



Australian Pharmaceutical Industries Limited

2011 Annual Report

For the year ended 31 August 2011



The Directors present their report together with the financial report of Australian Pharmaceutical Industries Limited ('the Company') and of the consolidated entity, being the Company and its controlled entities, for the year ended 31 August 2011 and the Auditor's report thereon.

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Chairman's and CEO's Report

We are pleased to present the Company's Annual Report for the year ended 31 August 2011.

OVERVIEW

This has been a challenging year for API with market conditions and significant non-recurring items impacting our results.

While we started the year knowing we faced a tough retail environment and that major PBS reforms would continue with a further deflationary cut to API's revenue base from February 2011 we did not expect to be confronted with Pfizer Australia (Pfizer) withdrawing from wholesale distribution in Australia or the material damage following the Queensland floods which closed our Brisbane distribution centre.

Despite these unexpected events and continued depressed consumer spending, difficult financing and credit conditions for pharmacists, we are pleased to report a solid operating and sales performance, with Priceline once again demonstrating a resilient retail sales result.

OPERATING PERFORMANCE

For the financial year to August 2011, API reported a net loss after tax of \$23.3 million. The loss included a financial guarantee and impairment charge of \$50 million and an expected timing loss of \$3.6 million after accounting for the material damage suffered to the Company's Queensland Distribution Centre. We also expect to recover in 2012 approximately \$5.5 million from a loss of profits insurance claim arising from the Queensland floods.

The Company's underlying net profit after tax was \$20.8 million, compared to \$22.6 million in the previous financial year. The Company's reported revenue was a credible 7.6% below last year following the impact of continued PBS reforms, the loss of Pfizer moving to a direct distribution model and temporary

customer losses following the Queensland floods.

The Company's operating result also included a number of other non-recurring items being settlement of the Company's claim with the New Zealand Internal Revenue Department, the effect of a recent Australian Tax office ruling that lease make-good provisions are non-deductible and a Community Service Obligation audit adjustment from prior years.

The Company's contribution from its investment in CH2 increased by \$591,000 to \$1.2 million for the year.

Cash management within the business remained strong with cash from operations increasing to \$48 million. Working capital reduced by 5% during the year along with a \$33 million reduction in average net debt.

During the year the Company extended its \$275 million and \$70 million securitisation programs to May 2013 and May 2012 respectively. Subsequent to year end the \$70 million facility was further extended to May 2013 and the Company's cash advance facilities extended (subject to final documentation) to May 2014.

We continue to focus on best practice injury prevention with the introduction of new programs dealing with safety management technology, running "safe at work" campaigns and initiating a safety leadership development program. We have also strengthened injury and claims management, promoting early notification of any injury claims. In addition, we continue to monitor our environmental performance as it applies to our wholesale distribution centres, retail stores and manufacturing operations.

This credible underlying operational performance, together with the Company's confidence in its strategic direction, has enabled the Board to declare an unfranked¹ final dividend of

1.5 cents per share in addition to the fully franked interim dividend of 1 cent per share at the half-year. In the absence of no further major deterioration in economic conditions, the Company expects to return to a fully franked dividend position in the 2012 financial year.

PRICELINE

Once again, Priceline demonstrated a credible retail sales performance in a very challenging environment. Total sales growth (excluding dispensary) increased by 2.3% on the previous year with comparable sales growth at 1.4% for the same period. This was against a backdrop of a flat sales result in the health and beauty category Australia wide. Priceline was one of only a few retailers to post positive like-for-like sales growth over the previous year, underscoring the difficult trading conditions facing the industry as a whole, as consumers continue to rein in discretionary spending.

The Priceline Clubcard program continues to be the key driver of Priceline's sales. It now has nearly 3.6 million members whose spend per visit is more than 47% higher than non-Clubcard customers. In total, sales to Clubcard members account for approximate 40% of total non-pharmacy sales. It is now firmly established as one of the strongest retail loyalty programs in the country and no other retailer in our sector has anything comparable in its armoury.

Our strategic alliance with leading insurer AIA Australia has passed the 'proof of concept' phase and Priceline Protects, a suite of life insurance and income products targeted specifically at women, gives us confidence that properly tailored, non-core product and service offerings will be embraced by our Clubcard membership base.

On the pharmacy front, following the successful trial of free heart check

¹ The Company has sufficient franking credits available to fully frank the final dividend. However, as a consequence of amendments in 2010 to the Corporations Act 2001, the Commissioner of Taxation expressed a preliminary view that where a company's net assets are less than its share capital and a company debits a dividend to an account such as accumulated losses, a dividend will be sourced indirectly from share capital and will be un-frankable. The Company is reporting net assets less than its share capital due to the non-cash impairment charge.

consultations last year, Priceline introduced a series of targeted, free consultation programs throughout the Priceline pharmacy stores. This year we ran separate programs covering pain management, contraception, menopause, asthma and a follow-up heart health program. In total, more than 16,000 consultations were provided during the year.

Priceline's store expansion program has slowed in the face of the tough retail and financing environment facing all pharmacists. While the Company opened 18 new franchise stores, including three conversions and six new Company-owned stores, one of which is in the new flagship Westfield Centre in Sydney's CBD, the closure of some existing stores meant that the total network of 327 stores was essentially flat against last year.

We remain confident that in Priceline we have a compelling proposition for prospective franchisees. In September 2011, a Franchise Partner Satisfaction Survey was undertaken by the Franchise Relationships Institute and was completed by the majority of our franchisees. These results were analysed by the Institute against previous surveys of Priceline franchisees and other franchise sector surveys.

These results show that our franchise partners are now clearly satisfied overall with their experience in the Priceline system and satisfaction ratings have increased in 18 out of 22 measures. Of particular importance, given the strategic imperative we place on the Clubcard program, is the fact that our franchisees identified the Priceline marketing program as being highly important and effective.

Our pharmacists also rate our approach to dispensary management as highly important and effective and gave high marks to our market competitive recommended script pricing strategy. Overall, our franchisees are clearly satisfied with our performance and we significantly outperform the franchise sector average. When the economic and financing environment stabilises, these findings support our belief that

we can anticipate growth in our Priceline network.

The impact of online trading has been a key factor in the decline of retail sales in many sectors. While health and beauty retailing is somewhat sheltered from this shift in consumer behaviour, the year-long trial of our customers' appetite for online shopping suggests that our consumers' desire for a full online shopping experience is greater than previously estimated.

We have therefore invested approximately \$3 million in our Priceline online shopping program which will launch in the first quarter of the 2012 calendar year. We believe we are significantly more advanced than any of our competitors in developing and launching this offer.

PHARMACY DISTRIBUTION

The first half of the year also saw the double impact of significant PBS reforms and Pfizer's decision to end its wholesaling arrangements in Australia. Pharmacy sales revenue was down 10.3% as a result of Pfizer's decision and lost sales following the Queensland floods.

We moved swiftly to right-size the wholesale distribution system and led the market by introducing new reduced trading terms for pharmacists on 1 February 2011. We are pleased to report that the rationale for and impact of these changes were communicated early to our customers to allow them to adjust their retail offering accordingly. The fact that these terms remain in place today is evidence that the wholesale market has remained stable and is responding rationally to structural change.

We do not anticipate a repeat of these conditions which saw an estimated total of 15% of revenue exit the wholesaling industry. However, if they do recur, we have demonstrated our ability to respond swiftly and effectively recover loss of income.

Pleasingly, our New Zealand manufacturing business rebounded strongly following the plant flood in the first half of 2010, to report a 70%

increase in earnings before interest and tax.

LOOKING FORWARD

We are cautiously optimistic that the current financial year will deliver an improvement in our net profit after tax result. This optimism is based in part on the fact that we could not deliver material benefits of our supply chain transformation program during the 2010/2011 financial year. The opening of our new Queensland distribution centre was key to that transformation so its enforced closure as a result of the Queensland floods was a significant blow. Now that it is fully operational we can expect the benefits of our supply chain transformation to follow accordingly.

Priceline remains in a better position than most to maintain growth in what appears to be enduring conditions of depressed consumer spending and increased online competition. The wholesale sector shows signs of stability and we will act appropriately to manage the next round of PBS reforms. However, like all businesses we are conscious that we operate in very uncertain economic times and whilst consumer confidence remains fragile our optimism is tempered by the knowledge that the Australian economy (excluding the resource sector) will take some time to recover.

In conclusion, we wish to thank our Board, management and employees, all of whom have acted decisively and in unison to address the unprecedented challenges of the year under review.



Peter Robinson

Chairman



Stephen Roche

Managing Director/CEO

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Directors' report

DIRECTORS

The Directors of the Company at any time during or since the end of the financial year are:

Mr Peter R. Robinson, B.Com, FAICD

Chairman

Non-executive Director.

Director since 5 May 2000.

Appointed Chairman 8 July 2003.

Mr Robinson joined Washington H Soul Pattinson and Company Limited in 1978 and was appointed a Director of Washington H Soul Pattinson and Company Limited in 1984. Mr Robinson is also Chairman of Clover Corporation Limited and a Director of New Hope Corporation Limited, and Northern Energy Corporation Limited (de-listed). Mr Robinson resigned as a Director of SP Telemedia Limited in April 2008.

Mr Robinson was also a non-executive Director of KH Foods Limited - appointed 2008 (company delisted 2009).

Mr Robert D. Millner, FAICD

Non-executive Director.

Director since 5 May 2000.

Member of the Remuneration Committee since 2 October 2007.

Mr Millner is the Chairman of Washington H Soul Pattinson and Company Limited and has been a non-executive Director of Washington H Soul Pattinson and Company Limited since 1984.

Mr Millner is also Chairman of Brickworks Limited, BKI Investment Company Limited, Souls Private Equity Limited, New Hope Corporation Limited, Milton Corporation Limited and Northern Energy Corporation Limited (de-listed). Mr Millner resigned as a Director of Choiseul Investments Limited in 2011.

Mr Millner is a non-executive Director of TPG Telecom Limited.

The Hon Dr Michael R. Wooldridge, BSc, MBBS, MBA, LL.D

Independent non-executive Director.

Director since 1 February 2006.

Member of the Remuneration Committee since 2 October 2007.

Appointed Lead Independent Director 2 December 2008.

Dr Wooldridge was Australia's Federal Minister for Health from 1996 to 2001. Dr Wooldridge is an Honorary Fellow of the Australasian Faculty of Public Health Medicine.

Dr Wooldridge is a former Director of Prime Trust Ltd, Cogstate Ltd, and Dia-B Tech Limited.

Ms E. Carol Holley, B.A, FCA, FAICD

Independent non-executive Director.

Director since 19 December 2006.

Appointed Chair of the Audit and Risk Committee on 19 December 2006.

Ms Holley is a non-executive Director, Chair of the Audit and Finance Committee and a member of the Governance Committee for Job Futures Ltd. She is also a non-executive Director of Defence Housing Australia.

Ms Holley is also Chair of the Risk Management and Audit and Risk Committees for NSW Department of Housing, NSW Police and NSW Department of Planning, Northern Sydney Central Coast Health and a member of the Audit and Risk Committee of the NSW Department of Human Services.

Ms Holley was a non-executive Director and chair of Resource Pacific Holdings Ltd until February 2008.

Mr Stephen P. Roche, B.Bus, GAICD

Executive Director.

Managing Director and Chief Executive Officer since 14 August 2006.

Mr Roche joined API in March 2005. Previously he was Group General Manager, Health Services for Mayne Group Limited with responsibility for pharmacy distribution, pathology and other business units. Previous roles included Chief Operating Officer, Healthcare Services for FH Faulding & Co and a number of management roles at CSR.

Mr Miles L. Hampton, BEc (Hons), FCIS, FCPA, FAICD

Independent non-executive Director.

Director since 7 August 2007.

Member of the Audit and Risk Committee since 7 August 2007.

Appointed Chair of the Remuneration Committee on 2 September 2008.

Mr Hampton was previously Managing Director of publicly listed Roberts Limited for 20 years prior to his resignation in 2006, and was previously a Director of Hobart Water and Impact Fertilisers Pty Ltd.

Mr Hampton is currently a Director of MyState Limited, Tasman Farms Limited, Forestry Tasmania, and The Van Diemen's Land Company.

Ms Lee Ausburn M.Pharm, B.Pharm,
 Dip. Hosp. Pharm, GAICD

Independent non-executive Director.

Director since 7 October 2008.

Member of the Audit and Risk
 Committee since 7 October 2008.

Ms Ausburn is a pharmacist with
 experience in retail and hospital
 pharmacy and in academia. She
 joined the pharmaceutical industry
 with Merck Sharp and Dohme
 (Australia) Pty Ltd in 1983 and most
 recently was Vice President, Asia, for
 Merck and Co Inc with responsibility for
 the Company's operations across Asia.

Ms Ausburn is a board member of the
 Clinical Excellence Commission and
 Agency for Clinical Innovation, NSW
 Health and Vice President, Pharmacy
 Faculty Foundation, University of
 Sydney. Ms Ausburn was appointed
 as a non-executive Director of
 SomnoMed Limited on 30th
 September 2011.

Mr Gerard J. Masters

Independent non-executive Director.

Director since 7 September 2010.

Mr Masters has had extensive
 experience in retailing. Until early 2006,
 he spent more than 33 years with the
 Coles Myer Group. This included a 10
 year period as Managing Director of
 Bi Lo, Coles and then the total
 Supermarkets Group which was Coles
 Myer's largest and most profitable
 business. His most recent role until his
 resignation in 2009, was as the
 Managing Director and CEO of The
 Reject Shop Limited.

COMPANY SECRETARY

Mr Peter Sanguinetti, has been
 Company Secretary and General
 Counsel since November 2007. Mr
 Sanguinetti BJuris, LLB, has extensive
 experience and was previously
 Company Secretary and General
 Counsel of Kodak (Australasia) Pty Ltd
 for 9 years, responsible for legal and
 company secretarial activities for the
 Kodak group across Asia. Mr
 Sanguinetti was also a non-executive
 Director of HPAL Limited (listed ASX)
 from January 2005 to November 2007.
 On 2 June 2009, Ms Genevieve Ryan
 (nee Browne) was appointed an
 Alternate Company Secretary.
 Ms Ryan BSc (Hons), LLB(Hons) is a
 qualified lawyer and supports the
 Company Secretary.

DIRECTORS' MEETINGS

The number of Directors' meetings (including meetings of committees of Directors) and number of meetings attended by each of the Directors of the Company during the period were:

Director	Directors' Board Meetings		Directors' Committee Meetings		Audit and Risk Committee Meetings		Remuneration Committee Meetings	
	Number attended	Number held*	Number attended	Number held*	Number attended	Number held*	Number attended	Number held*
Mr P R Robinson**	16	16	1	1	-	-	-	-
Mr R D Millner	14	16	-	-	-	-	4	4
Dr M R Wooldridge	16	16	-	-	-	-	4	4
Ms E C Holley	16	16	1	1	4	4	-	-
Mr S P Roche**	16	16	1	1	-	-	-	-
Mr M Hampton	15	16	-	-	4	4	4	4
Ms L Ausburn	16	16	-	-	4	4	-	-
Mr G Masters	16	16	-	-	-	-	-	-

* Number of meetings held during the time the Director held office or was a member of the committee during the period.

** Mr Robinson and Mr Roche attended all Audit and Risk and Remuneration Committee meetings by invitation.

All Directors who are not members of Committees are invited to attend Committee Meetings.

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Directors' report continued

CORPORATE GOVERNANCE STATEMENT

The Board recognises the importance of a strong governance framework and culture throughout the organisation. During the year ended 31 August 2011, it continued to build on and enhance the established corporate governance framework.

The roles and responsibilities of the Board are set out in the Board Charter. This is located on the Company's website (www.api.net.au). To assist with the execution of its responsibilities, the Board has established a Remuneration Committee and an Audit and Risk Committee. Both committees have documented charters, which are also available through the Company website.

Under ASX Listing Rules and the ASX Corporate Governance Council's "Principles of Good Corporate Governance and Best Practice Recommendations" (the Principles) the consolidated entity is required to disclose in its annual report the extent of its compliance with the Principles. The Directors have implemented internal control processes for identifying, evaluating and managing significant risks to the achievement of the Company's objectives. These internal control processes cover financial, operating and compliance risks.

The Directors have received and considered the annual control certification by the Chief Executive Officer and the Chief Financial Officer in accordance with the Principles relating to financial and operating risks. Material associates, which API does not control, are not dealt with for the purposes of this statement. Throughout the reporting period, and at the date of signing of this annual report the consolidated entity was in compliance with the Principles in all material respects.

Also available on the Company's website are the following policies:

- Code of Conduct and Ethics;
- Continuous Disclosure;
- Securities Trading;

- Director Nomination, Selection and Induction;
- Shareholder Communication Policy; and
- Diversity Policy.

The key initiatives completed or in progress during the current year, include:

- Financial policies and procedures are continually reviewed and updated where appropriate by management, prior to review and approval by the Audit and Risk Committee;
- An employee Code of Conduct and Ethics policy is in place and is available on the Company's website. This is planned to be reviewed over each year, and re-communicated to all employees;
- Implementing a Diversity Policy, which is available on the Company's website. A summary of the Policy, key statistics and initiatives already undertaken by the Company are noted in the Achieving Diversity section of this report; and
- A broader review of all corporate governance policies undertaken to ensure alignment with ASX Corporate Governance Council recommendations including the amendments to the 2nd edition of the Corporate Governance Principles and Recommendations in relation to diversity, remuneration, trading policies and briefings which are to apply from 1 January 2011.

The Board has continued the process of review and renewal including:

- The appointment of Mr Gerard Masters as an additional Non-executive independent Director; and
- The Board continues to be comprised of a majority of independent Directors, the Board Committees have independent Chairpersons and a majority of independent Directors.

The Board confirms that the Company adheres to all of the ASX Recommendations other than the

Chairman being a Director of the Company's major shareholder.

BOARD OF DIRECTORS

Role of the Board

The Board's primary role is the protection and enhancement of long-term shareholder value.

To fulfil this role, the Board is responsible for the overall corporate governance of the consolidated entity including formulating its strategic direction, approving and monitoring capital expenditure, setting remuneration, appointing, removing and creating succession policies for Directors and senior executives, establishing and monitoring measurable objectives for achieving diversity, establishing and monitoring the achievement of management's goals and ensuring the integrity of internal control and management information systems. It is also responsible for approving and monitoring financial and other reporting.

The Board has delegated responsibility for operation and administration of the consolidated entity to the Managing Director and executive management. Responsibilities are delineated by formal authority delegations.

Board Processes, including Induction and Contact with the Business

To assist in the execution of its responsibilities, the Board has established a Remuneration Committee and an Audit and Risk Committee. These committees have written charters. The Board has also established a framework for the management of the consolidated entity including a system of internal control, a business risk management process and the establishment of appropriate ethical standards.

The Board currently holds eleven scheduled meetings each year, as well as other meetings to address any special matters that may arise.

The agenda for meetings is prepared in conjunction with the Chairman, the Managing Director and the Company Secretary. Standing items include the Managing Director's report (which

includes updates on key projects), financial reports, strategic matters, governance and compliance. Papers are circulated in advance. Executives are regularly involved in Board discussions, by invitation.

The consolidated entity has a formal process to educate new Directors about the nature of the business, current issues, the corporate strategy and the expectations of the consolidated entity concerning performance of Directors. Directors also have the opportunity to visit business operations and meet with management, employees and other stakeholders, to gain a better understanding of business operations. Directors are given access to continuing education opportunities to update and enhance their skills and knowledge.

Independent Professional Advice and Access to Company information

Each Director has the right of access to all relevant Group information and to the consolidated entity's executives and, subject to prior consultation with the Chairman, may seek independent professional advice from a suitably qualified adviser at the consolidated entity's expense. A copy of the advice received by the Director is to be made available to all other members of the Board.

Composition of the Board

The names of the Directors of the Company in office at the date of this report are set out in the beginning of the Directors' Report.

The composition of the Board is determined using the following principles:

- A minimum of three Directors, with a broad range of expertise in the industries in which the Company operates and government regulation of those industries, or in significant aspects of accounting and finance and risk management;
- A majority of non-executive Directors;

- A non-executive Director as Chairman;
- Enough Directors to serve on various committees without compromising their ability to discharge their responsibilities; and
- Re-election of Directors every three years (except for the Managing Director).

Independence of Directors

The ASX Recommendations define an independent Director as a Director who is not a member of management (a non-executive Director) and who:

- Is not a substantial shareholder of the Company or an officer of, or otherwise associated, directly or indirectly, with a substantial shareholder;
- Has not within the last three years been employed in an executive capacity by the Company or another group member, or been a Director after ceasing to hold any such employment;
- Within the last three years has not been a principal or employee of a material¹ professional adviser or a material¹ consultant to the Company or another group member;
- Is not a material¹ supplier or customer of the Company or another group member, or an officer of or otherwise associated directly or indirectly, with a material¹ supplier or customer;
- Has no material¹ contractual relationship with the Company or another group member other than as a Director of the Company; and
- Is free from any interest and any business or other relationship which could, or could reasonably be perceived to, materially¹ interfere with the Director's ability to act in the best interests of the consolidated entity.

The Board confirms that all Directors meet the stated requirements for independence as set out in the ASX

Recommendations, except that Mr Robinson and Mr Millner are Directors of the Company's major shareholder, Washington H Soul Pattinson and Company Limited. The Board does not consider that this relationship impacts their ability to bring an independent mind and judgement to the Board. They are subject to re-election every three years by shareholders at the AGM.

Nomination, Appointment and Retirement of Directors

The Board is responsible for succession planning, identification and appointment of new Board members and regularly reviews Board membership. The Board oversees the appointment and induction process for Directors and committee members, and the selection, appointment and succession planning process of the Company's Managing Director. The Board considers the appropriate skill mix, personal qualities, expertise and diversity of Board and committee positions, based on the broad criteria outlined above (see "Composition of the Board"). The Board identifies potential candidates with advice from an external consultant. Directors appointed by the Board must stand for election by shareholders at the Company's next annual general meeting.

The Board also conducts an annual review of the performance of the Managing Director and the senior executives reporting directly to him and the results are discussed at a Board meeting.

The Board undertakes an annual self assessment of its collective performance. The self assessment:

- Compares the performance of the Board with the requirements of the Board's charter;
- Sets forth the goals and objectives of the Board for the upcoming year; and
- Effects any improvements to the Board's charter deemed necessary or desirable.

¹ The Board considers, 'material', in this context, where any Director-related business relationship has represented, or is likely in future to represent the lesser of at least 10% of the relevant segment's or the Director-related business revenue. The Board considered the nature of the Company's competition, alternative available services or supplies and the size and nature of each Director-related business relationship, in arriving at this threshold.

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Directors' report continued

The Chairman annually assesses the performance of individual Directors and where necessary meets privately with each Director to discuss this assessment. The Chairman's performance is reviewed by the Board.

The Managing Director does not participate in the review process for appointment of non-executive Directors, nor in the review of his own performance by the Board.

REMUNERATION COMMITTEE

The Remuneration Committee has a documented charter approved by the Board. The Committee reviews and makes recommendations to the Board on remuneration packages and policies applicable to the Managing Director, senior executives and non-executive Directors. It is also responsible for share schemes, senior executive incentive programs and a range of employment related matters.

The members of the Remuneration Committee during the year ended 31 August 2011 were:

Mr M L Hampton – (Chair) Independent non-executive – appointed 2 September 2008;

Mr R D Millner – Non-executive – appointed 2 October 2007; and

Dr M R Wooldridge – Independent non-executive – appointed 2 October 2007.

The Managing Director is invited to Remuneration Committee meetings, as required, to discuss senior executives' performance and remuneration packages.

The Remuneration Committee formally meets twice a year and otherwise as required.

AUDIT AND RISK COMMITTEE

The Audit and Risk Committee has a documented charter, approved by the Board. The Committee's objective is to advise on the establishment and maintenance of a framework of internal control and appropriate ethical standards for the management of the consolidated entity.

The members of the Audit and Risk Committee during the year ended 31 August 2011 were:

Ms E C Holley (Chair) – Independent non-executive – appointed 19 December 2006;

Mr M L Hampton – Independent non-executive – appointed 7 August 2007; and

Ms L Ausburn – Independent non-executive – appointed 7 October 2008.

The external auditor, the Managing Director and Chief Financial Officer, are invited to the Audit and Risk Committee meetings at the discretion of the Committee.

The Audit and Risk Committee's charter provides procedures for the selection and appointment of the external auditor, and for the rotation of external audit engagement partners.

The responsibilities of the Audit and Risk Committee include reporting to the Board on:

- Reviewing the annual and half-year financial reports and other financial information distributed externally. This includes considering the appropriateness of new accounting policies to ensure compliance with Australian Accounting Standards and generally accepted accounting principles;
- Assessing corporate risk assessment processes;
- Monitoring non-audit services provided by the external auditor for consistency with maintaining the external auditor's independence. Each reporting period, the external auditor provides an independence declaration in relation to the year end audit or half year review;
- Providing advice to the Board in respect of whether the provision of the non-audit services by the external auditor is compatible with the general standard of independence of auditors imposed by the Corporations Act 2001;
- Reviewing remuneration and effectiveness of performance of the external auditor;

- Assessing the adequacy of the internal control framework and the Company's Code of Conduct Policy;
- Assessment of compliance with internal controls to ensure prompt and appropriate rectification of any deficiencies or breakdowns identified; and
- Monitoring the procedures to ensure compliance with the Corporations Act 2001, the ASX Listing Rules and all other regulatory requirements.

The Audit and Risk Committee reviews the performance of the external auditors on an annual basis and normally meets with them during the year to:

- Discuss the external audit plans, identifying any significant changes in structure, operations, and internal controls or accounting policies likely to impact the financial statements and to review the fees proposed for the audit work to be performed;
- Review the annual, half-year and preliminary final reports prior to lodgement with the ASX, and any significant adjustments required as a result of the auditor's findings, and to recommend Board approval of these documents, prior to announcement of results; and
- As required, organise, review and report on any special reviews or investigations deemed necessary by the Board.

RISK MANAGEMENT

Overview of the Risk Management System

The Board oversees the establishment, implementation, and annual review of the Company's Risk Management System. Management has established and implemented the Risk Management System for assessing, monitoring and managing all risks, including material business risks for the consolidated entity (including sustainability risk).

Managing Director and Chief Financial Officer Assurances

The Managing Director and Chief Financial Officer provide an assurance to the Board in respect of the annual and half yearly financial reports. The Managing Director and the Chief Financial Officer have given assurances with respect to this report that :

- The financial reporting risk management and associated compliance and controls have been assessed and found to be operating efficiently and effectively in all material respects;
- The operational and other compliance risk management processes have also been assessed and found to be operating efficiently and effectively in all material respects;
- The consolidated entity's books and records have been adequately maintained; and
- The consolidated entity's financial statements and notes required by the accounting standards, for external reporting, give a true and fair view of the financial position and performance and comply with the accounting standards (and any further requirements in the Corporations Regulations), and applicable ASIC Class Orders.

Risk Profile

Material risks to the operations of the consolidated entity arise from matters including actions by existing and emerging competitors, government policy changes, compliance with government regulation, environment, occupational health and safety, property, pharmacy guarantee arrangements, pharmacists or pharmacy groups failing to honour contractual obligations including trading terms, and the purchase, development and use of information systems.

The Board has the overall responsibility for the consolidated entity's risk management and internal control framework, with delegation to the Audit and Risk Committee to oversee the process and then report back to

the Board the status of material risks. The consolidated entity's internal compliance and control systems are designed to ensure effective and efficient operations, including financial reporting and compliance with laws and regulations, with a view to identifying, assessing and managing risk across the consolidated entity's business activities. The internal control systems which have been adopted by the consolidated entity aim to develop a culture which is able to identify, communicate and manage material risk.

The consolidated entity has a full time Risk and Internal Audit Manager to continuously review risk management and compliance with internal controls. This role will be supplemented with assistance from an external accounting firm specialising in risk management, as necessary.

KPMG assists the Board by providing the external audit service.

Quality and Integrity of Personnel

The consolidated entity recognises the importance of training and development, appropriate remuneration and incentives and regular performance reviews. It also encourages an environment of co-operation and constructive dialogue with employees and senior management. A formal succession plan is being finalised to ensure competent and knowledgeable employees fill senior positions when retirements or resignations occur. Succession planning is supported by a Leadership Development Program which identifies high calibre employees and prepares them for future leadership roles.

Financial reporting

Monthly results are reported against budgets approved by the Directors and revised forecasts for the year are prepared regularly.

Environmental regulation

The consolidated entity's operations are subject to environmental regulation under Commonwealth, State and New Zealand government legislation in relation to its

manufacture of pharmaceutical products, retail stores and pharmaceutical distribution facilities.

Pharmaceutical and toiletries product manufacture – manufacturing plants operate under licence requirements relating to waste disposal, water and air pollution.

Wholesale distribution – distribution facilities operate under licence requirements relating to waste disposal, water and air pollution.

The Board believes that the consolidated entity has adequate systems in place for the management of its environmental requirements and is not aware of any significant breach of these environmental requirements as they apply to the consolidated entity.

Conflict of Interest

Directors must keep the Board advised, on an ongoing basis, of any interest that could potentially conflict with those of the Company. The Board has developed procedures to assist Directors to disclose potential conflicts of interest.

Where the Board believes that a conflict exists for a Director on a Board matter, the Director concerned does not receive the relevant Board papers and is not present at the meeting whilst the item is considered. Details of Director related entity transactions with the Company and consolidated entity are set out in Note 29.

Code of Conduct and Ethics

The consolidated entity has advised each Director, manager and employee that they must comply with the Code of Conduct and Ethics. The Code, which is available on the Company's intranet and website, covers the following:

- Aligning the behaviour of the Board and management with the Code of Conduct and Ethics by maintaining appropriate core Company values and objectives;
- Usefulness of financial information by maintaining appropriate accounting policies and practices and disclosure;

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Directors' report continued

- Fulfilling responsibilities to customers and consumers by maintaining high standards of product quality, service standards, commitments to fair value, and safety of goods produced;
- Employment practices such as occupational health and safety, employment opportunity, the level and structure of remuneration, and conflict resolution;
- Responsibilities to community, such as environmental protection policies, supporting the community activities and sponsorships and donations;
- Responsibilities to the individual, such as privacy, use of privileged or confidential information, and conflict resolution;
- Fair dealing; and
- Compliance with laws and reporting suspected breaches of laws.

Trading in Company Securities by Directors and Employees

The key elements of the Company's Securities Trading Policy are:

- Identification of those restricted from trading – Directors, officers and employees may acquire shares in the Company:
 - during the period of fourteen days after the Annual General Meeting;
 - during the period of 60 days following the issue of the annual results and half yearly results;
 - during the period of 60 days following the release of a prospectus by API relating to the issue of shares in the Company; and
 - provided they are not in possession of price sensitive information not yet released to the market.
- Raising the awareness of legal prohibitions;
- Requiring details to be provided of intended trading in the Company's shares; and
- Identification of processes for unusual circumstances where discretions may be exercised in cases such as financial hardship.

Directors are prohibited from using margin loans to finance the purchase of shares in the Company or from trading in any financial product issued or created over the Company's shares.

The policy also details the insider trading provisions of the Corporations Act. The Company's policy is promoted to all Directors, officers and employees through publication on the Company's intranet and website.

COMMUNICATION WITH SHAREHOLDERS

The Company has a Shareholder Communication Policy which is designed to:

- Promote effective communication with existing and potential shareholders;
- Ensure ready access to understandable information about the Company including the existence of this policy; and
- Encourage shareholders to participate at Annual General Meetings.

In addition, the Company has a comprehensive Continuous Disclosure Policy which includes identifying matters that may have a material effect on the price of the Company's securities, notifying them to the ASX, posting them on the Company's website and issuing media releases.

In summary, the Continuous Disclosure Policy operates as follows:

- The Company's management is responsible for monitoring and recognising events which may have a material effect on the price or value of the Company's securities and reporting these events to the Managing Director, Chief Financial Officer, or Company Secretary; and
- The Managing Director, Chief Financial Officer and Company Secretary are responsible for interpreting the Company's policy and where necessary informing the Board. The Company Secretary is responsible for all communications with ASX. These matters are advised to ASX as they are discovered.

The Company's Shareholder Communication Policy and Continuous Disclosure Policy are promoted to all Directors, officers and employees through publication in the Company's intranet and website.

In addition:

- The full annual financial report is available on the Company's website and printed copies are made available to shareholders who elect to receive a copy. This information includes relevant information about the operations of the consolidated entity during the year, changes in the state of affairs and details of future developments;
- The half-yearly report contains summarised financial information and a review of the operations of the consolidated entity during the period. The half-year reviewed financial report is lodged with the Australian Securities and Investments Commission and the ASX;
- All announcements made to the market, and related information (including information provided to analysts or the media during briefings), are placed on the Company's website after they are released to the ASX; and
- The external auditor is requested to attend the Annual General Meeting to answer any questions concerning the audit and the content of the auditor's report.

ACHIEVING DIVERSITY

The Company has a Diversity Policy which is designed to clarify the Company's commitment to an inclusive workforce that embraces and promotes diversity in all respects, including gender, age, race, ethnicity, disability and cultural. Diversity will strengthen the Company's capacity to meet its objectives.

The Diversity Policy is promoted to all Directors, officers and employees through publication on the Company's intranet and website. It is to be read in conjunction with other policies of the Company, including the Director Nomination, Selection and Induction

Policy and the Code of Conduct and Ethics.

The Company's strong commitment to gender diversity is demonstrated at all levels of the Company. In the latest Australian Equal Opportunity for Women in the Workplace Agency (EOWA) reporting period to 31 May 2011, the Company recorded that women constitute three quarters of the Company's workforce, with 76% of all employees being women. The Board has seven non-executive Directors, two of whom are female. High female participation is also reflected among executive and senior management, with over 50% female representation recorded in the EOWA as at 31 May 2011. The Company expects high female representation to continue.

The Board has the responsibility of establishing and reviewing measurable objectives for achieving diversity. The Company is committed to rewarding performance and providing opportunities that allow all individuals to reach their full potential irrespective of background, difference or gender. Some key achievements and initiatives already undertaken are:

- Implementing succession planning for business critical roles and developing a talent matrix to identify and develop high potential employees;
- Ensuring that the Company identifies and attracts female talent to be considered for all Board and key management vacancies;
- Implementing training programs for all employees in similar positions to encourage employees to develop their skills and reach their full potential;
- Conducting a gender pay equality analysis and implementing action plans to address any areas of concern; and
- Promoting appropriate flexible working practices.

The Company has also established the Priceline Sisterhood to assist in raising awareness and funds for chosen diverse charities.

REMUNERATION REPORT - AUDITED

The Remuneration Report sets out remuneration for Non-executive Directors, the Managing Director and Chief Executive Officer (CEO) and Senior Executives. For the purpose of this Remuneration Report, Key Management Personnel (KMP) have authority and responsibility for planning, directing and controlling the activities of the consolidated entity and includes Directors of the Company and Senior Executives.

This report is prepared in accordance with Section 300A of the Corporations Act 2001 for the Company and its subsidiaries.

API's KMP at the date of this report are:

KMP Non-executive Directors

Peter Robinson	Chairman
Lee Ausburn	Director
Miles Hampton	Director
Carol Holley	Director
Gerard Masters	Director
Robert Millner	Director
Michael Wooldridge	Director

KMP Executives

Stephen Roche	Managing Director and Chief Executive Officer
Stephen Arthurson	Group General Manager, People
Graeme Fallet	Chief Financial Officer
Michael Langham	Group General Manager, Priceline
Tom Mullins	Group General Manager, Supply Chain
Peter Sanguinetti	Company Secretary and Chief Legal Counsel
Richard Vincent	Group General Manager, Pharmacy

This report has been audited by the Company Auditors, KPMG as required by Section 308(3C) of the Corporations Act 2001.

The Remuneration Committee is governed by its Charter (available on www.api.net.au) which was developed in line with ASX Corporate Governance Principles and Recommendations. The Charter specifies the purpose, authority, membership and activities of the Remuneration Committee.

Membership of the Committee consists of a majority of independent Non-Executive Directors. During 2010-2011 members of the Committee were Miles Hampton (Chair), Michael Wooldridge and Robert Millner.

The Remuneration Report is in sections as follows:

Section 1 Non Executive Director Remuneration

- A Policy & Principles
- B Remuneration Details (including the Chief Executive Officer)

Section 2 Executive Remuneration

- A Policy & Principles
- B Remuneration Structure
- C Short Term Incentive Plan (STIP)
- D Long Term Incentive Plan (LTIP)
- E Summary of Employment Contracts
- F Remuneration Details (excluding the Chief Executive Officer)

SECTION 1

NON-EXECUTIVE DIRECTOR REMUNERATION

A Policy and Principles

Non-Executive Directors' fees are determined within an aggregate Non-Executive Directors' pool limit. An annual total fee pool of \$595,000 was approved by shareholders at the 4 September 2000 AGM. Total Non-Executive Directors remuneration including

section 2

Directors' report continued

Board Committee fees and superannuation paid at the statutory prescribed rate for the year ended 31 August 2011 was \$567,694 which is within the approved annual fee pool.

Non-Executive Directors' remuneration reflects the responsibilities of Non-Executive Directors and is determined based

on the advice of independent remuneration consultants. Non-Executive Directors do not receive performance related remuneration.

Under the Board's Retirement Scheme, which was approved by Shareholders at the 1994 AGM retiring Non-Executive Directors are paid on a pro-rata basis up to ten (10) years service to a maximum of

three (3) times the average annual remuneration in the three (3) years preceding retirement. The retirement benefit is capped at \$220,000 per Director and applies only to Directors appointed prior to 9 September 2003. The Directors have agreed to freeze this benefit as at 31 August 2009.

B Remuneration of Directors (including the Chief Executive Officer)

DIRECTORS	Short Term			Total	Post employment super-annuation contributions	Other long term	Termination payments	Equity value of rights	Total	Proportion of remuneration performance related	Value of options as proportion of remuneration (%)
	Salary & Fees	Short-term incentives	Non-monetary benefits								
	\$	\$	\$	\$	\$	\$	\$	\$	\$	%	%
Non-executive											
Mr P R Robinson											
31 August 2011	139,700	–	^18,920	158,620	12,573	–	–	–	171,193	–	–
31 August 2010	135,467	–	–	135,467	12,192	–	–	–	147,659	–	–
Mr R D Millner											
31 August 2011	57,200	–	–	57,200	5,148	–	–	–	62,348	–	–
31 August 2010	55,467	–	–	55,467	4,992	–	–	–	60,459	–	–
Dr M R Wooldridge											
31 August 2011	68,200	–	–	68,200	6,138	–	–	–	74,338	–	–
31 August 2010	66,133	–	–	66,133	5,952	–	–	–	72,085	–	–
Ms E C Holley											
31 August 2011	79,200	–	–	79,200	7,128	–	–	–	86,328	–	–
31 August 2010	76,800	–	–	76,800	6,912	–	–	–	83,712	–	–
Mr M L Hampton											
31 August 2011	68,200	–	–	68,200	6,138	–	–	–	74,338	–	–
31 August 2010	66,133	–	–	66,133	5,952	–	–	–	72,085	–	–
Ms L Ausburn											
31 August 2011	57,200	–	–	57,200	5,148	–	–	–	62,348	–	–
31 August 2010	55,467	–	–	55,467	4,992	–	–	–	60,459	–	–
Mr G Masters*											
31 August 2011	51,212	–	–	51,212	4,609	–	–	–	55,821	–	–
31 August 2010	–	–	–	–	–	–	–	–	–	–	–
Executive											
Mr S P Roche – Managing Director & CEO											
31 August 2011	839,605	–	22,306	861,911	15,295	16,163	–	21,895	915,264	2	2
31 August 2010	819,566	196,000	10,191	1,025,757	14,584	88,684	–	39,816	1,168,841	20	3

* Appointed 7 September 2010

^Participation at API 100 year anniversary offshore conference

Retirement benefits for Non-executive Directors are included on an accrual basis. They are paid on a pro rata basis up to 10 years service to a maximum of three times the average annual remuneration in the three years preceding retirement. The retirement benefit is capped at \$220,000 and does not apply to Directors first appointed after 9 September 2003. On 31 August 2009 the Directors agreed to freeze this benefit. Other long term benefits shown for the Executive Director and Executives are the amounts charged against profits for the year for accrued Long Service Leave Entitlements.

SECTION 2

EXECUTIVE REMUNERATION INCLUDING THE CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR

A Policy & Principles

In determining Executive remuneration the Board aims to do the following:

- attract, retain and reward a capable Executive team;
- motivate the Executive team to meet industry challenges; and
- align Executive rewards to API's performance.

To achieve this, Executive remuneration is set with regard to the size and nature of the role with reference to market benchmarks and the performance of the individual in the role. Remuneration will incorporate to a significant degree, "at risk" elements for which the objectives are:

- link Executive reward with API's business objectives and financial performance;
- align the interests of Executives with Shareholders; and
- ensure total remuneration is competitive by market standards.

The Remuneration Committee has the role of reviewing and making recommendations to the Board on Executive remuneration at API. The Remuneration Committee obtains independent advice on the appropriateness of remuneration levels given trends in comparative companies. The Remuneration Committee, in general, obtains this independent advice every second year, however is authorised to seek advice if and when required.

B Remuneration Structure

The Executive Remuneration Framework as it applies to the Managing Director and Senior Executives comprises:

- Fixed remuneration; and
- Performance linked remuneration in the form of a

Short Term Incentive Plan (STIP) and a Long Term Incentive Plan (LTIP).

Fixed Remuneration

Fixed remuneration is a guaranteed salary level inclusive of any Fringe Benefits Tax (FBT) charges related to employee benefits including motor vehicles and employer contributions to superannuation funds.

Fixed remuneration levels are reviewed annually under normal circumstances and the opportunity for an annual review is included in the employment contracts of Executives at API. The Remuneration Committee has adopted a process that considers individual segment results and overall performance of the consolidated entity. In addition external consultants provide analysis and advice to ensure that the Managing Director and Senior Executives' remuneration is competitive in the market place. A Senior Executive's remuneration is also reviewed in the event of a promotion to a more senior executive role in the Company.

Performance Linked Remuneration

Performance linked remuneration includes both short term and long term incentives and is designed to reward the Managing Director and Senior Executives for meeting or exceeding their financial and non-financial objectives. The short term incentive is an 'at risk' incentive provided in the form of a cash payment while the long term incentive is provided as Performance Rights over Ordinary Shares under the rules of API's Long Term Incentive Plan.

C Short Term Incentive Plan (STIP)

The STIP is an annual 'at risk' incentive plan for the Managing Director and Senior Executives at API. At the start of each year the Remuneration Committee sets a 'scorecard' of performance conditions for the STIP as follows:

- Group Net Profit After Tax (NPAT); and

- Other financial and non-financial measures tailored for each business segment.

Group NPAT is the key budgetary and financial performance measure for API. Other performance measures are selected to support the Company's Strategic Plan either at a Group or business segment level. These measures vary by business segment however each 'scorecard' includes a measure related to Earnings Before Interest and Tax (EBIT), Return on Net Assets (RONA), Return on Capital Employed (ROCE) and in relation to Supply Chain, overall cost measurement.

A base, target and maximum level of performance is set each year for each scorecard measure. At the conclusion of the year the Board assesses performance against Group and Segment Scorecard targets. STIP is payable upon the achievement of a number of measures with 80% of the total maximum percentage based on key financial objectives and 20% based on non-financial or individual objectives.

The Board retains absolute discretion over all awards made under the incentive award plans at API, including the STIP. The STIP provides an annual cash incentive that is calculated based on financial year ends and is based on a maximum percentage of the Executive's total remuneration.

Managing Director and Chief Executive Officer

The STIP provides for a maximum payment of 100% of Fixed Remuneration only if NPAT achieved is at a level which is 130% of the budgeted target. At target, Mr Roche's STIP equates to 65% of Fixed Remuneration.

Senior Executives

The STIP provides for a maximum payment of 40% of Fixed Remuneration only if NPAT achieved is at a level which is 130% of the budgeted target. At target, Senior

section 2

Directors' report continued

Executives STIP equates to 20% of Fixed Remuneration.

During the 2010-11 financial year there was no Short Term Incentive awarded to the Managing Director or Senior Executives as relevant targets were not met.

D Long Term Incentive Plan (LTIP)

The Remuneration Committee has responsibility for API's Long Term Incentive Plan (LTIP). The Plan was established during the year ended 30 April 2006. The Remuneration Committee is responsible for awards to be granted under the Plan as well as overseeing administration of the Plan. Part of the administration is the determination of the performance conditions associated with each grant.

The LTIP involves the granting of rights over API shares. If performance conditions are satisfied the Rights vest and convert to API shares on a one-for-one basis. If performance conditions are not met, the Rights lapse. Under the LTIP, shares can be purchased on market on behalf of the participant or new shares issued by the Company. If any vesting is satisfied through the achievement of a performance criteria, a participant has six (6) months from that time to exercise it and be provided with shares in API. Performance conditions will be tested only once and any Performance Rights that do not meet the performance conditions will lapse and will not be re-tested. The Company has a policy whereby Directors and employees are prohibited from dealing in financial products issued or created over or in respect of securities (eg hedges or derivatives) which have the effect of reducing or eliminating the risk associated with any equity incentives that may be offered from time to time.

The LTIP is in the form of a grant of 'rights to shares' for exceptional performance in the achievement of Return on Equity (ROE) across a three year period. The performance

condition is based on the actual ROE achieved by the consolidated entity during the three (3) year period commencing at the beginning of the performance period when compared to the target ROE set by the Board for the same period (Target ROE). In both cases, ROE is expressed as a percentage created by dividing the net profit after tax for the relevant financial period by total shareholder equity for the relevant financial year. After consultation with remuneration advisors, ROE was chosen as a more appropriate market benchmark measure to reflect the value created by executives for shareholders. Previous LTIP measures which included Total Shareholder Return (TSR) compared to comparator peer companies was affected by external factors irrespective (to some extent) of executive performance.

Managing Director and Chief Executive Officer

The LTIP provides for Performance Rights equivalent in value to 40% of Fixed Remuneration.

Senior Executives

The LTIP provides for Performance Rights equivalent in value to 25% of Fixed Remuneration.

2008 grant

During the 2010-11 financial year the 279,600 Performance Rights relating to the 2008 grant lapsed as the hurdles set for this grant were not achieved.

2009 grant

At 12 May 2010, performance rights (the 2009 grant) were granted with a performance period commencing 1 September 2009 and ending 31 August 2012. The performance condition, being API's return on equity (ROE) for the exercise of performance rights will be assessed on 31 October 2012. The ROE performance condition has the effect that:

- if a cumulative ROE of 21.1% is achieved for the three year

period ending 31 August 2012, then 50% of the Rights will vest;

- if a cumulative ROE of 25.3% is achieved for the three year period ending 31 August 2012, then 100% of the Rights will vest; and
- if the cumulative ROE is between these two levels, then the number of rights that vest will be calculated on a straight line proportional basis.

2010 grant

At 10 January 2011, further performance rights (the 2010 grant) were granted with a performance period commencing 1 September 2010 and ending 31 August 2013. The performance condition, being API's return on equity (ROE) for the exercise of performance rights will be assessed on 31 October 2013.

The performance condition for the performance rights is designed to take account of an absolute measure, being the consolidated entity's return on equity (ROE) over the performance period for the 2009 grant.

The ROE performance condition has the effect that:

- if a cumulative ROE of 18.5% is achieved for the three year period ending 31 August 2013, then 50% of the Rights will vest;
- if a cumulative ROE of 25.0% is achieved for the three year period ending 31 August 2013, then 100% of the Rights will vest; and
- if the cumulative ROE is between these two levels, then the number of rights that vest will be calculated on a straight line proportional basis.

E Employment Contracts

The Company has entered into service contracts with KMP. These contracts outline the components of remuneration paid to them but do not prescribe how remuneration levels are modified from year to

year. Remuneration levels are reviewed each year to take into account cost-of-living changes, any change in the scope of the role performed, and any other changes required to meet the principles of the Company's remuneration policy outlined earlier.

Mr Stephen Roche, the Company's Managing Director and CEO, has a contract of employment with the Company dated 27 September 2006. The contract continues until the employment is terminated in accordance with the contract. The contract states the following in respect of cessation of his employment:-

- Mr Roche may resign from the Company by giving three (3) months written notice;

- The Company may summarily terminate Mr Roche's employment in specified circumstances with immediate effect and no termination benefits will apply other than accrued entitlements; and
- The Company may terminate Mr Roche's employment by the giving of twelve (12) months written notice and may make a termination payment in lieu of notice of up to twelve (12) months fixed remuneration.

Mr Roche is subject to a twelve (12) month non-compete restriction after cessation of his employment.

Mr Roche's service contract has no fixed term.

Other key management personnel have employment contracts with differing lengths of time, between six (6) and twelve (12) months, by

which they or the consolidated entity must advise each other in the event of an intended separation. The Company may summarily terminate the employment in specified circumstances with immediate effect.

KMP are subject to a non-compete restriction of up to twelve (12) months after cessation of employment.

F Remuneration of Executives

Details of the nature and amount of each major element of remuneration of each of the six named Company executives and relevant group executives who receive the highest remuneration (excluding the Chief Executive Officer disclosed separately on page 12 of this report) and other KMP are:

EXECUTIVES	Short Term			Total	Post employment super-annuation contributions	Other long term	Termination payments	Equity value of rights	Total	Proportion of remuneration performance related	Value of options as proportion of remuneration (%)
	Salary & Fees	Short-term incentives	Non-monetary benefits								
	\$	\$	\$	\$	\$	\$	\$	\$	\$	%	%
Mr R Vincent – Group General Manager, Pharmacy											
31 August 2011	444,600	–	22,864	467,464	15,295	8,527	–	11,836	503,122	2	2
31 August 2010	434,566	62,000	16,294	512,860	14,584	45,979	–	21,385	594,808	14	4
Mr P Sanguinetti – Company Secretary and Chief Legal Counsel											
31 August 2011	313,790	–	–	313,790	15,295	–	–	8,562	337,647	3	3
31 August 2010	306,514	37,440	–	343,954	14,584	–	–	15,242	373,780	14	4
Mr G Fallet – Chief Financial Officer (appointed 7 September 2009)											
31 August 2011	396,705	–	–	396,705	15,295	–	–	5,605	417,605	1	1
31 August 2010	381,574	61,800	–	443,374	14,584	–	–	22,337	480,295	18	5
Mr M Langham – General Manager, Priceline (key management person from 1 May 2008)											
31 August 2011	360,655	–	30,427	391,082	15,295	6,893	–	9,578	422,848	2	2
31 August 2010	352,241	40,800	–	393,041	14,584	12,964	–	17,543	438,132	13	4
Mr T Mullins – Group General Manager, Supply Chain (appointed as a KMP on 1 November 2010)											
31 August 2011	320,572	–	–	320,572	12,762	–	–	27,137	360,471	8	8
31 August 2010	–	–	–	–	–	–	–	–	–	–	–
Mr S Arthurson – Group General Manager, People (appointed as a KMP on 1 September 2010)											
31 August 2011	284,705	–	–	284,705	15,295	–	–	20,347	320,347	6	6
31 August 2010	–	–	–	–	–	–	–	–	–	–	–

(i) The value of performance rights is calculated at grant date using the Monte Carlo Simulation model and Black-Scholes Option Pricing model. The value is allocated to each reporting period evenly over the performance period.

(ii) Negative values shown in "Equity Value of Rights" above represent the value of forfeitures resulting from these executives exiting the Company and/or forfeiture due to failure to meet performance conditions.

section 2

Directors' report continued

FORMER EXECUTIVES	Short Term			Total	Post employment super-annuation contributions	Other long term	Termination payments	Equity value of rights	Total	Proportion of remuneration performance related	Value of options as proportion of remuneration (%)
	Salary & Fees	Short-term incentives	Non-monetary benefits								
	\$	\$	\$	\$	\$	\$	\$	\$	\$	%	%
Mr J Meiliunas – General Manager, Change Management (separated 15 September 2010)											
31 August 2011	23,742	–	–	23,742	1,267	–	–	–	25,009	–	–
31 August 2010	327,297	–	–	327,297	14,584	13,639	342,000	(11,803)	685,717	(2)	(2)
Mr P Hourihan – Group General Manager, Supply Chain (separated 3 September 2010)											
31 August 2011	21,820	–	–	21,820	1,267	–	–	–	23,087	–	–
31 August 2010	430,416	–	–	430,416	14,584	–	225,000	–	670,000	–	–
Mr A Killick – Chief Financial Officer (appointed 4 February 2008 – separated 16 October 2009)											
31 August 2011	–	–	–	–	–	–	–	–	–	–	–
31 August 2010	49,745	–	–	49,745	2,410	–	29,710	–	81,865	–	–

(i) The value of performance rights is calculated at grant date using the Monte Carlo Simulation model and Black-Scholes Option Pricing model. The value is allocated to each reporting period evenly over the performance period.

(ii) Negative values shown in "Equity Value of Rights" above represent the value of forfeitures resulting from these executives exiting the Company and/or forfeiture due to failure to meet performance conditions.

Analysis of bonuses included in remuneration - audited

Due to performance hurdles not being met no STI payment was awarded for the 2011 financial year.

Specific bonus and equity remuneration analysis - audited

Analysis of Performance Rights over Equity Instruments granted as Compensation

Details of the vesting profile of performance rights awarded as remuneration to each key management person are detailed below.

EXECUTIVE DIRECTOR	Performance Rights granted		Performance period commences	Included in Remuneration	% Vested in the period	% Forfeited in the period ^(A)	Financial period in which grant vests
	Number	Value					
Mr S Roche	279,600	81,084	1 September 2008	10,252	0%	100%	31 August 2011
	330,900	138,978	1 September 2009	(46,340)	0%	0%	31 August 2012
	*497,000	173,950	1 September 2010	57,983	0%	0%	31 August 2013
Executive Officers							
Mr P Sanguinetti	111,400	32,306	1 September 2008	4,085	0%	100%	31 August 2011
	127,400	53,508	1 September 2009	(17,841)	0%	0%	31 August 2012
	191,300	66,955	1 September 2010	22,318	0%	0%	31 August 2013
Mr S Arthursen	174,400	61,040	1 September 2010	20,347	0%	0%	31 August 2013
Mr T Mullins	232,600	81,410	1 September 2010	27,137	0%	0%	31 August 2013
Mr R Vincent	151,800	44,022	1 September 2008	5,566	0%	100%	31 August 2011
	178,000	74,760	1 September 2009	(24,927)	0%	0%	31 August 2012
	267,400	93,590	1 September 2010	31,197	0%	0%	31 August 2013
Mr M Langham	121,400	35,206	1 September 2008	4,451	0%	100%	31 August 2011
	145,500	61,110	1 September 2009	(20,376)	0%	0%	31 August 2012
	218,600	76,510	1 September 2010	25,503	0%	0%	31 August 2013
Mr G Fallet	159,500	66,990	1 September 2009	(22,337)	0%	0%	31 August 2012
	239,500	83,825	1 September 2010	27,942	0%	0%	31 August 2013

- The performance rights granted on 31 March 2009 (2008 grant) lapsed on 31 August 2011 without vesting.
- Performance rights were granted on 12 May 2010 with a performance period commencing on 1 September 2009 and ending 31 August 2012 (the 2009 grant). The performance condition for the exercise of performance rights will be assessed on 31 Oct 2012. The fair value of the performance rights is dependent upon the ROE performance condition for the entire grant and is \$0.42 per share.
- Performance rights were granted on 10 January 2011 with a performance period commencing on 1 September 2010 and ending 31 August 2013 (the 2010 grant). The performance condition for the exercise of performance rights will be assessed on 31 Oct 2013. The fair value of the performance rights is dependent upon the ROE performance condition for the entire grant and is \$0.35 per share.

The performance rights were provided at no cost to the recipient.

(A) The % forfeited in the year represents the reduction from the maximum number of performance rights available to vest due to the performance criteria not being achieved.

* Subject to shareholder approval

CONSEQUENCES OF PERFORMANCE ON SHAREHOLDERS' WEALTH - AUDITED

In considering the consolidated entity's performance and the benefits for shareholder wealth, the Remuneration Committee has regard to a range of indicators in respect of senior executive remuneration and linked these to the previously described short and long term incentives.

The following table presents these indicators over 6 periods, spanning 1 May 2006 to 31 August 2011, showing the impact of the Company's performance on shareholder wealth, taking into account dividend payments, share price changes and returns of capital during the financial years:

	31 August 2011***	31 August 2010**	31 August 2009	31 August 2008	31 August 2007*	30 April 2007
Net (loss)/profit after tax (\$ thousand)	(23,310)	22,646	18,320	15,213	(2,598)	(11,485)
Dividends paid – cents per share	2.50	2.50	2.00	1.00	0.00	3.00
Share price at	0.23	0.43	0.75	0.69	1.85	2.20

* Four month financial period

** Dividend paid 15 December 2010

*** Final dividend of 1.50 cents per share payable 15 December 2011 (unfranked)

The Remuneration Report concludes at this point

PRINCIPAL ACTIVITIES

The principal activities of the consolidated entity during the course of the financial period were:

- the wholesale distribution of pharmaceutical and allied products;
- retail operations of the brands Priceline and Priceline Pharmacy;
- manufacture of pharmaceutical medicines and consumer toiletries;
- the distribution of pharmaceutical and medical consumable products to hospitals, through its associate CH2 Holdings Pty Ltd, in which the Company holds a 45.5% stake; and
- finance origination and retail services to pharmacists, including the retail banners of Soul Pattinson and Pharmacist Advice.

REVIEW OF OPERATIONS

For the year ended 31 August 2011 the Company reported a net loss after tax of \$23.3 million.

The Company's net loss for the year was significantly impacted by the following events.

- Following review of the Company's financial guarantee program during the year Directors determined that financial guarantee liabilities should be brought to account on balance sheet resulting in a \$50 million financial guarantee and impairment charge.

- The Company's Queensland Distribution Centre suffered material damage following the Queensland floods. Total flood related costs to 31 August 2011 were \$61.0 million with \$57.4 million recovered from insurance proceeds resulting in a \$3.6 million loss for the year. The Company reported a contingent asset of \$9.1 million on the basis of expectations that additional insurance proceeds totalling this amount will be recovered in the future.

The Company's reported revenue decreased by 7.6% to \$3.4 billion against a background of PBS reforms, the impact of a major supplier moving to a direct distribution model, customer losses following the Queensland floods and a challenging and competitive retail environment.

The Company's operating result included a number of other non-recurring items being settlement of the Company's claim with the New Zealand Internal Revenue Department, the effect of a recent Australian Tax office ruling that lease make-good provisions are non-deductible and a Community Service Obligation audit adjustment from prior years.

The Company's associate of which API did not have direct operational control accounted for profit of \$1.2 million, an increase of \$591,000 on the prior year.

The Company's capital expenditure reduced to \$18.2 million following the completion of the revitalise supply chain investment in 2010. The Company repaid \$15.9 million of its securitisation facility with gearing remaining stable at 22%.

During the year the Company extended its \$275 million securitisation facility until May 2013 and its \$70m million securitisation facility to May 2012.

section 2

Directors' report continued

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

There were no significant changes in the nature of the activities of the consolidated entity during the period.

DIVIDENDS

A dividend was paid during the year ended 31 August 2011 in respect of the year ended 31 August 2010. The dividend was at the rate of 1.5 cents per share, fully franked. The dividend totalled \$7.322 million and was paid on 15 December 2010.

An interim dividend of 1.0 cent per share amounting to \$4.881 million, fully franked in respect of half year ended 28 February 2011 was paid on 3 June 2011.

On 27 October 2011, a final dividend of 1.5 cents per share, unfranked to be paid on 15 December 2011 amounting to \$7.322 million was declared.

EVENTS SUBSEQUENT TO REPORTING DATE

Subsequent to 31 August 2011, the Company received commitments from its bankers (subject to final documentation) to extend the \$95.0 million cash advance facilities to May 2014. In addition the \$70.0 million Aspire securitisation facility was extended to May 2013.

On 20 October 2011, the Company obtained its lender's consents for breach of two loan covenants. The covenants relate to fixed charge cover and not achieving, during the twelve months ended 31 August 2011, a minimum performance target required under the lending terms. The basis of the performance target is the budgeted earnings before interest and taxes. The covenants apply to all Australian debt and no additional obligations were imposed by the lenders.

On 27 October 2011, a final dividend of 1.5 cents per share, unfranked to be paid on 15 December 2011, amounting to \$7,321,738 was declared.

Other than above, there has not arisen in the interval between the end of the financial period and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations or the state of affairs of the consolidated entity in future years.

LIKELY DEVELOPMENTS

The consolidated entity will continue to pursue its policy of improving the profitability and market share of each of its major operating businesses during the next financial year.

Further information regarding the business strategies of the consolidated entity and the expected results of those operations in future financial years have not been included in this report as disclosure of this information would likely result in unreasonable prejudice to the consolidated entity.

DIRECTORS' INTERESTS

The relevant direct and indirect and beneficial interest of each Director, in the share capital of the Company, as notified by the Directors to the Australian Securities Exchange in accordance with section 205G(1) of the Corporations Act 2001 at the date of this report is as follows:

	Ordinary Shares	Performance Rights over Ordinary Shares
Mr P R Robinson	202,168	–
Ms E C Holley	16,667	–
Mr R D Millner	755,001	–
Mr S P Roche	676,667	827,900
Dr M R Wooldridge	–	–
Mr M Hampton	200,000	–
Ms L Ausburn	83,334	–
Mr G Masters	93,000	–

PERFORMANCE RIGHTS GRANTED TO DIRECTORS AND OFFICERS OF THE COMPANY

Details of the performance rights granted to Directors and officers of the Company are set out in the Remuneration Report.

INSURANCE AND INDEMNIFICATION OF DIRECTORS AND OFFICERS

During the year the Company paid a premium in respect of a contract insuring its Directors and officers against all liabilities to another person (other than the Company or a related body corporate) that may arise from their position, except where the liability arises out of conduct involving a lack of good faith. The contract covers any past, present or future Director, secretary, executive officer or employee of the Company and its controlled entities. Further details have not been disclosed due to confidentiality provisions of the contract of insurance.

NON-AUDIT SERVICES

During the year KPMG, the Company's auditor, has performed certain other services in addition to their statutory duties.

The Board has considered the non-audit services provided during the period by the auditor and in accordance with written advice provided by resolution of the Audit and Risk Committee, is satisfied that the provision of those non-audit services during the period by the auditor is compatible with, and did not compromise, the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- All non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Audit and Risk Committee to ensure they do not impact the integrity and objectivity of the auditor; and
- The non-audit services provided do not undermine the general principles relating to auditor independence as set out in APES 110 Code of Ethics for Professional

Accountants, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company, or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services provided during the period are set out below.

Amounts Paid to Auditor

In AUD

Audit Services

KPMG Australia

- Audit and review of financial reports

Overseas KPMG firms

- Audit and review of financial reports

Other Services

Auditors of the Company

KPMG Australia

- Other assurance services
- Other advisory services

Overseas KPMG firms

- Taxation services

Total

	Year ended 31 August 2011	Year ended 31 August 2010
	500,800	521,864
	33,200	32,200
	534,000	554,064
	5,250	5,000
	40,109	59,137
	11,400	41,914
	590,759	660,115

Lead Auditor's Independence Declaration

The Lead Auditor's Independence Declaration is set out on page 20 and forms part of the Directors' report for the financial year ended 31 August 2011.

Rounding off of Amounts

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report and the Directors' report have been rounded off to the nearest thousand dollars, unless otherwise stated.

Dated at Melbourne, 11 November 2011

Signed in accordance with a resolution of the Directors:



Peter R. Robinson

Director

section 3

Auditor's Independence Declaration

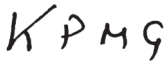


LEAD AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

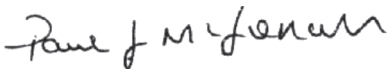
To: the Directors of Australian Pharmaceutical Industries Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 August 2011 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the audit.



KPMG



Paul J McDonald

Partner

Melbourne,

11 November 2011

section 4

Income statement

In thousands of AUD	Note	Consolidated	
		Yearended 31 August 2011	Yearended 31 August 2010
Revenue	3	3,425,890	3,706,207
Cost of sales		(3,056,098)	(3,338,186)
Gross profit		369,792	368,021
Other income and expense	3	11,779	12,779
Warehousing and distribution expenses		(125,369)	(120,198)
Marketing and sales expenses	6	(193,680)	(139,846)
Administration and general expenses		(65,557)	(62,686)
Loss from Queensland floods	7	(3,627)	-
Result from operating activities		(6,662)	58,070
Financial income		3,147	3,012
Financial expenses		(27,690)	(26,051)
Net financing costs	5	(24,543)	(23,039)
Share of profit of associates	14	1,228	637
(Loss)/profit before tax		(29,977)	35,668
Income tax benefit/(expense)	8	6,667	(13,022)
(Loss)/profit for the period		(23,310)	22,646
Attributable to:			
Equity holders of the Company		(23,310)	22,646
(Loss)/profit for the period		(23,310)	22,646
Earnings per share (cents per share):			
Basic earnings per share from continuing operations	9	(4.8)	5.1
Diluted earnings per share from continuing operations	9	(4.8)	5.1

Notes to the financial statements are annexed.

section 5

Statement of comprehensive income

In thousands of AUD	Consolidated	
	Yearended 31 August 2011	Yearended 31 August 2010
(Loss)/profit after income tax for the period	(23,310)	22,646
Foreign exchange translation differences	622	(1,291)
Effective portion of changes in fair value of cash flow hedges, net of tax	(2,035)	–
Other comprehensive expense for the period, net of Income tax	(1,413)	(1,291)
Total comprehensive (expense)/income for the period attributable to equity holders of the Company	(24,723)	21,355

Notes to the financial statements are annexed.

section 6

Statement of financial position

		Consolidated	
In thousands of AUD	Note	As at 31 August 2011	As at 31 August 2010
Assets			
Cash and cash equivalents	28	34,605	29,431
Trade and other receivables	10	586,536	700,278
Inventories	11	320,154	322,148
Total current assets		941,295	1,051,857
Trade and other receivables	10	72,920	73,759
Investments accounted for using the equity method	14	27,815	24,304
Deferred tax assets	15	34,184	9,646
Property, plant and equipment	16	119,929	128,285
Intangible assets	17	194,761	197,092
Total non-current assets		449,609	433,086
Total assets		1,390,904	1,484,943
Liabilities			
Trade and other payables	18	572,338	659,123
Loans and borrowings	19	184,815	201,161
Employee benefits	20	13,942	13,507
Provisions	21	41,337	2,631
Income tax payable	13	4,576	3
Total current liabilities		817,008	876,425
Trade and other payables	18	11,330	10,544
Loans and borrowings	19	469	490
Employee benefits	20	3,935	3,621
Provisions	21	3,795	2,688
Total non-current liabilities		19,529	17,343
Total liabilities		836,537	893,768
Net assets		554,367	591,175
Equity			
Share capital		566,461	566,461
Reserves		(6,347)	(5,052)
Retained earnings		(5,747)	29,766
Total equity		554,367	591,175

Notes to the financial statements are annexed.

section 7

Statement of cash flows

		Consolidated	
In thousands of AUD	Note	Year ended 31 August 2011	Year ended 31 August 2010
Receipts from customers		3,876,926	4,024,829
Payments to suppliers and employees		(3,849,113)	(3,942,192)
Cash generated from operations		27,813	82,637
Interest received		6,737	2,892
Financing costs paid		(27,690)	(26,051)
Insurance proceeds received- Queensland flood	7	53,304	-
Income taxes paid		(11,952)	(16,128)
Net cash from operating activities	28	48,212	43,350
Cash flows from investing activities			
Proceeds from sale of stores, property, plant and equipment		5,719	80
Acquisition of property, plant and equipment		(18,231)	(33,651)
Deferred consideration received		-	9,600
Loans to pharmacists		(1,234)	-
Repayment of loan from associate		-	10,000
Repayment of loan from employee		89	86
Payment for intangibles		(102)	(842)
Net cash from investing activities		(13,759)	(14,727)
Cash flows from financing activities			
Proceeds from issue of shares, net of share issue costs		-	145,660
Disinvestment of securitised receivables		(15,905)	(139,782)
Payment of finance lease liabilities		(1,151)	(882)
Dividends paid		(12,203)	(10,028)
Net cash from financing activities		(29,259)	(5,032)
Net increase in cash and cash equivalents		5,194	23,591
Cash and cash equivalents at the beginning of the period		29,431	5,856
Effect of exchange rate fluctuations on cash held		(20)	(16)
Cash and cash equivalents at the end of the period	28	34,605	29,431

Notes to the financial statements are annexed.

section 8

Statement of changes in equity

In thousands of AUD	Share Capital	Retained Earnings	Translation Reserve	Hedging Reserve	Equity Reserve	Total Equity
Balance at 1 September 2010	566,461	29,766	(5,514)	–	462	591,175
Total comprehensive income for the period						
Loss after tax	–	(23,310)	–	–	–	(23,310)
Total other comprehensive expense	–	–	622	(2,035)	–	(1,413)
Total comprehensive (expense)/ income for the period	–	(23,310)	622	(2,035)	–	(24,723)
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Dividends to equity holders	–	(12,203)	–	–	–	(12,203)
Share based payment transactions	–	–	–	–	118	118
Total contributions by and distributions to owners	–	(12,203)	–	–	118	(12,085)
Balance at 31 August 2011	566,461	(5,747)	(4,892)	(2,035)	580	554,367

In thousands of AUD	Share Capital	Retained Earnings	Translation Reserve	Hedging Reserve	Equity Reserve	Total Equity
Balance at 1 September 2009	419,499	*17,148	(4,223)	–	316	432,740
Total comprehensive income for the period						
Profit after tax	–	22,646	–	–	–	22,646
Total other comprehensive expense	–	–	(1,291)	–	–	(1,291)
Total comprehensive income/ (expense) for the period	–	22,646	(1,291)	–	–	21,355

In thousands of AUD	Share Capital	Retained Earnings	Translation Reserve	Hedging Reserve	Equity Reserve	Total Equity
Balance at 31 August 2010	566,461	29,766	(5,514)	–	462	591,175
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Issue of ordinary shares	146,962	–	–	–	–	146,962
Dividends to equity holders	–	(10,028)	–	–	–	(10,028)
Share based payment transactions	–	–	–	–	146	146
Total contributions by and distributions to owners	146,962	(10,028)	–	–	146	137,080

* Restated due to the change in accounting policy.

Notes to the financial statements are annexed.

section 9

Notes to the consolidated financial statements

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Reporting Entity

Australian Pharmaceutical Industries Limited (the 'Company') is a Company domiciled in Australia whose shares are publicly traded on the Australian Stock Exchange. The summarised information from the Company's financial statements are included in note 12.

The consolidated financial report of the Company included herein comprises the Company and its subsidiaries (together referred to as the 'consolidated entity') and the consolidated entity's interest in associates and jointly controlled entities.

The financial report was authorised for issue by the Directors on 11 November, 2011.

(b) Statement of Compliance and Basis of Preparation

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards ('AASBs') adopted by the Australian Accounting Standards Board ('AASB') – including Australian Interpretations and the Corporations Act 2001. The financial report of the consolidated entity also complies with International Financial Reporting Standards (IFRS) and interpretations adopted by the International Accounting Standards Board.

The financial report is presented in Australian dollars, which is the Company's and consolidated entity's functional currency.

The financial report is prepared on the historical cost basis except for derivative financial instruments and share based payments which are stated at their fair value.

The consolidated entity is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report and Directors' Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

The preparation of a financial report in conformity with Australian Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in future periods.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements include:

- Intangibles - measurement of recoverable amount

of cash generating units;

- Employee benefits - measurement of defined benefit obligations and share based payments;
- Provisions - measurement of recoverable amount of receivables and inventory; and
- Financial instruments – measurement of recoverable amount of financial assets and fair value of derivatives.

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial report by all entities in the consolidated entity.

Issued standards not early adopted

The following standards, amendments to standards and interpretations have been identified as those which may impact the entity in the period of initial application. They are available for early adoption at 31 August 2011 but have not been applied in preparing this financial report.

- AASB 124 *Related Party Disclosures* (revised December 2009) simplifies the related party disclosures. These amendments, which will become mandatory for the consolidated entity's 31 August 2012 financial statements are not expected to have any impact on the financial statements.
- AASB 9 *Financial Instruments* includes requirements for the classification and measurement of financial assets resulting from the first part of Phase 1 of the project to replace AASB 139 *Financial Instruments: Recognition and Measurement*. AASB 9 will become mandatory for the consolidated entity's 31 August 2014 financial statements. Retrospective application is generally required, although there are exceptions, particularly if the entity adopts the standard for the year ending 31 August 2012 or earlier. The consolidated entity has not yet determined the potential effect of the standard.
- AASB 119 *Employee Benefits* - The consolidated entity has a defined benefit superannuation plan accounted for under the corridor method and will need to revise its accounting for, and disclosures relating to the plan upon adoption of this standard. These changes will have an impact on the amounts recognised in profit and loss relating to defined benefit plans. The consolidated entity will need to re-consider the pre-existing classification of annual and long service leave. If the leave is not expected to be taken within the next 12 month period it will need to be discounted as a non-current liability. The discounting will not impact disclosure of annual leave as current due to the requirement to provide leave within the 12 month period if requested. The consolidated entity has not yet quantified the impact of this change. The revised standard is effective for reporting periods beginning on or after 1 July 2011.

- AASB 10 *Consolidated financial statements* introduces a single model to determine which investees should be consolidated. The new control model considers substantive potential voting rights when assessing control, de facto control and the agent vs. principle contract. The consolidated entity has chosen not to early adopt this standard. The consolidated entity has not yet quantified the impact of this change, if any.
- AASB 12 *Disclosures of interests* in other entities requires expanded disclosures for subsidiaries, associates, joint arrangements and unconsolidated structured entities. The consolidated entity has chosen not to early adopt this standard. The consolidated entity has not yet quantified the impact of this change.
- AASB 13 *Fair value measurement* will result in additional fair value hierarchy disclosures in the financial statements regarding non-financial assets and liabilities. The consolidated entity has chosen not to early adopt this standard. The consolidated entity has not yet quantified the impact of this change.
- In addition to the above, certain new accounting standards, amendments to the standards and interpretations have been issued that are not mandatory for 31 August 2011 reporting period and have not been applied in preparing these consolidated financial statements. The Company's assessment indicates that none of these are expected to have a material impact on the consolidated financial statements of the consolidated entity in the period of initial application.

(c) Going concern basis of accounting

In preparing the Financial Report, the Directors made an assessment of the ability of the consolidated entity to continue as a going concern, which contemplates the continuity of business operations, realisation of assets and settlement of liabilities in the ordinary course of business.

At 31 August 2011 the consolidated entity had classified finance facilities as current liabilities. Subsequent to balance date the facilities have been re-negotiated and the facilities now have maturity dates more than 12 months from balance date.

Based on budgeted trading results and cash flows, the Directors believe that the consolidated entity will continue to generate sufficient operating cash flows to meet its funding requirements and meet its debt covenants. However, the trading and cash flow budgets are necessarily based on best-estimate assumptions that may or may not occur as expected and are subject to influences and events outside the control of the consolidated entity.

Should the ability of the consolidated entity to realise

sufficient cash flows from trading operations be restricted, the consolidated entity will institute additional measures to preserve cash. These may include (but are not limited to) drawing down committed but undrawn debt facilities, and restriction of capital and operating expenditures.

In addition to the foregoing, the consolidated entity has long term loans to certain pharmacy customers and has guaranteed the bank facilities of some pharmacy customers. The obligations under these guarantees and the recovery of the trade debt and loans is dependent on the trading results and cash flows of the pharmacy customers and the value of collateral held over the receivables, which are subject to uncertainties arising from general trading conditions, the regulatory environment, and other factors impacting the pharmacy industry.

After making enquiries, and considering the uncertainties described above, the Directors have a reasonable expectation that the consolidated entity has the ability to continue to operate and meet its obligations as they fall due for the foreseeable future. For these reasons, they continue to adopt the going concern basis in preparing the financial report and accordingly no adjustments have been made relating to the recoverability and classification of asset carrying amounts and classification of liabilities that might be necessary should the consolidated entity not continue as a going concern.

(d) Basis of Consolidation

(i) *Subsidiaries*

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Investments in subsidiaries are carried at their cost, less any impairment, in the Company's financial statements.

(ii) *Associates*

Associates are those entities for which the consolidated entity has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the consolidated entity's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the consolidated entity's share of losses exceeds its interest in an associate, the consolidated entity's carrying amount is reduced to nil and recognition of further losses is discontinued

section 9

Notes to the consolidated financial statements continued

SIGNIFICANT ACCOUNTING POLICIES continued

except to the extent that the consolidated entity has an obligation or has made payments on behalf of an associate.

In the Company's financial statements, investments in associates are carried at cost.

(iii) *Transactions Eliminated on Consolidation*

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Unrealised gains arising from transactions with associates and jointly controlled entities are eliminated to the extent of the consolidated entity's interest in the entity with adjustments made to the "Investment in associates" and "Share of associates net profit" accounts.

Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Gains and losses are recognised as the contributed assets are consumed or sold by the associates and jointly controlled entities or, if not consumed or sold by the associate or jointly controlled entity, when the consolidated entity's interest in such entities is disposed of.

(e) Foreign Currency

(i) *Foreign Currency Transactions*

Transactions in foreign currencies are translated to the functional currencies of the consolidated entity companies at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement in other income and expense. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair value was determined.

(ii) *Financial Statements of Foreign Operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to Australian dollars at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to Australian dollars at rates approximating to the foreign exchange rates ruling at the dates of the transactions.

Foreign exchange differences arising on translation are recognised in other comprehensive income, and presented in the foreign currency translation reserve in equity.

(f) Financial Instruments

(i) *Non-derivative Financial Instruments*

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus, for instruments not measured at fair value through profit or loss, any directly attributable transaction costs, except as described below. Any financial instruments subject to material deferred settlement terms are recognised at their present value discounted using an interest rate that reflects the credit risk applicable to the counterparty equivalent to the extent of any underlying security. The unwinding of discounting is recognised in net finance costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the consolidated entity becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the consolidated entity's contractual rights to the cash flows from the financial assets expire or if the consolidated entity transfers the financial asset of another party without retaining control of substantially all risks and rewards of the asset. Regular purchases and sales of financial assets are accounted for at trade date, i.e. the date that the consolidated entity commits itself to purchase or sell the asset. Financial liabilities are derecognised if the consolidated entity's obligations specified in the contract expire or are discharged or cancelled.

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the consolidated entity's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Held to Maturity Investments

If the consolidated entity has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortised cost using the effective interest method, less any impairment losses.

Other

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

(ii) *Derivative Financial Instruments*

The consolidated entity sometimes holds derivative financial instruments to hedge its interest rate and foreign currency risk exposures.

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Cash Flow Hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in other comprehensive income to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in other comprehensive income remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in other comprehensive income is transferred to profit or loss in the same period that the hedged item affects profit or loss.

(iii) *Ordinary Shares*

Incremental costs directly attributable to issue of ordinary shares are recognised as a deduction from equity, net of any related income tax benefit.

Dividends

Dividends are recognised as a liability in the period in which they are declared.

(iv) *Financial guarantees*

Financial guarantees are initially recognised at fair value. The fair value is amortised as an expense through the income statement over the life of the guarantee. Subsequent to initial measurement, the guarantee is measured at the higher of the amortised balance of the guarantee or the value of the guarantee determined in accordance with AASB 137 *Provisions, Contingent assets and liabilities*.

During the current period, the consolidated entity has assessed that it is now probable that guarantees will be called in the foreseeable future, and accordingly recorded a provision for the maximum potential obligation that the consolidated entity has an obligation to meet at the time the assessment was made. The liability has not been discounted as the consolidated entity has a current obligation to settle the liability. No amounts have been paid in relation to these guarantees during the current period.

(v) *Securitised receivables*

Securitised receivables are recognised on the balance sheet to reflect the fact that the consolidated entity assumes risks and rewards of the receivables collection performance.

(g) Property, Plant and Equipment

(i) *Recognition and Measurement*

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the equipment is capitalised as part of that equipment.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) *Disposal of property, plant and equipment*

Property, plant and equipment is derecognised when scrapped or disposed of. For store sales, a disposal is considered to have taken place when the significant risks and rewards of ownership have passed to the acquirer, there is no continuing involvement in the asset and it is probable that the economic benefits associated with the disposal will flow to the consolidated entity.

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Notes to the consolidated financial statements continued

SIGNIFICANT ACCOUNTING POLICIES continued

The proceeds are recognised at the fair value of consideration received and a gain or loss on disposal is recognised equal to the difference between this amount and the carrying value of the asset disposed of.

(iii) *Subsequent Costs*

The consolidated entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied within the item will flow to the consolidated entity and the cost of the item can be measured reliably. All other costs are recognised in profit and loss as an expense as incurred.

(iv) *Depreciation*

Depreciation is charged to profit and loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated.

The estimated useful lives in the current and comparative periods are as follows:

- buildings 40 years
- plant and equipment 3-15 years
- fixtures and fittings 3 - 20 years

The residual value, the useful life and the depreciation method applied to an asset are reassessed at least annually.

(h) *Intangible Assets*

(i) *Goodwill*

Business Combinations prior to 1 May 2004

Goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous GAAP.

Business Combinations since 1 May 2004

All business combinations are accounted for by applying the purchase method. Goodwill represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired.

Goodwill is stated at cost less any accumulated impairment losses. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate. Negative goodwill arising on an acquisition is recognised directly in profit or loss.

(ii) *Brand Names*

Brand names acquired are included in the financial statements at cost less impairment losses.

Brand names are not amortised as the Directors believe the useful lives of these assets are considered indefinite at this point of time. The consolidated entity's

brand names have an unlimited legal life and based on industry experience it is rare for leading brand names to disappear or become commercially or technically obsolete. If an event occurs which results in an impairment of the value of a brand name then the difference between recoverable amount and carrying value is charged against profit and loss in the year in which the event occurred.

Independent valuations of brand names are obtained during the year of acquisition. Expenditure incurred in developing, maintaining and enhancing brand names is charged against profit and loss in the year in which it is incurred.

(iii) *Research and Development*

Expenditure on research activities, undertaken with the prospect of gaining new technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the consolidated entity has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and appropriate proportion of overheads. Other development expenditure is recognised in profit and loss as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses.

(iv) *Other Intangible Assets*

Other intangible assets that are acquired by the consolidated entity are stated at cost less accumulated amortisation and impairment losses.

(v) *Subsequent Expenditure*

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(vi) *Amortisation*

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets unless such lives are indefinite. Other intangible assets are amortised from the date they are available for use. The estimated useful lives in the current and comparative periods are as follows:

- capitalised software development expenses 2-5 years

(i) *Inventories*

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the

estimated costs of completion and selling expenses.

The cost of inventories is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition net of any rebates or trade discounts received or receivable. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

(j) Impairment

(i) Financial Assets

A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a debtor, restructuring of an amount due to the consolidated entity on terms that the consolidated entity would not consider otherwise, indications that a debtor or issuer will enter bankruptcy and the disappearance of an active market for a security. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of an impairment.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate, including cash flows from the realisation of security held, if applicable. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics. In determining the appropriate provision for impairment of pharmacy receivables, consideration is given to financial guarantees provided to individual debtors and debtor groups which are recorded as current liabilities where it is considered probable that the guarantees will be called. In assessing collective impairment the consolidated entity uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

All impairment losses are recognised in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the

impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

(ii) Non-Financial Assets

The carrying amounts of the consolidated entity's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, recoverable amount is estimated at each reporting date.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest group of assets that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of goodwill allocated to the cash generating unit and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(k) Leased Assets

Leases in terms of which the consolidated entity assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting

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Notes to the consolidated financial statements continued

SIGNIFICANT ACCOUNTING POLICIES continued

policy applicable to that asset.

Other leases are operating leases, the leased assets are not recognised in the consolidated entity's balance sheet.

(I) Employee Benefits

(i) Defined Contribution Plans

Obligations for contributions to defined contribution superannuation funds are recognised as an expense in profit and loss as incurred.

(ii) Defined Benefit Plans

The consolidated entity's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any plan assets is deducted.

The discount rate is the yield at the balance sheet date on Commonwealth government bonds that have maturity dates approximating the terms of the consolidated entity's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the profit and loss.

In respect of actuarial gains and losses in calculating the consolidated entity's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in the income statement over the expected average remaining working lives of the active employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

When the calculation results in plan assets exceeding liabilities to the consolidated entity, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

Past service cost is the increase in the present value of the defined benefit obligation for employee services in prior periods, resulting in

the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service costs may either be positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

(iii) Long-term Service Benefits

The consolidated entity's net obligation in respect of long-term service benefits, other than defined benefit superannuation funds, is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using expected future increases in wage and salary rates including related on-costs and expected settlement dates, and is discounted using the rates attached to the Commonwealth Government bonds at the balance sheet date which have maturity dates approximating to the terms of the consolidated entity's obligations.

(iv) Wages, Salaries, Annual Leave and Non-monetary Benefits

Liabilities for employee benefits for wages, salaries, annual leave and sick leave that are expected to be settled within 12 months of the reporting date represent present obligations resulting from employees' services provided to reporting date, are calculated at undiscounted amounts based on remuneration wage and salary rates that the consolidated entity expects to pay as at reporting date including related on-costs, such as workers compensation insurance and payroll tax. Non-accumulating non-monetary benefits, such as cars and free or subsidised goods and services, are expensed based on the net marginal cost to the consolidated entity as the benefits are taken by the employees.

(v) Share-based Payment Transactions

Share Performance Rights granted to employees are recorded at fair value and recognised as an expense with a corresponding increase in equity. The fair value is initially measured at grant date and spread over the period during which the employees become unconditionally entitled to payment. The fair value of the Share Performance Rights is measured based on the Monte Carlo Simulation formula for the EPS and TSR performance hurdles and Black-Scholes Option Pricing model for the ROE performance hurdle, taking into account the terms and conditions upon which the instruments were granted.

(m) Provisions

A provision is recognised in the balance sheet when the consolidated entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax

rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(i) *Onerous leases*

A provision for onerous leases is recognised when the expected benefits to be derived by the consolidated entity from a lease contract are lower than the unavoidable cost of meeting its obligations under the lease contract. The provision is measured at the present value of the lower of the expected cost of terminating the lease contract and the expected net cost of continuing with the lease contract.

(ii) *Dismantling and Make Good*

The provision is the best estimate of the present value of the expenditure required to complete dismantling and make good obligations on property leases at the reporting date, based on current lease contracts. Future dismantling and make good costs are reviewed annually and any changes are reflected in the present value of the dismantling and make good provision at the end of the reporting period.

The amount of the provision for future dismantling is capitalised and is depreciated over the useful life. Make good costs are provided for over the lease term as the make good obligation arises. The unwinding of the effect of discounting on the provision is recognised as a finance cost.

(iii) *Provision for Clubcard*

The provision for Clubcard points in the Retail Division which are convertible quarterly by customers in the form of gift vouchers is based upon the expected cost to the consolidated entity on redemption of Clubcard vouchers. A redemption rate is applied based on historical experience and is updated quarterly.

(n) Revenue

(i) *Goods Sold and Services Rendered*

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer, usually when goods are delivered to manufacturing and wholesale customers or the point of sale for retail customers.

Revenue from services represents fees (including licence and franchise fees), commissions earned and Community Service Obligation income earned after meeting government obligations, and is recognised as it accrues.

No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, the costs incurred or to be incurred cannot be measured reliably, there is a risk of return of goods, or there is continuing management involvement with the goods. Revenue is recognised net of returns, allowances, trade discounts and volume rebates.

(ii) *Loyalty Card (Clubcard)*

A provision for loyalty card deferred revenue is recognised as a reduction in sales revenue when the underlying products or services are sold. The deferred revenue is based on historical loyalty card data and a weighting of all possible outcomes against their associated probabilities. Revenue is then earned when loyalty card awards are redeemed.

(iii) *Interest on overdue accounts*

Interest revenue is recognised on financial assets on an accrual basis. Interest fee revenue includes interest earned on loans to customers and late fee charges on overdue debtors.

(o) Expenses

(i) *Operating Lease Payments*

Payments made under non-cancellable operating leases are recognised in profit and loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense and spread over the lease term.

(ii) *Finance Lease Payments*

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(iii) *Net Financing Costs*

Net financing costs comprise interest payable on borrowings calculated using the effective interest method, ancillary costs incurred in connection with the arrangement of borrowing, the expense associated with unwinding of the discount on provisions and the income associated with unwinding the discount on receivables, lease finance charges, interest receivable on funds invested, dividend income and gains and losses on hedging instruments that are recognised in profit and loss. The cost of debtor securitisation arrangements and the cost of other arrangements that bring forward cash receipts are also recorded as a finance cost. Interest income is recognised in the income statement as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive payments is established. The interest expense component of finance lease payments is recognised in the income statement using the effective interest method.

(p) Income Tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

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Notes to the consolidated financial statements continued

SIGNIFICANT ACCOUNTING POLICIES continued

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: initial recognition of goodwill, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

(q) Operating Segment

Determination and presentation of operating segments

An operating segment is a component of the consolidated entity that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to the transactions with any of the consolidated entity's other components. All operating segments' operating results are regularly reviewed by the consolidated entity's CEO to make decisions about resources to be allocated to the segment and assess its performance and for which discrete financial information is available.

Segment results that are reported to the CEO include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

Unallocated items comprise mainly corporate costs, finance costs and income tax.

Segment capital expenditure is the total costs incurred during the period to acquire property, plant and equipment and intangible assets other than goodwill.

(r) Non-Current Assets held for Sale and Discontinued Operations

On initial classification as held for sale, non-current assets and disposal groups are recognised at the lower of carrying amount and fair value less costs to sell.

(s) Earnings per Share

The consolidated entity presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share performance rights granted to employees.

(t) Insurance Reimbursements and Losses

Insurance reimbursements are recognised when it is virtually certain that the reimbursement will be receivable.

Insurance reimbursements where receipt is considered probable, but not virtually certain, are disclosed as a contingent asset but not recognised in the financial results.

The carrying amounts of the consolidated entity's assets, including property, plant and equipment and inventories, damaged by insurable events are written down to recoverable amount or derecognised upon the damage occurring. The insurance reimbursements that relate to these assets are recognised as an offset to the expense in the income statement when virtually certain. Other costs incurred as a result of insurable events are expensed as incurred, and any insurance reimbursement is recognised as other income.

2. OPERATING SEGMENTS

For internal reporting and risk management purposes, the consolidated entity is divided into three reportable segments as described below. The reportable segments offer different products and services, and are managed separately because they require different operational and marketing strategies. For each of the reportable segments, the CEO reviews internal management reports on at least a monthly basis. The following summary describes the operations in each of the consolidated entity's reportable segments:

Pharmacy Distribution

Australia – Distribution of pharmaceutical and medical products to pharmacies, provider of retail services to pharmacy customers.

Retailing

Australia – The sale of various health, beauty and lifestyle products within the retail industry in Australia including retail franchising arrangements.

Manufacturing

New Zealand – Manufacturer and owner of rights of pharmaceutical medicines and consumer toiletries.

2. OPERATING SEGMENTS continued

In thousands of AUD	Distribution Australia		Retailing Australia		Manufacturing New Zealand		Eliminations		Consolidated	
	Aug-11	Aug-10	Aug-11	Aug-10	Aug-11	Aug-10	Aug-11	Aug-10	Aug-11	Aug-10
REVENUE										
External Revenue	2,589,888	2,887,866	636,178	624,801	39,959	40,164	–	–	3,266,025	3,552,831
External Services	79,400	74,142	80,465	79,234	–	–	–	–	159,865	153,376
Inter-segment revenue*	–	–	–	–	12,117	8,947	(12,117)	(8,947)	–	–
Total Segment Revenue	2,669,288	2,962,008	716,643	704,035	52,076	49,111	(12,117)	(8,947)	3,425,890	3,706,207
Reportable Segment Profit before Group Supply Chain Allocations	138,156	137,979	41,899	46,430	2,246	1,338	–	–	182,301	185,747
Group Supply Chain Allocations	(88,891)	(85,731)	(35,956)	(34,738)	–	–	–	–	(124,847)	(120,469)
Reportable Segment Profit	49,265	52,248	5,943	11,692	2,246	1,338	–	–	57,454	65,278
Depreciation and amortisation	10,621	9,591	8,472	7,696	1,146	1,259	–	–	20,239	18,546
Capital expenditure including intangibles	8,582	16,400	9,094	17,311	657	782	–	–	18,333	34,493

* All sales between segments are conducted on an arm's length basis.

Reconciliations of reportable segment Profit

	Yearended 31 August 2011	Yearended 31 August 2010
Profit or loss		
Total profit for reportable segments	57,454	65,278
Unallocated amounts		
Corporate costs	(10,489)	(7,208)
Financial guarantee and impairment charge	(50,000)	–
Queensland flood costs	(3,627)	–
Net finance expense	(24,543)	(23,039)
Share of profit of equity accounted investees	1,228	637
Consolidated (loss)/profit before tax	(29,977)	35,668

6. MARKETING AND SALES EXPENSES

In thousands of AUD

Financial guarantee impairment
 Other marketing and sales expenses

Marketing and sales expenses

	Yearended 31 August 2011	Yearended 31 August 2010
Financial guarantee impairment	50,000	–
Other marketing and sales expenses	143,680	139,846
Marketing and sales expenses	193,680	139,846

7. FLOOD COSTS – SOUTH EAST QUEENSLAND

The consolidated entity's Brisbane Distribution Centre, located near Ipswich, Queensland, suffered material damage as a consequence of the January 2011 flood in south east Queensland. Insurance reimbursements are recognised when, and only when, it is virtually certain that the reimbursement will be received. The consolidated entity has recognised the following loss resulting from the flood damage.

Loss before tax expense has been arrived at after including the following:

In thousands of AUD

Insurance reimbursement received prior to 31 August
 Insurance reimbursement received after 31 August

Insurance reimbursement recognised

Impairment of inventory
 Impairment of plant and equipment
 Other flood related expenses

Total flood related expenses

Net flood related loss recognised

	Yearended 31 August 2011	Yearended 31 August 2010
Insurance reimbursement received prior to 31 August	53,304	–
Insurance reimbursement received after 31 August	4,052	–
Insurance reimbursement recognised	57,356	–
Impairment of inventory	(42,160)	–
Impairment of plant and equipment	(5,321)	–
Other flood related expenses	(13,502)	–
Total flood related expenses	(60,983)	–
Net flood related loss recognised	(3,627)	–

At 31 August 2011, the likelihood of future insurance reimbursements of \$3,627,000 is considered probable, but not virtually certain, accordingly, this amount is considered a contingent asset but not recognised in the consolidated entity's current year results. In addition, at reporting date a \$5,500,000 business interruption claim has also been estimated and included as a contingent asset.

The flood related expenses above are attributable to the following functions presented in the income statement:

In thousands of AUD

Cost of sales
 Warehousing and distribution expenses

Total flood related expenses

	Yearended 31 August 2011	Yearended 31 August 2010
Cost of sales	42,160	–
Warehousing and distribution expenses	18,823	–
Total flood related expenses	60,983	–

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Notes to the consolidated financial statements continued

8. INCOME TAX EXPENSE

Numerical reconciliation between tax expense and pre-tax net profit

In thousands of AUD

(Loss)/profit before tax	(29,977)	35,668
Income tax using the domestic corporation tax rate of 30% (2010: 30%)	(8,993)	10,701
Increase in income tax expense due to:		
Non-deductible expenses		
– Make-good costs	211	–
– Other	350	208
Effect on deferred tax assets of changes in New Zealand tax law		
– Tax depreciation no longer allowed on buildings	–	763
– Reduction in New Zealand tax rate from 30% to 28%	–	17
Effect of tax rate in foreign jurisdictions	10	–
Settlement of New Zealand tax audit	1,123	–
Capital works disposed of	73	–
Decrease in income tax expense due to:		
Share of associate's net profit	(368)	(191)
Tax incentives	–	(52)
Adjustment for prior years	927	1,576
Income tax (benefit)/expense on pre-tax net profit	(6,667)	13,022

Recognised in the Income Statement

In thousands of AUD

Current tax expense

Current year	9,852	6,619
Adjustments for prior years	7,127	400
	16,979	7,019

Deferred tax expense

Current year-origination and reversal of temporary differences	(17,446)	4,827
Adjustment for prior years	(6,200)	1,176
	(23,646)	6,003

Total income tax (benefit)/expense in income statement

	Yearended 31 August 2011	Yearended 31 August 2010
	(29,977)	35,668
	(8,993)	10,701
	211	–
	350	208
	–	763
	–	17
	10	–
	1,123	–
	73	–
	(368)	(191)
	–	(52)
	(7,594)	11,446
	927	1,576
	(6,667)	13,022

	Yearended 31 August 2011	Yearended 31 August 2010
	9,852	6,619
	7,127	400
	16,979	7,019
	(17,446)	4,827
	(6,200)	1,176
	(23,646)	6,003
	(6,667)	13,022

Deferred tax recognised in equity

In thousands of AUD

Relating to

Derivatives	(892)	–
Cost of issue of shares	–	(1,303)
	(892)	(1,303)

	Yearended 31 August 2011	Yearended 31 August 2010
	(892)	–
	–	(1,303)
	(892)	(1,303)

9. EARNINGS PER SHARE

In thousands of AUD

(Loss)/profit attributable to ordinary shareholders

In thousands of shares

Basic weighted average number of ordinary shares for the period

Effect of potential ordinary shares on issue

Diluted weighted average number of ordinary shares for the period

In cents

Basic earnings per share

In cents

Diluted earnings per share

	Yearended 31 August 2011	Yearended 31 August 2010
(Loss)/profit attributable to ordinary shareholders	(23,310)	22,646
Basic weighted average number of ordinary shares for the period	488,116	440,943
Effect of potential ordinary shares on issue	–	–
Diluted weighted average number of ordinary shares for the period	488,116	440,943
Basic earnings per share	(4.8)	5.1
Diluted earnings per share	(4.8)	5.1

Weighted Average number of ordinary shares

Ordinary shares outstanding at beginning of the year

Institutional Offer and Placement

Retail Entitlement Offer

	Yearended 31 August 2011	Yearended 31 August 2010
Ordinary shares outstanding at beginning of the year	488,115,883	257,346,455
Institutional Offer and Placement	–	98,603,898
Retail Entitlement Offer	–	84,992,970
	488,115,883	440,943,323

10. TRADE AND OTHER RECEIVABLES

In thousands of AUD

Current

Trade receivables

Provision for impairment

Amounts receivable as deferred consideration

Loans receivable from pharmacy customers

Other receivables and prepayments

Trade receivables due from associates

Non-current

Loans to associates

Loans to employees

Loans receivable from pharmacy customers

Pension asset

	Yearended 31 August 2011	Yearended 31 August 2010
Trade receivables	562,844	658,395
Provision for impairment	(21,297)	(14,000)
Amounts receivable as deferred consideration	541,547	644,395
Loans receivable from pharmacy customers	1,809	8,540
Other receivables and prepayments	1,234	–
Trade receivables due from associates	41,864	47,266
	82	77
	586,536	700,278
Loans to associates	–	5,927
Loans to employees	55	144
Loans receivable from pharmacy customers	71,561	66,402
Pension asset	1,304	1,286
	72,920	73,759

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Notes to the consolidated financial statements continued

11. INVENTORIES

In thousands of AUD

	Yearended 31 August 2011	Yearended 31 August 2010
Raw materials and consumables	2,870	3,042
Work in progress	235	239
Finished goods	322,615	323,924
Less: provision for obsolescence and shrinkage	(5,566)	(5,057)
	320,154	322,148

12. SUMMARISED PARENT ENTITY FINANCIALS

In thousands of AUD

	Yearended 31 August 2011	Yearended 31 August 2010
Current assets	362,539	425,786
Total assets	1,027,093	1,133,713
Current liabilities	497,200	540,423
Total liabilities	504,169	546,747
Net assets	522,924	586,966
Equity		
Share capital	566,461	566,461
Reserves	(1,455)	462
Retained earnings	(42,082)	20,043
Total equity	522,924	586,966
(Loss)/profit after tax	(49,924)	19,228
Other comprehensive expense	(2,035)	–
Total comprehensive (expense)/ income	(51,959)	19,228
Capital commitments of the parent entity at year end	1,081	1,319

Details of any guarantees and contingencies of the parent entity are included in note 25.

13. CURRENT TAX ASSETS AND LIABILITIES

The current tax liability for the consolidated entity of \$4,576,000 (31 August 2010: \$3,000) represents the amount of income taxes payable in respect of current and prior financial periods. In accordance with the Australian tax consolidation legislation, the Company as the head entity of the Australian tax consolidated group has assumed the current tax liability (asset) initially recognised by the members in the Australian consolidated tax group.

14. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

Investments in Associates

The consolidated entity accounts for investments in associates using the equity method.

During the year, the consolidated entity's ownership in CH2 increased from 45.3% to 45.5% as a result of the issue of equity shares of \$2.283 million with respect to the settlement of outstanding dividends on Redeemable Preference Shares.

The consolidated entity has the following investments in associates:

Venture	Principal Activities	Country	Reporting Date	Ownership	
				31 August 2011	31 August 2010
CH2 Holdings Pty Ltd	Hospital supplies distribution	Australia	30 June	45.5 %	45.3%

Details of Investments in Associates

In thousands of AUD	Revenues 100%	Profit/(Loss) 100%	Share of associates net profit/(loss) recognised	Net assets as reported by associate 100% at it's June end reporting period	Share of associate's net assets equity accounted (including goodwill)*
For the year ended 31 August 2011					
CH2 Holdings Pty Ltd	795,090	2,711	1,228	48,876	27,815
For the year ended 31 August 2010					
CH2 Holdings Pty Ltd	783,294	1,406	637	25,950	24,304

* The Share of net assets equity accounted (including goodwill) at 31 August 2010 includes the value of the consolidated entity's investment of Redeemable Preference Shares in the associate. In June 2011, CH2 converted its Redeemable Preference Shares to Ordinary Shares and made a cash settlement (presented in interest received).

The value in use (VIU) approach was adopted for assessing the recoverable value. VIU was determined by discounting the future cash flows generated from the continuing use of the cash generating unit and based on the following assumptions:

- Cash flows were projected based on actual results and the three year business plan – cash flows beyond the three year period are extrapolated using a growth rate of 5% for years four and five.
- Terminal value growth rates after five years are based on current market factors and management opinion and are 3.25%.
- A pre tax discount rate of 16.50% has been used in discounting the projected cash flows and in terminal values.
- The value of the investment in CH2 was reviewed with no impairment in the consolidated financial statements as the calculated value was higher than the value carried in the consolidated entity.

The values assigned to the key assumptions represent management's assessment of future trends in the industry and are based on other external sources and internal sources (including historical data). The value of the investment in CH2 was similarly reviewed.

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Notes to the consolidated financial statements continued

14. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD continued

Results of Associates

In thousands of AUD

Share of associate profit before income tax
 Share of income tax expense

Share of associates net profit accounted for using the equity method

Year ended 31 August 2011	Year ended 31 August 2010
1,791	1,125
(563)	(488)
1,228	637

Commitments

In thousands of AUD

Share of associates operating lease rentals
 Within one year
 One year or later and no later than five years
 Later than five years

Year ended 31 August 2011	Year ended 31 August 2010
1,967	1,289
4,778	3,082
279	15
7,024	4,386

15. DEFERRED TAX ASSETS AND LIABILITIES

Recognised Deferred Tax Assets and Liabilities

Deferred tax assets and liabilities are attributable to the following:

Consolidated	Assets		Liabilities		Net	
	31 August 2011	31 August 2010	31 August 2011	31 August 2010	31 August 2011	31 August 2010
In thousands of AUD						
Property, plant and equipment	–	–	(2,919)	(5,207)	(2,919)	(5,207)
Intangible assets	–	–	(148)	(148)	(148)	(148)
Unrealised foreign exchange losses	129	158	–	–	129	158
Employee benefits	5,062	4,859	–	–	5,062	4,859
Provisions	25,210	11,684	–	–	25,210	11,684
Costs of equity raising	748	1,303	–	–	748	1,303
Derivatives	892	–	–	–	892	–
Other items	5,001	–	–	(3,264)	5,001	(3,264)
Tax loss carried forward	209	261	–	–	209	261
Tax assets / (liabilities)	37,251	18,265	(3,067)	(8,619)	34,184	9,646

As at 31 August 2011, the Company considers it probable that future taxable profits will be available against which tax losses can be utilised.

Change in Deferred Tax Asset

In thousands of AUD

Balance at 1 September
 Recognised in income statement
 Recognised in share capital
 Recognised directly in equity
 Balance as at 31 August

31 August 2011	31 August 2010
9,646	14,346
23,646	(6,003)
–	1,303
892	–
34,184	9,646

16. PROPERTY, PLANT AND EQUIPMENT

In thousands of AUD

Cost	Land and Buildings	Plant and Equipment	Leased Plant and Equipment	Capital Works in Progress	Total
Balance at 1 September 2009	13,534	132,707	10,743	34,464	191,448
Additions**	–	–	–	34,388	34,388
Reclassification of assets*	–	66,279	991	(64,773)	2,497
Transfer of assets to intangibles	–	–	–	(1,490)	(1,490)
Disposals	–	(6,795)	(1,169)	–	(7,964)
Effect of movement in foreign exchange	(173)	(285)	–	(14)	(472)
Balance at 31 August 2010	13,361	191,906	10,565	2,575	218,407
Additions**	–	933	–	18,834	19,767
Reclassification of assets	–	15,987	584	(16,571)	–
Transfer of assets to intangibles	–	–	–	(102)	(102)
Disposal	(2,780)	(11,585)	(207)	(78)	(14,650)
Effect of movement in foreign exchange	65	104	–	2	171
Balance at 31 August 2011	10,646	197,345	10,942	4,660	223,593

Depreciation and impairment losses	Land and Buildings	Plant and Equipment	Leased Plant and Equipment	Capital Works in Progress	Total
Balance at 1 September 2009	(3,372)	(69,307)	(6,462)	–	(79,141)
Depreciation charge for the period	(357)	(13,314)	(1,174)	–	(14,845)
Reclassification of assets*	–	(1,220)	–	–	(1,220)
Disposals	–	4,741	70	–	4,811
Effect of movements in foreign exchange	16	257	–	–	273
Balance at 31 August 2010	(3,713)	(78,843)	(7,566)	–	(90,122)
Depreciation charge for the period	(278)	(16,224)	(1,066)	–	(17,568)
Disposals	(471)	4,492	127	–	4,148
Effect of movements in foreign exchange	(49)	(73)	–	–	(122)
Balance at 31 August 2011	(4,511)	(90,648)	(8,505)	–	(103,664)

Carrying amounts	Land and Buildings	Plant and Equipment	Leased Plant and Equipment	Capital Works in Progress	Total
At 1 September 2009	10,162	63,400	4,281	34,464	112,307
At 31 August 2010	9,648	113,063	2,999	2,575	128,285
At 31 August 2011	6,135	106,697	2,437	4,660	119,929

* Includes stores development costs, previously recognised in Other receivables and prepayments.

** Includes the capitalisation of interest of \$Nil (31 August 2010:\$1.304 million) within Capital Works in Progress.

Financing costs are expensed in the income statement except where they relate to the financing of projects under construction, where they are capitalised up to the date of commissioning.

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Notes to the consolidated financial statements continued

17. INTANGIBLE ASSETS

In thousands of AUD

Cost	Goodwill	Brand names	Software	Development Costs	Total
Balance at 1 September 2009	93,208	99,000	17,387	548	210,143
Transfer from property, plant and equipment	-	-	1,490	-	1,490
Effect of movements in foreign exchange	(761)	-	-	(15)	(776)
Balance at 31 August 2010	92,447	99,000	18,877	533	210,857
Transfer from property, plant and equipment	-	-	102	-	102
Disposals	-	-	-	(51)	(51)
Effect of movements in foreign exchange	243	-	-	3	246
Balance at 31 August 2011	92,690	99,000	18,979	485	211,154
Amortisation and impairment losses					
Balance at 1 September 2009	-	-	(9,776)	(294)	(10,070)
Amortisation for the period	-	-	(3,595)	(106)	(3,701)
Effect of movements in foreign exchange	-	-	-	6	6
Balance at 31 August 2010	-	-	(13,371)	(394)	(13,765)
Amortisation for the period	-	-	(2,583)	(88)	(2,671)
Disposals	-	-	-	48	48
Effect of movements in foreign exchange	-	-	-	(5)	(5)
Balance at 31 August 2011	-	-	(15,954)	(439)	(16,393)
Carrying amounts					
At 1 September 2009	93,208	99,000	7,611	254	200,073
At 31 August 2010	92,447	99,000	5,506	139	197,092
At 31 August 2011	92,690	99,000	3,025	46	194,761

Amortisation and Impairment Charge

The amortisation charge was recognised within administration and general expenses in the income statement.

Impairment tests for Cash Generating Units (CGU) containing Goodwill and Brand Names

The following cash generating units have significant carrying amounts of goodwill and brand names:

Goodwill

In thousands of AUD	As at 31 August 2011	As at 31 August 2010
Australian pharmaceutical distribution	29,418	29,418
Australian retailing	35,664	35,664
New Zealand manufacturing	27,608	27,365
	92,690	92,447

17. INTANGIBLE ASSETS continued

Assumptions

The assumptions used for determining the recoverable amount of each asset and CGU are based on past experience and expectations for the future. Cashflow projections have been based on Board approved budgets and the Board approved five year strategic plan. These forecasts use management estimates to determine income, expenses, working capital movements, capital expenditure and cashflows for each CGU.

The projected cashflows for each CGU are discounted using an appropriate discount rate and terminal growth rate applicable to each CGU. Management apportions a reasonable allocation of its corporate overhead and supply chain distribution costs to the Retailing and Pharmacy Distribution CGU based on a reasonable allocation methodology. The Retailing and Pharmacy Distribution CGU's are particularly sensitive to the allocation of supply chain distribution costs.

For all cash generating units containing goodwill, the value in use (VIU) approach was adopted for assessing the recoverable value of non-financial assets. VIU was determined by discounting the future cash flows generated from the continuing use of the CGU and based on the following assumptions:

Terminal value growth rates for each individual CGU after five years are based on current market factors and management opinion and are 3%.

A pre tax discount rate of 14% has been used in discounting the projected cash flows and terminal values. An impairment charge would arise if there was an increase in the pre tax discount rate of 340bps for the Retailing CGU, 110bps for the Pharmacy Distribution CGU or 140bps for the Manufacturing CGU.

The values assigned to the key assumptions represent management's assessment of future trends in the industry and are based on other external sources and internal sources (including historical data).

Sensitivity to changes in assumptions

Pharmacy Distribution

The Company has modelled the recent structural changes in the industry and believe that the recoverable amount comfortably exceeds its carrying value after considering the supply chain distribution charge. There would need to be a significantly adverse movement in one or more of the following assumptions in order for an impairment to arise in future periods;

- gross margin trading expenses relative to sales;
- selling prices; and / or Pharmacists' trading terms; and
- synergies from supply chain improvements.

Retailing

The Company has forecasted the expected growth of the Priceline business over the next five year strategic plan period. Management have identified the following two key assumptions for which a reasonable possible change could cause the carrying amount to exceed the VIU:

- long term retail sales growth; and
- expected additional Priceline stores to be opened over the five year forecast period.

The Company has modelled a 50% reduction in each scenario which indicates that in either scenario the VIU would approach, but not be lower than, the carrying amount and therefore no impairment charge would arise.

Manufacturing

The Company has forecasted expected growth of the New Zealand business over the next five years. The Company has modelled a 50% reduction in contract renewals which results in a \$200,000 impairment.

Brand names

In thousands of AUD

Australian pharmaceutical distribution

- Soul Pattinson brand name

Australian retailing

- Priceline brand name

	As at 31 August 2011	As at 31 August 2010
	37,500	37,500
	61,500	61,500
	99,000	99,000

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Notes to the consolidated financial statements continued

17. INTANGIBLE ASSETS continued

The valuation of Soul Pattinson (SP) brand has been completed as part of Australian Pharmacy Distribution CGU as predominant economic benefits of the SP brand have been realised in Pharmacy Distribution business. Additionally, the cash flows derived from the SP brand cannot be separated from the cash flows derived from the wholesale distribution business and banner group operations.

18. TRADE AND OTHER PAYABLES

In thousands of AUD

Current

Trade payables and accrued expenses

Non-current

Other payables

	Year ended 31 August 2011	Year ended 31 August 2010
	572,338	659,123
	11,330	10,544

19. LOANS AND BORROWINGS

This note provides information about the contractual terms of the consolidated entity's interest-bearing loans and borrowings.

In thousands of AUD

Current liabilities

Customer deposits

Finance lease liabilities

Securitisation of trade receivables

Cash advance facility - secured

Non-current liabilities

Finance lease liabilities

Financing Facilities

Bank overdraft - secured

Standby letters of credit

Cash advance facility - secured

Securitisation of trade receivables

Facilities utilised at reporting date¹

Bank overdraft - secured

Standby letters of credit

Cash advance facility - secured

Securitisation of trade receivables

Facilities not utilised at reporting date²

Bank overdraft - secured

Standby letters of credit

Cash advance facility - secured

Securitisation of trade receivables

	As at 31 August 2011	As at 31 August 2010
	7	7
	544	974
	179,469	195,375
	4,795	4,805
	184,815	201,161
	469	490
	469	490
	12,397	12,376
	100	100
	95,000	95,000
	345,000	355,000
	452,497	462,476
	-	-
	-	-
	4,795	4,805
	179,469	195,375
	184,264	200,180
	12,397	12,376
	100	100
	90,205	90,195
	165,531	159,625
	268,233	262,296

¹. Average used facilities during the year was \$280,382,150 (2010:\$300,093,664)

². Average unused facilities during the year was \$174,015,111 (2010:\$231,372,089).

19. LOANS AND BORROWINGS continued

Refer to Note 31 which outlines lender's consent for not achieving a minimum performance requirement under the lending terms.

Bank Overdraft

The Company is a guarantor to a bank facility agreement which provides a total overdraft facility of \$12,397,000 (31 August 2010: \$12,376,000) to entities in the Australian Pharmaceutical Industries Limited Group.

The facility is subject to set off arrangements between the consolidated entity companies. Interest on bank overdrafts is charged at prevailing market rates. The bank overdraft is repayable on demand and subject to annual review.

Standby Letter of Credit

The standby letter of credit facility is available to be drawn down over the next year and is subject to annual review.

Finance Lease Facility

The consolidated entity's lease liabilities are secured by the leased assets. In the event of default, the assets revert to the lessor.

Cash Advances

The consolidated cash advance facilities total \$95,000,000. The borrowings are secured by way of fixed and floating charge over the assets of the consolidated entity. Interest is based on the bank-bill reference rate plus a margin charged by the lender.

Securitisation

Refer Note 23.

Finance Lease Liabilities

Finance lease liabilities of the consolidated entity are payable as follows:

	Minimum Lease Payments 31 August 2011	Interest 31 August 2011	Principal 31 August 2011	Minimum Lease Payments 31 August 2010	Interest 31 August 2010	Principal 31 August 2010
In thousands of AUD						
Less than one year	588	44	544	1,040	66	974
Between one and five years	486	17	469	521	31	490
	1,074	61	1,013	1,561	97	1,464

The consolidated entity lease plant and equipment under finance leases expiring within five years. At the end of the lease term the consolidated entity have the option to purchase the leased equipment at a price considered to be a bargain purchase option.

Under the terms of the lease agreements no contingent rents are payable.

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Notes to the consolidated financial statements continued

20. EMPLOYEE BENEFITS

Current

In thousands of AUD	As at 31 August 2011	As at 31 August 2010
Liability for long service leave	4,986	4,684
Liability for annual leave	8,956	8,823
	13,942	13,507
Non-current		
Liability for long service leave	3,935	3,621

(a) Defined Benefit Plan

The consolidated entity makes contributions to a defined benefit superannuation fund that provides defined benefit amounts for employees upon retirement.

In thousands of AUD	31 August 2011	31 August 2010
Fair value of fund assets - funded	2,308	2,191
Present value of funded obligations	(2,281)	(2,010)
Present value of net fund assets	27	181
Unrecognised actuarial losses	1,277	1,105
Recognised asset for defined benefit obligations (see below)	1,304	1,286

Movements in the net asset for defined benefit obligations recognised in the balance sheet

In thousands of AUD	31 August 2011	31 August 2010
Net defined benefit asset at beginning of the period	1,286	1,245
Contributions received	137	138
Expense recognised in the income statement	(119)	(97)
Net defined benefit asset at end of the period	1,304	1,286

(b) Defined Contribution Superannuation Funds

In addition to the contributions to the defined benefit plan outlined above, the consolidated entity makes contributions to various defined contribution superannuation funds. The amount recognised as expense was \$9,794,000 for the year ended 31 August 2011 (year ended 31 August 2010: \$9,502,000).

20. EMPLOYEE BENEFITS continued

(c) Share Based Payments

Share performance rights

The consolidated entity granted equity settled performance rights that entitle key management personnel and senior employees to receive shares in the Company if defined performance conditions are achieved.

The Performance Rights granted on 31 March 2009 (2008 grant) did not vest and lapsed on 31 August 2011.

On 12 May 2010, performance rights (the 2009 grant) were granted with a performance period commencing 1 September 2009 and ending 31 August 2012. The performance condition, being API's return on equity ('ROE') for the exercise of performance rights will be assessed on 31 October 2012.

On 10 January 2011, further performance rights (the 2010 grant) were granted with a performance period commencing 1 September 2010 and ending 31 August 2013. The performance condition, being API's return on equity ('ROE') for the exercise of performance rights will be assessed on 31 October 2013.

Performance conditions will be tested once only, and any performance rights that do not meet the performance conditions will lapse and will not be re-tested.

Grant date / employee entitled	Number of instruments	Vesting conditions	Contractual life of Performance Rights
Performance rights to key management personnel and senior employees at 31 August 2011 – Performance period to Aug 2012	1,289,600	Three years of service and cumulative ROE with a minimum of 21.08% permitting exercise of 50% of the rights and 25.3% achievement to exercise 100% of the rights and proportionate between these two levels.	3 years
Performance rights to key management personnel and senior employees at 31 August 2011 – Performance period to Aug 2013	2,449,800	Three years of service and cumulative ROE with a minimum of 18.5% permitting exercise of 50% of the rights and 25% achievement to exercise 100% of the rights and proportionate between these two levels.	3 years
	3,739,400		

The number of performance rights outstanding in the period is as follows:

	Number of performance rights 31 August 2011	Number of performance rights 31 August 2010
In thousands of performance rights		
Outstanding at the beginning of the period	2,410	1,541
Forfeited/Lapsed during the period	(1,211)	(530)
Exercised during the period	–	–
Granted during the period	2,540	1,399
Outstanding at the end of the period	3,739	2,410
Exercisable at the end of the period	–	–

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Notes to the consolidated financial statements continued

20. EMPLOYEE BENEFITS continued

(c) Share Based Payments continued

Fair value of performance rights and assumptions	Key Management Personnel and Senior Managers 31 August 2011			
	1 Sept 2008 TSR	1 Sept 2008 EPS	1 Sept 2009 ROE	1 Sept 2010 ROE
Performance period commences and performance condition				
Grant date	31 March 09	31 March 09	12 May 10	10 Jan 11
Fair value at measurement date	\$0.22	\$0.36	\$0.42	\$0.35
Share price	\$0.39	\$0.39	\$0.45	\$0.41
Exercise price	–	–	–	–
Expected volatility (expressed as weighted average)	40%	40%	40%	40%
Performance Rights life (expressed as weighted average life)	3yrs	3yrs	3yrs	3yrs
Expected dividends	2.5%	2.5%	3.0%	5.0%
Risk-free interest rate (based on national government bonds)	3.40%	3.40%	4.78%	5.12%

The expected volatility is based on the historic volatility (calculated based on the weighted average expected life of the share performance rights), adjusted for any expected changes to future volatility due to publicly available information.

Share performance rights are granted under a service condition and, for grants to key management personnel and, senior executives market and non-market performance conditions apply. Non-market performance conditions are not taken into account in the grant date fair value measurement of the services received.

Employee expenses

In thousands of AUD	31 August 2011	31 August 2010
Performance rights granted in 2007 – equity settled	–	(5)
Performance rights granted in 2008 – equity settled	28	(45)
Performance rights granted in 2009 – equity settled	(196)*	196
Performance rights granted in 2010 – equity settled	286	–
Total expense recognised as employee costs	118	146

* Reflects the reversal of expenses previously recognised for performance rights forfeited in the current period.

21. PROVISIONS

In thousands of AUD	Directors retirement scheme	Provision for dismantling	Provision for financial guarantees	Provision for onerous leases	Other	Total
Balance at 1 September 2010	351	2,579	–	330	2,059	5,319
Provisions made during the year	–	748	50,000	262	9,120	60,130
Provisions used during the year	–	(201)	–	(262)	(8,361)	(8,824)
Provision reversed during the year	–	–	(11,968)	–	–	(11,968)
Unwind of discount	–	475	–	–	–	475
Balance at 31 August 2011	351	3,601	38,032	330	2,818	45,132
Current	–	209	38,032	278	2,818	41,337
Non-current	351	3,392	–	52	–	3,795
	351	3,601	38,032	330	2,818	45,132

Directors Retirement Scheme

Retirement benefits for non-executive Directors are included on an accrual basis. They are paid on a pro-rata basis up to 10 years service to a maximum of three times the average annual remuneration in the three years preceding retirement. The retirement benefit is capped at \$220,000 per Director and applies only to Directors appointed prior to 9 September 2003. On 31 August 2009 the Directors agreed to freeze this benefit.

Dismantling

The consolidated entity provides for the estimated costs to cover its obligations to lessors to restore premises to the condition that existed when leases of real property were entered into.

Financial guarantees

Guarantees are issued to pharmacists on the basis of being fully recoverable from the pharmacist. Guarantees are typically recovered in line with pharmacy refinancing timetables. During the year it was assessed that it was now probable that guarantees will be called in the foreseeable future and accordingly a provision for the maximum potential obligation was recognised. During the year a number of guarantees matured without being called resulting in a partial reduction in the provision. The reduction in the financial guarantee provision was transferred to the provision for impairment losses in respect of trade receivables (refer Note 23).

Onerous leases

On 2 July 2007 the consolidated entity acquired the Making Life Easy-Mobility and Independent Living Superstores Pty Ltd ("MLE") business. MLE, at the date of acquisition, was committed to a plan to phase out its retail operations and had recognised a provision of \$3,354,000 to allow for the costs of closure of retail outlets and write down of fixed assets. The consolidated entity has reassessed the remaining obligation for the discounted future lease payments. The obligation at 31 August 2011 is \$330,000.

Other

Other consists only of provision for Clubcard points in the Retail Division which are convertible quarterly by customers in the form of gift vouchers. The provision is based upon the expected cost to the consolidated entity on redemption of Clubcard vouchers. A redemption rate is applied based on historical experience and is updated quarterly.

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Notes to the consolidated financial statements continued

22. CAPITAL AND RESERVES

Share capital

Ordinary shares

In thousands of shares

Shares on issue at the beginning of the period – fully paid

Add: Issue of ordinary shares – fully paid

Shares on issue at the end of the period – fully paid

	31 August 2011	31 August 2010
	488,116	257,346
	–	230,770
	488,116	488,116

Ordinary shares

The Company does not have authorised capital or par value in respect of its issued shares. All issued shares are fully paid. Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders meetings. In the event of a winding up of the Company, ordinary shareholders rank after all other creditors and are fully entitled to any proceeds of liquidation.

Translation reserve

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity, as well as from the translation of liabilities that hedge the Company's net investment in a foreign subsidiary.

Equity reserve

The equity reserve relates to share-based payment transactions measured at fair value.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments relating to hedged transactions that have not yet occurred.

Dividends

During the current year the Company recognised the following dividends:

\$7.322 million was paid on 15 December 2010 in respect of earnings for the year ended 31 August 2010, and was at the rate of 1.5 cents per share, fully franked.

An interim dividend in respect of half year ended 28 February 2011 amounting to \$4.881 million paid on 3 June 2011 was also recognised during the current year. It was at the rate of 1.0 cent per share, fully franked.

On 27 October 2011 a final dividend of 1.5 cents per share unfranked to be paid on 15 December 2011, amounting to \$7.322 million was declared.

Dividend Franking Account

The Company

In thousands of AUD

30 per cent franking credits available to shareholders of the Company for subsequent financial years

	31 August 2011	31 August 2010
	29,833	17,144

The above available amounts are based on the balance of the dividend franking account at year-end adjusted for:

- (a) Franking credits that will arise from the payment of the current tax liabilities;
- (b) Franking debits that will arise from the payment of dividends recognised as a liability at the year end;
- (c) Franking credits that will arise from the receipt of dividends recognised as receivables by the tax consolidated group at the year end;
- (d) Franking credits that the entity may be prevented from distributing in subsequent years; and
- (e) Franking debits that will arise from receipt of the current income tax receivable.

The ability to utilise the franking credits is dependent upon there being sufficient available profits to declare dividends. The future reduction in the dividend franking account of dividends proposed after the balance sheet date but not recognised as a liability at year end is \$Nil (31 August 2010: \$3,137,888).

23. FINANCIAL INSTRUMENTS

Overview

The consolidated entity has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risk

The Board of Directors has overall responsibility for the establishment and oversight of the consolidated entity's risk management framework. The Board has established an Audit and Risk Committee, which is responsible for developing and monitoring the consolidated entity's risk management policies. The Committee reports regularly to the Board of Directors on its activities.

The consolidated entity's risk management policies are established to identify and analyse the risks faced by the consolidated entity, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the consolidated entity's activities.

The Audit and Risk Committee oversees how management monitors compliance with the risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks. The Audit and Risk Committee is assisted in its oversight by Internal Audit. Internal Audit undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the Audit and Risk Committee.

Credit risk

Credit risk is the risk of financial loss to the consolidated entity if a customer or counterparty to a financial instrument fails to meet its constructive obligations, and arises principally from the consolidated entity's receivables from customers and financial guarantees.

Trade and other receivables

The consolidated entity's exposure to credit risk is mainly influenced by the individual characteristics of each customer.

The consolidated entity has established a credit policy under which new customers are analysed individually for credit worthiness including using external ratings, where available. Purchase limits are established for each customer, which represents the maximum open amount available and limits are reviewed on a needs-basis. Customers that fail to meet the benchmark credit worthiness may transact with the consolidated entity only on a prepayment basis.

In monitoring customer credit risk, customers are grouped by state and reviewed monthly. "High risk" customers are placed on "credit hold", with orders manually released as appropriate.

Goods sold under some customer arrangements are subject to retention of title clauses, so that in the event of non-payment the consolidated entity may have a secured claim.

The consolidated entity establishes an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables and investments. The main component of this allowance is a specific loss component that relates to individually significant exposures (after consideration of any collateral held).

Guarantees

Financial guarantees are initially recognised at fair value. The fair value is amortised as an expense through the income statement over the life of the guarantee. Subsequent to initial measurement, the guarantee is measured at the higher of the amortised balance of the guarantee or the value of the guarantee determined in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

During the current year, the consolidated entity has assessed that it is now probable that guarantees will be called in the foreseeable future, and accordingly has recorded a provision for the maximum potential obligation that the consolidated entity has an obligation to meet. The liability has not been discounted as the consolidated entity has a current obligation to settle the liability. No amounts have been paid in relation to these guarantees during the current period.

Liquidity risk

Liquidity risk is the risk that the consolidated entity will not be able to meet its financial obligations as they fall due.

The consolidated entity's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions.

The Company and consolidated entity have varying borrowing levels based on seasonal requirements of the business. Any obligations can be met by the unused facilities.

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Notes to the consolidated financial statements continued

23. FINANCIAL INSTRUMENTS continued

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the consolidated entity's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and monitor market risk exposures within acceptable parameters, whilst optimising the return on risk.

Currency risk

The consolidated entity had no material exposure to foreign currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of the consolidated entity companies.

Interest rate risk

The consolidated entity is exposed to interest rate risk as a consequence of its financing facilities. The consolidated entity adopts a policy that up to 80% of its exposure to the changes in interest rates on its long term variable rate borrowings relating to the securitised trade receivables may be hedged on a fixed rate basis. At 31 August 2011, the consolidated entity had entered into four interest rate swaps with a notional contract amount of \$150,000,000 with maturity dates ranging from February 2013 to June 2014 with fixed rates ranging from 5.15% to 5.19%. The consolidated entity classifies interest rate swaps as cash flow hedges.

The net fair value of the swap has been recognised in equity.

Capital Management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

The Board seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

There were no changes in the consolidated entity's approach to capital management during the period.

The consolidated entity has access to funds as a result of the securitisation of current trade receivables provided the receivables meet certain criteria. There are two separate programs which have limits of \$275,000,000 and \$70,000,000 (31 August 2010: \$275,000,000 and \$80,000,000). As part of these programs, the program provider charges a monthly variable interest rate plus margin based on the drawn down portion of this program. Settlement of the funds is monthly and daily respectively. These agreements expire in May 2013 and May 2012, respectively.

Subsequent to 31 August 2011, the \$70,000,000 facility was extended to May 2013. Refer to note 31 for further information regarding lending covenants.

At 31 August 2011, \$155,000,000 and \$24,469,153 respectively were drawn down on these programs by the consolidated entity (31 August 2010: \$160,000,000 and \$35,374,652). The trade receivables and loans and borrowings relating to these transactions are recognised on the balance sheet.

The amounts drawn down under the securitisation facility accrue finance charges at the prevailing market rate. For the year ended 31 August 2011 the weighted average rate was 6.92% (31 August 2010: 5.97%).

Credit Risk

Exposure to credit risk

The consolidated entity's exposure to credit risk as at the reporting date was in relation to the carrying amounts of current and non current trade receivables (note 10), other receivables (note 10), cash deposits and the amount disclosed in respect of contingent liabilities arising from financial guarantees provided to pharmacy customers (note 25).

Concentrations of credit risk

Concentrations of credit risk arise from customers that have similar characteristics and are affected in a similar manner where there are changes in economic, regulatory or other conditions. In this regard, the economic entity has a significant concentration of credit risk associated with the pharmacy and retail industries in Australia.

23. FINANCIAL INSTRUMENTS continued

Trade Receivables

Details of the ageing of Trade receivables and the impairment losses recorded at the reporting date are set out below:

In thousands of AUD	31 August 2011	31 August 2010
Not past due	473,993	570,605
Past due 0-30 days	26,261	20,773
Past due 31+ days	62,590	67,017
Sub-total	562,844	658,395
Impairment	(21,297)	(14,000)
	541,547	644,395

The movement in the provision for impairment losses in respect of Trade receivables was as follows:

In thousands of AUD	31 August 2011	31 August 2010
Balance at start of year	14,000	10,776
Amounts provided during the year	20,700	7,301
Transfer from Non-current Provision for Impairment	–	3,248
Amounts written off during the year	(13,403)	(7,325)
Balance at end of year	21,297	14,000

Loans receivable from Pharmacy customers

Historically, the consolidated entity has provided financial assistance to certain pharmacy customers in the form of long term loans. The loan agreements include an annual interest rate of up to 10% and full repayment due in approximately three years. These balances have been classified as non-current assets. During the year the consolidated entity has renegotiated the settlement terms of \$19.2 million of outstanding trade debt for periods of between 6 and 24 months attracting interest at rates of up to 12.5% per annum until settled.

The movement in the provision for impairment losses in respect of Loans receivable from pharmacy customers are set out below:

In thousands of AUD	31 August 2011	31 August 2010
Balance at start of year	–	3,158
Amounts provided during the year	–	90
Transfer to Current Provision for Impairment	–	(3,248)
Balance at end of year	–	–

The consolidated entity seeks to obtain collateral wherever long term funding arrangements are agreed to. This collateral may include personal guarantees and formal charges over pharmacy assets. The security held by the consolidated entity over pharmacy assets is generally in the form of a second-ranking charge after the security held by the pharmacist's financiers.

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Notes to the consolidated financial statements continued

23. FINANCIAL INSTRUMENTS continued

Provisions for impairment

In determining the provision for impairment for both Trade receivables and Loans receivable from Pharmacy customers, the Directors have taken into account the value of collateral held, the history of collections and overdue of individual debtors, financial guarantees provided to individual debtors and debtor groups which are recorded as current liabilities where it is considered probable that the guarantees will be called, the risks associated with general trading conditions and the specific circumstances of individual pharmacy debtors. Where appropriate, advice from independent valuation experts has been obtained to support the valuation of assets held as collateral for long term and past-due debts.

The determination of the impairment provisions is necessarily based on a number of best-estimate assumptions and is subject to inherent uncertainties based on information available at balance date. These uncertainties include general economic and trading conditions, the valuation of assets held as security (and the priority rights of other financiers over those assets), the regulatory environment and other factors impacting the pharmacy industry.

Liquidity Risk

The following are the contractual maturities of financial liabilities, including interest payments and excluding the impact of netting arrangements.

In thousands of AUD	Carrying amount	Contract Cash Flows	1 year or less	1-2 years	2-5 years	More than 5 years
31 August 2011						
Non-derivative financial liabilities						
Finance lease liabilities	1,013	1,074	588	346	140	–
Customer deposits	7	7	7	–	–	–
Trade and other payables	583,668	583,668	572,338	8,163	3,167	–
Cash Advance facility	4,795	4,795	4,795	–	–	–
	589,483	589,544	577,728	8,509	3,307	–
31 August 2010						
Non-derivative financial liabilities						
Finance lease liabilities	1,464	1,561	1,040	316	205	–
Customer deposits	7	7	7	–	–	–
Trade and other payables	669,667	669,667	659,123	7,217	3,323	4
Cash Advance facility	4,805	4,805	4,805	–	–	–
	675,943	676,040	664,975	7,533	3,528	4

Cash Flow Hedges

The following table indicates the periods in which the cash flows and profit and loss impact associated with derivatives that were designated as cash flow hedges existing as at 31 August 2011 are expected to occur:

In thousands of AUD	Carrying amount	Expected Cash Flows	6 months or less	6-12 months	1-2 years	2-5 years	More than 5 years
Interest Rate Swap-Liability	(2,907)	(2,907)	–	–	(1,645)	(1,262)	–

23. FINANCIAL INSTRUMENTS continued

Interest Rate Risk

Effective Interest Rates and Repricing Analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice.

Consolidated	In thousands of AUD	Note	31 August 2011					31 August 2010					
			Effective interest rate	Total	1 year or less	1-2 years	2-5 years	More than 5 years	Effective interest rate	Total	1 year or less	1-2 years	2-5 years
Cash and cash equivalents	28	4.50%	34,605	34,605	–	–	–	4.00%	29,431	29,431	–	–	–
Loans to associates*	10	–	–	–	–	–	–	6.25%	5,927	–	2,287	3,640	–
Loans receivable from pharmacy customers*	10	8.08%	71,561	–	–	71,561	–	8.36%	66,402	–	–	66,402	–
Securitised trade receivables	19	6.92%	(179,469)	(179,469)	–	–	–	5.97%	(195,375)	(195,375)	–	–	–
Finance lease liabilities*	19	7.00%	(1,013)	(544)	(331)	(138)	–	6.90%	(1,464)	(974)	(295)	(195)	–
Bank overdrafts and cash advance facility	19	6.43%	(4,795)	(4,795)	–	–	–	6.55%	(4,805)	(4,805)	–	–	–
Employee Loans	10	7.80%	55	–	–	–	55	6.65%	144	90	–	–	54
			(79,056)	(150,203)	(331)	71,423	55		(99,740)	(171,633)	1,992	69,847	54

* Fixed rate income earning financial assets and interest bearing financial liabilities. Remaining balances are variable rates.

Foreign Currency Risk

The consolidated entity had no material exposure to foreign currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of the consolidated entity companies.

Fair value sensitivity analysis for fixed rate instruments

The consolidated entity does not account for any fixed rate financial assets and liabilities at fair value through profit and loss, and the consolidated entity does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at reporting date would not affect profit and loss unless any hedges became ineffective.

Cash flow sensitivity analysis for variable rate instruments

A strengthening by 100 basis points in interest rates at the reporting date would have increased (or in the event of a commensurate weakening, decreased) profit or loss and equity (pre tax) by the amounts shown below for the consolidated entity. This analysis assumes that all other variables remain constant.

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Notes to the consolidated financial statements continued

23. FINANCIAL INSTRUMENTS continued

In thousands of AUD	Profit/(loss)		Equity	
	100bp increase	100bp decrease	100bp increase	100bp decrease
31 August 2011				
Variable rate instruments	(1,435)	1,435	-	-
Interest rate swap	1,500	(1,500)	2,793	(2,793)
Cash flow sensitivity (net)	65	(65)	2,793	(2,793)
31 August 2010				
Variable rate instruments	(1,571)	1,571	-	-
Interest rate swap	-	-	-	-
Cash flow sensitivity (net)	(1,571)	1,571	-	-

Fair values

The fair values of financial assets and liabilities are not materially different from the carrying amounts shown in the balance sheet.

Estimation of Fair Values

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the table.

Loans and Borrowings

Fair value is calculated based on discounted expected future principal and interest cash flows.

Finance Lease Liabilities

The fair value is estimated as the present value of future cash flows, discounted at market interest rates for homogeneous lease agreements. The estimated fair values reflect change in interest rates.

Trade and other Receivables / Payables

For receivables / payables with a remaining life of less than one year, the notional amount is deemed to reflect the fair value. All other receivables / payables are discounted to determine the fair value.

Interest rates used for determining fair value

The entity uses the government yield curve as of the year end, plus an adequate constant credit spread, to discount financial instruments. The interest rates used are as follows:

	31 August 2011	31 August 2010
Loans and borrowings	6.0% - 8.5%	5.0% - 7.0%
Leases	6.0% - 7.0%	6.0% - 7.0%
Receivables	8.0% - 10.0%	6.0% - 10.0%

24. COMMITMENTS

Operating Leases - Leases as Lessee

Non-cancellable operating lease rentals are payable as follows:

In thousands of AUD	31 August 2011	31 August 2010
Less than one year	40,984	40,486
Between one and five years	82,442	90,994
More than five years	27,944	42,930
	151,370	174,410

24. COMMITMENTS continued

The consolidated entity leases property and plant under non-cancellable operating leases expiring from two to fifteen years. Leases generally provide the consolidated entity with a right of renewal at which time all terms are renegotiated.

During the year ended 31 August 2011, \$51,502,911 was recognised by the consolidated entity as an expense in the profit and loss in respect of operating leases and other related occupancy costs (31 August 2010: \$53,241,000).

Certain leases are subject to contingent rental clauses calculated as a percentage of revenue earned in excess of pre determined thresholds set out in the lease agreements. The consolidated entity recognises these amounts as an expense in the period where it is anticipated these thresholds will be reached.

With certain franchise arrangements, the consolidated entity continues to hold the head lease and recharges the franchisee the appropriate rental charge. For those leases, the franchisee is invoiced in advance and offset against the rental charge from the landlord.

Capital commitments

In thousands of AUD

Contracted but not provided for or payable:

Within one year

One year or later and no later than five years

Later than five years

	31 August 2011	31 August 2010
Within one year	6,214	1,783
One year or later and no later than five years	–	–
Later than five years	–	–
	6,214	1,783

25. CONTINGENCIES

Contingent liabilities

The Directors are of the opinion that provisions are not required in respect of these matters, as it is not probable that a future sacrifice of economic benefits will be required or the amount is not capable of reliable measurement.

In thousands of AUD		Consolidated		The Company	
		Yearended 31 August 2011	Yearended 31 August 2010	Yearended 31 August 2011	Year ended 31 August 2010
Guarantee of bank facilities to controlled entities	(i)	–	–	8,397	8,376
Guarantee of bank facilities of pharmacy customers	(ii),(iii)	–	50,260	–	50,260
Contingent liability for potential Clubcard voucher redemptions	(iv)	880	701	–	–

(i) These guarantees all relate to the parent entity.

(ii) Guarantees are issued to pharmacists on the basis of being fully recoverable from the pharmacist. Guarantees are typically recovered in line with pharmacy refinancing timetables.

(iii) As it is now probable that guarantees will be called in the foreseeable future, a provision for the maximum potential obligation has been recorded in the current period.

(iv) The contingent liability for Clubcard voucher redemptions represents the value of vouchers issued and not redeemed or provided for. A provision has been recognised for potential voucher redemptions based on historical redemption rates.

The parent entity has entered into a deed of cross guarantee with the effect that Australian Pharmaceuticals Industries Limited guarantees debts in respect of its subsidiaries.

Further detail of the Deed of Cross Guarantee and the subsidiaries subject to the deed are disclosed in Note 27.

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Notes to the consolidated financial statements continued

25. CONTINGENCIES continued

Contingent assets

The Directors are of the opinion that the following should not be recognised in the financial statements as the inflow of economic benefits, while probable, is not virtually certain. When it becomes virtually certain that an inflow of economic benefits will arise, the asset and related income will be recognised in the financial statements in the period in which the change occurs.

		Consolidated		The Company	
		Yearended 31 August 2011	Yearended 31 August 210	Yearended 31 August 2011	Yearended 31 August 2010
In thousands of AUD					
Insurance receivable	(i)	9,127	–	9,127	–

(i) The contingent asset relates to future potential reimbursements considered probable but not virtually certain with respect to the Queensland flood loss insurance claim.

26. CONSOLIDATED ENTITIES

	Note	Ownership interest	
		31 August 2011	31 August 2010
Parent Entity			
Australian Pharmaceutical Industries Limited			
Subsidiaries			
Thriff Chemist Merchandising Pty Limited		100	100
Australian Pharmaceutical Industries (Queensland) Pty Limited	(ii)	100	100
API Victoria Pty Limited	(ii)	100	100
Soul Pattinson (Manufacturing) Pty Limited		100	100
API Financial Services Australia Pty Limited	(ii)	100	100
Pharma-Pack Pty Limited		100	100
API (Canberra) Pty Limited		100	100
Canberra Pharmaceutical Supplies Trust		100	100
Stevens KMS Equities Limited	(i)	100	100
API Healthcare Nominees (NZ) Limited	(i)	100	100
API Healthcare Holdings (NZ) Unit Trust	(i)	100	100
API Healthcare Holdings (NZ) Limited	(i)	100	100
Priceline (NZ) Pty Ltd	(i)	100	100
PAF (New Zealand) Ltd	(i)	100	100
The Medicine Shoppe Limited	(i)	100	100
PSM Healthcare Limited	(i)	100	100
Pharmaceutical Sales and Marketing Ltd	(i)	100	100
Garrett Investments Limited	(i)	100	100
Healthcare Manufacturing Group Limited	(i)	100	100
Synapse Finance Pty Ltd	(ii)	100	100
New Price Retail Finance Pty Ltd	(ii)	100	100
New Price Retail Pty Ltd		100	100
New Price Retail Services Pty Ltd		100	100
You Pay Less Pty Ltd		100	100
PAF (Priceline) Pty Ltd		100	100
Priceline Unit Trust		100	100
Second Priceline Unit Trust		100	100
Priceline Proprietary Limited	(ii)	100	100
Making Life Easy - Mobility and Independent Living Superstores Pty Ltd		100	100
MLE Unit Trust		100	100

(i) These controlled entities are incorporated in New Zealand and carry on business predominantly in New Zealand. All other controlled entities are incorporated and carry on business predominantly in Australia.

(ii) These controlled entities have each entered into a Deed of Cross Guarantee with Australian Pharmaceuticals Industries Limited in respect of relief granted from specific accounting and financial reporting requirements in accordance with ASIC Class Order 98/1418.

All subsidiaries have a balance date equivalent to the parent entity.

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Notes to the consolidated financial statements continued

27. DEED OF CROSS GUARANTEE

Pursuant to ASIC Class Order 98/1418 (as amended) dated 13 August 1998, the wholly-owned subsidiaries listed below are relieved from the Corporation Act 2001 requirements for preparation, audit and lodgement of financial reports, and Directors reports.

It is a condition of the Class Order that the Company and each of the subsidiaries enter into a Deed of Cross Guarantee. The effect of the Deed is that the Company guarantees to each creditor payment in full of any debt in the event of winding up of any of the subsidiaries under certain provisions of the Corporations Act 2001. If a winding up occurs under other provisions of the Act, the Company will only be liable in the event that after six months any creditor has not been paid in full. The subsidiaries have also given similar guarantees in the event that the Company is wound up.

The subsidiaries subject to the Deed are:

- API Financial Services Australia Pty Ltd
- API Victoria Pty Ltd
- Australian Pharmaceutical Industries (Queensland) Pty Ltd
- New Price Retail Finance Pty Ltd
- Priceline Pty Ltd
- Synapse Finance Pty Ltd

A condensed consolidated income statement and consolidated balance sheet comprising the Company and controlled entities which are party to the Deed, after eliminating all transactions between parties to the Deed of Cross Guarantee, at 31 August 2011 is set out as follows:

Summarised Statement of Comprehensive Income and Retained Profits

In thousands of AUD	Year ended 31 August 2011	Year ended 31 August 2010
(Loss)/profit before tax	(37,136)	29,991
Income tax benefit/(expense)	10,390	(9,271)
(Loss)/profit after tax	(26,746)	20,720
Other comprehensive expense	(2,035)	–
Total comprehensive (expense)/ income for the period	(28,781)	20,720
Retained earnings at beginning of the year	33,765	22,436
(Loss)/profit after tax	(26,746)	20,720
Share of associate profit	1,228	637
Dividends recognised during the year	(12,203)	(10,028)
(Accumulated losses)/retained profits at end of the year attributable to equity holders	(3,956)	33,765

27. DEED OF CROSS GUARANTEE continued

Summarised Statement of Financial Position

In thousands of AUD	Closed group	
	As at 31 August 2011	As at 31 August 2010
Assets		
Cash and cash equivalents	64,261	9,196
Trade and other receivables	458,139	505,908
Inventories	185,086	190,865
Total current assets	707,486	705,969
Trade and other receivables	365,285	239,015
Investments	128,506	128,506
Investments accounted for using the equity method	27,815	24,304
Deferred tax assets	23,101	1,449
Property, plant and equipment	70,210	78,739
Intangible assets	113,644	115,528
Total non-current assets	728,561	587,541
Total assets	1,436,047	1,293,510
Liabilities		
Trade and other payables	632,298	479,160
Loans and borrowings	180,017	196,356
Employee benefits	8,427	8,168
Provisions	38,033	–
Income tax payable	5,594	36
Total current liabilities	864,369	683,720
Trade and other payables	5,509	4,860
Loans and borrowings	466	490
Employee benefits	1,898	2,014
Provisions	2,755	1,738
Total non-current liabilities	10,628	9,102
Total liabilities	874,997	692,822
Net assets	561,050	600,688
Equity		
Share capital	566,461	566,461
Reserves	(1,455)	462
Retained earnings	(3,956)	33,765
Total equity	561,050	600,688

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Notes to the consolidated financial statements continued

28. RECONCILIATION OF CASH FLOWS FROM OPERATING ACTIVITIES

In thousands of AUD

Cash Flows from Operating Activities

	Year ended 31 August 2011	Year ended 31 August 2010
(Loss)/profit for the period	(23,310)	22,646
<i>Adjustments for:</i>		
Depreciation	17,568	14,845
Amortisation	2,671	3,701
Foreign exchange losses/(gains)	82	(108)
Share of (profit)/loss of associates net of dividends received	(1,228)	(637)
Net loss/(gain) on sale of stores, property, plant and equipment	789	(2,706)
Equity-settled share-based payment expenses	118	146
Net finance cost	24,543	23,039
Income tax (benefit)/expense	(6,667)	13,022
Decrease/(increase) in trade and other receivables	113,430	(55,026)
Decrease/(increase) in inventories	1,994	(31,800)
(Decrease)/increase in trade and other payables	(88,700)	96,024
Increase/(decrease) in provisions and employee benefits	39,827	(509)
	81,117	82,637
Net interest paid	(20,953)	(23,159)
Income taxes paid	(11,952)	(16,128)
Net Cash from Operating Activities	48,212	43,350

In thousands of AUD

	As at 31 August 2011	As at 31 August 2010
Cash and cash equivalents	34,605	29,431
Cash and cash equivalents in the statement of cash flows	34,605	29,431

29. RELATED PARTIES

Key management personnel compensation

The key management personnel compensation included in 'personnel expenses' is as follows

	Year ended 31 August 2011	Year ended 31 August 2010
In AUD		
Short-term employee benefits	3,621,623	3,981,911
Post employment benefits	185,531	306,756
Termination benefits	–	596,710
Share based payments	104,960	104,520
	3,912,114	4,989,897

29. RELATED PARTIES continued

Individual Directors and executives compensation disclosures

Information regarding individual Directors and executives compensation and some equity instruments disclosures as required by Corporations Act S300A and Corporations Regulations 2M.3.03 are provided in the Remuneration Report section of the Directors' Report.

Apart from the details disclosed in this note, no Director has entered into a material contract with the Company or the consolidated entity since the end of the previous financial year and there were no material contracts involving Directors' interests existing at year-end.

Other Key Management Personnel transactions with the Company or its Controlled Entities

Certain members of key management personnel are Directors of an associate entity (as discussed in Note 14) that result in them having influence over the financial or operating policies of that entity. The associate transacted with the Company or its subsidiaries in the reporting period. The terms and conditions of the transactions with that party were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-related entities on an arm's length basis.

Certain Directors of the Company are also Directors of companies that have entered into transactions with the Company and its controlled entities during the financial year. These transactions may include purchasing of inventories from the Company or its controlled entities. All transactions with the Directors and the companies they represent are on the same terms and conditions as those entered into by other entities, employees or customers and are trivial or domestic in nature.

MOVEMENTS IN SHARES

The movement during the reporting period in the number of ordinary shares of the Company, held directly, indirectly or beneficially, by each key management person, including their personally related parties is as follows:

In shares	Held at 1 September 2010	Purchases	Sales	Held at 31 August 2011
Directors				
Mr P R Robinson	202,168	–	–	202,168
Mr M Hampton	108,334	91,666	–	200,000
Ms E C Holley	16,667	–	–	16,667
Mr R D Millner	755,001	–	–	755,001
Mr S P Roche	336,667	–	–	336,667
Ms L Ausburn	83,334	–	–	83,334
Mr G Masters	–	93,000	–	93,000
Executives				
Mr J Meiliunas	292,609	–	–	292,609
Mr P Sanguinetti	8,334	–	–	8,334
Mr P Hourihan	–	11,466	(11,466)	–
Mr T Mullins	–	20,000	–	20,000

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Notes to the consolidated financial statements continued

29. RELATED PARTIES continued

The movement during the previous reporting period in the number of ordinary shares of the Company, held directly, indirectly or beneficially, by each key management person, including their personally related parties is as follows:

In shares	Held at 1 September 2009	Purchases	Sales	Held at 31 August 2010
Directors				
Mr P R Robinson	67,300	134,868	–	202,168
Mr M Hampton	65,000	43,334	–	108,334
Ms E C Holley	10,000	6,667	–	16,667
Mr R D Millner	411,000	344,001	–	755,001
Mr S P Roche	70,000	266,667	–	336,667
Ms L Ausburn	50,000	33,334	–	83,334
Executives				
Mr J Meiliunas	292,609	–	–	292,609
Mr P Smith	242,607	20,000	(235,407)	27,200
Mr P Sanguinetti	5,000	3,334	–	8,334

29. RELATED PARTIES continued

Performance rights over equity instruments

The movement during the reporting period in the number of performance rights over ordinary shares in Australian Pharmaceutical Industries Limited held directly or beneficially, by each key management person, including their related parties, is as follows:

	Held at 1 Sept 10	Granted as compensation	Exercised	Other changes*	Held at 31 Aug 11	Vested during the year	Vested and exercisable at 31 Aug 11
Directors							
Mr S P Roche	610,500	**497,000	–	(279,600)	827,900	–	–
Executives							
Mr S Arthurson	–	174,400	–	–	174,400	–	–
Mr R Vincent	329,800	267,400	–	(151,800)	445,400	–	–
Mr P Sanguinetti	238,800	191,300	–	(111,400)	318,700	–	–
Mr M Langham	266,900	218,600	–	(121,400)	364,100	–	–
Mr T Mullins	–	232,600	–	–	232,600	–	–
Mr G Fallet	159,500	239,500	–	–	399,000	–	–

	Held at 1 Sept 09	Granted as compensation	Exercised	Other changes*	Held at 31 Aug 10	Vested during the year	Vested and exercisable at 31 Aug 10
Directors							
Mr S P Roche	367,100	330,900	–	(87,500)	610,500	–	–
Executives							
Mr J Meillunas	161,600	–	–	(161,600)	–	–	–
Mr R Vincent	198,700	178,000	–	(46,900)	329,800	–	–
Mr P Sanguinetti	111,400	127,400	–	–	238,800	–	–
Mr M Langham	142,000	145,500	–	(20,600)	266,900	–	–
Mr P Hourihan	–	179,400	–	(179,400)	–	–	–
Mr G Fallet	–	159,500	–	–	159,500	–	–

* Other changes represent performance rights that expired or were forfeited during the year.

No options held by key management personnel are vested but not exercisable at 31 August 2010 or 2011.

** Subject to shareholder approval.

No shares were granted during the period to Directors or senior executives.

Messrs R D Millner, and P R Robinson are Directors of Washington H Soul Pattinson and Company Limited. Washington H Soul Pattinson and Company Limited holds 120,214,969 shares (31 August 2010: 120,214,969 shares) in the Company at year end 31 August 2011.

During the year, further performance rights were issued by the Company to key management personnel and certain senior executives. Share rights forfeited by and issued to key management personnel have been disclosed in the Remuneration Report contained within the Directors Report of this report.

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Notes to the consolidated financial statements continued

29. RELATED PARTIES continued

Non Key Management Personnel Disclosures

Associates

During the year ended 31 August 2011, associates purchased goods from the consolidated entity in the amount of \$743,206 (year ended 31 August 2010: \$1,190,673) and at 31 August 2011 associates owed the consolidated entity \$82,185 (31 August 2010: \$77,331). Transactions with associates are priced on an arm's length basis. Non-current loans to associates was fully settled in cash and by issuance of equity shares in the Associate. Interest revenue brought to account by the Company and consolidated entity in relation to these loans during the year to 31 August 2011 was \$621,000 (August 2010: \$652,000).

No dividends were received from associates during the period ended 31 August 2011 nor for the period ended 31 August 2010.

30. AUDITORS' REMUNERATION

In AUD	Year ended 31 August 2011	Year ended 31 August 2010
Audit services		
Auditors of the Company		
<i>KPMG Australia:</i>		
Audit and review of financial reports	500,800	521,864
<i>Overseas KPMG firms:</i>		
Audit and review of financial reports	33,200	32,200
	534,000	554,064
Other services		
Auditors of the Company		
<i>KPMG Australia:</i>		
Other assurance services	5,250	5,000
Other advisory services	40,109	59,137
<i>Overseas KPMG firms:</i>		
Taxation services	11,400	41,914
	590,759	660,115

31. SUBSEQUENT EVENTS

Subsequent to 31 August 2011, the Company received commitments from its bankers (subject to final documentation) to extend the \$95,000,000 cash advance facilities to May 2014. In addition the \$70,000,000 Aspire securitisation facility was extended to May 2013.

On 20 October 2011, the Company obtained its lender's consents for breach of two loan covenants. The covenants relate to fixed charge cover and not achieving, during the 12 months ended 31 August 2011, a minimum performance target required under the lending terms. The basis of the performance target is the budgeted earnings before interest and taxes. The covenants apply to all Australian debt and no additional obligations were imposed by the lenders.

On 27 October 2011, a final dividend of 1.5 cents per share, unfranked to be paid on 15 December 2011, amounting to \$7,321,738 was declared.

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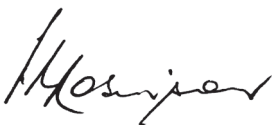
Directors' declaration

DIRECTORS' DECLARATION

- 1 In the opinion of the Directors of Australian Pharmaceutical Industries Limited ('API'):
- (a) the financial statements and notes set out on pages 21 to 68, and the Remuneration Report set out on pages 11 to 17 in the Directors' Report, are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the consolidated entity as at 31 August 2011 and of their performance, for the financial period ended on that date; and
 - (ii) complying with Australian Accounting Standards (including Australian Accounting Interpretations) and the Corporations Regulations 2001;
 - (b) the financial report also complies with International Financial Accounting Standards as disclosed in note 1(b); and
 - (c) there are reasonable grounds to believe that API will be able to pay its debts as and when they become due and payable.
- There are reasonable grounds to believe that API and the controlled entities identified in note 26 will be able to meet any obligations or liabilities to which they are or may become subject to by virtue of the Deed of Cross Guarantee between the Company and those controlled entities pursuant to ASIC Class Order 98/1418.
- 2 The Directors have been given the declarations by the chief executive officer and chief financial officer for the financial period ended 31 August 2011 pursuant to Section 295A of the Corporations Act 2001.

Dated at Melbourne, 11 November 2011

Signed in accordance with a resolution of the Directors:



Peter R. Robinson

Director

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Independent audit report

**Independent auditor's report to the members of Australian Pharmaceutical Industries Limited****REPORT ON THE FINANCIAL REPORT**

We have audited the accompanying financial report of Australian Pharmaceutical Industries Limited (the Company), which comprises the consolidated statement of financial position as at 31 August 2011, and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date, notes 1 to 31 comprising a summary of significant accounting policies and other explanatory information and the Directors' declaration of the Group comprising the Company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The Directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001 and for such internal control as the Directors determine is necessary to enable the preparation of the financial report that is free from material misstatement whether due to fraud or error. In note 1(b), the Directors also state, in accordance with Australian Accounting Standard AASB 101 Presentation of Financial Statements, that the financial statements of the Group comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001 and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Group's financial position and of its performance.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independent audit report continued



Independence

In conducting our audit, we have complied with the independence requirements of the Corporations Act 2001.

Auditor's opinion

In our opinion:

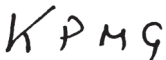
- (a) the financial report of the Group is in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Group's financial position as at 31 August 2011 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 1(b).

REPORT ON THE REMUNERATION REPORT

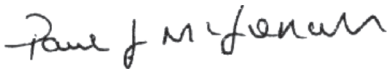
We have audited the Remuneration Report included in pages 11 to 17 of the Directors' report for the year ended 31 August 2011. The Directors of the Company are responsible for the preparation and presentation of the remuneration report in accordance with Section 300A of the Corporations Act 2001. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with auditing standards.

Auditor's opinion

In our opinion, the remuneration report of Australian Pharmaceutical Industries Limited for the year ended 30 August 2011, complies with Section 300A of the Corporations Act 2001.



KPMG



Paul J McDonald

Partner

Melbourne,

11 November 2011

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Shareholder information

ASX ADDITIONAL INFORMATION

Additional information required by the Australian Stock Exchange Limited Listing Rules and not disclosed elsewhere in this report is set out below.

Shareholdings as at 15 November 2011

Substantial shareholders

The number of shares held by substantial shareholders and their associates are set out below:

Washington H Soul Pattinson and Company Limited	120,214,969	ordinary shares
SL Nominees Pty Ltd	58,122,597	ordinary shares
J P Morgan Nominees Australia Limited	48,235,148	ordinary shares
Citicorp Nominees Pty Limited	39,690,401	ordinary shares
National Nominees Limited	31,636,235	ordinary shares

Voting rights

The voting rights attaching to the ordinary shares, as set out in clause 16.2 of the Company's Constitution, are:

- (a) on a show of hands:
 - (i) if a member has appointed two proxies, neither of those proxies may vote;
 - (ii) a member who is present and entitled to vote and is also a proxy, attorney or representative of another member has one vote; and
 - (iii) subject to paragraphs (a)(i) and (a)(ii), every individual present who is a member, or a proxy, attorney or representative of a member, entitled to vote has one vote;
- (b) on a poll every member entitled to vote who is present in person or by proxy, attorney or representative:
 - (i) has one vote for every fully paid share held; and
 - (ii) subject to paragraph (c), in respect of each partly paid share held has a fraction of a vote equal to the proportion which the amount paid bears to the total issue price of the share; and
- (c) unless:
 - (i) permitted under the Listing Rules; and
 - (ii) otherwise provided in the terms on which shares are issued,in calculating the fraction of a vote which the holder of a partly paid share has, the Company must not count an amount:
 - (iii) paid in advance of a call; or
 - (iv) credited on a partly paid share without payment in money or money's worth being made to the Company.

On-market share buy-back

There is no current on-market share buy-back.

Distribution of Shareholders as at 15 November 2011

Category	Number of Shareholders
Ordinary Shares	
1 – 1,000	1,568
1,001 – 5,000	2,718
5,001 – 10,000	1,144
10,001 – 100,000	1,953
100,001 and over	319
	7,702

The number of shareholders holding less than a marketable parcel at 15 November 2011 was 2,233 (18 October 2010: 1,265)

Stock Exchange

The Company is listed on the Australian Stock Exchange. The Home Exchange is Sydney.

Other Information

Australian Pharmaceutical Industries Limited, incorporated and domiciled in Australia, is a publicly listed company limited by shares.

Twenty largest Shareholders as at 15 November 2011*

Name	Number of Ordinary shares held	Percentage of Capital held
Washington H Soul Pattinson and Company Limited	120,214,969	24.63
J P Morgan Nominees Australia Limited	48,235,148	9.88
SL Nominees Pty Ltd	44,734,167	9.17
National Nominees Limited	31,636,235	6.48
Citicorp Nominees Pty Limited	29,546,041	6.05
HSBC Custody Nominees (Australia) Limited	22,022,334	4.51
Dancetown Pty Limited	13,388,430	2.74
Citicorp Nominees Pty Limited (Colonial First State In)	10,144,360	2.07
Equitas Nominees Pty Ltd (2882479 A/c)	6,300,000	1.29
Bell Potter Nominees Limited (BB Nominees A/c)	3,022,804	0.62
Cogent Nominees Pty Limited	1,995,946	0.41
McNeill Nominees Pty Ltd	1,750,000	0.35
Snowside Pty Limited (snowside A/c)	1,333,383	0.27
MLEQ Nominees Pty Limited	1,172,267	0.24
Goldman Sachs Australia Nominee Holdings	1,165,952	0.23
Mr Ernest Geoffrey Albers	1,000,000	0.20
Brohok Investment Company Pty Limited	1,000,000	0.20
Concord Pacific Investments Pty Ltd	1,000,000	0.20
Prudential Nominees Pty Limited	1,000,000	0.20
Milne Investments Pty Ltd	800,000	0.16
	341,462,036	69.95

* As shown on the register, beneficial holdings may differ.

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Shareholder information continued

Shareholder Communications

Enquiries or notifications by shareholders regarding their shareholdings or dividend should be directed to API's share registry:

Boardroom Pty Limited

Level 7

207 Kent Street

Sydney NSW 2000

GPO Box 3993

Sydney NSW 2001

Telephone 1300 737 760

International +61 2 9290 9600

Facsimile 1300 653 459

Shareholders can also send queries to the share registry via email:
enquiries@boardroomlimited.com.au

You can access information about your API shareholding and download forms via the internet by visiting:
www.boardroomlimited.com.au

Dividends

If you wish your dividends to be paid directly to a bank, building society or credit union account in Australia contact the share registry or visit the website of Boardroom at www.boardroomlimited.com.au for an application form. The payments are electronically credited on the dividend payment date and confirmed by payment advices sent through the mail to the shareholder's registered address. All instructions received remain in force until amended or cancelled in writing.

Tax File Number (TFN), Australia Business Number (ABN or exemption)

You are strongly advised to lodge your TFN, ABN or exemption with the share registry. If you choose not to lodge these details, then API is obliged to deduct tax at the highest marginal rate (plus the Medicare levy) from the unfranked portion of any dividend. Certain pensioners are exempt from supplying their TFN's. You can confirm whether you have lodged your TFN, ABN or exemption via the Boardroom website.

Uncertificated Forms of Shareholdings

Two forms of uncertificated holdings are available to API shareholders:

Issuer Sponsored Holdings:

This type of holding is sponsored by API and provides shareholders with the advantages of uncertificated holdings without the need to be sponsored by any particular stockbroker.

Broker Sponsored Holdings ('CHESS'):

Shareholders may arrange to be sponsored by a stockbroker (or certain other financial institutions) and are required to sign a sponsorship agreement appointing the sponsor as their 'controlling participant' for the purposes of CHESS. This type of holding is likely to attract regular stock market traders or those shareholders who have their share portfolio managed by a stockbroker.

Shareholders communicating with the share registry should have their Security Holder Reference Number (SRN) at hand or Holder Identification Number (HIN) as it appears on the Issuer Sponsored/ CHESS statements or dividend advices. For security reason, shareholders should keep their Security Holder Reference Numbers confidential.

Annual Report Mailing List

Shareholders (whether Issuer or Broker Sponsored) wishing to receive the Annual Report should advise Boardroom in writing so that their names can be added to the mailing list. Shareholders are able to update their preference via the Boardroom website. Shareholders can also elect to receive the Annual report by e-mail or by accessing the Company website.

Change of Address

Shareholders who are Issuer Sponsored should notify any change of address to the share registry promptly in writing quoting their Security Holder Reference Number, previous address and new address. Application forms for Change of Address are also available for download via the Boardroom website. Broker Sponsored (CHESS) holders must advise their sponsoring broker of the change.

Share Trading and Price

API shares are traded on the Australian Stock Exchange Limited ('ASX'). The stock code under which they are traded is 'API' and the details of trading activity are published in most daily newspapers under that abbreviation.

Off-Market Share Transfers

Stamp duty on transfer of listed shares was abolished on 1 July 2001. Share transfers dated after 1 July 2001 should be forwarded directly to Boardroom at the address noted above.

Information on API

API has an internet site featuring news items, announcements, corporate information and a wide range of product and service information. API's internet address is www.api.net.au

The Annual Report is the main source of information for shareholders. Other sources of information include:

- Interim results
- Annual results
- The Annual General Meeting - the Chairman and the Managing Director address the meeting
- ASX announcements

Financial Calendar*

Half year end	29 February 2012
Half year profit announcement	19 April 2012
Year end	31 August 2012
Full year profit announcement	25 October 2012
Annual General Meeting	15 January 2013

* Timing of events is subject to change

Requests for publications and other enquiries about API's affairs should be communicated to:

Company Secretary

Australian Pharmaceutical Industries Limited

885 Mountain Highway

Bayswater VIC 3153

Enquiries can also be made via email by accessing

www.api.net.au – "contact us"

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Corporate directory

Offices and Officers

Company Secretary

Mr Peter Sanguinetti B.Juris, LLB
Principal Registered Office
Australian Pharmaceutical Industries Limited
11 Grand Avenue
Camellia NSW 2142
Telephone: (02) 8844 2000
Facsimile: (02) 8844 2400

Location of Share Registry

Boardroom Pty Limited
Level 7
207 Kent Street
Sydney NSW 2000

GPO Box 3993
Sydney NSW 2001
Telephone 1300 737 760
International +61 2 9290 9600
Facsimile 1300 653 459
E-mail enquiries@boardroomlimited.com.au



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