



**Australian Pharmaceutical Industries
Annual General Meeting
20 January 2009
Address by the Chairman, Peter Robinson**

At our last Annual General Meeting I outlined the strategic direction of the company and the Board's confidence in an improved financial performance. The Board believed that continuing to use the core assets, with pharmacy wholesaling as the base business and Priceline as the major development vehicle, would provide API with a point of differentiation in the market that would see it continue to gain momentum regardless of any medium or long term industry changes. The Board is pleased that the management team has been able to deliver that promised improvement in performance and also implement strategic initiatives that will ensure API's competitiveness in future years.

Before moving onto a review of the company's performance I would like to begin by first updating you on the company's trading over the Christmas period. As you know this period is a significant profit contributor to our full year results.

The lead up to the Christmas period was no different for API than it was for many retailers. With sales more unpredictable than experienced in prior years, the management team was already focussed on targeted marketing initiatives and vigilant control of variable costs. Christmas sales came through very late and were in fact very strong in the days after Christmas. Comparable store growth across the group was approximately 4% during this time. We were pleased to record sales ahead of last year and we believe that at this stage of the current year it puts us on target to improve on last year's first half net profit after tax of \$6.1 million by up to 10%, assuming that trading continues as expected in the final six weeks of this period.



While the Christmas period was positive, the result was also due to strict cost management. The continuing uncertain nature of the retail environment only reinforces your directors' view that it will be another tough year, albeit we know management has already prepared for the expected challenging conditions.

Like every other business our caution is based around the current global financial crisis and its impact on the Australian economy.

This brings me to conversations I have had with some shareholders about our share price performance. The recent share price is not where any of us would like it to be, however we do not believe it reflects the long term value of API.

It is often difficult to provide a rationale for share price movements but I would like to share with you a sense of the volatility in the market during 2008. At the announcement of our half year results at the end of April the company stated that it expected full year earnings before interest and tax of \$49-50 million despite toughening economic conditions. This was within the consensus earnings forecast of the financial community for our performance. At that time the share price was \$1.31.

In the ensuing four months nothing changed in relation to API's business. There was nothing in day to day trading that we had not anticipated, we met our forecast result target, we had no other material change, however the share price had decreased to 53.5 cents at the time of our results announcement in October where we announced earnings before interest and tax of \$49.7 million.

Since the global financial crisis firmly took hold in October the All Ordinaries Index has in fact declined by slightly more than the API share price. While



this may be of little immediate comfort to shareholders, it demonstrates that API's share price movements are affected by many factors, including industry issues and global events. While we are responsible for all the company indicators, including the share price, the Board is concentrating on making sure API is generating consistent financial results for long term improvement.

As I've already mentioned, in our view today's share price does not reflect the strength of API's long term future and I would like to talk briefly about our performance to demonstrate our progress.

Company performance

Due to API's change in financial periods there is no directly comparable 12 month period. However if we compare the 2008 results with the 2007 12 month results we can see a dramatic improvement in performance. A profit was recorded, earnings were up more than 30% and we eliminated the company's retained losses that had been carried forward.

We began the 2008 year on a positive note by announcing the strategic partnership with Alphapharm, Australia's largest generic pharmaceutical company. The partnership proved to be valuable to API, providing us with extra volume and income from the growing generic pharmaceuticals market without needing to make an expensive investment in manufacturing facilities.

The benefits of the partnership assisted the already improving pharmaceutical wholesale division. Throughout 2007 this division recovered its previous market position and in 2008 it consolidated that further and became Australia's leading distributor of pharmaceuticals. Importantly it also increased returns and its earnings margins. This was achieved due to cost reductions through initiatives such as restructuring work practices and despite higher cartage and labour costs.



We continued to invest in products and services to support independent pharmacy. The new Soul Pattinson retail format and merchandise ranging has been well received and Pharmacist Advice and the API members program have also been developed to provide pharmacists with a much wider range of options for their businesses.

In Priceline we continued to build our presence and went past the 300 store milestone. We now have more franchised Priceline Pharmacy stores than we do traditional company-owned Priceline stores. This is indicative of the demand that pharmacists have shown to join Priceline when they are looking for a compliant retail brand. In 2008 the comparable growth rate per Priceline Pharmacy store was 9%.

Priceline is clearly differentiated as a leading health and beauty retail brand through its range, choice, service and value that is not matched by any competitor in the industry. We are confident about Priceline's future success because it also continued to improve its underlying operational profit margins.

In our other business we have continued to see the steady improvement in our New Zealand based consumer business and that is tracking to our long term strategic plans, with it more than doubling earnings from the previous full year.

A specific area of focus for the Board is in working capital management across all divisions. Across the entire pharmaceutical wholesaling industry pharmacies consume probably more than \$1 billion in working capital held by all the wholesalers. API's view is that this is a significant level of funding and is not sustainable even though there has been a decline in official interest rates. Management has specific initiatives in place to address this because it is important that we bring funding costs back to a more sustainable level. In



doing so it is important that we work constructively with pharmacies so that benefits are brought to both parties.

The major new strategic development launched during the year was the re-engineering of the supply chain. The project is named "Revitalise" and is designed to help API cope with increasing distribution volumes and growth plans for Priceline.

Stephen Roche will talk about this project in some detail, but in essence the Board had a critical decision to make. We had to invest in new pharmaceutical warehouses for Melbourne and Brisbane, they were at capacity and could not cope with more volume beyond 2009. Additionally we had to invest in the Priceline warehouse at Dandenong because it was at risk of becoming jammed in peak periods thus preventing delivery of stock. The Board believed the best option was to bring the pharmaceutical and Priceline supply chains together, that would derive greater efficiencies and see substantial cost savings. The alternative would have updated the existing supply chain just to cope with more volume without generating additional savings.

The Board and management are being advised on this substantial project by XAct Solutions, an expert in supply chain re-engineering. They have extensive experience and are highly regarded having previously worked on very successful programs for companies such as Woolworths and Myer.

The integration of the supply chains will require an investment of approximately \$60 million and will generate savings of more than \$18 million per year. The alternative would have cost approximately \$30 million and had a relatively minor cost saving attached. It was clear we had to invest.

As we have previously said we would have liked to participate in some form of industry consolidation in regards to infrastructure for pharmaceutical



wholesaling but it appeared nothing was imminent for API and we had to consider our own circumstances.

Revitalise is the best path for API and will ensure competitiveness, not just for us but also for independent pharmacists.

Having had a successful year in meeting the operational targets, executing existing and new strategies, the company reported a profit. This meant that the Board considered the matter of dividends given that the retained losses were eliminated.

The Board previously committed to providing a dividend to shareholders at the earliest possible opportunity. The dividend was small but directors believed that shareholders have been through a trying period in the past two years and this was some acknowledgement of their views, as well as their patience and support.

I would like to thank your directors for their time and dedication during the year. Most of all I would like to thank all APIs many staff for their dedication and contribution in 2008, it has been a long couple of years for the company and they deserve full recognition for the role they have played.