Australian Pharmaceutical Industries Limited

Annual General Meeting

Address by the Managing Director & Chief Executive Officer, Stephen Roche

18 December 2007

Last year at the AGM we discussed the future for API and today I believe that we can demonstrate that we have gone a considerable way to restoring the company's position in the industry and its financial status, although there is still more work to do.

A year ago we set out with a purpose to fix the foundation of this business. Market share was in decline and the Sigma takeover proposal was causing unwanted distractions for us in the industry. We had to get the fundamentals right – critically our product and service offering, and to be consistent in delivering on our promise.

We determined that management time and attention was needed to focus on the core strengths of the company. The greatest return to API comes from Pharmacy distribution and the Priceline brands. Improving their performance was our priority.

A little over 12 months on from the last AGM and API has become the leading pharmaceutical distributor in the market, with sales growth above the industry average, and in addition, today we are now the fastest growing retailer as measured by the number of stores opened.

Today I will cover the methodical approach we took towards our operational performance and our next steps. This covers four main areas.

Firstly, API had very good assets, but we believed that it was imperative to reconnect with independent pharmacy to re-establish a level of confidence with API.

At the same time we needed to keep the Priceline brands operating well, particularly as it is the major growth opportunity for the company. It provides us with the key point of differentiation in the market from all competition and its growth is integral to our future.

Thirdly, the regulatory changes also led us to develop our generic pharmaceuticals position. The changes meant that having a long term partner in generics was important to maintain growth and relevance with independent pharmacy. The partnership with Alphapharm delivers that to API.

Finally, our competitiveness should be more than just growing sales – hence we need to be better at supply chain management and we are now looking to constantly improve our practices for increasing benefits to shareholders.

In regards to re-building API's base business with independent pharmacy, we added experienced management to our team, and concentrated on getting the fundamentals right – to that end our service levels for product delivery improved during the year. Our service reliability came to underpin our performance in 2007.

However being mindful that we had to improve our returns for shareholders, we carefully transitioned the business to once a day deliveries. This has not had any discernible negative affect on our business and will assist in improving margins.

We also looked at the effectiveness of the value added business services to independent pharmacists. This included, among other things, increased investment in the Soul Pattinson retail brand.

The new Soul Pattinson stores are leveraging our retail expertise and the format goes beyond refitting, they include a detailed core ranging or category management program which is having the effect of increasing sales and gross profit across the pharmacy.

The first stores to adopt the new branding program are reporting increases to GP in key categories, such as analgesics, medicinal health and vitamins of between 27% and 55%.

We see that delivering these business services and reliability is part of increasing the collaboration with customers. Our goal is that we build this more and look towards further treating individual pharmacists in a way that best suits their needs. Some will require product only, some a level of retail services - however it is about keeping that balance right.

During the year we also needed to address the performance of the Retail division. The traditional Priceline stores owned by the company experienced good trading for Christmas 2006, however the results became softer than anticipated in the early months of 2007.

The management team reviewed the brand and conducted research that has led to a gradual but effective change in the brand position.

The review undertaken during the year provided us with the tools to improve the brand offering to customers and in September we implemented sponsorship of the "30 Days of Fashion". This was the first time the brand had diverged from catalogue marketing for many years. The market research indicated that we needed to broaden the demographic appeal of the brand.

The results have been very pleasing and immediately injected new life into what is one of the most well known brands in this market. As you will see shortly the like-for-like traditional Priceline store growth has been at 6% in the past three months which we believe is very good in the current trading conditions. The work on the brand is not yet complete and developments will continue to be rolled out in coming months.

The focus on the Priceline brands has been thrown into sharper context since we made the decision to divest our non-core retail assets. API believed that the franchise brands of House and Price Attack were in less attractive markets and were not going to provide a substantial return to the company. As such it made little sense for API to hold onto them and they were sold without diluting shareholder value.

The health and beauty categories are far more attractive to us than either professional hair care or homewares, and API has the ideal position from which to grow its presence in these markets.

Now turning to our Priceline brands. API is continuing to open approximately 50 Priceline Pharmacy stores each year. It now has almost 140 stores and combined with our traditional Priceline stores we have a footprint of more than 280 stores.

API believes the acceptance the brand has gained is because it is providing what the stakeholders want, whether that be pharmacists, suppliers, consumers or API. We are experiencing excellent demand from pharmacists to be part of the brand and, in general, their experiences are overwhelmingly positive. Same store year-on-year growth at more than 14% for the first quarter is a testament to this and it tells us that consumers like the experience they have in a Priceline Pharmacy.

Indeed the consumer research we've conducted tells us that it has many points that are attractive to our targeted consumer. She can get the products she wants in a friendly, open environment where she can also browse comfortably. In addition she can try a broader range of products, get value for money and advice.

The penetration into key categories signals both the strength and opportunity. In some beauty categories the Priceline brands have up to 20% national share of the category – this is the total national market – not just pharmacy. For example the beauty categories of lips, colour cosmetics and skin care are where we have a disproportionate share compared to our size.

The big opportunity for us lies in the health categories where our market share is low, sometimes as low as 2% in key areas, but we are experiencing very high growth rates. For example, where we have targeted specific categories like weight loss, we have been able to grow sales more than 200% since launch, demonstrating the effectiveness of the retail brand.

The success of these developments has seen us gain very good support from suppliers who wish to partner with us in this market segment. We believe the brands occupy a unique position in the Australian market across the health and beauty categories.

Finally, the financial returns to API have been measured and over time we anticipate the returns to API will increase.

The next major project was for us to determine API's position in the generic pharmaceuticals market.

The strength of API's retail and pharmacy distribution strategies came into their own when we were looking for a solution to generic pharmaceuticals.

The government's PBS reforms made this segment of the pharmaceuticals market an area in which API had to take a position. The reforms are such that they encourage generic substitution and we expect generics will significantly increase their penetration. We did not believe that investing in our own generics company made sense, so we sought to lock in a strategic partnership. It had to be a global player with access to a strong product pipeline, low cost of goods and preferably with a presence in the Australian market.

After a review process we were able to agree a partnership with Alphapharm, where we became their preferred distributor and they became a preferred supplier to our brands.

Alphapharm is Australia's leading generics brand, representing 20% of prescriptions by volume on the PBS.

They are well known to pharmacists and patients and, as part of the global pharmaceutical company Mylan, we expect they will be a major player in the industry for many years to come.

This is the first time that Alphapharm products have been available at the best prices through one of the major pharmaceutical distributors. This means we now service more than 4000 pharmacists on a daily basis and hence we are rapidly increasing our industry exposure.

Alphapharm was keen to partner with API because of its distribution strength, but also because of the strength of our retail pharmacy brands. As a result our pharmacy brands can also access a preferred deal with Alphapharm just by being part of our branded groups.

I'm pleased to report that despite the size of the program to bring Alphapharm products into API, the transition has been relatively smooth and, with some standard teething issues to one side, it is meeting our expectations.

As I mentioned earlier our competitiveness needs to rely on more than being good at increasing sales. At API we need to unlock further value in the supply chain.

It is an area that we have long wanted to address, however it was important to ensure the core business base was sound first.

As I've already mentioned, a project commenced earlier in the calendar year to streamline deliveries to one per day in each state and this has progressed well.

Now the extra volume created by Alphapharm also presents us with the real chance to better utilise our assets with increased volumes.

API has had supply chain assets operated separately between the main divisions, and now we are looking at the feasibility of bringing those requirements together to create a more efficient and competitive supply chain. We are scoping the first phase of that work, and sensibly we expect that there are working capital and infrastructure savings to be gained over time.

We will provide more colour on this project in coming months, however, like the generics situation we are committed to maximising our position for shareholders and making API the most competitive company in this industry.

As the Chairman has mentioned, the approach we've taken is bringing us improved sales results in the first quarter of the current financial year.

The pharmacy business had shown positive signs in the last four month period and now both major divisions are demonstrating better results.

Total company sales are up by 16.0% on the same three month period last year to $770 million.

Retail sales are up 7.0% in total, with Priceline Pharmacy showing 14.6% same store growth, traditional Priceline stores are showing 6.0% same store growth. Both these results are very pleasing in the current trading environment which was more challenging around the election.

Pharmacy sales are up 19%, if Alphapharm is excluded, we still achieved double digit growth, again showing the consistent improvement in performance.

As always the Christmas trading period will be crucial and we've seen some softness in trading both before and after the election, however we are only now entering the critical week immediately before Christmas day.

Management is committed to building on the position that has now been established for API. We are now leading the market in many areas and we intend to continue on this path.

We will be focused on our plan of creating API as the leading company in the retail health and beauty sector in Australia.

As the Chairman has already said, we have work to do on our capital management strategy and we are working closely with the Board on this project.

I would like to specifically thank our staff who have also endured a difficult year and who have applied themselves exceptionally well to the rebuilding task. Together with the Board we believe that much better prospects lie ahead.

In summary, we have re-established API and placed us in industry leading positions from which we now need to focus on maintaining steady growth and generating better returns for shareholders.