

Australian Pharmaceutical Industries Limited  
and its controlled entities  
ABN 57 000 004 320

Annual report  
30 April 2007

# Australian Pharmaceutical Industries Limited and its controlled entities Directors' report

For the year ended 30 April 2007

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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 30 April 2007 and the auditor's report thereon.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report

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### Directors

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

<b>Name, qualifications and independence status</b>	<b>Experience, special responsibilities and other directorships</b>
<b>Mr Peter R. Robinson</b> , <i>B.Com</i> Chairman Non-executive director - age 55	Appointed Chairman 8 July 2003. Director since 5 May 2000.  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 SP Telemedia Limited.  During the last 3 years Mr Robinson has also been a non-executive director of KH Foods Limited (1987-2006).
<b>Mr Barry A. Frost</b> , <i>B.Pharm, FPS, FAIPM, Dip.Fin.Plan.</i> Deputy Chairman Independent non-executive director - age 64	Appointed Deputy Chairman 1 July 2001. Director since 20 September 1993. Member of the Remuneration Committee. Member of the Audit and Risk Committee – appointed 22 December 2006.  Mr Frost is a pharmacist, a Fellow of the Pharmaceutical Society of Australia and a Fellow of the Australian Institute of Pharmacy Management.
<b>Mr David J. Fairfull</b> , <i>B.Com, CPA, fFin, MAICD, ACIS.</i> Non-executive director - age 65	Director since 5 May 2000. Member of the Audit and Risk Committee - retired 22 December 2006.  Mr Fairfull is a non-executive director of Washington H Soul Pattinson and Company Limited and has been a director of Washington H Soul Pattinson and Company Limited since 1997.  Mr Fairfull is a non-executive director of New Hope Corporation Ltd, SP Telemedia Limited and Souls Private Equity Limited.  During the last 3 years, Mr Fairfull has also been a non-executive director of KH Foods Limited (1997-2004), Clover Corporation Limited (2002-2004), Gazal Corporation Limited (1987-2004) and Stockland Limited (1990-2006).
<b>Mr Robert D. Millner</b> , <i>FAICD</i> Non-executive director - age 56	Director since 5 May 2000. Member of the Audit and Risk Committee – retired 22 December 2006.  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, Brickworks Investment Company Limited, Choiseul Investments Limited, SP Telemedia Limited, Souls Private Equity Limited, New Hope Corporation Limited and Milton Corporation Limited.  During the last 3 years Mr Millner has also been a non-executive director of KH Foods Limited (1994-2004).

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

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### Directors (continued)

Name, qualifications and independence status	Experience, special responsibilities and other directorships
<b>Mr John W. Murphy</b> , <i>B.Com, M.Com, CA, FCPA</i> Non-executive director – age 54	<p>Director since 7 October 2004. Appointed Chairman of the Remuneration Committee 3 April 2005. Appointed Acting Chairman of the Audit and Risk Committee from 13 August 2006 until 19 December 2006.</p> <p>Mr Murphy is the Managing Director of Investec Wentworth Private Equity Limited and in this capacity is a board member of the fund's investments, including the following listed companies: Fone Zone Group Limited, Specialty Fashion Group Limited and AAV Limited.</p> <p>Mr Murphy is also a non-executive director of First Opportunity Fund Limited and Investec Bank (Australia) Ltd.</p> <p>During the last 3 years, Mr Murphy has also been a non-executive director of the following listed companies: Southcorp Limited (2003-2005), Invocare Limited (2001-2005) and SMS Management and Technology Limited (2001-2004).</p> <p>Alternate director – Mr Greg Robertson.</p>
<b>The Hon Dr Michael R. Wooldridge</b> , <i>BSc, MBBS, MBA</i> Independent non-executive director - age 51	<p>Director since 1 February 2006.</p> <p>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.</p> <p>Dr Wooldridge is Deputy Chairman of Resonance Health Ltd, Chairman of Dia-b Tech Limited, and a Director of Cogstate Ltd.</p>
<b>Ms E. Carol Holley</b> , <i>B.A, FCA, FAICD</i> Independent non-executive director - age 58	<p>Director since 19 December 2006. Appointed Chair of the Audit and Risk Committee on 19 December 2006.</p> <p>Ms Holley is the Chair of Resource Pacific Holdings Ltd, Job Futures Ltd and Cochlear Foundation Ltd.</p> <p>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.</p> <p>During the last 3 years, Ms Holley has also been a non-executive director of Cochlear Limited (1995-2004).</p>
<b>Mr Stephen P. Roche</b> , <i>B.Bus, GAICD</i> Executive director – age 45	<p>Managing Director and Chief Executive Officer since 14 August 2006.</p> <p>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 &amp; Co and a number of management roles at CSR.</p>

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

### Directors (continued)

**Mr Jeffrey C. Sher, B.Arts, MBA.**  
Executive director – age 48

Managing Director and Group Leader from 7 October 2004 until 11 August 2006.

Resigned with effect from 11 August 2006

Mr Sher had extensive experience in retailing, having been involved with leading brand Priceline since 1993 until his resignation.

**Mr Michael S. Smith, M.Sc., B.Pharm(Hons),  
Diploma of Business Administration**  
Independent non-executive director - age 61

Director from 25 August 1981 to 30 September 2006.  
Chairman of the Audit and Risk Committee from 1 July 2001 until 13 August 2006.

Resigned 30 September 2006

Mr Smith is a pharmacist.

### Company Secretary

Mr Christopher J. Gardoll CA, B.Bus was appointed to the position of Company Secretary in October 1998. Mr Gardoll previously held the role of Partner with a major accounting firm for 14 years. He was Chief Financial Officer of the Company from October 1998 to 6 March 2006.

### Officers who were previously partners of the audit firm

Mr Gardoll, an officer of the Company during the financial year, was previously a partner of the current audit firm, KPMG, at a time when KPMG undertook an audit of the Company (he resigned from KPMG in October 1998).

### 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 financial year were:

Director	Directors' Meetings		Audit and Risk Committee Meetings		Remuneration Committee Meetings	
	Number attended	Number held*	Number attended	Number held*	Number attended	Number held*
Mr P R Robinson**	25	25	-	-	-	-
Mr B A Frost	25	25	2	2	3	3
Mr D J Fairfull	25	25	8	8	-	-
Mr R D Millner	21	25	8	8	-	-
Mr J W Murphy	25***	25	10	10	3	3
Mr M S Smith	14	14	2	2	-	-
Mr J C Sher	10	10	-	-	-	-
Mr M R Wooldridge	24	25	-	-	-	-
Ms E C Holley	4	4	2	2	-	-
Mr S P Roche	14	14	-	-	-	-

\* Number of meetings held during the time the director held office or was a member of the committee during the year.

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

\*\*\* One of these meetings was attended by Mr Murphy's alternate director, Mr Robertson.

### Corporate Governance Statement

The Board recognises the importance of a strong governance framework and culture throughout the organisation. In its Annual Report for 2006, the Board outlined that it was reviewing its governance framework, including with a view to continuing to improve adherence to the ASX Recommendations.

In addition, the Board stated in its annual results presentation on 14 August 2006, that it was fast tracking improvements in its financial team. These improvements would build on recommendations made by the auditor and by the external consultant to the Company (following their review of the Company's net unreconciled balance of \$17.178 million for the year ended 30 April 2006) and the qualification in the auditor's report for that year.

The last year has seen significant transformation and progress in these areas, including:

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

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- A restructured senior management team reporting by business unit with clear objectives and accountability
- A review and update of the Board and Committee charters and Company policies ( which are published on the Company's website)
- A strengthened financial team, through the appointment of an interim Chief Financial Officer from 20 October 2006 to 1 June 2007, the appointment of a new Chief Financial Officer, David Marr, as of 1 May 2007 and the appointment of a Risk and Internal Audit Manager
- The appointment of Carol Holley as a director. Upon her appointment, Ms Holley has assumed the role as Chair of the Audit and Risk Committee.

With the significant progress made, the Board is satisfied that the Company adheres to all of the ASX Recommendations, other than the recommendation that a majority of directors be independent. This is described in more detail below under "Independence of Directors". The Board is, however, continuing to undergo a process of review and renewal and expects to make an announcement on further changes shortly.

### **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 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 Company 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 Company 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 Company information and to the Company's executives and, subject to prior consultation with the Chairman, may seek independent professional advice from a suitably qualified adviser at the Company'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 on pages 3 to 5 of the Directors' Report.

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

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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.
- Re-election of directors every three years (except for the Managing Director).

### **Independence of Directors**

The Board considers that all directors, other than the Managing Director, are independent of management influence.

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 holder;
- 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 material\* professional adviser or a material\* consultant to the Company or another group member;
- Is not a material\* supplier or customer of the Company or another group member, or an officer of or otherwise associated, directly or indirectly, with a material\* supplier or customer;
- Has no material\* 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, materially\* interfere with the director's ability to act in the best interests of the Company.

\* 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.

The Board confirms that all directors meet the stated requirements for independence as set out in the ASX Recommendations, except that:

- As identified earlier in this Report, 3 directors (Mr Robinson, Mr Millner and Mr Fairfull) are directors of the Company's major shareholder, Washington H Soul Pattinson and 1 director (Mr Murphy) is the managing director of Investec Private Equity Limited (the manager of 2 funds that, together, held a substantial holding interest in the Company namely Investec Wentworth Private Equity Fund and MGB Equity Growth Unit Trust No 2). The shares held by the funds were sold on 26 March 2007. As noted earlier, the Board does not consider that these relationships impact their ability to bring an independent mind and judgement to the Board. They are subject to re-election by shareholders every 3 years and follow strict conflict procedures, if potential conflicts arise.

### **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 "Board Composition"). 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.

## Australian Pharmaceutical Industries Limited and its controlled entities

### Directors' report (continued)

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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 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, incentive performance packages, superannuation entitlements, retirement and termination entitlements, fringe benefits policies and indemnity and liability insurance policies.

The members of the Remuneration Committee during the year were:

Mr J W Murphy – Non-executive  
Mr B A Frost – Independent non-executive

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 30 April 2007 were:

Ms E C Holley (Chair) – Independent non-executive – appointed 19 December 2006  
Mr J W Murphy – Non-executive – retired as Acting Chairman of the Audit and Risk Committee 19 December 2006  
Mr M S Smith (Chairman) – Independent non-executive – retired from the Audit and Risk Committee 13 August 2006  
Mr R D Millner – Non-executive – retired from the Audit and Risk Committee 22 December 2006  
Mr D J Fairfull – Non-executive - retired from the Audit and Risk Committee 22 December 2006  
Mr B A Frost – Independent non-executive – appointed 22 December 2006

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 Committee met ten times during the year.

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.
- 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:

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

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- 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.
- 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 operational, financial reporting, and compliance risks for the consolidated entity.

#### *Managing Director and Chief Financial Officer assurances*

The Managing Director and Chief Financial Officer provide an assurance to the Board, for annual and half-yearly financial reports. This assurance was given by the Managing Director and by the interim Chief Financial Officer for the half year ended 31 October 2006 and by the Managing Director and the Chief Financial Officer for the year ended 30 April 2007. They gave assurance 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 aspects.
- 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 Company's books and records have been adequately maintained.
- The Company'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**

Major risks to the operations of the consolidated group 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, and the purchase, development and use of information systems.

#### **Risk management**

The Board has the overall responsibility for the Company's risk management and internal control framework, with delegation to the Audit and Risk Committee to oversee the process. The Company'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 Company's business activities. The internal control systems which have been adopted by the Company aim to develop a culture which is able to identify, communicate and manage risk.

The Company's financial control processes and procedures including a comprehensive review of the risk management and compliance and control framework was undertaken during the year by an external accounting firm. Key recommendations on changes to processes and procedures identified in this review have been implemented with other recommendations being progressively implemented.

During the year the Company appointed a full time internal auditor 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 Company 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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

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### *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 the Commonwealth, State and New Zealand legislation in relation to its manufacture of pharmaceutical products, retail stores and pharmaceutical distribution facilities.

Pharmaceutical 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**

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

- Aligning the behaviour of the Board and management with the Code of Conduct by maintaining appropriate core Company values and objectives.
- Usefulness of financial information by maintaining appropriate accounting policies and practices and disclosure.
- 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 the 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.
- Compliance with laws and reporting suspected breaches of laws.

### **Trading in Company securities by directors and employees**

The key elements of the Company's Share 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 Companyprovided 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.
- Identification of processes for unusual circumstances where discretions may be exercised in cases such as financial hardship.

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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

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### Communication with shareholders

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.
- 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 Continuous Disclosure Policy is promoted to all Directors, officers and employees through publication in the Company's intranet.

In addition:

- The full annual financial report is distributed to all shareholders (unless a shareholder has specifically requested not to receive the document), including 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.
- 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.

### Remuneration report

This Remuneration report forms part of the Directors' report.

For the purposes of this Remuneration report, key management personnel have authority and responsibility for planning, directing and controlling the activities of the consolidated entity, including directors of the Company and senior executives. Key management personnel comprise the directors of the Company and the 5 most highly remunerated executives of the Company and the consolidated entity for the purposes of section 300A of the Corporations Act.

### Remuneration policies and principles

Remuneration levels are competitively set to attract and retain appropriately qualified and experienced directors and senior executives. The Remuneration Committee obtains independent advice on the appropriateness of remuneration packages, given trends in comparative companies locally. The Committee reviews the remuneration of directors and senior executives annually.

#### ***Non executive directors***

Under the Company's constitution, the maximum aggregate remuneration available for division among the non-executive directors is to be determined by the shareholders in a general meeting. The maximum aggregate is currently fixed at \$595,000. This amount (or part of it) is divided among the non-executive directors as determined by the Board.

Directors' fees cover all Board and Board committee activities. Superannuation is paid for non-executive directors at the statutory prescribed rate.

Non-executive directors do not receive performance-related remuneration.

Under the Board's Retirement Scheme, which was approved by shareholders at the 1994 Annual General Meeting, after 10 years service, retiring non-executive directors receive, on a sliding scale capped at \$220,000, benefits up to a maximum of three times the average annual remuneration in the three years preceding retirement. The scheme does not apply to directors first appointed after 9 September 2003.

Details of directors' remuneration are set out below and in note 29 to the financial statements.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

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### ***Executive director and senior executives***

Remuneration packages include a mix of:

- Fixed remuneration.
- Performance linked remuneration.

#### *Fixed remuneration*

Fixed remuneration consists of base remuneration (which is calculated on a total cost basis and includes any FBT charges related to employee benefits including motor vehicles), as well as employer contributions to superannuation funds.

Remuneration levels are reviewed annually by the Remuneration Committee through a process that considers individual segment and overall performance of the consolidated entity. In addition, external consultants provide analysis and advice to ensure that senior executives' remuneration is competitive in the market place. A senior executive's remuneration is also reviewed on promotion.

#### *Performance linked remuneration*

Performance linked remuneration includes both short-term and long-term incentives and is designed to reward executive directors and senior executives for meeting or exceeding their financial and personal objectives. The short-term incentive (STI) is an 'at risk' bonus provided in the form of cash, while the long-term incentive (LTI) is provided as performance rights over ordinary shares of the Company under the rules of API's Long Term Incentive Plan.

#### *Short-term incentive bonus*

Each year the Remuneration Committee sets the KPI's (key performance indicators) for the executive director and senior executives. The KPI's generally include measures relating to the consolidated entity, the relevant segment and the individual. They include financial, people, customers, strategy and risk measures. These measures are chosen as they directly align the individual's reward to the KPI's of the consolidated entity and to its strategy and performance.

The financial performance objectives are 'profit after tax' and 'net debt' compared to budgeted amounts. The non-financial objectives vary with position and responsibility and include measures such as achieving strategic outcomes, safety and environmental performance, customer satisfaction and staff development. Financial and non-financial objectives each account for varying percentages of the maximum STI, depending upon the executive's role.

At the end of the financial year, the Remuneration Committee assesses the actual performance of the consolidated entity, the relevant segment and individual against the KPI's set at the beginning of the financial year. For each key management personnel, a percentage of the pre-determined maximum amount is awarded depending on results. No bonus is awarded where performance falls below applicable KPI targets.

The Remuneration Committee recommends the cash incentive to be paid to the individuals for approval by the Board. This method of assessment was chosen as it provides the Committee with an objective assessment of the individual's performance.

The Company applies a similar system for staff generally, through the annual strategic planning process.

For the year ended 30 April 2007, the Company has not paid any short term incentives to key management personnel.

#### *Long-term incentive bonus*

The Remuneration Committee had responsibility for API's Long Term Incentive Plan established during the year ended 30 April 2006. The Remuneration Committee is responsible for determining awards to be granted under the Plan, as well as overseeing administration of the Plan. The Remuneration Committee is currently finalising the performance conditions for an issue of performance rights to key executives.

A performance right is a right to be provided with a fully paid ordinary share in the Company. Under the Plan, shares can either be purchased on market on behalf of the participant, or new shares issued by the Company.

If a performance right is satisfied through the achievement of a performance condition (as described below), a participant has approximately 6 months from that time to exercise it and be provided with a share in API.

The performance conditions for the exercise of performance rights will be assessed after 3 years from the date they are granted. 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.

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

The performance conditions for the performance rights are designed to take account of absolute and relative measures, being:

- the Company's total shareholder return (TSR) performance relative to the total shareholder return performance of a comparator group of ASX-listed companies; and
- the Company's earnings per share (EPS) relative to an EPS growth target determined by the Board.

For any participant, one half of the total performance rights granted will be assessed against the TSR measure and the other half will be assessed against the EPS measure.

The TSR performance condition has the effect that:

- none of the performance rights subject to the TSR performance condition may be exercised at the end of the performance period, unless API's TSR performance is at least above the median level when compared against the comparative group; and
- if API's TSR is at or above the 75<sup>th</sup> percentile, all the performance rights subject to this condition can be exercised.

The EPS performance condition has the effect that:

- none of the performance rights subject to the EPS performance condition may be exercised unless API's actual EPS performance over the performance period results in EPS that is equivalent to at least 10% per annum compound EPS growth over the 3 year period; and
- if API's actual EPS performance results in EPS over the performance period that is equivalent to being at or above 15% per annum, compound EPS growth over the same period, all the performance rights subject to this condition can be exercised.

### Consequences of performance on shareholders' wealth

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.

The following table shows the Company's annual performance over a 5 year period, spanning 1 May 2002 to 30 April 2007, 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:

	2007	2006	2005	2004	2003
Net (loss)/profit after tax (\$m)	(\$11.485)	\$20.374	\$34.781	\$18.444*	\$23.567*
Dividends paid – cents per share	3.00	9.25	13.0	13.0	13.0
Share price at 30 April	\$2.20	\$2.48	\$2.75	\$2.56	\$2.76
Return of capital	Nil	Nil	Nil	Nil	Nil

\* Net profit after tax for 2004, and 2003 was calculated under the former AGAAP.

### Service contracts

The Company has entered into service contracts with key management personnel. 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 strategy outlined above.

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 months written notice.
- The Company may summarily terminate Mr Roche's employment in specified circumstances with immediate effect.
- The Company may terminate Mr Roche's employment by the giving of twelve months written notice and may make a termination payment in lieu of notice of up to twelve months fixed remuneration.

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

All other key management personnel agreements have service contracts with notice periods of 12 months. The Company may summarily terminate the employment in specified circumstances with immediate effect. All key management personnel are subject to a twelve month non-compete restriction after cessation of employment.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

### Directors' and senior executives' remuneration

Details of the nature and amount of each major element of the remuneration for the year ended 30 April 2007 (and the previous period) of each director and each of the executives of the Company and the consolidated entity receiving the highest emoluments are:

		Short Term		Post employment	Other long term	Termination payments	Equity	Total	Proportion of remuneration performance related (%)	Value of options as proportion of remuneration (%)
		Salary & Fees \$	Short-term incentives \$	Non-monetary benefits \$	Super-annuation Contribution \$	\$	\$	Value of Options & Rights \$		
<b>Directors</b>										
<i>Non-executive</i>										
Mr P R Robinson	2007	127,000	-	-	11,430	-	-	138,430	-	-
	2006	127,000	-	-	11,430	-	-	138,430	-	-
Mr D J Fairfull	2007	52,000	-	-	4,680	29,700	-	86,380	-	-
	2006	52,000	-	-	4,680	15,150	-	71,830	-	-
Mr B A Frost	2007	87,000	-	-	7,830	-	-	94,830	-	-
	2006	87,000	-	-	7,830	-	-	94,830	-	-
Mr R D Millner	2007	52,000	-	-	4,680	29,700	-	86,380	-	-
	2006	52,000	-	-	4,680	15,150	-	71,830	-	-
Mr M S Smith (resigned 30 September 2006)	2007	23,750	-	-	2,117	-	-	25,867	-	-
	2006	57,000	-	-	5,130	-	-	62,130	-	-
Mr J W Murphy	2007	57,000	-	-	-	-	-	57,000	-	-
	2006	57,000	-	-	-	-	-	57,000	-	-
Mr M R Wooldridge	2007	52,000	-	-	4,680	-	-	56,680	-	-
	2006	13,000	-	-	1,170	-	-	14,170	-	-
Ms E C Holley (appointed 19 December 2006)	2007	26,571	-	-	2,391	-	-	28,962	-	-
	2006	-	-	-	-	-	-	-	-	-
<i>Executive</i>										
Mr S P Roche – Managing Director/CEO (appointed 14 August 2006)	2007	648,072	-	-	12,595	-	-	660,667	-	-
	2006	387,440	-	-	12,140	-	-	399,580	-	-
Mr J C Sher – Group Leader (resigned 11 August 2006) **	2007	299,612	-	-	27,742	1,078,027	-	1,405,381	-	-
	2006	605,380	153,592	16,368	79,650	8,556	22,157	885,703	19.8	2.5
<b>Total directors</b>	2007	1,425,005	-	-	78,145	59,400	1,078,027	2,640,577	-	-
	2006	1,437,820	153,592	16,368	126,710	38,856	22,157	1,795,503	-	-
<b>Executives</b>										
Mr S Burrow - Leader Marketing & Communication (resigned 30 November 2006)	2007	180,389	-	-	9,191	-	320,998	510,578	-	-
	2006	290,304	-	-	23,424	-	-	313,728	-	-
Mr C Gardoll – Company Secretary	2007	235,752	-	28,004	58,938	6,055	-	328,749	-	-
	2006	235,752	14,500	30,029	57,109	6,055	-	343,445	-	-
Mr J Meiliunas –General Manager OD / HR	2007	300,488	-	-	12,595	-	-	313,083	-	-
	2006	287,954	-	12,134	12,046	-	-	312,134	-	-
Mr P Smith – General Manager Retail	2007	389,958	-	-	15,801	-	-	405,759	-	-
	2006	348,625	-	15,322	31,377	-	-	395,324	-	-
Mr S Kilner – Leader Information Management *	2007	113,849	-	-	5,248	-	-	119,097	-	-
	2006	269,097	-	5,738	11,128	-	-	285,963	-	-
Mr R Vincent – General Manager Pharmacy Distribution	2007	336,092	-	-	12,595	-	-	348,687	-	-
	2006	265,448	-	-	12,140	-	-	277,588	-	-
Mr R Tassie – General Manager Corporate Affairs*	2007	109,970	-	-	7,347	-	-	117,317	-	-
	2006	-	-	-	-	-	-	-	-	-
Mr D Lucas – Leader Finance & Administration (Appointed 6 March 2006, resigned 18 August 2006)	2007	130,954	-	-	4,046	-	547,853	682,853	-	-
	2006	61,207	-	-	2,023	-	-	63,230	-	-
Mr I McDonald – CEO Pharmacy ***	2007	-	-	-	-	-	-	-	-	-
	2006	234,999	121,645	30,010	52,968	16,381	643,325	1,099,328	26.7	-
<b>Total executives (Company &amp; consolidated entity)</b>	2007	1,797,452	-	28,004	125,761	6,055	868,851	2,826,123	-	-
	2006	1,993,386	136,145	93,233	202,215	22,436	643,325	3,090,740	-	-
<b>Total directors and executives (Company &amp; consolidated entity)</b>	2007	3,222,457	-	28,004	203,906	65,455	1,946,878	5,466,700	-	-
	2006	3,431,206	289,737	109,601	328,925	61,292	643,325	4,886,243	-	-

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.

The value of options is calculated at grant date using the Binominal model. The value is allocated to each reporting period evenly over the period from grant date to vesting date.

\* Mr Kilner was defined as an executive from 1 May 2006 to 30 September 2006. Mr Tassie was defined as an executive from 1 October 2006. Their remuneration is only included for the period during which they were executives.

\*\* At the time API acquired New Price Retail in October 2004, Mr Sher had some outstanding legacy amounts owing to companies in the NPR group. The nature of these loans and the circumstances in which they became repayable were complex and related to Mr Sher as a former shareholder of NPR. API did not ascribe any value to these legacy amounts

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

on acquisition. At the time of Mr Sher's separation from API in August 2006, it was important to him that there was a formal recording about these legacy items. While this was recorded as a payment to Mr Sher and an immediate repayment by him, there was no net amount received by him from API as a result."

\*\*\* Mr McDonald has been included in 2006, due to his termination payment making him the highest paid executive.

^ Messrs Sher, Gardoll, and McDonald were paid bonuses in the year ended 30 April 2006 which were in respect of the year ended 30 April 2005 short-term incentive program. These bonus amounts were not accrued into the 2005 result. As noted earlier, no STI bonuses were paid in respect of the year ended 30 April 2006.

### Specific bonus and equity remuneration analysis

#### Analysis of bonuses included in remuneration

Details of the vesting profile of the short-term incentive cash bonuses awarded as remuneration to a director of the Company and each of the named Company and consolidated entity executives in respect of the current year are detailed below:

	Short term incentive bonus		
	Included in remuneration \$(A)	% vested in year	% forfeited in year (B)
<b>Executive Director</b>			
Mr S Roche	-	0%	100%
Mr J Sher	-	0%	100%
<b>Executive officers (excluding directors)</b>			
Mr S Burrow	-	0%	100%
Mr C Gardoll	-	0%	100%
Mr G Meiliunas	-	0%	100%
Mr P Smith	-	0%	100%
Mr S Kilner	-	0%	100%
Mr R Vincent	-	0%	100%
Mr D Lucas	-	0%	100%

(A) Amounts included in remuneration for the financial year represents the amount that vested in the financial year based on achievement of personal goals and satisfaction of specified performance criteria. No amounts vest in future financial years in respect of the short-term incentive bonus schemes for the year ended 30 April 2007.

(B) The amounts forfeited are due to the performance or service criteria not being met in relation to the year ended 30 April 2007.

#### Analysis of options and performance rights over equity instruments granted as compensation

Details of vesting profile of the performance rights awarded and options granted as remuneration to each director of the Company and each of the eight named Company and consolidated entity executives is detailed below.

##### Performance rights

Executive Director	Performance rights granted		% vested in year	Forfeited in year (A)	Financial years in which grant vests	Value yet to vest \$*	
	Number*	Date				Min (B)	Max (C)
Mr J Sher	53,000	28 September 2005	0%	100%	30 April 2009	Nil	N/A

The fair value of each performance right at grant date was \$2.15. The exercise price was nil.

\* Mr Sher's performance rights lapsed on his resignation from the Company as of 11 August 2006.

No other options or performance rights were granted during the year ended 30 April 2007.

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

##### Options

Consolidated entity executives	Options granted		% vested in year	Forfeited in year (A)	Financial years in which grant vests	Value yet to vest \$	
	Number	Date				Min (B)	Max (C)
Mr C Gardoll	60,000	4 June 2002	0%	0%	30 April 2008	Nil	N/A

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

(B) The minimum value of performance rights or options yet to vest is \$nil as the performance criteria may not be met and consequently the performance right or option may not vest.

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

(C) *The maximum value of performance rights and options yet to vest is not determinable as it depends on the market price of shares of the Company on the Australian Securities Exchange at the date the performance right or option is exercised.*

### Analysis of movements in performance rights

The movement during the reporting period, by value, of performance rights over ordinary shares in the Company held by the former Managing Director is detailed below.

	Value of Performance Rights			
	Granted in year \$ (A)	Exercised in year \$ (B)	Forfeited in year \$ (C)	Total performance rights value in year \$
<b>Executive Director</b>				
Mr J Sher*	-	-	22,157	-

\* Mr Sher's performance rights lapsed on his resignation from the Company as of 11 August 2006. None of his performance rights vested during the 2006/07 year.

- (A) *The value of performance rights granted in the year is the fair value of the performance rights calculated at grant date using a Black-Scholes and Monte-Carlo / Binominal option-pricing model. The total value of the performance rights granted is included in the table above. This amount is allocated to remuneration over the vesting period.*
- (B) *The value of performance rights exercised during the year is calculated as the market price of shares of the Company on the Australian Securities Exchange as at close of trading on the date the performance rights were exercised after deducting the price paid to exercise the option.*
- (C) *The value of the performance rights that lapsed during the year represents the benefit forgone and is calculated at the date the option lapsed using a binominal option-pricing model with no adjustments for whether the performance criteria have or have not been achieved.*

### Analysis of movements in options

There has been no movement in options for executives or directors during the financial year. Subsequent to the financial year end the options available did not vest as the performance hurdle was not achieved during the period to 4 June 2007.

### Principal activities

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

- the wholesale distribution of pharmaceutical and allied products;
- retail operations of the brands Priceline, Priceline Pharmacy, House and Price Attack;
- manufacture of pharmaceutical medicines and consumer toiletries;
- the distribution of pharmaceutical and medical consumable products to hospitals, through CH2 Pty Ltd, its 50/50 joint venture with private equity funds managed by ABN AMRO Capital Advisory Australia Pty Ltd; and
- finance origination and retail services to pharmacists, including the retail banners of Soul Pattinson, Chemworld and Pharmacist Advice.

### Review and results of operations

The income statement shows a consolidated net loss from ordinary activities of \$11.485 million (2006: \$20.374 million profit) after an income tax benefit on continuing operations of \$4.358 million (2006: \$7.775 million expense).

The loss from continuing operations before income tax amounted to \$15.843 million, a decrease of 160% on the 2006 year profit of \$26.414 million.

The net loss after tax was adversely affected by a number of significant items amounting to \$30.533million (2006: \$21.883 million). These significant items included termination and redundancy costs of \$3.449 million, Pharmacy inventory obsolescence \$8.163 million, Retail shrinkage and stocktake costs \$7.656 million, joint venture and divestment costs \$3.946 million, corporate expenses \$3.244 million, and completion costs for the 2006 financial year of \$4.075 million.

The revenue achieved by the consolidated entity during the year was \$2.649 billion which was up 2.6% on the previous year.

The consolidated entity's total net assets decreased by \$17.66 million to \$411.24 million (2006: \$428.90 million) over the year.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Directors' report (continued)

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At 30 April 2007 there was a bank overdraft of \$6.693 million (2006: \$6.016 million) and cash of \$21.315 million (2006: \$36.076 million). A further \$50m utilisation in the securitisation program was entered into during March 2007 which resulted in a reduction of receivables and borrowings on that date.

### Significant changes in the state of affairs

The key changes in the consolidated entity's activities were as follows:

- On 1 July 2006, the nature of the Company's pharmacy distribution business remuneration altered with the implementation of the Community Service Obligation (CSO) requirements that were part of the Fourth Community Pharmacy Agreement. The regulations require pharmaceutical wholesalers to reduce their mark up on Pharmaceutical Benefit Schedule items. To compensate wholesalers for the lower margin available, the Federal Government pay wholesalers a share of a \$150 million CSO pool according to the proportion of PBS medicines each participating eligible wholesaler delivers to community pharmacies and subject to other criteria.

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

### Dividends

Dividends paid or declared by the Company to members since the end of the previous financial year were:

Declared and paid during the year:

– a final 2006 dividend of 3.00 cents per share, franked to 100% at 30% franking credits paid on 8 September 2006 amounting to \$7.720 million.

### Events subsequent to reporting date

Subsequent to 30 April 2007 the following matters have arisen:

- Making Life Easy (MLE) has been an equity accounted joint venture for the Company. On 2nd July, 2007 the Company acquired the remaining 50% of the equity of MLE for \$1,000,000. As a result of this, MLE will be accounted for as a wholly owned subsidiary from 2 July, 2007.
- On 24 July 2007, the Company announced that an agreement had been reached for the sale of Eighty First Tribute Pty Limited and House Unit Trust, which incorporates the House Brand business. The sale proceeds are \$8,500,000 and subject to completion accounts as at 31 July, 2007, the Company will book a profit on disposal.

The Company has received approval from the Australian Securities and Investments Commission (ASIC) to transition to a financial year end of 31 August. The Company requested the change based on its retail business requirements which has peak trading periods at Christmas and to a lesser extent, Easter. The current reporting cycle required the Company to provide financial reports for periods ending 31 October and 30 April, which coincide with peak periods.

The changes will take place over a transitional period, in accordance with ASIC relief:

- API closed its full year on 30 April 2007 and provided its preliminary results to the market on 28 June 2007.
- API will then close a transitional financial year for the 4 months to 31 August 2007 and report those results in the last week of October 2007 followed by the full audited accounts in November 2007.
- Following the 31 August 2007 results and accounts being released, an AGM will be held on 18 December 2007 to consider the 30 April 2007 and 31 August 2007 financial reports.

Other than the matters discussed above, there has not arisen in the interval between the end of the financial year 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 financial 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.

At the date of this report, there have been several developments in the operations of the consolidated entity that are likely to be finalised in the next year. These include:

- The consolidated entity's pharmacy distribution business is likely to continue to be affected by the Community Service Obligation (CSO) requirements as a result of the CSO remuneration. The Company may also be affected by government regulations relating to pharmaceuticals or other factors that influence the growth rate of the overall

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

Pharmaceutical Benefits Schedule items. The involvement of the Company in retailing means it will be subject to changes in consumer buying behaviour that may be influenced by changes in interest rates, petrol prices or other such factors. The Company mitigates these factors as much as possible with strategies that can adapt to customer behaviour requirements.

- The Company will consider the opportunity of further developing its involvement in the generic pharmaceuticals business in Australia through an alignment or association with an existing manufacturer.
- The Company may look further at participating in consolidation of the pharmaceutical distribution assets of the three main companies in the sector in Australia. This may be in the form of a merger, joint venture or acquisition which may involve one or more of the other industry participants.

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 because disclosure of the information would be likely to result in unreasonable prejudice to the consolidated entity.

### Directors' interests

The relevant 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	Options / Performance rights over Ordinary Shares
Mr P R Robinson	15,800	-
Mr B A Frost	461,548	-
Mr D J Fairfull	5,000	-
Ms E C Holley**	10,000	-
Mr R D Millner	11,000	-
Mr J W Murphy*	-	-
Mr S P Roche***	-	-
Mr M R Wooldridge	-	-

\* Mr Murphy is the managing director of Investec Wentworth Private Equity Limited, which is the manager of two funds MGB Equity Growth Unit Trust No 2 and Investec Wentworth Private Equity Fund. Each fund holds 5,156,616 shares in API and is entitled to receive 35.0384% of any deferred consideration payable by API (in cash or shares) in connection with the acquisition of New Price Retail in October 2004. Interests associated with Mr Murphy had a 17.5% interest in MGB Equity Growth Unit Trust No 2. Each fund sold all of its shares in API on 26 March, 2007.

\*\* Director since 19 December 2006.

\*\*\* Director since 14 August 2006.

### Options granted to Directors and Officers of the Company

Details of the options and 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 year 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 year 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.
- 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

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

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 year are set out below.

<i>In Aud</i>	<b>Consolidated 2007</b>	<b>Consolidated 2006</b>
	\$	\$
<b>Assurance services</b>		
<i>KPMG Australia</i>		
- Audit and review of financial reports – for the 2007 financial year	637,550	380,000
- Audit and review of financial reports – finalisation of the 2006 financial year	331,123	-
- Other regulatory audit services	-	7,500
<i>Overseas KPMG firms</i>		
- Audit and review of financial reports	29,000	51,462
	<b>997,673</b>	<b>438,962</b>
<b>Other services</b>		
Auditors of the Company		
<i>KPMG Australia</i>		
- Other assurance services	54,500	107,295
- Sale of business completion audits	12,000	65,427
- Taxation services	300,016	86,596
<i>Overseas KPMG offices</i>		
- Taxation services	20,000	44,327
- Other assurance services	-	16,662
<b>Total</b>	<b>1,384,189</b>	<b>759,269</b>

## Australian Pharmaceutical Industries Limited and its controlled entities Directors' report (continued)

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### **Lead Auditor's Independence Declaration**

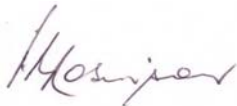
The Lead Auditor's Independence Declaration is set out on page 21 and forms part of the Directors' report for financial year ended 30 April 2007.

### **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 Sydney this 30th day of July 2007

Signed in accordance with a resolution of the directors:



Peter R. Robinson  
Director



**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 30 April 2007 there have been:

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

KPMG

KPMG

A handwritten signature in black ink, appearing to read 'C. Slapp', written in a cursive style.

Cameron Slapp  
*Partner*

Sydney, 30<sup>th</sup> July 2007

# Australian Pharmaceutical Industries Limited and its controlled entities

## Income statements

### For the year ended 30 April 2007

<i>In thousands of AUD</i>	<b>Note</b>	<b>Consolidated</b>		<b>The Company</b>	
		<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenue	2	2,648,989	2,582,144	1,005,932	1,049,204
Cost of sales		(2,321,396)	(2,231,242)	(929,973)	(956,165)
<b>Gross profit</b>		<b>327,593</b>	<b>350,902</b>	<b>75,959</b>	<b>93,039</b>
Other income	3	12,513	4,328	10	3,612
Warehousing and distribution expenses		(86,052)	(81,907)	(43,585)	(36,496)
Marketing and sales expenses		(172,456)	(156,091)	(13,589)	(15,406)
Administration and general expenses		(74,524)	(60,658)	(46,714)	(40,750)
Other expenses		-	(17,178)	-	(9,437)
<b>Result from operating activities</b>		<b>7,074</b>	<b>39,396</b>	<b>(27,919)</b>	<b>(5,438)</b>
Financial income		3,478	2,278	8,952	40,135
Financial expenses		(23,850)	(15,569)	(7,613)	(16,518)
<b>Net financing (costs)/income</b>	6	<b>(20,372)</b>	<b>(13,291)</b>	<b>1,339</b>	<b>23,617</b>
Share of (loss)/profit of associates	14	(2,545)	309	-	-
<b>(Loss)/profit before tax</b>		<b>(15,843)</b>	<b>26,414</b>	<b>(26,580)</b>	<b>18,179</b>
Income tax benefit/(expense)	7	4,358	(7,775)	8,753	4,203
<b>(Loss)/profit from continuing operations</b>		<b>(11,485)</b>	<b>18,639</b>	<b>(17,827)</b>	<b>22,382</b>
Profit of discontinued operation, net of tax	8	-	1,735	-	-
<b>(Loss)/profit for the year</b>		<b>(11,485)</b>	<b>20,374</b>	<b>(17,827)</b>	<b>22,382</b>
<b>Attributable to:</b>					
Equity holders of the Company		(11,270)	20,561	(17,827)	22,382
Minority interest		(215)	(187)	-	-
<b>(Loss)/profit for the year</b>		<b>(11,485)</b>	<b>20,374</b>	<b>(17,827)</b>	<b>22,382</b>
<b>Earnings per share (cents per share):</b>					
Basic earnings per share from continuing operations	9	(4.4)	7.3		
Diluted earnings per share from continuing operations	9	(4.4)	7.3		

The income statements are to be read in conjunction with the notes of the financial statements set out on pages 26 to 85.

Australian Pharmaceutical Industries Limited and its controlled entities  
 Statements of recognised income and expense

For the year ended 30 April 2007

<i>In thousands of AUD</i>	<b>Note</b>	<b>Consolidated</b>		<b>The Company</b>	
		<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Foreign exchange translation differences		2,626	(4,686)	-	-
Effective portion of changes in fair value of cash flow hedges, net of tax		(362)	-	(362)	-
<b>Net income/(expense) recognised directly in equity</b>		<b>2,264</b>	<b>(4,686)</b>	<b>(362)</b>	<b>-</b>
<b>(Loss)/profit for the period</b>		<b>(11,485)</b>	<b>20,374</b>	<b>(17,827)</b>	<b>22,382</b>
<b>Total recognised income and expense for the period</b>	<b>22</b>	<b>(9,221)</b>	<b>15,688</b>	<b>(18,189)</b>	<b>22,382</b>
<b>Attributable to:</b>					
Equity holders of the Company		(9,006)	15,875	(18,189)	22,382
Minority interest		(215)	(187)	-	-
<b>Total recognised income and expense for the period</b>		<b>(9,221)</b>	<b>15,688</b>	<b>(18,189)</b>	<b>22,382</b>
<b>Effects of change in accounting policy - financial instruments:</b>					
Equity holders of the parent		-	(1,378)	-	(138)
Minority interest		-	-	-	-
		-	(1,378)	-	(138)

Other movements in equity arising from transactions with owners as owners are set out in note 22.

The statements of recognised income and expense are to be read in conjunction with the notes to the financial statements set out on pages 26 to 85.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Balance sheets

As at 30 April 2007

<i>In thousands of AUD</i>	<i>Note</i>	<b>Consolidated</b>		<b>The Company</b>	
		<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Assets</b>					
Cash and cash equivalents	28	21,315	36,076	22	18,127
Trade and other receivables	10	120,461	167,858	12,238	64,693
Inventories	11	256,492	250,388	82,383	73,535
Income tax receivable	13	14,068	613	14,027	2,147
<b>Total current assets</b>		<b>412,336</b>	<b>454,935</b>	<b>108,670</b>	<b>158,502</b>
Receivables	10	124,844	91,932	252,623	228,300
Investments	12	-	-	231,163	229,214
Investments accounted for using the equity method	14	26,330	28,221	-	-
Deferred tax assets	15	12,284	13,033	6,655	5,118
Property, plant and equipment	16	76,046	69,228	23,502	27,763
Intangible assets	17	217,524	215,931	46,168	48,726
<b>Total non-current assets</b>		<b>457,028</b>	<b>418,345</b>	<b>560,111</b>	<b>539,121</b>
<b>Total assets</b>		<b>869,364</b>	<b>873,280</b>	<b>668,781</b>	<b>697,623</b>
<b>Liabilities</b>					
Bank overdraft	28	6,693	6,016	13,138	-
Trade and other payables	18	423,807	411,348	214,205	259,889
Loans and borrowings	19	1,831	760	1,508	309
Employee benefits	20	13,134	12,558	4,186	4,918
Income tax payable		-	-	-	-
Provisions	21	656	1,017	-	47
<b>Total current liabilities</b>		<b>446,121</b>	<b>431,699</b>	<b>233,037</b>	<b>265,163</b>
Trade and other payables	18	4,233	3,613	30,184	-
Loans and borrowings	19	2,650	3,299	1,605	2,134
Employee benefits	20	2,762	3,192	793	1,176
Provisions	21	2,363	2,580	1,052	1,131
<b>Total non-current liabilities</b>		<b>12,008</b>	<b>12,684</b>	<b>33,634</b>	<b>4,441</b>
<b>Total liabilities</b>		<b>458,129</b>	<b>444,383</b>	<b>266,671</b>	<b>269,604</b>
<b>Net assets</b>		<b>411,235</b>	<b>428,897</b>	<b>402,110</b>	<b>428,019</b>
<b>Equity</b>					
Share capital		419,499	419,499	419,499	419,499
Reserves		1,441	(823)	(347)	15
Retained earnings		(9,705)	9,285	(17,042)	8,505
<b>Total equity attributable to equity holders of the Company</b>	22	<b>411,235</b>	<b>427,961</b>	<b>402,110</b>	<b>428,019</b>
<b>Minority interest</b>		-	936	-	-
<b>Total equity</b>	22	<b>411,235</b>	<b>428,897</b>	<b>402,110</b>	<b>428,019</b>

The balance sheets are to be read in conjunction with the notes to the financial statements set out on pages 26 to 85.

Australian Pharmaceutical Industries Limited and its controlled entities  
Statements of cash flows

For the year ended 30 April 2007

<i>In thousands of AUD</i>		<b>Consolidated</b>		<b>The Company</b>	
<i>Note</i>	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	
<b>Cash flows from operating activities</b>					
	2,961,285	3,021,572	1,158,980	1,269,114	
	(2,883,828)	(2,853,241)	(1,176,652)	(1,151,453)	
	77,457	168,331	(17,672)	117,661	
	-	-	-	31,104	
	3,478	2,278	6,241	9,031	
	(23,850)	(15,569)	(7,613)	(11,683)	
	(7,185)	(7,932)	(6,985)	(7,619)	
<b>28</b>	<b>49,900</b>	<b>147,108</b>	<b>(29,029)</b>	<b>138,494</b>	
<b>Cash flows from investing activities</b>					
	2,338	7,687	1,444	747	
	(19,272)	(17,881)	(893)	(2,901)	
	5,460	-	5,868	-	
	-	(4,189)	-	-	
	(389)	(285)	(4,197)	(1,329)	
	(7,327)	(16,873)	(7,327)	(16,873)	
	4,000	25,443	-	3,578	
	(1,949)	-	(1,949)	(2,000)	
	(6,364)	(4,230)	(161)	(4,230)	
	-	-	57,551	15,012	
	(23,503)	(10,328)	50,336	(7,996)	
<b>Cash flows from financing activities</b>					
	(32,543)	(35,294)	(46,685)	(15,815)	
	-	(56,964)	-	(55,000)	
	(1,434)	(957)	(1,146)	(274)	
	1	(117)	1	(117)	
	(7,720)	(33,455)	(7,720)	(33,455)	
	(41,696)	(126,787)	(55,550)	(104,661)	
	(15,299)	9,993	(31,243)	25,837	
	30,060	20,080	18,127	(7,710)	
	(139)	(13)	-	-	
<b>28</b>	<b>14,622</b>	<b>30,060</b>	<b>(13,116)</b>	<b>18,127</b>	

The statements of cash flows are to be read in conjunction with the notes to the financial statements set out on pages 26 to 85.

## Australian Pharmaceutical Industries Limited and its controlled entities

### Notes to the consolidated financial statements

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# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 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 consolidated financial report of the Company for the financial year ended 30 April 2007 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 30 July 2007.

#### (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. Financial reports of the consolidated entity and the Company also comply 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 functional currency.

#### *Issued standards not early adopted*

The following standards and amendments have been identified as those which may impact the entity in the period of initial application. They are available for early adoption but have not been applied by the consolidated entity in these financial statements:

- AASB 7 *Financial instruments: Disclosure* (August 2005) replacing the presentation requirements of financial instruments in AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after 1 January 2007
- AASB 2005-10 *Amendments to Australian Accounting Standards* (September 2005) makes consequential amendments to AASB 132 *Financial Instruments: Disclosures and Presentation*, AASB 101 *Presentation of Financial Statements*, AASB 114 *Segment Reporting*, AASB 117 *Leases*, AASB 133 *Earnings per Share*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*, arising from the release of AASB 7. AASB 2005-10 is applicable for annual reporting periods beginning on or after 1 January 2007
- AASB 8 *Operating Segments* replaces the presentation requirements of segment reporting in AASB 114 *Segment Reporting*. AASB 8 is applicable for annual reporting periods beginning on or after 1 January 2009.

The initial application of AASB 7, AASB 2005-10 and AASB 8 is not expected to have an impact on the financial results of the Company and the consolidated entity as the standards and the amendments are concerned only with disclosures.

The financial report is prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, financial instruments held for trading and financial instruments classified as available-for-sale.

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 (updated by CO 05/641 effective 28 July 2005 and CO 06/51 effective 31 January 2006) 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.

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

The accounting policies have been applied consistently by all entities in the consolidated entity.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (c) 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 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 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) Joint ventures

Joint ventures are those entities over whose activities the consolidated entity has joint control, established by contractual agreement.

##### *Jointly controlled entities*

In the consolidated financial statements, investments in jointly controlled entities are accounted for using equity accounting principles.

The consolidated entity's share of the jointly controlled entity's net profit or loss is recognised in the consolidated income statement from the date joint control commenced until the date joint control ceases. Other movements in reserves are recognised directly in the consolidated reserves. In the Company's financial statements, investments in joint venture entities are carried at cost.

##### (iv) Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup 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.

#### (d) 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. 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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (d) Foreign currency (continued)

##### (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 directly in a separate component of equity.

##### (iii) Net investment in foreign operations

Exchange differences arising from the translation of the net investment in foreign operations, and of related hedges are taken to translation reserve to the extent that the hedge is effective. They are released into the profit and loss upon disposal of the foreign operation.

In respect of all foreign operations, any differences that have arisen after 1 May 2004, the date of transition to AIFRS, are presented as a separate component of equity. Differences arising prior to 1 May 2004 have been transferred to retained earnings.

#### (e) 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 at fair value through profit or loss, any directly attributable transaction costs, except as described below. 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 or substantially all risks and rewards of the asset. Regular purchases and sales of financial assets are accounted for at trade date, ie, 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 from 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.

##### *Available-for-sale financial assets*

The consolidated entity's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses, and foreign exchange gains and losses on available-for-sale monetary items, are recognised as a separate component of equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss.

##### *Investments at fair value through profit or loss*

An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the consolidated entity manages such investments and makes purchase and sale decisions based on their fair value in accordance with the consolidated entity's documented risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments are measured at fair value, and changes therein are recognised in profit or loss.

##### *Other*

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

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (e) Financial instruments (continued)

##### (ii) Derivative financial instruments

The consolidated entity holds derivative financial instruments to hedge its interest rate 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 measure 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 equity 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 equity 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 equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

##### *Ordinary Shares*

Incremental costs directly attributable to issue of ordinary shares and share options 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.

#### (iii) Derecognition of financial assets and liabilities

A financial asset (or where applicable, a part of a financial asset or part of a group or similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the consolidated entity retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party; or
- the consolidated entity has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in profit and loss.

The Company's and consolidated entity's investment in its securitisation program is classified as a non current interest bearing note receivable. The note receivable is carried at amortised cost using the effective interest rate method.

#### (f) 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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (f) Property, plant and equipment (continued)

##### (ii) 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.

##### (iii) 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 3-10 years
- fixtures and fittings 3-10 years

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

#### (g) 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 between the cost of the acquisition and 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 extremely 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 and every three years thereafter. 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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (g) Intangible Assets (continued)

##### (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. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment at each balance sheet date. 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
- capitalised store development expense 3-5 years

#### (h) 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. In the case of manufactured inventories and work in progress, cost includes an appropriate share of overheads based on normal operating capacity.

#### (i) 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.

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. 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.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred 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 identifiable asset a group 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 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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (i) Impairment (continued)

#### (ii) Non-Financial Assets (continued)

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.

#### (j) 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 policy applicable to that asset.

Other leases are operating leases and, except for investment property, the leased assets are not recognised in the consolidated entity's balance sheet. Investment property held under an operating lease is recognised on the consolidated entity's balance sheet at its fair value.

#### (k) Employee benefits

#### (i) Defined contribution superannuation funds

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

#### (ii) Defined benefit superannuation funds

The consolidated entity's net obligation in respect of defined benefit pension plans is calculated separately for each plan 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 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.

All actuarial gains and losses as at 1 May 2004, the date of transition to AIFRSs, were recognised. In respect of actuarial gains and losses that arise subsequent to 1 May 2004 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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (k) Employee benefits (continued)

##### (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 the fair value of the amount payable to the employee 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 Black-Scholes formula for the EPS performance hurdle and the Monte Carlo/Binomial formula for the TSR performance hurdle, taking into account the terms and conditions upon which the instruments were granted. The liability is remeasured at each balance sheet date and at settlement date.

#### (l) 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) Restructuring

A provision for restructuring is recognised when the consolidated entity has approved a detailed and formal restructuring plan, and the restructuring has either commenced or has been announced publicly. Future operating costs are not provided for.

##### (ii) Loyalty card

A provision for loyalty card expenses is recognised when the underlying products or services are sold. The provision is based on historical loyalty card data and a weighting of all possible outcomes against their associated probabilities.

##### (iii) 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 in accordance with the policy set out in note (f). 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.

#### (m) 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) and commissions earned 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.

#### (n) Expenses

##### (i) Operating lease payments

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

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (n) Expenses (continued)

##### (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, interest receivable on funds invested, dividend income, foreign exchange gains and losses, and gains and losses on hedging instruments that are recognised in profit and loss. Borrowing costs are expensed as incurred and included in net financing costs.

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.

#### (o) 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.

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.

#### Tax consolidation

The Company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 1 May 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Australian Pharmaceutical Industries Limited.

Current tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'separate taxpayer within group' approach by reference to the carrying amounts of assets and liabilities in the separate financial statements of each entity and the tax values applying under tax consolidation.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses of the subsidiaries is assumed by the head entity in the tax-consolidated group and are recognised as amounts payable (receivable) to (from) other entities in the tax-consolidated group in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Company as an equity contribution or distribution.

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses as a result of revised assessments of the probability of recoverability is recognised by the head entity only.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (o) Income tax (continued)

##### **Nature of tax funding arrangements and tax sharing arrangements**

The head entity, in conjunction with other members of the tax-consolidated group, has entered into a tax funding arrangement which sets out the funding obligations of members of the tax-consolidated group in respect of tax amounts. The tax funding arrangements require payments to/from the head entity equal to the current tax liability (asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity, resulting in the head entity recognising an inter-entity receivable (payable) equal in amount to the tax liability (asset) assumed. The inter-entity receivable (payable) is at call.

Contributions to fund the current tax liabilities are payable as per the tax funding arrangement and reflect the timing of the head entity's obligation to make payments for tax liabilities to the relevant tax authorities.

The head entity in conjunction with other members of the tax-consolidated group, has also entered into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement as payment of any amounts under the tax sharing agreement is considered remote.

#### (p) Segment reporting

A segment is a distinguishable component of the consolidated entity that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

#### (q) Non-current assets held for sale and discontinued operations

Immediately before classification as held for sale, the measurement of the assets (and all assets and liabilities in a disposal group) is brought up-to-date in accordance with applicable accounting standards. Then, 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.

Impairment losses on initial classification as held for sale are included in profit or loss, even when there is a revaluation. The same applies to gains and losses on subsequent remeasurement.

A discontinued operation is a component of the consolidated entity's business that represents a separate major line of business or geographical area of operations or is a subsidiary acquired exclusively with a view to resale.

Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. A disposal group that is to be abandoned may also qualify.

#### (r) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the ATO is included as a current asset or liability in the balance sheet.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

#### (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 convertible notes and share options granted to employees.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 2. Segment reporting

Segment information is presented in respect of the consolidated entity's business and geographical segments. The primary format, business segments, is based on the consolidated entity's management and internal reporting structure.

Intersegment pricing is determined on an arm's length basis.

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly loyalty program costs and corporate assets and expenses.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year.

#### **Business Segments**

The consolidated entity comprises the following operating divisions:

#### **Pharmacy Distribution**

Australia – Distribution of pharmaceutical and medical products to pharmacys, provider of retail services to pharmacy customers; load and leases to pharmacy customers

#### **Retailing**

Australia – the purchase and sale of various health, beauty and lifestyle products within the retail industry in Australia.

#### **Manufacturing**

Australia – Owner of rights to pharmaceutical medicines manufactured by related parties.

New Zealand – Manufacture of pharmaceutical medicines and consumer toiletries.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

2. Segment reporting (continued)

	DISTRIBUTION								RETAILING		MANUFACTURING				ELIMINATIONS		CONSOLIDATED		Less: Pharmacy Distribution New Zealand (discontinued)		Less: Healthcare Distribution (discontinued)		Consolidated Continuing Operations		
	PHARMACY				HEALTHCARE (discontinued)				AUSTRALIA		AUSTRALIA		NEW ZEALAND												
	AUSTRALIA		NEW ZEALAND (discontinued)		AUSTRALIA		NEW ZEALAND		AUSTRALIA		AUSTRALIA		NEW ZEALAND												
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	
<b>Revenue</b>																									
External segment sales	1,962,927	1,985,837	-	303,524	-	25,130	-	576	566,030	477,675	6,248	5,885	35,417	34,924	-	-	2,570,622	2,833,551	-	303,524	-	25,706	2,570,622	2,504,321	
External segment services	26,458	34,594	-	8,055	-	125	-	-	51,909	43,229	-	-	-	-	-	-	78,367	86,003	-	8,055	-	125	78,367	77,823	
Internal segment sales	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
<b>Total segment revenue</b>	<b>1,989,385</b>	<b>2,020,431</b>	<b>-</b>	<b>311,579</b>	<b>-</b>	<b>25,255</b>	<b>-</b>	<b>576</b>	<b>617,939</b>	<b>520,904</b>	<b>9,748</b>	<b>9,366</b>	<b>42,583</b>	<b>42,336</b>	<b>(10,666)</b>	<b>(10,893)</b>	<b>2,648,989</b>	<b>2,919,554</b>	<b>-</b>	<b>311,579</b>	<b>-</b>	<b>25,831</b>	<b>2,648,989</b>	<b>2,582,144</b>	
<b>Segment result</b>	<b>27,581</b>	<b>42,167</b>	<b>-</b>	<b>2,782</b>	<b>-</b>	<b>(730)</b>	<b>-</b>	<b>-</b>	<b>24,654</b>	<b>24,844</b>	<b>(166)</b>	<b>(1,319)</b>	<b>147</b>	<b>1,332</b>	<b>-</b>	<b>-</b>	<b>52,216</b>	<b>69,076</b>	<b>-</b>	<b>2,782</b>	<b>-</b>	<b>(730)</b>	<b>52,216</b>	<b>67,024</b>	
Unallocated income																									
Significant Expenses																									
Unallocated expenses																	(30,533)	(17,178)	-	-	-	-	-	(30,533)	(17,178)
Profit before financing costs																	7,074	41,448	-	2,782	-	(730)	7,074	39,396	
Net financing costs																	(20,372)	(13,130)	-	161	-	-	(20,372)	(13,291)	
Share of profit of associates																	(2,545)	309	-	-	-	-	(2,545)	309	
Gain/(loss) on sale of discontinued operation																	-	300	-	-	-	-	-	-	
(Loss)/Profit before tax																	(15,843)	28,927	-	3,243	-	(730)	(15,843)	26,414	
Income tax expense																	4,358	(8,553)	-	(1,009)	-	231	4,358	(7,775)	
<b>Net (loss)/ profit</b>																	<b>(11,485)</b>	<b>20,374</b>	<b>-</b>	<b>2,234</b>	<b>-</b>	<b>(499)</b>	<b>(11,485)</b>	<b>18,639</b>	
Depreciation & amortisation	8,296	5,323	-	494	-	54	-	2	6,028	5,468	-	125	1,046	784	-	-	15,370	12,250	-	494	-	56	15,370	11,700	
<b>Assets</b>																									
<b>Segment assets</b>	546,308	540,079	-	-	-	-	-	-	371,475	311,073	26,579	23,716	73,146	68,274	(174,474)	(98,083)	843,034	845,059							
<b>Equity accounted investments</b>	26,330	26,311	-	-	-	-	-	-	-	-	-	-	-	-	-	-	26,330	26,221							
<b>Consolidated total assets</b>	<b>572,638</b>	<b>566,390</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>371,475</b>	<b>311,073</b>	<b>26,579</b>	<b>23,716</b>	<b>73,146</b>	<b>70,184</b>	<b>(174,474)</b>	<b>(98,083)</b>	<b>869,364</b>	<b>873,280</b>							
<b>Liabilities</b>																									
<b>Segment liabilities</b>	386,504	372,546	-	-	-	-	-	-	211,919	137,376	18,848	16,102	14,740	15,697	(174,474)	(98,083)	457,537	443,638							
<b>Unallocated corporate liabilities</b>	592	745	-	-	-	-	-	-	-	-	-	-	-	-	-	-	592	745							
<b>Consolidated total liabilities</b>	<b>387,096</b>	<b>373,291</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>211,919</b>	<b>137,376</b>	<b>18,848</b>	<b>16,102</b>	<b>14,740</b>	<b>15,697</b>	<b>(174,474)</b>	<b>(98,083)</b>	<b>458,129</b>	<b>444,383</b>							
<b>Capital Expenditure</b>	3,045	6,794	-	-	-	-	-	-	22,129	10,255	-	-	2,319	6,401	-	-	27,493	23,450							

\*1H07: Pharmacy Segment included 13m Segment Revenue and 2.8m Segment result which is reflected in Retail Australia Segment revenue and Segment result for the full year.

In thousands of AUD  
**Secondary reporting – Geographical segments**  
External segment revenue by location of customers  
Segment assets by location of assets  
Capital Expenditure

	Australia		New Zealand		Consolidated	
	2007	2006	2007	2006	2007	2006
External segment revenue by location of customers	2,606,406	2,565,063	42,583	354,491	2,648,989	2,919,554
Segment assets by location of assets	796,218	803,096	73,146	70,184	869,364	873,280
Capital Expenditure	25,174	17,049	2,319	6,401	27,493	23,450

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 3. Other income

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Net gain on disposal of stores, property, plant and equipment	12,261	2,539	10	34
Gain on sale of business	252	1,789	-	3,578
	<u>12,513</u>	<u>4,328</u>	<u>10</u>	<u>3,612</u>

### 4. Significant expenses

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Termination & redundancy costs	3,449	-	3,130	-
Financial year 2006 completion costs	4,075	-	4,075	-
Corporate expenses	3,244	-	3,244	-
Joint venture and divestment costs	3,946	-	3,946	-
Retail shrinkage & stocktake costs	7,656	-	-	-
Pharmacy inventory obsolescence	8,163	-	6,507	-
IT system conversion discrepancies written off	-	17,178	-	9,437
	<u>30,533</u>	<u>17,178</u>	<u>20,902</u>	<u>9,437</u>

### 5. Personnel expenses

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Wages and salaries	133,254	121,163	33,944	33,470
Other associated personnel expenses	15,444	14,353	5,353	4,962
Contributions to defined contribution superannuation funds	9,975	8,966	2,552	2,808
Expenses related to defined benefit superannuation funds	28	79	28	79
Increase/(decrease) in liability for annual leave	155	(1,654)	(653)	(43)
Decrease in liability for long service leave	(9)	(2)	(462)	(47)
Equity settled transactions`	-	22	-	22
	<u>158,847</u>	<u>142,927</u>	<u>40,762</u>	<u>41,251</u>

### 6. Finance income and expense

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Interest income on bank deposits	(3,478)	(2,278)	(6,241)	(9,031)
Dividend income	-	-	-	(31,104)
Net foreign exchange gain*	-	-	(2,711)	-
Financial income	<u>(3,478)</u>	<u>(2,278)</u>	<u>(8,952)</u>	<u>(40,135)</u>
Interest expense on financial liabilities measured at amortised cost	23,850	15,569	7,613	11,683
Net foreign exchange loss*	-	-	-	4,835
Financial expenses	<u>23,850</u>	<u>15,569</u>	<u>7,613</u>	<u>16,518</u>
Net financing costs/(income)	<u>20,372</u>	<u>13,291</u>	<u>(1,339)</u>	<u>(23,617)</u>

\* The net foreign exchange gain/loss in respect of the Company principally related to a long term loan receivable which on consolidation is taken to the foreign currency translation reserve.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**7. Income tax expense**

**Recognised in the income statement**

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Current tax expense</b>				
Current year	(8,753)	10,831	(10,756)	1,798
Adjustments for prior years	106	-	-	-
	<u>(8,647)</u>	<u>10,831</u>	<u>(10,756)</u>	<u>1,798</u>
<b>Deferred tax expense</b>				
Origination and reversal of temporary differences	4,289	(2,278)	2,003	(6,001)
Total income tax expense/(benefit) in income statement	<u>(4,358)</u>	<u>8,553</u>	<u>(8,753)</u>	<u>(4,203)</u>
<b>Attributable to:</b>				
Continuing operations	(4,358)	7,775	(8,753)	(4,203)
Discontinued operations	-	778	-	-
	<u>(4,358)</u>	<u>8,553</u>	<u>(8,753)</u>	<u>(4,203)</u>

**Numerical reconciliation between tax expense and pre-tax net profit**

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Profit before tax- continuing operations	(15,843)	26,414	(26,580)	18,179
Profit before tax- discontinued operations	-	2,513	-	-
Profit before tax	<u>(15,843)</u>	<u>28,927</u>	<u>(26,580)</u>	<u>18,179</u>
Income tax using the domestic corporation tax rate of 30% (2006: 30%)	(4,753)	8,678	(7,974)	5,454
Increase in income tax expense due to:				
Share of associates net losses	764	-	-	-
Non-deductible expenses	388	217	45	17
Effect on tax rate in foreign jurisdictions	89	123	-	-
Other	-	-	12	-
Decrease in income tax expense due to:				
Tax exempt revenues	(836)	(465)	(836)	(9,674)
Other	(116)	-	-	-
	<u>(4,464)</u>	<u>8,553</u>	<u>(8,753)</u>	<u>(4,203)</u>
Under provided in prior years	106	-	-	-
Income tax expense/(benefit) on pre-tax net profit	<u>(4,358)</u>	<u>8,553</u>	<u>(8,753)</u>	<u>(4,203)</u>

**Deferred tax recognised directly in equity**

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Relating to equity settled transactions	-	7	-	7
Relating to derivatives	(155)	-	(155)	-

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 8. Discontinued operations

In May 2005, the consolidated entity discontinued its Healthcare Distribution segment by selling the share capital of Halas Dental Limited and Shalfoon Bros Limited and the business assets and liabilities of the Hospital Supplies of Australia ("HSA") division.

#### Effect of the disposal on individual assets and liabilities of the consolidated entity

<i>In thousands of AUD</i>	Pharmacy Distribution New Zealand		Healthcare Distribution	
	2007	2006	2007	2006
<b>Assets and liabilities disposed</b>				
Property, plant and equipment	-	5,079	-	2,321
Inventories	-	42,693	-	41,956
Trade receivables	-	68,895	-	15,377
Other receivables	-	2,742	-	2,030
Deferred tax assets	-	1,060	-	1,004
Goodwill	-	15,881	-	5,611
Cash and cash equivalents	-	13,584	-	4,450
Employee benefits	-	-	-	(2,733)
Trade payables	-	(98,778)	-	(16,223)
Other payables	-	(10,928)	-	(2,256)
Lease liabilities	-	-	-	(172)
Other liabilities	-	(2,725)	-	(862)
Net identifiable assets and liabilities	-	37,503	-	50,503
<b>Total consideration on sale</b>				
Cash	-	30,332	-	13,750
Deferred consideration	-	7,583	-	15,998
Transaction costs	-	(112)	-	(493)
Equity in joint venture	-	-	-	21,248
	-	37,803	-	50,503
Gain on sale of discontinued operation	-	300	-	-
<b>Net change in cash</b>				
Consideration received, satisfied in cash	-	30,332	-	13,750
Transaction costs	-	(112)	-	(493)
Cash disposed of	-	(13,584)	-	(4,450)
Net cash inflow	-	16,636	-	8,807

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**8. Discontinued operations (continued)**

**Analysis of profit and loss of the discontinued operation, gain on sale of discontinued operations and related income tax expense**

<i>In thousands of AUD</i>	<b>Pharmacy Distribution New Zealand</b>		<b>Healthcare Distribution</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Revenue	-	311,579	-	25,831
Cost of sales	-	(298,537)	-	(22,810)
Gross profit	-	13,042	-	3,021
Warehousing and distribution expenses	-	(9,061)	-	(971)
Marketing and sales expenses	-	(66)	-	(2,664)
Administrative expenses	-	(1,133)	-	(116)
Operating profit /(loss) before financing costs	-	2,782	-	(730)
Net financing costs	-	161	-	-
Profit/(loss) before tax	-	2,943	-	(730)
Income tax (expense) / benefit	-	(1,009)	-	231
Profit/(loss) after tax	-	1,934	-	(499)
Gain on sale of discontinued operation	-	300	-	-
Income tax expense	-	-	-	-
Gain on sale of discontinued operation after tax	-	300	-	-
Net gain on sale	-	2,234	-	(499)
	<b>Consolidated</b>			
	<b>2007</b>	<b>2006</b>		
Profit of discontinued operations, net of tax				
Pharmacy distribution – New Zealand	-	2,234		
Healthcare distribution	-	(499)		
	-	1,735		

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 9. Earnings per share

#### Basic earnings per share

The calculation of basic earnings per share at 30 April 2007 was based on the loss attributable to ordinary shareholders of \$11,270,000 (2006: profit of \$20,561,000) and a weighted average number of ordinary shares outstanding during the financial year ended 30 April 2007 of 257,346,455 (2006: 257,346,455), calculated as follows:

#### Profit attributable to ordinary shareholders

<i>In thousands of AUD</i>	Consolidated	
	2007	2006
(Loss)/profit attributable to ordinary shareholders	(11,270)	20,561

#### Weighted average number of ordinary shares

<i>In thousands of shares</i>	Consolidated	
	2007	2006
Issued ordinary shares at 1 May	257,346	257,346
Weighted average number of ordinary shares at 30 April	257,346	257,346

#### Diluted earnings per share

The calculation of diluted earnings per share at 30 April 2007 was based on loss attributable to ordinary shareholders of \$11,270,000 (2006: profit of \$20,561,000) and a weighted average number of ordinary shares outstanding during the financial year ended 30 April 2007 of 257,346,455 (2006: 257,377,455), calculated as follows:

#### Profit attributable to ordinary shareholders (diluted)

<i>In thousands of AUD</i>	Consolidated	
	2007	2006
(Loss)/profit attributable to ordinary shareholders (diluted)	(11,270)	20,561

#### Weighted average number of ordinary shares (diluted)

<i>In thousands of shares</i>	Consolidated	
	2007	2006
Weighted average number of ordinary shares at 30 April	257,346	257,346
Effect of potential ordinary shares on issue	-	31
Weighted average number of ordinary shares (diluted) at 30 April	257,346	257,377

#### Earnings per share for continuing and discontinued operations

##### Basic earnings per share

<i>In cents</i>	Consolidated	
	2007	2006
From continuing operations	(4.4)	7.3
From discontinued operations	-	0.7
	(4.4)	8.0

##### Diluted earnings per share

<i>In cents</i>	Consolidated	
	2007	2006
From continuing operations	(4.4)	7.3
From discontinued operations	-	0.7
	(4.4)	8.0

100,000 options on issue throughout the financial year, that could potentially dilute basic earnings per share in the future, were not included in the calculation of diluted earnings per share because they are anti dilutive for the year ended 30 April 2007.

For the financial year ended 30 April 2006, the earnings per share was split between continuing and discontinued operations. There were no discontinued operations for the financial year ended 30 April 2007.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 10. Trade and other receivables

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Current</b>				
Trade receivables and prepayments	112,668	162,741	2,552	57,823
Provision for impairment	(3,534)	(4,795)	(1,457)	(3,042)
	109,134	157,946	1,095	54,781
Amounts receivable as deferred consideration	6,000	5,057	6,000	5,057
Trade receivables due from associates	5,327	4,855	5,143	4,855
	120,461	167,858	12,238	64,693
<b>Non-current</b>				
Loans to associates	24,200	16,873	24,200	16,873
Provision for impairment	(1,495)	-	-	-
	22,705	16,873	24,200	16,873
Loans to controlled entities	-	-	147,540	174,907
Loans to employees	259	-	-	-
Amounts receivable as deferred consideration	9,286	15,689	-	6,811
Loans receivable from pharmacy customers	16,990	16,601	10,616	6,419
Pension asset	1,267	975	1,267	975
Interest bearing notes – securitised receivables	74,337	41,794	69,000	22,315
	124,844	91,932	252,623	228,300

At 30 April 2007 the consolidated entity and the Company have derecognised securitised trade receivables amounting to \$357,984,000 (2006: \$269,113,000) and \$182,501,000 (2006: \$119,418,000) respectively.

### 11. Inventories

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Raw materials and consumables	3,823	3,733	-	-
Work in progress	221	193	-	-
Finished goods	260,844	253,158	85,437	76,846
Less: provision for obsolescence	(8,396)	(6,696)	(3,054)	(3,311)
	256,492	250,388	82,383	73,535

### 12. Investments

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Investments in controlled entities - at cost	-	-	201,441	201,441
Investments in associates - at cost	-	-	29,722	27,773
	-	-	231,163	229,214

### 13. Current tax assets and liabilities

The current tax asset for the consolidated entity of \$14,068,000 (2006: \$613,000) and for the Company of \$14,027,000 (2006: \$2,147,000) represents the amount of income taxes recoverable in respect of prior periods and that arise from the payment of tax in excess of the amounts due to the relevant tax authority. In accordance with the 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 tax-consolidated group.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 14. Investments accounted for using the equity method

#### Investments in associates and joint venture entities

In the financial statements of the Company, investments in associates and joint venture entities are accounted for at cost. The consolidated entity accounts for investments in associates and joint venture entities using the equity method.

The consolidated entity has the following investments in associates and joint venture entities:

	Principal activities	Country	Reporting Date	Ownership	
				2007	2006
CH2 Holdings Pty Ltd	Hospital supplies distribution	Australia	30 June	45.3%	48.4%
Making Life Easy Pty Ltd	Operates mobility and independent living retail superstores	Australia	30 June	50%	50%

#### CH2 Holdings Pty Ltd

During February and April 2007, the consolidated entity reduced its ownership in CH2 Holdings Pty Ltd to 45.3% as a result of employees taking an equity stake. As part of this agreement the consolidated entity made a further investment of \$1,948,747 in this business.

	Revenues 100%	Profit/(loss) 100%	Share of associates net profit/(loss) recognised	Net assets as reported by associates 100%	Share of associate's net assets equity accounted (including goodwill)
For the Year Ended 30 April 2007					
<i>In thousands of AUD</i>					
<b>2007</b>					
CH2 Holdings Pty Ltd	652,565	(2,020)	(1,010)	47,688	26,330
Making Life Easy Pty Ltd	16,712	(3,070)	(1,535)	(4,513)	-
	<u>669,277</u>	<u>(5,090)</u>	<u>(2,545)</u>	<u>43,175</u>	<u>26,330</u>
<b>2006</b>					
CH2 Holdings Pty Ltd	751,809	996	498	44,481	26,271
Making Life Easy Pty Ltd	1,417	(375)	(187)	82	41
Pharmacybrands Limited equity investments	9,735	(4)	(2)	3,977	1,909
	<u>762,961</u>	<u>617</u>	<u>309</u>	<u>48,540</u>	<u>28,221</u>

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

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**14. Investments accounted for using the equity method**

**Investments in associates – (continued)**

**Results of associates**

<i>In thousands of AUD</i>	<b>Consolidated</b>	
	<b>2007</b>	<b>2006</b>
Share of associate (loss)/profit before income tax	(2,978)	441
Share of income tax benefit/(expense)	433	(132)
Share of associates net (loss)/profit accounted for using the equity method	<u>(2,545)</u>	<u>309</u>

**Commitments**

<i>In thousands of AUD</i>	<b>Consolidated</b>	
	<b>2007</b>	<b>2006</b>
<i>Share of associates operating leases</i>		
Within one year	2,045	1,361
One year or later and no later than five years	5,496	3,354
Later than five years	1,440	1,449
	<u>8,981</u>	<u>6,164</u>

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**15. Deferred tax assets and liabilities**

**Recognised deferred tax assets and liabilities**

Deferred tax assets and liabilities are attributable to the following:

<b>Consolidated</b>	<b>Assets</b>		<b>Liabilities</b>		<b>Net</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<i>In thousands of AUD</i>						
Property, plant and equipment	-	-	(445)	(1,091)	(445)	(1,091)
Intangible assets	-	-	(2,292)	(2,579)	(2,292)	(2,579)
IT discrepancies	-	5,153	-	-	-	5,153
Unrealised foreign exchange losses	1,281	2,250	-	-	1,281	2,250
Employee benefits	4,652	4,756	-	-	4,652	4,756
Provisions	5,581	4,696	-	-	5,581	4,696
Derivatives*	155	-	-	-	155	-
Other items	-	662	(33)	(814)	(33)	(152)
Tax loss carried forward	3,385	-	-	-	3,385	-
Tax assets / (liabilities)	15,054	17,517	(2,770)	(4,484)	12,284	13,033
Set off of tax	(2,770)	(4,484)	2,770	4,484	-	-
Net tax assets / (liabilities)	12,284	13,033	-	-	12,284	13,033

**The Company**

	<b>Assets</b>		<b>Liabilities</b>		<b>Net</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<i>In thousands of AUD</i>						
Property, plant and equipment	-	-	(1,414)	(2,631)	(1,414)	(2,631)
IT discrepancies	-	2,861	-	-	-	2,861
Other investments	-	-	-	(800)	-	(800)
Unrealised foreign exchange losses	1,281	2,250	-	-	1,281	2,250
Employee benefits	1,295	2,100	-	-	1,295	2,100
Provisions	1,862	1,644	-	-	1,862	1,644
Derivatives*	155	-	-	-	155	-
Other items	91	-	-	(306)	91	(306)
Tax loss carried forward	3,385	-	-	-	3,385	-
Tax assets / (liabilities)	8,069	8,855	(1,414)	(3,737)	6,655	5,118
Set off of tax	(1,414)	(3,737)	1,414	3,737	-	-
Net tax assets / (liabilities)	6,655	5,118	-	-	6,655	5,118

\* Recognised in equity

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

16. Property, plant and equipment

	Consolidated					The Company				
	Land and Buildings	Plant and equipment	Leased plant and equipment	Capital works in progress	Total	Land and buildings	Plant and equipment	Leased plant and equipment	Capital works in progress	Total
<i>In thousands of AUD</i>										
<b>Cost</b>										
Balance at 1 May 2005	9,439	115,961	4,829	3,070	133,299	2,505	48,180	-	-	50,685
Additions	-	10,006	1,844	6,031	17,881	-	1,373	-	1,528	2,901
Acquisitions through business combinations	-	310	-	-	310	-	-	-	-	-
Reclassification of assets	-	(4,014)	4,014	-	-	-	(4,014)	4,014	-	-
Transfer to intangibles	-	(3,361)	-	-	(3,361)	-	-	-	-	-
Disposals	(331)	(7,184)	(490)	-	(8,005)	-	(1,086)	-	-	(1,086)
Discontinued operations	(3,082)	(8,688)	-	-	(11,770)	-	-	-	-	-
Effect of movement in foreign exchange	(311)	(807)	-	(666)	(1,784)	-	-	-	-	-
Balance at 30 April 2006	5,715	102,223	10,197	8,435	126,570	2,505	44,453	4,014	1,528	52,500
Balance at 1 May 2006	5,715	102,223	10,197	8,435	126,570	2,505	44,453	4,014	1,528	52,500
Additions	-	1,122	1,857	18,150	21,129	-	893	1,817	-	2,710
Reclassification of assets	3,984	12,350	464	(16,798)	-	-	1,528	-	(1,528)	-
Transfer from intangibles	-	236	-	-	236	-	-	-	-	-
Disposals	-	(5,966)	(1,045)	-	(7,011)	-	(2,049)	(402)	-	(2,451)
Effect of movement in foreign exchange	345	618	-	175	1,138	-	-	-	-	-
Balance at 30 April 2007	10,044	110,583	11,473	9,962	142,062	2,505	44,825	5,429	-	52,759

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

16. Property, plant and equipment – (continued)

	Consolidated					The Company				
	Land and Buildings	Plant and equipment	Leased plant and equipment	Capital works in progress	Total	Land and Buildings	Plant and equipment	Leased plant and equipment	Capital works in progress	Total
<i>In thousands of AUD</i>										
<b>Depreciation and impairment losses</b>										
Balance at 1 May 2005	(893)	(55,856)	(1,930)	-	(58,679)	(423)	(19,930)	-	-	(20,353)
Depreciation charge for the year	(214)	(10,003)	(1,358)	-	(11,575)	(47)	(4,376)	(334)	-	(4,757)
Reclassification of assets	-	729	(729)	-	-	-	729	(729)	-	-
Transfer to intangibles	-	2,332	-	-	2,332	-	-	-	-	-
Discontinued operations	-	6,691	-	-	6,691	-	-	-	-	-
Disposals	-	2,892	338	-	3,230	-	373	-	-	373
Effect of movements in foreign exchange	11	648	-	-	659	-	-	-	-	-
Balance at 30 April 2006	(1,096)	(52,567)	(3,679)	-	(57,342)	(470)	(23,204)	(1,063)	-	(24,737)
Balance at 1 May 2006	(1,096)	(52,567)	(3,679)	-	(57,342)	(470)	(23,204)	(1,063)	-	(24,737)
Depreciation charge for the year	(298)	(9,306)	(2,014)	-	(11,618)	(47)	(4,483)	(1,007)	-	(5,537)
Disposals	-	2,970	383	-	3,353	-	1,017	-	-	1,017
Effect of movements in foreign exchange	(16)	(393)	-	-	(409)	-	-	-	-	-
Balance at 30 April 2007	(1,410)	(59,296)	(5,310)	-	(66,016)	(517)	(26,670)	(2,070)	-	(29,257)
<b>Carrying amounts</b>										
At 1 May 2005	8,546	60,105	2,899	3,070	74,620	2,082	28,250	-	-	30,332
At 30 April 2006	4,619	49,656	6,518	8,435	69,228	2,035	21,249	2,951	1,528	27,763
At 1 May 2006	4,619	49,656	6,518	8,435	69,228	2,035	21,249	2,951	1,528	27,763
At 30 April 2007	8,634	51,287	6,163	9,962	76,046	1,988	18,155	3,359	-	23,502

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

17. Intangible assets

	Consolidated					The Company			
	Goodwill	Brand names	Software	Development Costs	Total	Goodwill	Brand names	Software	Total
<i>In thousands of AUD</i>									
<b>Cost</b>									
Balance at 1 May 2005	117,232	112,500	13,340	-	243,072	11,115	23,881	12,777	47,773
Acquisitions through business combinations	2,268	-	-	-	2,268	-	-	-	-
Other acquisitions	-	-	4,230	-	4,230	-	-	4,230	4,230
Transfer from plant and equipment	-	-	3,361	-	3,361	-	-	-	-
Disposals	(17,500)	-	-	-	(17,500)	-	-	-	-
Effect of movements in foreign exchange	(908)	-	-	-	(908)	-	-	-	-
Balance at 30 April 2006	101,092	112,500	20,931	-	234,523	11,115	23,881	17,007	52,003
Balance at 1 May 2006	101,092	112,500	20,931	-	234,523	11,115	23,881	17,007	52,003
Other acquisitions	4,036	-	1,922	406	6,364	-	-	161	161
Transfer to plant and equipment	-	-	(236)	-	(236)	-	-	-	-
Disposals	(1,742)	-	(318)	-	(2,060)	-	-	-	-
Effect of movements in foreign exchange	1,388	-	-	-	1,388	-	-	-	-
Balance at 30 April 2007	104,774	112,500	22,299	406	239,979	11,115	23,881	17,168	52,164

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

17. Intangible assets – (Continued)

	Consolidated					The Company			
	Goodwill	Brand names	Software	Development Costs	Total	Goodwill	Brand names	Software	Total
<i>In thousands of AUD</i>									
<b>Amortisation and impairment losses</b>									
Balance at 1 May 2005	(17,328)	-	-	-	(17,328)	(2,602)	-	-	(2,602)
Amortisation for the year	-	-	(675)	-	(675)	-	-	(675)	(675)
Transfer from plant and equipment	-	-	(2,332)	-	(2,332)	-	-	-	-
Disposals	1,619	-	-	-	1,619	-	-	-	-
Effect of movements in foreign exchange	124	-	-	-	124	-	-	-	-
Balance at 30 April 2006	(15,585)	-	(3,007)	-	(18,592)	(2,602)	-	(675)	(3,277)
Balance at 1 May 2006	(15,585)	-	(3,007)	-	(18,592)	(2,602)	-	(675)	(3,277)
Amortisation for the year	-	-	(3,677)	(75)	(3,752)	-	-	(2,719)	(2,719)
Other acquisitions	-	-	-	-	-	-	-	-	-
Transfer from plant and equipment	-	-	-	-	-	-	-	-	-
Disposals	-	-	-	-	-	-	-	-	-
Effect of movements in foreign exchange	(111)	-	-	-	(111)	-	-	-	-
Balance at 30 April 2007	(15,696)	-	(6,684)	(75)	(22,455)	(2,602)	-	(3,394)	(5,996)
<b>Carrying amounts</b>									
At 1 May 2005	99,904	112,500	13,340	-	225,744	8,513	23,881	12,777	45,171
At 30 April 2006	85,507	112,500	17,924	-	215,931	8,513	23,881	16,332	48,726
At 1 May 2006	85,507	112,500	17,924	-	215,931	8,513	23,881	16,332	48,726
At 30 April 2007	89,078	112,500	15,615	331	217,524	8,513	23,881	13,774	46,168

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 17. Intangible assets (continued)

#### Amortisation and impairment charge

The amortisation charge of \$3,752,000 (2006: \$675,000) for the consolidated entity and \$2,719,000 (2006: \$675,000) for the Company was recognised within administration and general expenses in the income statement.

#### Impairment tests for cash generating units containing goodwill and brandnames

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

<b>Goodwill</b> <i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Australian pharmaceutical distribution				
- Goodwill	15,075	15,075	8,513	8,513
Australian retail				
- Goodwill	37,025	33,060	-	-
Australian manufacturing				
- Goodwill	5,525	5,525	-	-
New Zealand manufacturing				
- Goodwill	30,815	27,649	-	-
Other goodwill	638	4,198	-	-
	<b>89,078</b>	<b>85,507</b>	<b>8,513</b>	<b>8,513</b>

For all cash generating units containing goodwill, value in use (VIU) approach was adopted. VIU was determined by discounting the future cash flows generated from the continuing use of the unit and based on the following assumptions:

- Cash flows were projected based on actual results and the 3 year business plan.
- Growth rates for each individual CGU used were applicable to that revenue stream based on current market factors and management opinion ranging from 2% to 6%.
- A pre-tax discount rate of 10.5% has been used in discounting the projected cash flows.

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

<b>Brandnames</b> <i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Australian pharmaceutical distribution				
- Soul Pattinson brandname	37,500	37,500	23,881	23,881
Australian retail				
- Priceline brandname	61,500	61,500	-	-
- Price Attack brandname	11,500	11,500	-	-
- House brandname	2,000	2,000	-	-
	<b>112,500</b>	<b>112,500</b>	<b>23,881</b>	<b>23,881</b>

The recoverable amount of the Soul Pattinson and Priceline brands was determined by reference to the value in use approach using the relief from royalty method. The relief from royalty method is generally used for brand name valuations and it has been undertaken using a DCF approach due to the availability of forecast cash flows for each of the brand names.

A combination of the relief from royalty and capitalisation of earnings approach was used to value the Soul Pattinson brandname due the fact that the business has exhibited a history of earnings and there is market information available in relation to prices observed on similar assets.

The Price Attack and House brandnames impairment test was based on fair value less cost to sell. In the past year, businesses in the same sector and of generally similar size have been bought and sold by companies as part of ongoing industry consolidation. The same prices for these businesses were used to derive price to earnings ratios that was applied to the Price Attack and House business units to determine the recoverable amount. Price to earnings ratios in the industry ranged from 6.0 times to 6.5 times. The consolidated entity has applied the lower end of that range to current business unit earnings in order to determine recoverable amount.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**18. Trade and other payables**

In thousands of AUD	Consolidated		The Company	
	2007	2006	2007	2006
<b>Current</b>				
Trade payables and accrued expenses	423,290	411,348	213,688	259,889
Derivatives	517	-	517	-
	<u>423,807</u>	<u>411,348</u>	<u>214,205</u>	<u>259,889</u>
<b>Non-current</b>				
Other payables	4,233	3,613	-	-
Non interest bearing loans from controlled entities	-	-	30,184	-
	<u>4,233</u>	<u>3,613</u>	<u>30,184</u>	<u>-</u>

**19. Loans and borrowings**

This note provides information about the contractual terms of the consolidated entity's and Company's interest-bearing loans and borrowings. For more information about the consolidated entity's and Company's exposure to interest rate and foreign currency risk, see note 23.

In thousands of AUD	Consolidated		The Company	
	2007	2006	2007	2006
<b>Current liabilities</b>				
Customer deposits – unsecured	71	72	71	72
Finance lease liabilities	1,760	688	1,437	237
	<u>1,831</u>	<u>760</u>	<u>1,508</u>	<u>309</u>
<b>Non-current liabilities</b>				
Finance lease liabilities	2,650	3,299	1,605	2,134
	<u>2,650</u>	<u>3,299</u>	<u>1,605</u>	<u>2,134</u>

**Financing facilities**

In thousands of AUD	Consolidated		The Company	
	2007	2006	2007	2006
Bank overdraft	25,357	25,028	20,000	20,000
Standby letters of credit	100	100	100	100
Bill acceptance facility	160,000	160,000	160,000	160,000
Securitisation of trade receivables *	350,000	300,000	120,001	103,604
	<u>535,457</u>	<u>485,128</u>	<u>300,101</u>	<u>283,704</u>

**Facilities utilised at reporting date**

Bank overdraft	6,693	6,016	13,138	-
Standby letters of credit	-	-	-	-
Bill acceptance facility	-	-	-	-
Securitisation of trade receivables *	290,147	233,819	120,001	103,604
	<u>296,840</u>	<u>239,835</u>	<u>133,139</u>	<u>103,604</u>

**Facilities not utilised at reporting date**

Bank overdraft	18,664	19,012	6,862	20,000
Standby letters of credit	100	100	100	100
Bill acceptance facility	160,000	160,000	160,000	160,000
Securitisation of trade receivables *	59,853	66,181	-	-
	<u>238,617</u>	<u>245,293</u>	<u>166,962</u>	<u>180,100</u>

\* The securitisation facility is not recognised in the balance sheet as it results in the derecognition of trade receivable balances. Facilities utilised at reporting date include 6,500,000 subordinated note.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 19. Loans and borrowings (continued)

#### Bank overdraft

The Company is a guarantor to a bank facility agreement which provides a total overdraft facility of \$25,357,000 to entities in the Australian Pharmaceutical Industries Limited Group. The facility is subject to set off arrangements between the Group 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 a committed facility, available to be drawn down over the next year.

#### 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.

#### Bill acceptance facility

The bill acceptance facility amount in current liabilities represents the portion of the consolidated entity's bills payable within one year. Bank bills of \$Nil (2006: \$Nil) bear interest at varying rates, based on the roll over period of the bills and the bank prime rate.

#### Securitisation

Refer Note 23.

#### Finance lease liabilities

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

<i>In thousands of AUD</i>	Consolidated					
	Minimum lease payments		Interest	Principal	Minimum lease payments	
	2007	2007	2007	2006	2006	2006
Less than one year	1,977	217	1,760	780	92	688
Between one and five years	2,848	198	2,650	3,589	290	3,299
	<u>4,825</u>	<u>415</u>	<u>4,410</u>	<u>4,369</u>	<u>382</u>	<u>3,987</u>

<i>In thousands of AUD</i>	Company					
	Minimum lease payments		Interest	Principal	Minimum lease payments	
	2007	2007	2007	2006	2006	2006
Less than one year	1,614	177	1,437	269	32	237
Between one and five years	1,741	136	1,605	2,338	204	2,134
	<u>3,355</u>	<u>313</u>	<u>3,042</u>	<u>2,607</u>	<u>236</u>	<u>2,371</u>

The Company and consolidated entity leases plant and equipment under finance leases expiring within five years. At the end of the lease term the Company and consolidated entity has 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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 20. Employee benefits

#### Current

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Liability for long service leave	3,943	3,522	1,695	1,774
Liability for annual leave	9,191	9,036	2,491	3,144
	<u>13,134</u>	<u>12,558</u>	<u>4,186</u>	<u>4,918</u>

#### Non-current

Liability for long service leave	<u>2,762</u>	<u>3,192</u>	<u>793</u>	<u>1,176</u>
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#### (a) Defined benefit plan

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

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Fair value of fund assets - funded	4,517	7,680	4,517	7,680
Present value of funded obligations	(3,521)	(6,894)	(3,521)	(6,894)
Present value of net fund assets	<u>996</u>	<u>786</u>	<u>996</u>	<u>786</u>
Unrecognised actuarial losses	271	189	271	189
Recognised asset for defined benefit obligations (see below)	<u>1,267</u>	<u>975</u>	<u>1,267</u>	<u>975</u>

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

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Net defined benefit asset at 1 May	975	565	975	565
Contributions received	320	489	320	489
Expense recognised in the income statement	(28)	(79)	(28)	(79)
Net defined benefit asset at 30 April	<u>1,267</u>	<u>975</u>	<u>1,267</u>	<u>975</u>

#### Amounts for the current and previous period

<i>In thousands of AUD</i>	Consolidated and the Company		
	2007	2006	2005
Fund assets	4,517	7,680	7,436
Defined benefit obligation	(3,521)	(6,894)	(7,166)
Surplus	<u>996</u>	<u>786</u>	<u>270</u>
Experience adjustments on fund liabilities	(357)	(1,051)	(445)
Experience adjustments on fund assets	275	1,157	150

The consolidated entity and the Company have used the AASB 119.120A exemption and disclosed amounts under AASB 119.120A(p) above for each annual reporting period prospectively from the transition date.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**20. Employee benefits (continued)**

**Changes in the present value of the defined benefit obligation**

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Opening defined benefit obligation	6,894	7,166	6,894	7,166
Change in actuarial assumption	(139)	-	(139)	-
Service cost	243	352	243	352
Interest cost	330	322	330	322
Actuarial losses	357	1,051	357	1,051
Benefits paid	(4,365)	(1,997)	(4,365)	(1,997)
Losses on curtailments	201	-	201	-
Closing defined benefit obligation	<u>3,521</u>	<u>6,894</u>	<u>3,521</u>	<u>6,894</u>

**Changes in the fair value of fund assets**

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Opening fair value of fund assets	7,680	7,436	7,680	7,436
Expected return	607	595	607	595
Actuarial gains	275	1,157	275	1,157
Contributions by employer (net of tax)	320	489	320	489
Benefits paid	(4,365)	(1,997)	(4,365)	(1,997)
Closing fair value of fund assets	<u>4,517</u>	<u>7,680</u>	<u>4,517</u>	<u>7,680</u>

The major categories of fund assets as a percentage of total Fund assets are as follows:

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Growth assets – shares and property	76%	76%	76%	76%
Defensive assets – fixed interest and cash	24%	24%	24%	24%
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

**Expense recognised in the income statement**

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Current service costs	243	352	243	352
Interest on obligation	330	322	330	322
Expected return on fund assets	(607)	(595)	(607)	(595)
Change in actuarial assumptions and losses on curtailments	62	-	62	-
	<u>28</u>	<u>79</u>	<u>28</u>	<u>79</u>

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 20. Employee benefits (continued)

The expense is recognised in the following line items in the income statement:

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Administrative expenses	28	79	28	79
Actual return on fund assets	882	1,752	882	1,752

The consolidated entity expects to contribute \$260,000 to its defined benefit superannuation funds in the 2008 financial year.

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages):

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Discount rate at 30 April	5.0%	4.9%	5.0%	4.9%
Expected return on fund assets at 30 April	8.0%	8.0%	8.0%	8.0%
Future salary increases	3.0%	3.0%	3.0%	3.0%

The overall expected long-term rate of return on assets is 8.0%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**20. Employee benefits (continued)**

**(b) Surplus/(deficit) for each defined benefit superannuation fund on a funding basis**

**Consolidated entity**

	<b>Fund assets</b>	<b>Accrued benefit (iv)</b>	<b>2007<sup>(i)</sup> Fund excess/(deficit)</b>	<b>Contribution recommendations (per year) (iii)</b>	<b>Fund assets</b>	<b>Accrued benefits (iv)</b>	<b>2006<sup>(ii)</sup> Fund excess/(deficit)</b>	<b>Contribution recommendations (per year) (iii)</b>
<i>In thousands of AUD</i>								
Funds sponsored by entities in the consolidated entity								
API Executive Superannuation (v)	12,441	11,514	927	405	11,991	11,514	477	499

- (i) Fund assets at net market value, and accrued benefits have been calculated at 30 June 2006, being the date of the most recent financial statements of the funds.  
(ii) Fund assets at net market value and accrued benefits were calculated at 30 June 2005, being the date of the most recent financial statements of the funds.  
(iii) Contribution recommendations are based on a funding methodology that will result in adequate funding for payments expected to be made over the next three years. The levels of the contributions to the funds are reassessed annually.  
(iv) Accrued benefits are benefits which the funds are presently obliged to pay at some future date, as a result of membership of the funds and calculated in accordance with AAS 25. Accordingly, the excess/(deficit) does not always equal the defined benefit obligation.  
(v) Includes defined benefits and accumulation benefits

The consolidated entity has a legal liability to make up a deficit in the funds but no legal right to benefit from any surplus in the funds.

The principal economic assumptions used in making these recommendations include:

	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Expected return on fund assets	8.0%	8.0%	8.0%	8.0%
Future salary increases	3.0%	3.0%	3.0%	3.0%

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 20. Employee benefits (continued)

#### (c) Defined contribution superannuation funds

The consolidated entity makes contributions to a defined contribution superannuation fund. The amount recognised as expense was \$9,975,000 for the financial year ended 30 April 2007 (2006: \$8,966,000).

#### (d) Share based payments

At 4 June 2002, the consolidated entity granted share options that entitle key management personnel and senior employees to purchase shares in the Company. In accordance with these programmes options are exercisable at the market price of the shares at the date of the grant subject to achievement of performance hurdles.

At 28 September 2005, the consolidated entity granted share performance rights to Mr Sher, the then Managing Director, that entitled him to ordinary shares. The amount of the ordinary shares to be issued is determined based on the increase to the shareholder return against a comparative group and annual EPS growth of at least 10% in the Company from grant date until vesting date.

Mr Sher's performance rights lapsed on his resignation from the Company as of 11 August 2006.

The terms and conditions of the grants are as follows, whereby all options and performance rights are settled by physical delivery of shares:

Grant date / employee entitled	Number of instruments	Vesting conditions	Contractual life of options
Option grant to senior employees at 4 June 2002	100,000	Three years of service and increase of 7.5% compound growth in EPS over three years	5 years
Performance rights to the managing director at 28 September 2005	53,000*	Three years of service and total shareholder return against a comparative group over three years and EPS growth of 10% per annum over three years	5 years

\* The performance rights have been forfeited during 2007.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 20. Employee benefits (continued)

The number and weighted average exercise price of performance rights is as follows:

<i>In thousands of performance rights</i>	Weighted average exercise price	Number of performance rights	Weighted average exercise price	Number of performance rights
	2007	2007	2006	2006
Outstanding at the beginning of the period	\$nil	53	\$nil	-
Forfeited during the period	\$nil	(53)	\$nil	-
Exercised during the period	\$nil	-	\$nil	-
Granted during the period	\$nil	-	\$nil	53
Outstanding at the end of the period	\$nil	-	\$nil	53
Exercisable at the end of the period		-		-

During the financial year, no share performance rights were exercised.

The fair value of services received in return for share performance rights granted are measured by reference to the fair value of share performance rights granted. The estimate of the fair value of the services received is measured based on a Black-Scholes and Monte-Carlo / Binominal option-pricing model. The contractual life of the performance rights is used as an input into this model. Expectations of early exercise are incorporated into the option-pricing models.

<i>Fair value of performance rights and assumptions</i>	Key management personnel 2007	Key management personnel 2006
Fair value at measurement date	-	\$2.15
Share price	-	\$3.12
Exercise price	-	\$nil
Expected volatility (expressed as weighted average volatility used in the modelling under binominal option-pricing model)	-	27.0%
Option life (expressed as weighted average life used in the modelling under binominal option-pricing model)	-	4 years
Expected dividends	-	4.16%
Risk-free interest rate (based on national government bonds)	-	5.26%

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining 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, market and non-market performance conditions. Non-market performance conditions are not taken into account in the grant date fair value measurement of the services received.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**20. Employee benefits (continued)**

The number and weighted average exercise prices of share options is as follows:

	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
	2007	2007	2006	2006
<i>In thousands of options</i>				
Outstanding at the beginning of the period	\$3.45	160	\$3.45	260
Forfeited during the period	\$3.45	(60)	\$3.45	(100)
Exercised during the period	-	-	-	-
Granted during the period	-	-	-	-
Outstanding at the end of the period	\$3.45	100	\$3.45	160
Exercisable at the end of the period		-		-

The options outstanding at 30 April 2007 have an exercise price of \$3.45 and a weighted average contractual life of 1 month.

During the financial year, no share options were issued or exercised.

**Employee expenses**

	Consolidated and The Company	
	2007	2006
<i>In thousands of AUD</i>		
Share options granted in 2006 - equity settled	-	22
Total expense recognised as employee costs	-	22

The fair value of the share performance rights at grant date is determined based on Black-Scholes and Monte-Carlo / Binominal option pricing model. The model inputs were the share price of \$3.12, the exercise price of \$nil, expected volatility of 27.0%, expected dividends of 4.16%, term of four years and a risk-free interest rate of 5.26%.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**21. Provisions**

	Directors retirement scheme	Provision for dismantling	Other	Total
<i>In thousands of AUD</i>				
<b>Consolidated</b>				
Balance at 1 May 2006	743	1,837	1,017	3,597
Provisions made during the year	22	440	2,447	2,909
Provisions used during the year	(173)	(206)	(2,611)	(2,990)
Disposal of business during year	-	-	(533)	(533)
Unwind of discount	-	36	-	36
Balance at 30 April 2007	<u>592</u>	<u>2,107</u>	<u>320</u>	<u>3,019</u>
Current	-	336	320	656
Non-current	<u>592</u>	<u>1,771</u>	<u>-</u>	<u>2,363</u>
	<u>592</u>	<u>2,107</u>	<u>320</u>	<u>3,019</u>
<b>The Company</b>				
Balance at 1 May 2006	743	435	-	1,178
Provisions made during the year	22	-	-	22
Provisions used during the year	(173)	-	-	(173)
Unwind of discount	-	25	-	25
Balance at 30 April 2007	<u>592</u>	<u>460</u>	<u>-</u>	<u>1,052</u>
Current	-	-	-	-
Non-current	<u>592</u>	<u>460</u>	<u>-</u>	<u>1,052</u>
	<u>592</u>	<u>460</u>	<u>-</u>	<u>1,052</u>

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

	Share capital	Retained earnings	Translation reserve	Hedging reserve	Equity reserve	Total	Minority interest	Total equity
<b>22. Capital and reserves</b>								
<b>Consolidated</b>								
<i>In thousands of AUD</i>								
Balance at 1 May 2005	419,499	23,557	3,848	-	-	446,904	-	446,904
Effect of change in accounting policy (note 34)	-	(1,378)	-	-	-	(1,378)	-	(1,378)
Balance at 1 May 2005 restated	419,499	22,179	3,848	-	-	445,526	-	445,526
Acquisition during the year	-	-	-	-	-	-	1,123	1,123
Equity settled transactions	-	-	-	-	15	15	-	15
Total recognised income and expense	-	20,561	(4,686)	-	-	15,875	(187)	15,688
Dividends to shareholders	-	(33,455)	-	-	-	(33,455)	-	(33,455)
Balance at 30 April 2006	419,499	9,285	(838)	-	15	427,961	936	428,897
Balance at 1 May 2006	419,499	9,285	(838)	-	15	427,961	936	428,897
Disposals during the year	-	-	-	-	-	-	(721)	(721)
Total recognised income and expense	-	(11,270)	2,626	(362)	-	(9,006)	(215)	(9,221)
Dividends to shareholders	-	(7,720)	-	-	-	(7,720)	-	(7,720)
Balance at 30 April 2007	419,499	(9,705)	1,788	(362)	15	411,235	-	411,235
<b>Company</b>								
Balance at 1 May 2005	419,499	19,716	-	-	-	439,215	-	439,215
Effect of change in accounting policy	-	(138)	-	-	-	(138)	-	(138)
Balance at 1 May 2005 restated	419,499	19,578	-	-	-	439,077	-	439,077
Equity settled transactions	-	-	-	-	15	15	-	15
Total recognised income and expense	-	22,382	-	-	-	22,382	-	22,382
Dividends to shareholders	-	(33,455)	-	-	-	(33,455)	-	(33,455)
Balance at 30 April 2006	419,499	8,505	-	-	15	428,019	-	428,019
Balance at 1 May 2006	419,499	8,505	-	-	15	428,019	-	428,019
Total recognised income and expense	-	(17,827)	-	(362)	-	(18,189)	-	(18,189)
Dividends to shareholders	-	(7,720)	-	-	-	(7,720)	-	(7,720)
Balance at 30 April 2007	419,499	(17,042)	-	(362)	15	402,110	-	402,110

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 22. Capital and reserves (continued)

#### Share capital

*In thousands of shares*

Shares on issue at 1 May

Shares on issue at 30 April – fully paid

The Company	
Ordinary shares	
2007	2006
257,346	257,346
<u>257,346</u>	<u>257,346</u>

#### Ordinary shares

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.



# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 23. Financial instruments

Exposure to credit, interest rate and currency risks arises in the normal course of the consolidated entity's business. Derivative financial instruments are used to hedge exposure to fluctuations in interest rates.

#### Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. The consolidated entity requires collateral in respect of certain financial assets.

At the balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet, plus the guarantee of bank facilities of pharmacy customers disclosed in Note 25.

#### 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.

The Company has a New Zealand denominated long term inter-company receivable designated as a hedge of the Company's investment in its subsidiary in New Zealand (see note 26). The carrying amount of the loan at 30 April 2007 was \$45,283,000 (2006: \$39,421,000).

#### Interest Rate Risk

The Group's variable rate borrowings are exposed to a risk of change in cash flows due to changes in interest rates.

#### *Derecognised Financial Instruments*

The consolidated entity has entered into a securitisation program, whereby the consolidated entity and company borrow funds that are secured by current trade receivables. There are two separate programs which have limits of \$250,000,000 and \$100,000,000 respectively. As part of these programs, the program provider charges a monthly variable interest rate plus margin based on the drawn down of this program. Settlement of the funds is monthly and daily. These agreements expire in April 2009 and October 2008 respectively.

At 30 April 2007, \$250,000,000 and \$40,147,000 respectively were drawn down on these programs by the consolidated entity. The trade receivables and loans and borrowings relating to these transactions are derecognised.

The amounts drawn down under the securitisation facility accrue interest at the prevailing market rate. At 30 April 2007 the weighted average rate was 6.90%.

The consolidated entity and Company are also required to invest in the securitisation program. At 30 April 2007 an amount of \$74,337,000 (the consolidated entity) and \$41,794,000 (the Company) were invested as interest bearing notes receivable in the program (refer to Note 10). These notes receivable earn interest at the prevailing market rate. At 30 April 2007 the weighted average rate was 7.22%.

#### *Hedging*

The consolidated entity adopts a policy that up to 80% of its exposure to the changes in interest rates on its variable rate borrowings, relating to the securitised trade receivables, is hedged on a fixed rate basis. An interest rate swap denominated in Australian dollars has been entered into to achieve this. The swap matures in April 2009 and has a fixed rate of 6.54%. At 30 April 2007 notional contract amount of the swap was \$200,000,000. The consolidated entity classifies interest rate swaps as cash flow hedges.

The net fair value of the swaps at 30 April 2007 was \$517,000. This has been recognised in equity for the consolidated entity and Company.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**23. Financial instruments (continued)**

**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.

<b>Consolidated</b>		<b>2007</b>							<b>2006</b>						
	<b>Note</b>	<b>Effective interest rate</b>	<b>6 months or less</b>	<b>6-12 months</b>	<b>1-2 years</b>	<b>2-5 years</b>	<b>More than 5 years</b>	<b>Effective interest rate</b>	<b>6 months or less</b>	<b>6-12 months</b>	<b>1-2 years</b>	<b>2-5 years</b>	<b>More than 5 years</b>		
<i>In thousands of AUD</i>		<b>Total</b>						<b>Total</b>							
Cash and cash equivalents	28	5.75%	21,315	21,315	-	-	-	5.00%	36,076	36,076	-	-	-		
Loans to associates*	10	8.50%	24,200	-	-	24,200	-	8.50%	16,873	-	-	16,873	-		
Loans receivable from pharmacy customers*	10	5.00%	16,990	-	-	-	16,990	5.00%	16,601	-	-	16,601	-		
Interest bearing notes	10	5.60%	74,337	-	-	74,337	-	5.60%	41,794	-	-	41,794	-		
Finance lease liabilities	19	6.90%	(4,410)	(880)	(880)	(1,760)	(890)	6.83%	(3,987)	(201)	(250)	(1,301)	(2,235)		
Bank overdrafts	28	9.75%	(6,693)	(6,693)	-	-	-	9.20%	(6,016)	(6,016)	-	-	-		
Customer deposits*	19	3.25%	(71)	(71)	-	-	-	3.25%	(72)	(72)	-	-	-		
Employee Loans		6.55%	258	-	-	-	258	-	-	-	-	-	-		
			125,926	13,671	(880)	96,777	16,100	258	101,269	29,787	(250)	73,967	(2,235)		

<b>The Company</b>		<b>2007</b>							<b>2006</b>						
	<b>Note</b>	<b>Effective interest rate</b>	<b>6 months or less</b>	<b>6-12 months</b>	<b>1-2 years</b>	<b>2-5 years</b>	<b>More than 5 years</b>	<b>Effective interest rate</b>	<b>6 months or less</b>	<b>6-12 months</b>	<b>1-2 years</b>	<b>2-5 years</b>	<b>More than 5 years</b>		
<i>In thousands of AUD</i>		<b>Total</b>						<b>Total</b>							
Cash and cash equivalents	28	5.75%	22	22	-	-	-	5.00%	18,127	18,127	-	-	-		
Loans to associates*	10	8.50%	24,199	-	-	24,199	-	8.50%	16,873	-	-	16,873	-		
Loans to controlled entities	10	5.00%	147,540	-	-	-	147,540	6.50%	174,907	-	-	-	174,907		
Loans receivable from pharmacy customers*	10	5.60%	10,617	-	-	-	10,617	5.00%	6,419	-	-	6,419	-		
Interest bearing notes	10	5.60%	69,000	-	-	69,000	-	5.60%	22,315	-	-	-	22,315		
Finance lease liabilities	19	6.90%	(3,042)	(718)	(718)	(1,436)	(170)	6.83%	(2,371)	(135)	(175)	(1,041)	(1,020)		
Bank overdrafts	28	9.75%	(13,138)	(13,138)	-	-	-	9.20%	-	-	-	-	-		
Customer deposits*	19	3.25%	(71)	(71)	-	-	-	3.25%	(72)	(72)	-	-	-		
			235,127	(13,905)	(718)	91,763	10,447	147,540	236,198	17,920	(175)	22,251	(1,020)		

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

The securitisation is not recognised on balance sheet. For details regarding interest rates, in relation to securitisation, refer to previous page.

Interest rates swap from floating to fixed debt with a base value of 200,000,000 has been recognised against trade receivables. Refer to previous page for further details in relation to the swap.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**23. Financial instruments (continued)**

**Fair values**

The fair values of financial assets and liabilities together with the carrying amounts shown in the balance sheet are as follows:

<b>Consolidated</b>		<b>Carrying amount</b>	<b>Fair value</b>	<b>Carrying amount</b>	<b>Fair value</b>
<i>In thousands of AUD</i>		<b>2007</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
	<b>Note</b>				
Trade and other receivables	10	245,305	245,305	259,790	259,790
Cash and cash equivalents	28	21,315	21,315	36,076	36,076
Finance lease liabilities	19	(4,410)	(4,410)	(3,987)	(3,987)
Trade and other payables (including derivatives)	18	(428,040)	(428,040)	(414,961)	(414,961)
Bank overdraft	28	(6,693)	(6,693)	(6,016)	(6,016)
		<u>(172,523)</u>	<u>(172,523)</u>	<u>(129,098)</u>	<u>(129,098)</u>
<b>The Company</b>					
<i>In thousands of AUD</i>		<b>Carrying amount</b>	<b>Fair value</b>	<b>Carrying amount</b>	<b>Fair value</b>
	<b>Note</b>	<b>2007</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
Loans to/(from) controlled entities	10,18	117,356	117,356	174,907	174,907
Trade and other receivables	10	117,321	117,321	118,086	118,086
Cash and cash equivalents	28	22	22	18,127	18,127
Finance lease liabilities	19	(3,042)	(3,042)	(2,371)	(2,371)
Trade and other payables (including derivatives)	18	(214,205)	(214,205)	(259,889)	(259,889)
Bank overdraft	28	(13,138)	(13,138)	-	-
		<u>4,314</u>	<u>4,314</u>	<u>48,860</u>	<u>48,860</u>

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 23. Financial instruments (continued)

#### 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 30 April 2007 plus an adequate constant credit spread to discount financial instruments. The interest rates used are as follows:

	2007	2006
Loans and borrowings	4.0% - 7.0%	4.0% - 6.0%
Leases	6.5% - 8.0%	6.5% - 7.5%
Receivables	4.0% - 5.5%	4.0% - 5.0%

### 24. Commitments

#### Operating Leases - leases as lessee

Non-cancellable operating lease rentals are payable as follows:

<i>In thousands of AUD</i>	Consolidated		The Company	
	2007	2006	2007	2006
Less than one year	42,361	60,869	5,074	5,308
Between one and five years	108,536	122,516	21,905	18,318
More than five years	31,685	56,724	5,761	13,441
	182,582	240,109	32,740	37,067

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

During the financial year ended 30 April 2007, \$62,558,000 was recognised by the consolidated entity as an expense in profit and loss in respect of operating leases (2006: \$57,681,000). For the company this expense was \$ 6,826,614 (2006: \$5,183,515)

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 25. Contingencies

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.

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Contingent liabilities considered remote				
Guarantee of bank facilities to controlled entities	-	-	20,000	20,000
Guarantee of bank facilities of pharmacy customers (i)	97,043	112,137	97,043	112,137
Contingent liability on termination of a director's service contract	710	683	710	683
Guarantee for property rentals (ii)	19,535	28,246	-	-
Contingent liability for potential ClubCard voucher redemptions (iii)	4,888	3,049	-	-

These guarantees are not secured.

- (i) The Company has strict controls over the approval of guarantees of pharmacy customers and takes security over the assets of the relevant pharmacy.
- (ii) The guarantee for property rentals represents guarantees on franchisee leases of premises.
- (iii) 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.

Potential deferred consideration is payable in respect of the acquisition of the Synapse Financial Pty Ltd (Re: New Price Retail business). The deferred consideration will be calculated on 7 October, 2007, three years from the acquisition date and will be the amount by which the API share price then exceeds \$3.00, multiplied by 20,000,000.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 26. Consolidated entities

	Note	Ownership interest	
		2007	2006
<b>Parent Entity</b>			
Australian Pharmaceutical Industries Limited			
<b>Subsidiaries</b>			
Thrift Chemist Merchandising Pty Limited		100	100
Healthcare Logistics Pty Limited		100	100
Australian Pharmaceutical Industries (Queensland) Pty Limited		100	100
API Victoria Pty Limited		100	100
Amed Supplies Australia Pty Limited		100	100
Soul Pattinson (Manufacturing) Pty Limited		100	100
Healthcare Manufacturing Group Pty Limited		100	100
Pharmacists of Australia Medicines Pty Limited		100	100
API Financial Services Australia Limited		100	100
Pharma-Pack Pty Limited		100	100
API (Canberra) Pty Limited		100	100
Canberra Pharmaceutical Supplies Trust		100	100
Zuellig Australia Pty Limited		100	100
Stevens Australia Pty Limited		100	100
Dental Forum Australasia Pty Limited		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
Price Attack Franchising (New Zealand) Ltd	(i)	100	100
PSM Healthcare Limited	(i)	100	100
Pharmaceutical Sales and Marketing Limited	(i)	100	100
Garrett Investments Limited	(i)	100	100
Healthcare Manufacturing Group Limited	(i)	100	100
The Medicine Shoppe Limited	(i)	100	100
Synapse Finance Pty Ltd		100	100
New Price Retail Finance Pty Ltd		100	100
New Price Retail Pty Ltd		100	100
Pricemart Pty Ltd		100	100
New Price Retail Services Pty Ltd		100	100
You Pay Less Pty Ltd		100	100
Price Attack Properties Pty Ltd		100	100
Price Attack Franchising Pty Ltd		100	100
Priceline Unit Trust		100	100
Second Priceline Unit Trust		100	100
House Unit Trust		100	100
Priceline Propriety Limited		100	100
Eight-First Tribute Pty Ltd		100	100
Pharmacybrands Limited	(i)	-	66

(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 predominately in Australia.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 27. Acquisition of subsidiaries

#### Acquiree's net assets at the acquisition date

##### Acquisition of controlled entities

On 31 December 2005 the consolidated entity acquired an additional 15% of the issued capital in Pharmacybrands Limited a provider of services to retail pharmacy in New Zealand.

Details of the acquisition are as follows:

*In thousands of AUD*

	Consolidated		The Company	
	2007	2006	2007	2006
Consideration (cash)	-	4,916	-	-
Cash acquired	-	(727)	-	-
Net consideration	-	4,189	-	-
Fair value of net assets of entities acquired:				
Property, plant and equipment	-	310	-	-
Goodwill – at cost	-	576	-	-
Goodwill – accumulated amortisation	-	(60)	-	-
Equity accounted investment	-	1,747	-	-
Deferred tax assets	-	27	-	-
Inventories	-	96	-	-
Receivables	-	4,626	-	-
Prepayments	-	103	-	-
Payables	-	(3,276)	-	-
	-	4,149	-	-
Less Minority interest	-	(1,123)	-	-
	-	3,026	-	-
Goodwill and other intangibles on acquisition	-	1,163	-	-
	-	4,189	-	-

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**28. Reconciliation of cash flows from operating activities**

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities</b>				
Profit / (loss) for the period	(11,485)	20,374	(17,827)	22,382
<i>Adjustments for:</i>				
Interest expense	23,850	15,569	7,613	11,683
Interest income	(3,478)	(2,278)	(6,241)	(9,031)
Depreciation	11,618	11,575	5,537	4,757
Amortisation	3,752	675	2,719	675
Foreign exchange (gains)/losses	-	-	(2,711)	4,835
Share of (profit) / loss of associates net of dividends received	2,545	(309)	-	-
Gain on sale of property, plant and equipment and business	(12,513)	(4,328)	(10)	(3,612)
Equity-settled share-based payment expenses	-	15	-	15
Income tax benefit	(4,358)	7,775	(8,753)	(4,203)
<b>Operating profit before changes in working capital and provisions</b>	9,931	49,068	(19,673)	27,501
(Increase)/decrease in trade and other receivables	59,049	136,469	54,691	76,787
(Increase)/decrease in inventories	(6,104)	(55,999)	(8,591)	31,339
(Decrease)/increase in trade and other payables	13,079	48,523	(41,016)	12,118
(Decrease)/Increase in provisions and employee benefits	1,502	(9,112)	(3,083)	1,020
	77,457	168,949	(17,672)	148,765
Interest received	3,478	1,660	6,241	9,031
Interest paid	(23,850)	(15,569)	(7,613)	(11,683)
Income taxes paid	(7,185)	(7,932)	(6,985)	(7,619)
Gain on sale of discontinued operations, net of tax	-	-	-	-
<b>Net cash from operating activities</b>	49,900	147,108	(26,029)	138,494

<i>In thousands of AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Cash and cash equivalents	21,315	36,076	22	18,127
Bank overdrafts repayable on demand	(6,693)	(6,016)	(13,138)	-
Cash and cash equivalents in the statement of cash flows	14,622	30,060	(13,116)	18,127

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 29. Related parties

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Company and the consolidated entity, including directors of the Company and other executives. Key management personnel includes the five most highly remunerated S300A directors and executives for the Company and the consolidated entity.

The following were key management personnel of the consolidated entity at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

#### **Directors**

##### *Non-executive directors*

Mr Peter R Robinson	Chairman
Mr Barry A Frost	Non-executive director and Deputy Chairman
Mr David J Fairfull	Non-executive director
Mr Robert D Millner	Non-executive director
Mr John W Murphy	Non-executive director
Mr Michael S Smith	Non-executive director (Resigned 30 September 2006)
Mr Michael R Wooldridge	Non-executive director
Ms Carol Holley	Non-executive director (Appointed 19 December 2006)

##### *Executive director*

Mr Stephen P Roche	Executive Director and CEO/Managing Director (Appointed 14 August 2006 as Managing Director and an Executive prior to that date)
Mr Jeffrey C Sher	Executive Director and Group Leader/ Managing Director (Resigned 11 August 2006)

The following persons were the eight executives with the greatest authority for the strategic direction and operational management of the consolidated entity (specified executives) during the financial year:

#### **Executives**

Mr Simon Burrow	Manager	Marketing and Communication (Resigned 30 November 2006)
Mr Chris Gardoll	Manager	Company Secretary
Mr George Meiliunas	Manager	Organisational Development and Human Resources
Mr Rob Tassie	Manager	Corporate Affairs
Mr Phil Smith	Manager	Retail
Mr Simon Kilner	Manager	Information Management
Mr Richard Vincent	Manager	Pharmacy Distribution
Mr Daniel Lucas	Manager	Finance and Administration (Appointed 6 March 2006 and resigned 18 August 2006)

Mr Kilner was defined as an executive from 1 May 2006 to 30 September 2006. Mr Tassie was defined as an executive from 1 October 2006.

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.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 29. Related parties (continued)

#### Principles used to determine the nature and amount of remuneration

##### Non-executive Directors Remuneration

The remuneration of non-executive directors is determined by the full Board with an aggregate maximum amount approved by shareholders in general meeting. The maximum aggregate amount was increased to \$595,000 per annum in total remuneration at the Company's 2000 Annual General Meeting.

Non-executive directors do not receive bonuses nor are they issued options on securities. Directors' fees cover all main board activities with additional amounts paid for membership of board committees. Superannuation is paid for non-executive directors at the statutory prescribed rate.

Under the Board's Retirement Scheme, which was approved by shareholders at the 1994 Annual General Meeting, after 10 years service, retiring non-executive directors receive, on a sliding scale capped at \$220,000, benefits up to a maximum of three times the average annual remuneration in the three years preceding retirement. The scheme does not apply to directors appointed after 9 September 2003.

Remuneration levels are competitively set to attract and retain appropriately qualified and experienced directors. The Remuneration Committee obtains independent advice on the appropriateness of remuneration packages, given trends in comparative companies locally.

##### Chief Executive Officer & Managing Director Remuneration

Mr Roche was appointed Managing Director & CEO effective 14 August 2006.

The employment agreement specified the following components regarding Mr Roche's remuneration:-

- Mr Roche was paid a fixed annual remuneration of \$700,000 (inclusive of superannuation and fringe benefits tax). Mr Roche's remuneration is to be reviewed on 1 July each year;
- During the year ended 30 April 2007 Mr Roche was entitled to a short term incentive payment of up to \$250,000 eligibility for which was measured against agreed key performance indicators including Company financial performance. These key performance indicators are consistent with those for senior executives noted below; and
- Mr Roche will be entitled to participate in the API Long Term Incentive Plan. The first grant of performance rights will be approved by shareholders at the Annual General Meeting to be held on 18 December 2007. Mr Roche's participation will be on the same terms and conditions that apply to all participants and will be in accordance with the principles of the Trust Deed. Exercise of the performance rights will be dependent on the satisfaction of performance conditions assessed 3 years from the grant date.

The agreement between Mr Roche and the Company made the following provisions in respect of cessation of employment:-

- Mr Roche may resign from the Company by giving three months written notice.
- The Company may summarily terminate Mr Roche's employment in specified circumstances with immediate effect.
- The Company may terminate Mr Roche's employment by giving twelve months written notice and may make a termination payment in lieu of notice of up to twelve months fixed remuneration.

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

##### Senior Executives Remuneration

Remuneration levels are competitively set to attract and retain appropriately qualified and experienced senior executives. The Remuneration Committee obtains independent advice on the appropriateness of remuneration packages, given trends in comparative companies locally. Remuneration packages include a mix of fixed remuneration, performance-based remuneration and equity-based remuneration.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 29. Related parties (continued)

#### Principles used to determine the nature and amount of remuneration (continued)

##### *Fixed Remuneration*

Fixed remuneration consists of base remuneration (which is calculated on a total cost basis and includes any FBT charges related to employee benefits including motor vehicles), as well as employer contributions to superannuation funds.

Remuneration levels are reviewed annually by the Remuneration Committee through a process that considers individual segment and overall performance of the consolidated entity. In addition external consultants provide analysis and advice to ensure the directors' and senior executives' remuneration is competitive in the market place. A senior executive's remuneration is also reviewed on promotion.

##### *Performance-linked Remuneration*

Performance linked remuneration includes both short-term and long-term incentives and is designed to reward executive directors and senior executives for meeting or exceeding their financial and personal objectives. The short-term incentive (STI) is an 'at risk' bonus provided in the form of cash, while the long-term incentive (LTI) is provided as performance rights over ordinary shares of the Company under the rules of API's Long Term Incentive Plan.

##### *Short-term incentive bonus*

Each year the Remuneration Committee sets the KPI's (key performance indicators) for the executive directors and senior executives. The KPI's generally include measures relating to the consolidated entity, the relevant segment, and the individual, and include financial, people, customers and strategy and risk measures. The measures are chosen as they directly align the individual's reward to the KPI's of the consolidated entity and to its strategy and performance.

The financial performance objectives are 'profit after tax' and 'net debt' compared to budgeted amounts. The non-financial objectives vary with position and responsibility and include measures such as achieving strategic outcomes, safety and environmental performance, customer satisfaction and staff development. Financial and non-financial objectives each account for varying percentage of the maximum STI depending upon the executive's role.

At the end of the financial year the Remuneration Committee assess the actual performance of the consolidated entity, the relevant segment and the individual against the KPI's set at the beginning of the financial year. A percentage of the pre-determined maximum amount is awarded depending on results. No bonus is awarded where performance conditions are not achieved.

The Remuneration Committee recommends the cash incentive to be paid to the individuals for approval by the Board. The method of assessment was chosen as it provides the Committee with an objective assessment of the individual's performance.

For the year ended 30 April 2007, the Company and consolidated entity have not paid any short term incentives to key management personnel.

##### *Long Term Incentive Bonus*

The Remuneration Committee had responsibility for API's Long Term Incentive Plan established during the year ended 30 April 2006. The Remuneration Committee is responsible for determining awards to be granted under the Plan, as well as overseeing administration of the Plan. The Remuneration Committee is currently finalising the performance conditions for an issue of performance rights to key executives.

A "performance right" is a right to be provided with a fully paid ordinary share in the Company. Under the Plan, the shares can either be purchased on market on behalf of the participant, or new shares issued by the Company. If a performance right is satisfied through the achievement of a performance condition (as described below), a participant has approximately 2 years from that time to "exercise" it and be provided with a share in API.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 29. Related parties (continued)

#### Principles used to determine the nature and amount of remuneration (continued)

##### *Long Term Incentive Bonus (continued)*

The performance conditions for the exercise of performance rights will be assessed after 3 years from the date they are granted.

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 performance conditions for the performance rights are designed to take account of absolute and relative measures – being:

- the Company's total shareholder return (TSR) performance relative to the total shareholder return performance of a comparative group of ASX-listed companies; and
- the Company's earnings per share (EPS) relative to an EPS growth target as determined by the Board.

For each participant one half of the total performance rights granted will be assessed against the TSR measure and the other half will be assessed against the EPS measure.

The TSR performance condition has the effect that:

- none of the performance rights subject to the TSR performance condition may be exercised at the end of the performance period, unless API's TSR performance is at least above the median level when compared against the comparative group; and
- if API's TSR is at or above the 75<sup>th</sup> percentile, all the performance rights subject to this condition can be exercised.

The EPS performance condition has the effect that:

- none of the performance rights subject to the EPS performance condition may be exercised unless API's actual EPS performance over the performance period results in EPS that is equivalent to at least 10% per annum compound EPS growth over the 3 year period; and
- if API's actual EPS performance results in EPS over the performance period that is equivalent to being at or above 15% per annum, compound EPS growth over the same period, all the performance rights subject to this condition can be exercised.

No performance rights were issued during the year and the performance rights issued to Mr J Sher during 2006 lapsed during 2007.

##### *Other Benefits*

Non-cash benefits typically include motor vehicles and health insurance including fringe benefits tax.

##### *Former Executive Share Option Plan*

Options have previously been issued under the Executive Share Option Plan (made in accordance with the plan approved by shareholders at the 8 December 1997 Extraordinary General Meeting). The most recent issue of options was in July 2002 and at year end 3 current executives (one key management person) remain eligible to receive up to an aggregate of 100,000 options (within a range of 20,000 to 60,000 each) over ordinary shares for consideration of \$3.45 per share. The ability to exercise the options is conditional upon the consolidated entity achieving a performance hurdle which is a 7.5% compound growth in EPS over the three year period commencing 1 May 2002 and is able to be achieved up to 1 May 2007, the end of the exercise period using the EPS compound growth over the most recent three year period. These options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

Subsequent to the financial year end 30 April 2007, the options available did not vest, as the performance hurdle was not achieved during the period to 4 June 2007.

## Australian Pharmaceutical Industries Limited and its controlled entities

### Notes to the consolidated financial statements

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#### *Service Contracts*

It is the consolidated entity's policy that service contracts for key management executives, excluding the Managing Director and CEO, be unlimited in term but capable of termination on 12 months notice. The consolidated entity may summarily terminate the employment in specified circumstances with immediate effect. All key management executives are subject to a 12 months non-compete restriction after cessation of employment.

The consolidated entity has entered into service contracts with each senior executive, excluding the Managing Director and CEO, that provides for the payment of benefits where the contract is terminated by the consolidated entity. The senior executives are also entitled to receive on termination of employment their statutory entitlements of accrued annual and long service leave, together with any superannuation benefits.

The service contract outlines the components of remuneration paid to the senior executives but does not prescribe how remuneration levels are modified year to year. Remuneration levels are reviewed each year to take into account cost-of-living changes, any changes in the scope of the role performed by the senior executive and any changes required to meet the principles of the remuneration policy.

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

**29. Related parties (continued)**

**Remuneration of directors and executives**

Details of the nature and amount of each major element of the remuneration of each director of the Company and each of the executives of the Company and consolidated entity are:

		Short Term		Non-	Post	Other	Termination	Equity	Total
		Salary	Short-term	monetary	Superannuation	long term	payments	Value of	
		& Fees	incentives	benefits	contribution			Options &	
		\$	\$	\$	\$	\$	\$	Rights	\$
<b>Directors</b>									
<i>Non-executive</i>									
Mr P R Robinson	2007	127,000	-	-	11,430	-	-	-	138,430
	2006	127,000	-	-	11,430	-	-	-	138,430
Mr D J Fairfull	2007	52,000	-	-	4,680	29,700	-	-	86,380
	2006	52,000	-	-	4,680	15,150	-	-	71,830
Mr B A Frost	2007	87,000	-	-	7,830	-	-	-	94,830
	2006	87,000	-	-	7,830	-	-	-	94,830
Mr R D Millner	2007	52,000	-	-	4,680	29,700	-	-	86,380
	2006	52,000	-	-	4,680	15,150	-	-	71,830
Mr M S Smith (resigned 30 September 2006)	2007	23,750	-	-	2,117	-	-	-	25,867
	2006	57,000	-	-	5,130	-	-	-	62,130
Mr J W Murphy	2007	57,000	-	-	-	-	-	-	57,000
	2006	57,000	-	-	-	-	-	-	57,000
Mr M R Wooldridge	2007	52,000	-	-	4,680	-	-	-	56,680
	2006	13,000	-	-	1,170	-	-	-	14,170
Ms E C Holley (appointed 19 December 2006)	2007	26,571	-	-	2,391	-	-	-	28,962
	2006	-	-	-	-	-	-	-	-
<i>Executive</i>									
Mr S P Roche – Managing Director/CEO (appointed 14 August 2006 as Managing Director and prior to that date as an Executive)	2007	648,072	-	-	12,595	-	-	-	660,667
	2006	387,440	-	-	12,140	-	-	-	399,580
Mr J C Sher – Group Leader (resigned 11 August 2006) **	2007	299,612	-	-	27,742	-	1,078,027	-	1,405,381
	2006	605,380	153,592	16,368	79,650	8,556	-	22,157	885,703
<b>Total directors</b>	2007	1,425,005	-	-	78,145	59,400	1,078,027	-	2,640,577
	2006	1,437,820	153,592	16,368	126,710	38,856	-	22,157	1,795,503

Australian Pharmaceutical Industries Limited and its controlled entities  
Notes to the consolidated financial statements

29. Related parties (continued)

Remuneration of directors and executives (continued)

		Short Term		Non-	Post	Other	Termination	Equity	Total
		Salary	Short-term	monetary	employment	long term	payments	Value of	
		& Fees	incentives	benefits	Superannuation			Options &	
		\$	\$	\$	contribution	\$	\$	Rights	\$
					\$			\$	
<b>Executives</b>									
Mr S Burrow - Leader Marketing & Communication	2007	180,389	-	-	9,191	-	320,998	-	510,578
(resigned 30 November 2006)	2006	290,304	-	-	23,424	-	-	-	313,728
Mr C Gardoll – Company Secretary	2007	235,752	-	28,004	58,938	6,055	-	-	328,749
	2006	235,752	14,500	30,029	57,109	6,055	-	-	343,445
Mr J Meiliunas –General Manager OD / HR	2007	300,488	-	-	12,595	-	-	-	313,083
	2006	287,954	-	12,134	12,046	-	-	-	312,134
Mr P Smith – General Manager Retail	2007	389,958	-	-	15,801	-	-	-	405,759
	2006	348,625	-	15,322	31,377	-	-	-	395,324
Mr S Kilner – Leader Information Management*	2007	113,849	-	-	5,248	-	-	-	119,097
	2006	269,097	-	5,738	11,128	-	-	-	285,963
Mr R Vincent – General Manager Pharmacy	2007	336,092	-	-	12,595	-	-	-	348,687
Distribution	2006	265,448	-	-	12,140	-	-	-	277,588
Mr R Tassie – General Manager Corporate Affairs	2007	109,970	-	-	7,347	-	-	-	117,317
(key management person from 1 October 2006)	2006	-	-	-	-	-	-	-	-
Mr D Lucas – Leader Finance & Administration	2007	130,954	-	-	4,046	-	547,853	-	682,853
(Appointed 6 March 2006, resigned 18 August 2006)	2006	61,207	-	-	2,023	-	-	-	63,230
Mr I McDonald – CEO Pharmacy ***	2007	-	-	-	-	-	-	-	-
	2006	234,999	121,645	30,010	52,968	16,381	643,325	-	1,099,328
<b>Total executives (Company &amp; consolidated entity)</b>	2007	1,797,452	-	28,004	125,761	6,055	868,851	-	2,826,123
	2006	1,993,386	136,145	93,233	202,215	22,436	643,325	-	3,090,740
<b>Total directors and executives (Company &amp; consolidated entity)</b>	2007	3,222,457	-	28,004	203,906	65,455	1,946,878	-	5,466,700
	2006	3,431,206	289,737	109,601	328,925	61,292	643,325	22,157	4,886,243

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.

The value of options is calculated at grant date using the Binominal model. The value is allocated to each reporting period evenly over the period from grant date to vesting date.

\* Mr Kilner was defined as an executive from 1 May 2006 to 30 September 2006. Mr Tassie was defined as an executive from 1 October 2006. Their remuneration is only included for the period during which they were executives.

\*\* At the time API acquired New Price Retail in October 2004, Mr Sher had some outstanding legacy amounts owing to companies in the NPR group. The nature of these loans and the circumstances in which they became repayable were complex and related to Mr Sher as a former shareholder of NPR. API did not ascribe any value to these legacy amounts on acquisition. At the time of Mr Sher's separation from API in August 2006, it was important to him that there was a formal recording about these legacy items. While this was recorded as a payment to Mr Sher and an immediate repayment by him, there was no net amount received by him from API as a result.

\*\*\* Mr McDonald has been included in 2006, due to his termination payment making him the highest paid executive.

^ Messrs Sher, Gardoll, and McDonald were paid bonuses in the year ended 30 April 2006 which were in respect of the year ended 30 April 2005 short-term incentive program. These bonus amounts were not accrued into the 2005 result. As noted earlier, no STI bonuses were paid in respect of the year ended 30 April 2006.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 29. Related parties (continued)

#### Loans to key management personnel

Loans totalling \$144,740 made to key management personnel were outstanding at 30 April 2007. The recipients of these loans were Mr P Smith (\$72,370) and Mr G Meiliunas (\$72,370). Interest accrued during the year was \$10,748 for Mr Smith and \$10,748 for Mr Meiliunas.

For all loans to key management personnel, interest is payable at prevailing market rates, currently 6.55%.

All loans are secured by shares in the consolidated entity and are repayable on termination of employment, or earlier at the borrower's discretion.

No amounts have been written down or recorded as allowances, as the balances are considered fully collectable.

#### Other key management personnel transactions with the Company or its controlled entities

Members of key management personnel are directors of joint venture entities (as discussed in note 14) that result in them having influence over the financial or operating policies of those entities. A number of the joint venture entities transacted with the Company or its subsidiaries in the reporting period. The terms and conditions of the transactions with those joint venture parties 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 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 are on the same terms and conditions as those entered into by other entities, employees or customers and are trivial or domestic in nature.

Certain non-executive directors of the Company are associated with entities which derive fees for work done for the Company and its controlled entities.

Mr J Murphy is a director of Investec Wentworth Pty Limited. During the financial year ended 30 April 2007 an amount of \$250,000 was paid by the Company to Investec Wentworth Pty Limited. The payment related to arms length professional services provided in connection with corporate advice in relation to merger and acquisition activity.

There are no amounts receivable from or payable to key management personnel and their related parties arising from the above transactions at 30 April 2007.

#### Options and performance rights over equity instruments granted as compensation

No share performance rights or options were granted as compensation during the year.

The movement during the year in the number of options and performance over ordinary shares in the Company, held directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

#### Performance rights

	Held at 1 May 2006	Forfeited during the year	Held at 30 April 2007	Vested during the year	Vested and exercisable at 30 April 2007
<i>In shares</i>					
<b>Directors</b>					
Mr JC Sher	53,000	(53,000)	-	-	-

No performance rights held by key management personnel are vested but not exercisable. Mr Sher's performance rights were forfeited upon his resignation from the Company.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 29. Related parties (continued)

#### Options

The number of options over ordinary shares in the Company held during the financial year by any of the executives of the consolidated entity are set out below:

	Held at 1 May 2006	Exercised	Held at 30 April 2007	Vested during the year	Vested and exercisable at 30 April 2007
<i>In shares</i>					
Mr C Gardoll	60,000	-	60,000	-	-

No options held by key management personnel are vested but not exercisable.

Subsequent to the financial year end 30 April 2007, the options available did not vest, as the performance hurdle was not achieved during the period to 4 June 2007.

#### 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:

	Held at 1 May 2006	Purchases	Received on Exercise of performance rights / options	Sales	Held at 30 April 2007
<i>In shares</i>					
<b>Directors</b>					
Mr P R Robinson	15,800	-	-	-	15,800
Mr B A Frost	461,548	-	-	-	461,548
Mr D J Fairfull	5,000	-	-	-	5,000
Ms E C Holley	-	-	-	-	-
Mr R D Millner	11,000	-	-	-	11,000
Mr J W Murphy	-	-	-	-	-
Mr S P Roche	-	-	-	-	-
Mr M S Smith	192,498	-	-	-	192,498
Mr J C Sher	1,700,815	-	-	(1,700,815)	-
Mr M Wooldridge	-	-	-	-	-
<b>Executives</b>					
Mr S Burrow	640,163	-	-	(640,163)	-
Mr C Gardoll	40,898	-	-	-	40,898
Mr S Kilner	-	-	-	-	-
Mr D Lucas	-	-	-	-	-
Mr G Meiliunas	588,192	-	-	(13,020)	575,172
Mr R Tassie	-	-	-	-	-
Mr P Smith	588,192	-	-	(13,020)	575,172
Mr R Vincent	-	-	-	-	-

No shares were granted during the year to directors or senior executives.

Messrs D J Fairfull , 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 55,867,070 shares (2006: 55,867,070 shares) in the Company at year end.

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 29. Related parties (continued)

Mr Murphy is the managing director of Investec Wentworth Private Equity Limited, which is the manager of two funds MGB Equity Growth Unit Trust No 2 and Investec Wentworth Private Equity Fund. Each fund previously held 5,156,616 shares in API and is entitled to receive 35.0384% of any deferred consideration payable by API (in cash or shares) in connection with the acquisition of New Price Retail in October 2004. Interests associated with Mr Murphy have a 17.5% interest in MGB Equity Growth Unit Trust No 2.

### Changes in key management personnel in the period after the reporting date and prior to the date when the financial report is authorised for issue

Mr David Marr was appointed Chief Financial Officer on 1 May 2007.

There have been no other changes in key management personnel in the period after the reporting date and prior to the date when the financial report was authorised for issue.

### Non key management personnel disclosures

#### Subsidiaries

Details of interests in wholly-owned controlled entities are set out in note 26. Details of dealings with these entities are set out below.

#### Loans

Loans to and from the Company with controlled entities are initially for a period of 5 years and then subject to further negotiation. Interest is charged monthly at varying rates, based on the bank prime rate of interest, on the outstanding balance.

Interest revenue brought to account by the Company in relation to these loans during the year was \$2,900,000 (2006: \$9,031,000)

#### Other transactions

During the year the Company received a fee for administrative services provided to a controlled entity, API Financial Services Limited of \$494,000 (2006 :\$512,000).

#### Balances with entities within the wholly-owned group

The aggregate amounts receivable by the Company from wholly-owned controlled entities at balance date:

<i>In thousands of AUD</i>	<b>2007</b>	<b>2006</b>
<i>Receivables</i>		
Current trade receivables	3,731	152
Non-current loans to consolidated entities	147,540	174,907
<i>Payables</i>		
Current trade payables	3	1,260
Non-current loans from consolidated entities	30,184	-

#### Dividends

Dividends and distributions received or due and receivable by the Company from wholly-owned controlled entities was \$Nil (2006: \$30,487,000).

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

### 29. Related parties (continued)

#### Joint venture entities and associates

During the financial year ended 30 April 2007, associates purchased goods from the consolidated entity in the amount of \$17,073,000 (2006: \$9,234,000) and at 30 April 2007 associates owed the consolidated entity \$5,327,000 (2006: \$5,857,000). Transactions with associates are priced on an arm's length basis. Non-current loans to joint venture entities and associates of \$24,200,000 (2006: \$16,873,000) are unsecured, and bear interest at market rates. Interest revenue brought to account by the Company in relation to these loans during the year was \$1,817,000 (2006: \$526,000). No dividends were received from associates in the 2007 or 2006 financial years.

### 30. Auditors' remuneration

<i>In AUD</i>	<b>Consolidated</b>		<b>The Company</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Audit services</b>				
Auditors of the Company				
<i>KPMG Australia:</i>				
Audit and review of financial reports				
- 2007 financial year	637,550	380,000	330,000	265,000
- finalisation of the 2006 financial year	331,123	-	331,123	-
Other regulatory audit services	-	7,500	-	-
<i>Overseas KPMG Firms:</i>				
Audit and review of financial reports	29,000	51,462	-	-
	997,673	438,962	661,123	265,000
<b>Other services</b>				
Auditors of the Company				
<i>KPMG Australia</i>				
Other assurance services	54,500	107,295	54,500	107,295
Sale of business completion audits	12,000	65,427	12,000	65,427
Taxation services	300,016	86,596	300,016	86,596
<i>Overseas KPMG offices</i>				
Taxation services	20,000	44,327	-	-
Other assurance services	-	16,662	-	-
	1,384,189	759,269	1,027,639	524,318

# Australian Pharmaceutical Industries Limited and its controlled entities

## Notes to the consolidated financial statements

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### 31. Subsequent events

Subsequent to 30 April 2007 the following matters have arisen:

- Making Life Easy (MLE) has been an equity accounted joint venture for the Company. On 2nd July, 2007 the Company acquired the remaining 50% of the equity of MLE for \$1,000,000. As a result of this, MLE will be accounted for as a wholly owned subsidiary from 2 July, 2007.
- On 24 July 2007, the Company announced that an agreement had been reached for the sale of Eighty First Tribute Pty Limited and House Unit Trust, which incorporates the House Brand business. The sale proceeds are \$8,500,000 and subject to completion accounts as at 31 July, 2007, the Company will book a profit on disposal.

The Company has received approval from the Australian Securities and Investments Commission (ASIC) to transition to a financial year end of 31 August. The Company requested the change based on its retail business requirements which has peak trading periods at Christmas and to a lesser extent, Easter. The current reporting cycle required the Company to provide financial reports for periods ending 31 October and 30 April, which coincide with peak periods.

The changes will take place over a transitional period, in accordance with ASIC relief:

- API closed its full year on 30 April 2007 and provided its preliminary results to the market on 28 June 2007.
- API will then close a transitional financial year for the 4 months to 31 August 2007 and report those results in the last week of October 2007 followed by the full audited accounts in November 2007.
- Following the 31 August 2007 results and accounts being released, an AGM will be held on 18 December 2007 to consider the 30 April 2007 and 31 August 2007 financial reports.

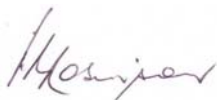
Other than the matters discussed above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations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

## Directors' declaration

- 1 In the opinion of the directors of Australian Pharmaceutical Industries Limited ('the Company'):
  - (a) the financial statements and notes set out on pages 22 to 85, are in accordance with the Corporations Act 2001, including:
    - (i) giving a true and fair view of the financial position of the Company and the consolidated entity as at 30 April 2007 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and
    - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
  - (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- 2 The directors have been given the declarations by the chief executive officer and chief financial officer for the financial year ended 30 April 2007 pursuant to Section 295A of the Corporations Act 2001.

Dated at Sydney 30th day of July 2007

Signed in accordance with a resolution of the directors:



Peter R Robinson  
Director



## Independent audit report to the members of Australian Pharmaceutical Industries Limited

### Scope

#### ***The financial report and directors' responsibility***

The financial report comprises the income statements, statements of recognised income and expense, balance sheets, statements of cash flows, accompanying notes 1 to 31 to the financial statements and the Directors' declaration, for both Australian Pharmaceutical Industries Limited (the 'Company') and Australian Pharmaceutical Industries Limited and its controlled entities (the 'consolidated entity'), for the financial year ended 30 April 2007. The consolidated entity comprises both the Company and the entities it controlled during that financial year.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

#### **Audit approach**

We conducted an independent audit in order to express an opinion to the members of the Company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, Australian Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's and the consolidated entity's financial position, of their performance as represented by the results of their operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

#### **Audit opinion**

In our opinion the financial report of Australian Pharmaceutical Industries Limited is in accordance with:

- (a) the Corporations Act 2001, including:
  - i. giving a true and fair view of the Company's and the consolidated entity's financial position as at 30 April 2007 and of their performance for the year ended on that date; and
  - ii. complying with Australian Accounting Standards and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.

KPMG

Cameron Slapp  
Partner

Sydney, 30<sup>th</sup> July 2007