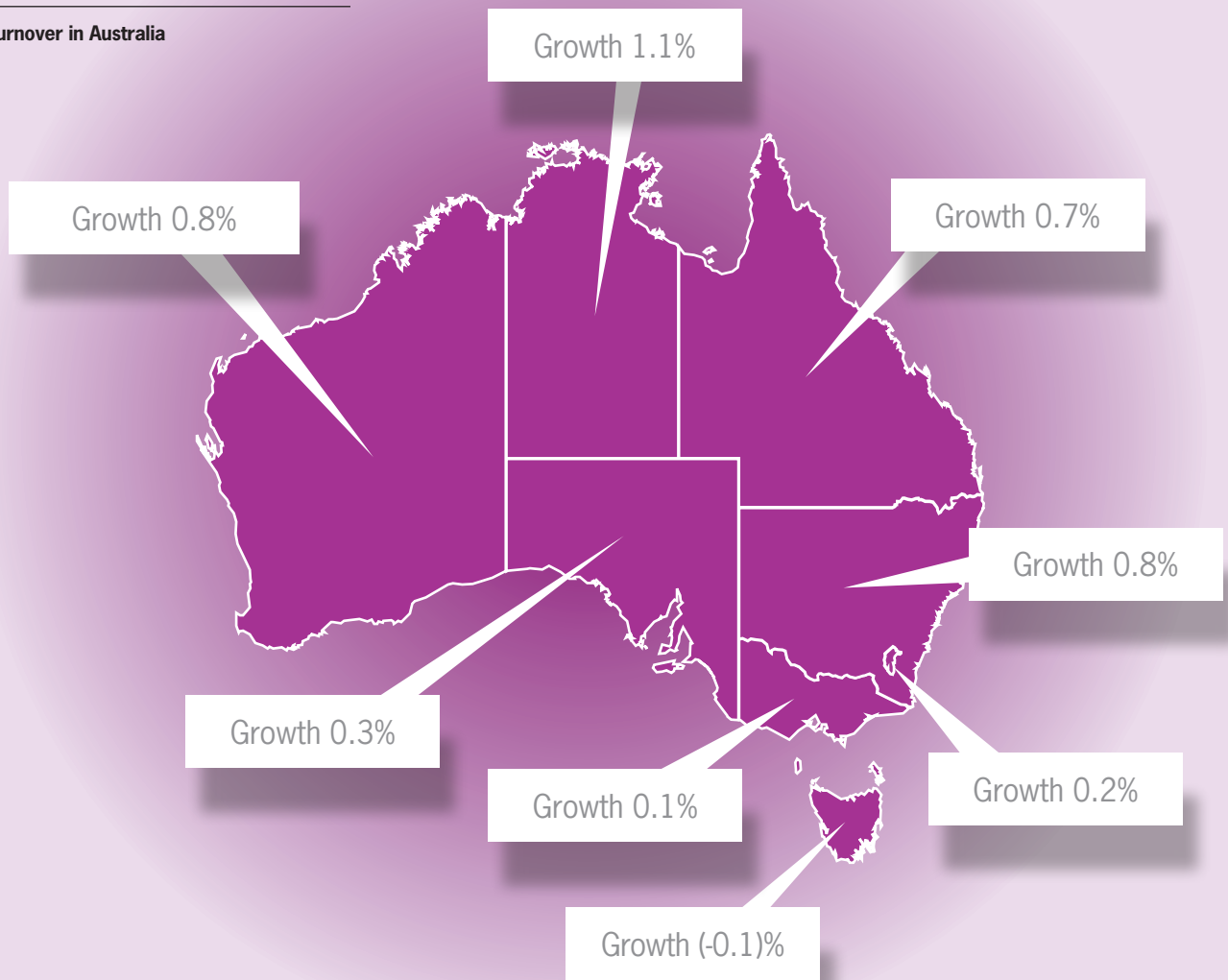


## The detail

The flat sales in the December 2011 retail turnover quarter have been followed by two increases in March 2012 and June 2012 quarters.

The calendar year started well with the 0.3% seasonally adjusted retail turnover rise for the month of January 2012 and the 1.0% growth of March 2012. April 2012 experienced a slight fall of 0.2%, predominantly driven by the bad results in the household goods, department stores, other retailing and food retailing industry sub-groups. Nevertheless, this small decline was not enough to jeopardise the trend and May 2012 and June 2012 had respectively seasonally adjusted results of 0.8% and 1.0%.

**Retail turnover in Australia**



In volume terms the June quarter’s result of 1.4% is consistent with the March quarter’s result of 1.4%. The last quarter’s retail sales may have been buffered by the Government’s decision to launch the stimulating Household Assistance Package. The RBA’s rate cutting over the strong Australian dollar in June also deserves to be highlighted along with lower petrol prices.

Every industry sub-group, except one, follows this general growth trend since the March 2012 quarter. The poor performer in the sector relates to the “Household goods retailing” sub-group which, on a seasonally adjusted basis, saw its turnover falling by 2.0% compared to the March 2012 quarter.

For the June 2012 quarter, the sub-sector results were:

- Food retailing: Up 1.3%
- Clothing, footwear and personal accessory retailing: Up 2.0%
- Department stores: Up 2.5%
- Other retailing: Up 1.3%
- Cafes, restaurants and takeaway food services: Up 3.1%

Despite the encouraging June quarter growth in turnover, particularly for department stores who have really had a tough time of it over the last year, many retail businesses remain in a distressed situation and we expect to see more store closures. This will represent an opportunity for sales in high-demand

CBD locations. However, regional strip malls will likely see higher vacancy rates. Competition for premium retail sites will be driven by overseas brands such as River Island, Topshop, Zara and H&M who plan to continue their spread across Australia.

Indeed, Woolworth and Coles operations represent 75% of grocery, liquor and food market in Australia. Big retailers keep on being bigger at the expense of smaller businesses according to a report on the Australian retail sector issued by Morgan Stanley<sup>1</sup>. Smaller retailers cannot compete on lower prices and therefore need to differentiate themselves on value and quality.

1. The Sydney Morning Herald, “Big retail fattens up on the small guys”. August 7, 2012.

# The Australian Omni-channel shopper

A year ago you had probably never heard of the word Omni-channel, but since then, it has hardly been out of the news when retailers talk about strategy. A number of high profile, publicly-listed Australian retailers have cited Omni-channel as their key strategic initiative for 2012 and cite it as the way they hope to change the fortunes of their business. So what is Omni-channel and why are so many retailers seeing it as so vitally important?

Omni-channel is often thought of as simply the combination of online and physical retailing, but it is really a new way to think about distribution channel design. In traditional distribution channel design, a market is segmented into groups of customers that are maximally similar by group and maximally different between groups. Channels of distribution and communication are then designed to suit the needs of these groups of customers. For example, your bank probably has separate channels for large corporate, small business and consumer customers. Likewise, at Telstra, we operate Enterprise and Government, Business and Consumer channels. Underlying this model is the belief that each customer buys only from one channel, and thus the profitability of each channel should be judged separately.

The Omni-channel hypothesis is that traditional channel design is not effective for retailers. The customer who's browsing the online channel for clothes is the same customer who visits the store looking for clothes. The customer who's looking online for a

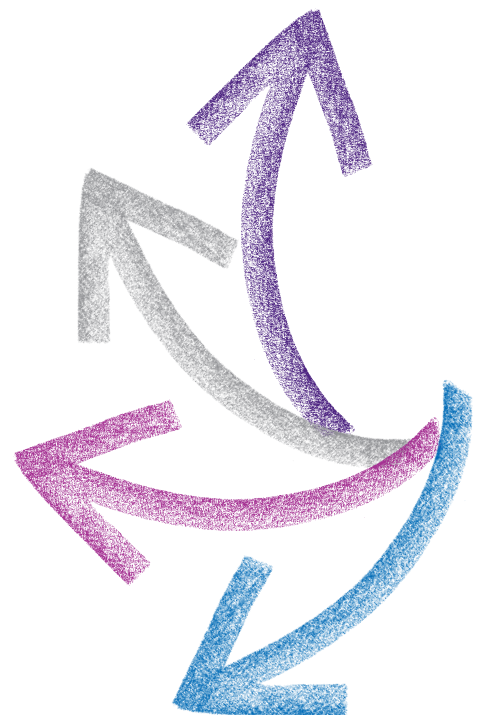
holiday is the same customer who visits a store to buy a holiday. Online and physical stores are not separate channels in the traditional sense because the one person may use both channels. In fact, online and physical more rightly should be considered an Omni-channel.

At Telstra, we have been interested in the blended online/in-store Omni-channel shopping experience for some time, but all the examples of Omni-channel success, like John Lewis and Best Buy and most of the research on the subject, seemed to be from overseas. We were interested in finding out if the conditions exist for Omni-channel retailing in Australia. We also wanted to find out if the Omni-channel consumer exists in our market, and if so, how they like to shop. The research we commissioned consisted of a telephone survey of 813 randomly selected respondents across Australia. Quotas and weighting were applied so that the results are reflective of the actual Australian population.

In parallel with our field research, we also studied existing research to find out if the Australian consumer is equipped with the technology to have a blended online and in-store shopping experience. The answer to that question was a resounding yes. We found that:

- Australia has the fifth highest level of internet penetration in the world<sup>2</sup>
- Australians now spend an average of almost 22 hours per week online<sup>3</sup> (in terms of media consumption, this is 40% more time than they spend in front of a TV)

A white paper entitled, "How you can join the Omni-channel Shopper in transforming Australian retail" includes a full discussion of the research we conducted and some original customer case studies. This whitepaper is available on [Telstra.com](http://Telstra.com) Telstra Business - Whitepapers or contact Gareth Jude at [gareth.jude@team.telstra.com](mailto:gareth.jude@team.telstra.com)



2. Internet World Stats: [www.internetworldstats.com](http://www.internetworldstats.com)  
3. Nielsen 2012 Australian Online Consumer Report

- 51% of all online Australians aged 16+ owned a smartphone in 2011, up from 36% in 2010. This compares to penetration rates of 45% in the UK and 38% in the USA<sup>4</sup>
- 18% of Australian households now own a tablet computer, up from 8% in 2010 and forecast to be 39% by 2013
- Australians use social media more than any other developed country<sup>5</sup>

Our conclusion is that Australians are better equipped to be Omni-channel shoppers than most of our overseas contemporaries.

The field research gave some fascinating insights into Omni-channel shopping in Australia.

- Two thirds of Australians have bought online in the last twelve months with an average spend of over \$2,200
- The most popular categories for online purchasing are clothing/accessories and books, while the least popular are cosmetics and sporting goods
- The online shopper is overwhelmingly an Omni-channel shopper. Most online buyers have also bought goods from the same category in a physical store. The most popular Omni-channel category is clothing/accessories, with 89% of online buyers also shopping in store. The least popular Omni-channel category is airline tickets, but even here 31% of online buyers also buy in bricks and mortar stores
- The benefits of shopping in store or online are very different in consumer's minds. Consumers gave their top reasons for preferring to shop online as price and the convenience of being able to shop from anywhere. The top reasons given for preferring to shop in a physical store were sensory (feel, touch, the ability to try on clothes, etc.) as well as face-to-face customer service
- The online world has given birth to "showrooming". Showrooming occurs when a consumer uses a bricks and mortar store to touch,

feel and try a product but then buys online. Our research shows that the showrooming phenomenon is real. Half of the population has researched a product in a physical store then bought it online, but of these, about a quarter made the online purchase from the same retailer with whom they did the research. In other words, showrooming results in an online sale for the physical retailer in about 25% of cases

- Consumers value Omni-channel shopping for the way it combines the different strengths of in store and online to create an anytime, anywhere shopping experience. For example, they see benefit in being able to order in store or online and then take delivery somewhere else, to check stock availability across various locations, or to check out extended ranges online while visiting a store

The research shows that the Omni-channel shopper is equipped and already active in the Australian market. What do retailers need to do to serve this new high value customer? There are five key lessons.

### 1. Get the technology platform right

In the bricks and mortar world, the foundations of customer experience are physical. Bricks and mortar retailers are understandably obsessive about their facilities, their stock and their signage. In the Omni-channel world, the foundation of customer experience is technological. Retailers now need to be equally obsessive about their technology infrastructure, because without it, the online extension of their store will not always open for business.

### 2. Keep the doors open between the physical and online worlds

The essence of Omni-channel is the free movement of the customer between the physical and virtual worlds of retail. WiFi hotspots and digital media, when used in store, can facilitate this. WiFi hotspots enable customers to go online

when in store for free, while digital media can be used to display a message or provide information via a kiosk.

### 3. Embrace the smartphone

The Smartphone is the new shopping companion of choice and they are already owned by the majority of the Australian population. Retailers should make sure that all their online applications are optimised for mobile, but according to Google<sup>6</sup> only 21% of Australian web sites qualify.

### 4. Facilitate anywhere anytime communications

In the Omni-channel world, customers are wandering around your shop 24/7 and will be sending messages at any time and in any form. Retailers need to implement a unified communications platform so that customers' messages can be received and responded to in a timely manner.

### 5. Embrace social media

A study by Cisco in the USA showed that social media is now five times more influential than in store assistants in determining shopping choice<sup>7</sup>. Combine that with the knowledge that Australians are the biggest consumers of social media in the world and retailers have another item for their to do list.

Our research shows that the high profile retailers who have identified Omni-channel as an area of opportunity have been right to do so. Bricks and mortar retailers are in the best position to exploit the potential of Omni-channel, as the full experience can't be delivered without a network of physical facilities. Most Australian shoppers are already Omni-channel shoppers but they want more. To exploit the opportunity, retailers will need to become as obsessive about their technology platforms as they have been traditionally about their physical facilities. The vast potential of the Omni-channel world is untapped. It will be interesting to see who has the skill to grasp the opportunity.

4. Google Mobile Internet and Smartphone Adoption Report January 2012.

5. Nielsen's Social Media Report: Q3 2011.

6. Google "Our mobile planet: Australia - understanding the mobile consumer" May 2012.

7. Cisco ISBG "Catch'em and keep'em 2011".

# Fraud – the unknown, unknown

I would like to start off with a quote from the former US Department of Defense Secretary Donald Rumsfeld in 2002 which was made in response to questioning about Iraq and weapons of mass destruction.

“Reports that say that something hasn’t happened are always interesting to me, because as we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don’t know we don’t know. And if one looks throughout the history of our country and other free countries, it is the latter category that tend to be

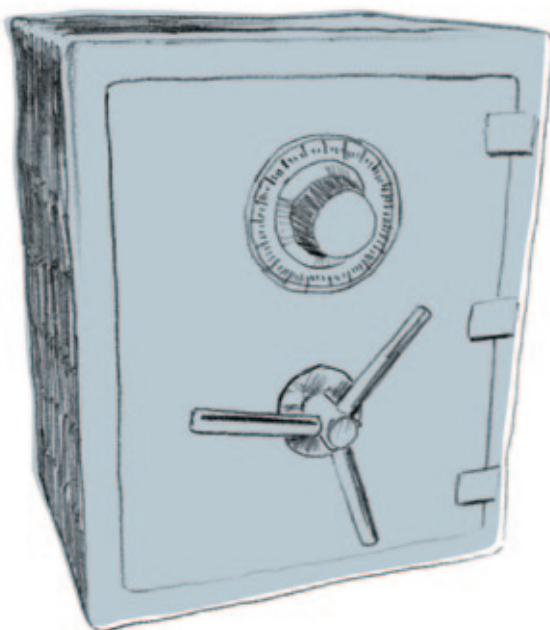
the difficult ones. And so people who have the omniscience that they can say with high certainty that something has not happened or is not being tried have capabilities that are [beyond mine].”

I will give you a moment or two to get your head around that set of statements. Although at the time Rumsfeld was much maligned and mocked for this apparently nonsensical set of hypothesis, when you take each sentence apart they actually make perfect sense. Fraud and fraud prevention, much like any security question – as was Rumsfeld’s point – can equally be categorised as known knowns, known unknowns and unknown unknowns. Sadly it is also true in that there are

those who “say with high certainty that something has not happened or is not being tried”.

What’s the first thing that pops into your mind when you think about fraud? I will almost guarantee it is one of the following; “I don’t have a problem”, “it can’t happen here” or “I trust everyone”. Be honest, you did didn’t you? The amazing thing about fraud is that everyone acknowledges it exists and that it is a problem but, bizarrely, not a problem for them. Similarly, the accepted wisdom is that it only happens to the big guys or is for such insanely huge sums of money it could never happen to them without discovering it quickly. These, I am sure, are thoughts that ring hollow with the former executives of the now defunct retailer Clive Peeters where \$20 million evaporated without their having so much as an inkling that it had done so.

Ms Sonya Causer joined Clive Peeters as a senior financial accountant and in April 2007 was given additional responsibilities which included authorisation of salaries, super payments, group tax and payroll tax. Over the course of the next two years Ms Causer then made 125 individual fraudulent payments to herself totalling nearly \$20 million. It is fair to say that her modus operandi was basic. She merely altered payee details in order to divert the funds to her bank accounts. A trivial matter given that she had sole responsibility for this very system. An internal audit identified a \$2 million discrepancy





which led to a full investigation and the subsequent revelation that nearly \$20 million had actually been stolen.

As we are all aware this fraud had calamitous results, with Ms Causer cited as being a significant contributory factor in the stores' demise. But not all frauds need to be on this scale to have a serious or fatal impact on your business. Consider another less well known but nonetheless true, retail story of woe: A medium sized retail organisation with its own warehousing and distribution operations discovered quite by chance that certain numbers "didn't quite add up". Upon investigation it turned out that a number of warehouse staff didn't actually exist. What is more worrying is that when presented with this evidence the warehouse manager said, "you know I thought it was strange I would see these names but couldn't put a face to them!".

In another example, this time at the customer end, a restaurant was experiencing stagnant revenue despite maintaining the same level of clientele much to the confusion of the owner. Our investigation revealed a number of schemes where cash was being skimmed from the system. One of which was to simply "reverse out" or cancel transactions as if to refund a disgruntled customer but pocket the cash instead. To compound matters the same member of staff was also responsible for cashing up at the end of the day and was able to remove more cash without any further checks by the owner. These are just two of the many schemes we identified which were not only incredibly simple to perpetrate but had gone unnoticed for some considerable time.

The key challenge for the business owner is not only to be open to the possibility that fraud could occur in your business but to also recognise and identify the warning signals or red flags that would allow an early and hopefully less costly (in every sense of the word) resolution to the problem.

When thinking about this challenge I am reminded of an observation by the irreverent surrealist cartoonist Gary Larson in his Far Side series where he succinctly sums up this issue which I shall attempt to describe. Imagine if you



will the scene, a doughnut store and in the store there is an empty cabinet where doughnuts once resided and a very large young man is sweeping the floor whilst the manager scratches his head and exclaims he cannot understand why he isn't making any money as he is shifting lots of doughnuts. The clear implication from the drawing itself is that of course the large young man is eating all of them and they aren't selling many if any at all.

What may you ask has that to do with red flags? Well, the shop owner failed to follow the literal and metaphorical trail of doughnut crumbs to the real source of his dilemma and to recognise let alone identify the red flag literally in front of his face.

"This is a cartoon" I hear you further proclaim and would never happen in real life let alone in my organisation. For obvious reasons I will not name names or identify companies but I can assure you I have heard the following during some of my investigations in numerous retail chains and outlets, big and small: "I thought it was strange he drove a Ferrari!" and "I trusted him with the cash, I cant believe he had been sacked for stealing before", "she was a model employee, never took time off and always worked late". There is also the person who had accumulated numerous boxes of luxury goods under their desk despite the fact that given their level and pay grade they were unlikely to be able to actually afford such shiny baubles.

That is not to say that just because your store manager who drives to work in a Ferrari is skimming cash or fiddling the books. On the contrary there may be some plausible and perfectly logical reasons: a lottery win or family inheritance for example. The key to effectively assessing red flags is to be able to take a "step back" through the use of appropriate controls and procedures which will enable you to look at the cumulative flags and decide whether there is indicative behaviour that should be investigated.

Red flags generally fall into two broad categories, individual and systemic.

### Red flags

#### Individual

1. Change in lifestyle
2. Purchasing patterns
3. Gambling habits
4. Never takes a holiday/refuses help
5. Unusual working patterns

#### Systemic

1. Destruction or loss of documentation
2. Overriding controls
3. Lack of ethical culture
4. Lack of effective (cash) procedures
5. Consistent failure in timely detection of fraudulent activity

Where the individual flags represent behaviour or actions by the perpetrator of the fraud or misconduct and the systemic where the organisation fails to prevent or facilitates the misconduct through a lack of ethical culture, controls or procedures. There are numerous red flags that can be identifiers of fraud or misconduct but they are merely that, identifiers. In and of themselves they do not necessarily mean anything untoward has occurred but with the right policies and procedures these flags can be effectively assessed and mitigated.

You may feel, even after these cautionary tales, that fraud is still not an issue for your store. Again sadly the statistics simply don't bear this out. In the most recent survey conducted by KPMG<sup>8</sup> the value of fraud was estimated at \$345 million up from \$301 million in its previous outing two years earlier. Now, there are a couple of things to remember when considering this number. The first is to remember that this only represents figures provided by the respondents to the survey and not Australia as a whole. Secondly and perhaps critically this represents the figure for fraud that has been discovered and quantified.

There are many difficulties faced when attempting to put a definitive

number on the total amount of fraud committed in corporate Australia and one of the key problems is that a lot of fraud goes undetected and that which is detected is very often not reported to the police. Again the various fraud surveys give us an indication that fraud is probably under reported by about 50%. A quick sum from a non accountant \$345million x 2 (100%) gives us an approximate fraud figure of around \$700 million. I would go further and say that both those figures should be considered conservative for a variety of factors: undetected fraud, lack of reporting through embarrassment or market reaction and sadly a perception that the law enforcement agencies won't be interested. To further bolster the scary figures the Australian Institute of Criminology estimates that fraud accounts for 40% of the total cost of all crime perpetrated in Australia<sup>9</sup>.

Let's revisit the initial question. Is fraud a problem for you? Hopefully the answer has changed to "this could be a problem and I need to assess the potential". If it has then thankfully you are well on the way to effectively managing the risk of fraud and preventing a Clive Peeters scenario from occurring within your organisation.

8. KPMG Fraud survey 2010.

9. [http://www.aic.gov.au/crime\\_communitycrime/costs.aspx](http://www.aic.gov.au/crime_communitycrime/costs.aspx)

# Our National Retail Team

Grant Thornton is a national full service accounting and business advisory practice that specialises in working with retailers of all makes and types, big and small. We closely work with our retail clients, so we understand this complex and diverse market well. If you would like to discuss any aspect of the above, please do not hesitate to contact one of our industry experts detailed right.

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# Industry Intelligence Unit

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The IIU is unique in its objective of providing stakeholders with information, understanding and analysis of the issues faced within specific industries and sub-industries. The IIU also seeks to provide pragmatic, commercial, practical measures and initiatives to improve stakeholder value.

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- Aged Care
- Automotive Dealerships
- Energy & Resources
- Financial Services
- Food & Beverage
- Healthcare
- Hospitality
- Life Sciences
- Manufacturing & Automotive
- Not for Profit
- Professional Services
- Public Sector
- Real Estate & Construction
- Retail
- Technology

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