



**BRANDED HEALTH PRODUCTS**



**CONTRACT MANUFACTURING**



**INTELLECTUAL PROPERTY**

# WHAT WE DO

**PROBIOTEC IS A LEADING  
DEVELOPER, MANUFACTURER  
AND DISTRIBUTOR  
OF PRESCRIPTION AND  
OVER-THE-COUNTER (OTC)  
PHARMACEUTICALS AND  
CONSUMER HEALTH PRODUCTS  
IN AUSTRALIA AND EMERGING  
GLOBAL MARKETS.**

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ABN 91 075 170 151

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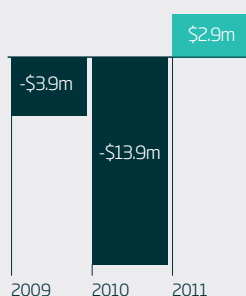
# CHAIRMAN AND CEO'S LETTER TO SHAREHOLDERS

**Dear fellow shareholders,**

Your Board presents herewith the annual report of the Company for the 2011 year. We acknowledge up front that the result delivered for the past financial year was very disappointing, to both Board and management, and no doubt to shareholders as well. Since its initial public offering in FY2007 the company has experienced strong growth and delivered some excellent results, but this latest year was a break in that momentum which causes us to take stock, regroup and reset ourselves for the future.

As it became clear that the year was going to deliver a tough result, and that some of our previous set strategies were not delivering as expected, the Board and management moved quickly to undertake a strategic review of all operations, reset priorities, and look to exit those activities that were not performing as expected. This saw the Company take an aggressive attitude towards year end in shutting down non-performing activities; booking impairment charges and writing down associated inventory and assets. The result of this pro-active restructure is the loss as reported, however we see this as very much a one-off pause in the continuing growth story of Probiotec. Importantly, despite the result as booked, the business generated a strong positive cash flow which demonstrates the sound underlying margins within the business. The core manufacturing sales activities that delivered the prior year's good results are still in place. Underlying gross margin on the \$70 million plus in sales remains well above 45%, which provides the capability to deliver strong profit results if the growth initiatives pursued by the business are well managed and not weighing down on the underlying core business.

So where did the company go wrong in the 2011 year? The financial details suitably explain where the losses and write downs have occurred, but in brief the Company's expansion of its business into multiple offshore destinations simultaneously, at a time of a rapidly rising AUD, and a sluggish international retail economy was not successful. Add to this, the retreat of our weight loss sales in a slow domestic retail environment, and the momentum of the business was temporarily lost, with an imbalance of committed expenditures to below expectation revenues.

**FREE CASH FLOW\* (\$M)**

\*Calculated as cash flow from operations less cash flows used in investing activities.

**IMPROVED CASH FLOW**

The Company has leveraged its significant investments over past years and together with reducing working capital levels from a simplified business model, this has improved the cash generating ability of the Company.

The strategic review which took place in the last quarter of the financial year saw us take a number of decisive actions to reposition the business for the future. In the international market, our operations in the China market have been largely wound back, to the point where we are maintaining a presence, but at a manageable ongoing cost; and in the domestic market we have elected to exit, or sell off, a number of non-core operating activities, and to sell off the associated surplus land, buildings and equipment. These initiatives will return the company to net profitability in the year ahead, as well as generate useful non-operating positive cash flows.

Going forward, the Company's simplified structure will focus on the three core business units, being:

- **Branded Health Products** – This business unit provides ongoing sustainable revenue through the development, potential acquisition, and commercialisation of brand equities. This division is focused on human health categories in both domestic and international markets. Our brands include Milton, Gold Cross, Celebrity Slim, Lomotil, Vermox and Biosource, amongst others.

**BIOSOURCE**

A premium range of nutritional supplements and vitamins containing clinically researched and naturally based ingredients.



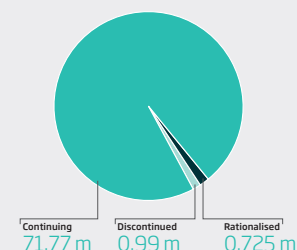
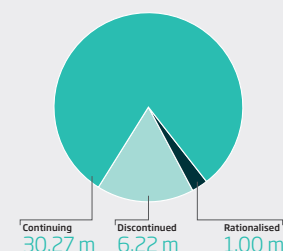
- **Contract Manufacturing** – This business unit manufactures pharmaceutical and therapeutical products for a range of customers, including large international pharmaceutical corporations. By growing our contract manufacturing, the Company is able to achieve a steady, reliable ongoing revenue and earnings base. This business unit also enables the Company to underwrite the upgrading of its manufacturing capabilities and capacity for both contract customers and its own products. Encouragingly, the Company is continuing to experience strong demand in contract manufacturing and has a growing order book for the 2012 financial year.
- **Intellectual Property** – With a suite of pharmaceutical products in advanced stages of development, along with six clinical trials currently in progress, three pharmaceutical products recently released to market and a further 16 pharmaceutical products in development and/or registration, the Company is building a substantial intellectual property asset. Although risks attach to the ultimate commercialisation of resulting products, these intellectual property assets have the potential to deliver significant long-term value through both use in the Company's own branded products and by licensing to third parties.

By the time of the annual general meeting we expect to disclose first-quarter actual performance as compared to the prior year and in doing so we expect to see improvement on the prior period comparatives, reflecting the positive outcomes from the restructure activities, and the underlying solidarity of the business.

With focus and hard work over the next 12 months we look forward to presenting a much improved result this time next year.

**Maurice Van Ryn**  
Chairman

**Wayne Stringer**  
CEO

**SALES REVENUE****OPERATING COSTS\***

\* Excluding impairment charges and finance costs

**PROFITABLE CORE BUSINESS**

By disposing of several non-core assets and closing several loss making entities, the Company has improved its ability to generate earnings in the short to medium term.

# OUR BUSINESS

## OUR VISION

### OUR VISION IS TO BE ONE OF THE WORLD'S BEST CONSUMER HEALTHCARE COMPANIES

## OUR FOCUS

Our focus is national and international markets with good long-term prospects

## OUR AIM

Our aim is to create long-term shareholder value by:

- leading in the innovative development of consumer health products;
- growing revenues while improving margins; and
- increasing distribution levels in both domestic and international markets.

#### PHARMACEUTICALS & CONSUMER HEALTH

# \$49.5 m

of 2011 revenue (2010: \$50.9m)

Strong growth in pharmaceuticals and sports nutrition was offset by decline in Meal Replacement ranges.

The Group's pharmaceutical and consumer health segment fell by 2.7% over the previous year. Growth in the Group's established pharmaceutical ranges and sports nutrition brands was offset by declines in the Group's meal replacement ranges. The difficult economic conditions in the domestic retail environment continued to impact upon the sales of the Group's products, most notably its meal replacement weight management ranges.

#### Products/Services

- Pharmaceuticals
- Consumer health
- Weight management
- Sports nutrition

#### Primary Markets

- Australia
- Europe
- Asia
- New Zealand

#### CONTRACT MANUFACTURE

# \$16.8 m

of 2011 revenue (2010: \$17.5m)

The Group's contract manufacturing continued to experience good demand, with a greater level of focus and resources allocated to this segment.

Contract manufacturing activity decreased by 4.1% from the prior year due to decreased demand from existing customers, reflecting the difficult retail conditions in the domestic market. However, this segment experienced a material increase in demand in the second half of the 2011 financial year with sales of \$10,902,503, an increase of 18.1% over the corresponding period in the prior year resulting from expanded contracts with existing customers and new business.

#### Products/Services

- Pharmaceutical manufacture
- Food manufacture
- Animal nutrition manufacture

#### Primary Markets

- Australia

#### ADDITIVE PRODUCTS

# \$7.2 m

of 2011 revenue (2010: \$6.4m)

The Group's additive products business experienced growth of 12.3% on the prior corresponding period to \$7,184,150.

This growth in sales of additive products was achieved despite difficult trading conditions, several extraordinary weather events and a shortage of available raw materials. Encouragingly, demand for this segment was able to withstand the difficulties outlined above and contribute to the Group's earnings.

#### Products/Services

- Ingredient and input supply
- Animal nutrition

#### Primary Markets

- Australia
- New Zealand



**DAVID CRAIG**

A trusted name among healthcare professionals since 1942, our David Craig brand continues to provide pharmacy dispensaries with galenical products (compounding materials and preparations) and skin care formulations of uncompromising quality.

**EUROPE**

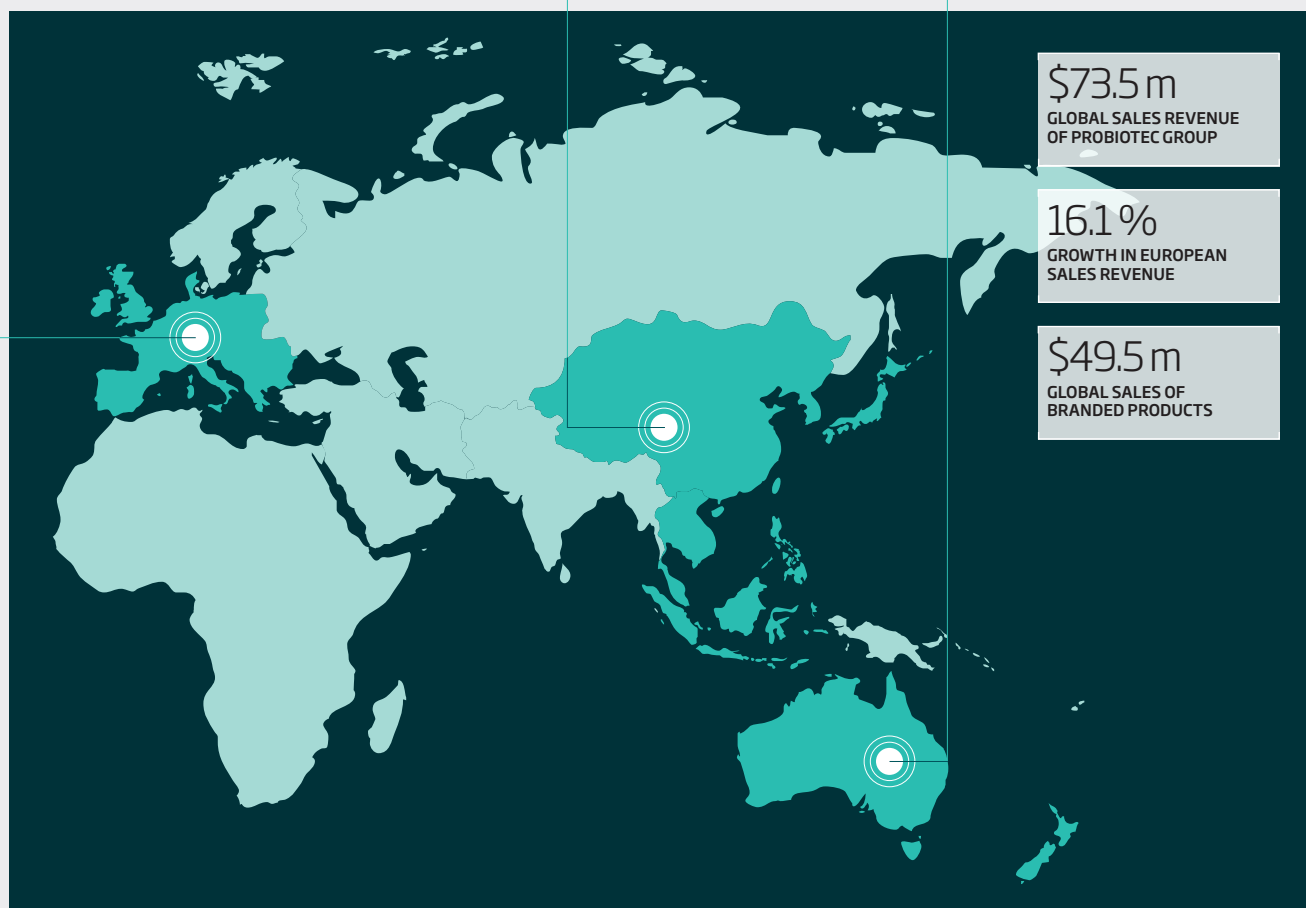
- Manufacturing facility fully operational in Dundalk, Ireland and continues to service our EU-based customers, with significant capacity available;
- 16.1% growth in sales revenue in FY2011 despite difficult trading conditions caused by depressed economies; and
- Revenue continues to be impacted by substantial currency headwinds caused by the appreciation of the Australian dollar against the Euro and Great Britain Pound.

**ASIA**

- Presence and cost structure significantly reduced;
- Hong Kong sales and distribution office closed as part of strategic review; and
- Aiming to increase sales revenue and drive earnings under the reduced cost structure implemented as part of the strategic review.

**AUSTRALIA**

- 4 fully-owned manufacturing sites;
- Substantial distribution through pharmacy, grocery, health food and online channels supported by sales field force of 17 staff; and
- Corporate head office and executive team located in Melbourne, Victoria.



# OUR PERFORMANCE

## SALES REVENUE

**\$73.5 m**

Sales revenues broadly in line with prior year with growth in pharmaceutical and sports nutrition products offset by declines in the Group's Meal Replacement ranges.

## NPAT FROM CONTINUING OPERATIONS

**\$1.03 m**

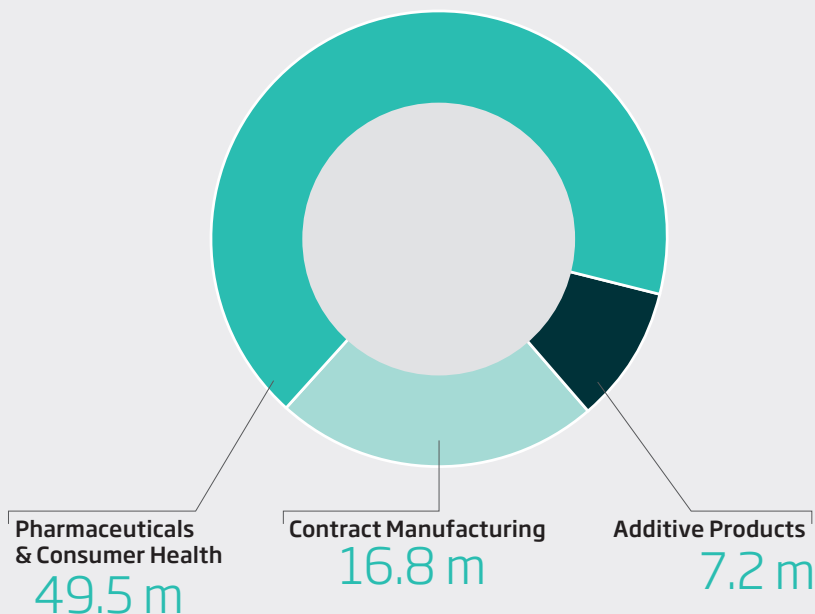
Profitability of the Group was impacted by difficult global economic conditions combined with a rising cost base (which has now been addressed as part of the strategic review).

## CASH FLOW FROM OPERATIONS

**\$6.3 m**

28% increase in cash flow from operations over the prior year driven by initial impact of strategic review and inventory reduction program.

## REVENUE BREAKDOWN BY SECTOR (\$M)



## WINS IN 2011:

**28% INCREASE IN CASH FLOW FROM OPERATIONS**

**\$7.7M REDUCTION IN INVENTORY LEVEL**

**NET DEBT REDUCED BY \$2M**

**GEARING RATIO DOWN FROM 45.6% TO 43.7%**

**16.1% INCREASE IN EUROPEAN SALES REVENUE**

**STRONG CONTRACT MANUFACTURING IN 2ND HALF**

**6**  
trials

6 clinical trials currently in progress

**3**  
products

3 pharmaceutical products released in FY11

**16**  
new products

16 pharmaceutical products currently in development and/or registration phase

The directors believe that the current pipeline of **innovative new products** will assist the Group in securing **significant future growth**.



**GOLD CROSS**

Provides a range of effective traditional medicines endorsed by the Pharmacy Guild of Australia. Includes remedies for coughs & colds, skin care, arthritis, pain and wound management and also incorporates vitamins and general medicines.



## OPPORTUNITIES FOR THE FUTURE

- ▶ Continued development and commercialisation of Intellectual Property assets to drive significant future growth;
- ▶ Improved ability to generate earnings and cash flow from simplified structure;
- ▶ Ongoing growth in pharmaceutical products ranges;
- ▶ Growth in contract manufacturing business; and
- ▶ Growth in revenue and earnings from developing United Kingdom and Ireland business.

## ACTIONS FOR COMING YEAR

- Continue to progress pharmaceutical product development and commercialisation;
- Aggressively pursue contract manufacturing opportunities with both existing and new customers;
- Continue to increase distribution points for our growing suite of pharmaceutical products;
- Stabilise sales of weight management ranges;
- Complete divestment of assets and closure of loss-making entities as identified in the strategic review announced in June 2011; and
- Increase operation efficiency across our manufacturing sites by utilising our lean manufacturing resources.

**WITH A RENEWED FOCUS AND HARD WORK, THE BOARD LOOKS FORWARD TO PRESENTING A MUCH IMPROVED RESULT OVER THE COMING FINANCIAL YEAR AND RETURNING THE COMPANY TO GROWTH.**

# OUR STRATEGY
















STRATEGY	PRIORITIES	PROGRESS/ACTIONS	OPPORTUNITIES	RISKS	PERFORMANCE METRICS
LEAD IN THE DEVELOPMENT OF CONSUMER HEALTH PRODUCTS	Development and release of registered pharmaceutical products	<ul style="list-style-type: none"> <li>16 pharmaceutical products in development and scheduled for release in FY12 and onwards</li> <li>3 pharmaceutical products released late in FY11</li> </ul>	<ul style="list-style-type: none"> <li>Obtain substantial sales revenue from launch of products</li> <li>License product and/or registration</li> </ul>	<ul style="list-style-type: none"> <li>Unsuccessful commercialisation</li> <li>Diversion of resources (both human and capital)</li> <li>Competitive products developed by others</li> </ul>	Pharmaceutical products under development <b>08</b> 0 <b>09</b> 4 <b>10</b> 16 <b>11</b> 16
INCREASE DISTRIBUTION AND MARKET COMPETITIVENESS	Grow and leverage off our distribution base whilst driving new product introduction and sales	<ul style="list-style-type: none"> <li>Celebrity Slim brand overhauled</li> <li>Secured 100% rights to the Biggest Loser Meal Replacement license from November 2011 (previously owned 50% in joint venture)</li> </ul>	<ul style="list-style-type: none"> <li>Increase sales and distribution of new pharmaceutical products</li> <li>Obtain additional distribution and shelf space in both pharmacy and grocery channels for our diverse product ranges</li> </ul>	<ul style="list-style-type: none"> <li>Change in consumer preferences may decrease demand for Probiotec's products</li> </ul>	Sales & marketing expenditure <b>08</b> \$7.97m <b>09</b> \$15.05m <b>10</b> \$16.03m <b>11</b> \$15.40m
STRENGTHEN THE PRODUCT RANGE	Grow new sports nutrition ranges	<ul style="list-style-type: none"> <li>Acquisition of four sports nutrition brands in February 2010</li> <li>Relaunch of Redbak and Ladybird ranges, including new products in November 2010</li> </ul>	<ul style="list-style-type: none"> <li>Increase distribution through health food stores</li> <li>Expand into pharmacy channel</li> <li>Increase product range by utilising manufacturing capabilities</li> </ul>	<ul style="list-style-type: none"> <li>Sales, marketing and development activities are ineffective</li> </ul>	Total SKUs (excl. international variants) <b>08</b> 338 <b>09</b> 416 <b>10</b> 564 <b>11</b> 571
OPERATIONAL EXCELLENCE	Increase operational efficiency and reduce production costs	<ul style="list-style-type: none"> <li>Substantial upgrades of production facilities over past years now complete</li> </ul>	<ul style="list-style-type: none"> <li>Focus on lean manufacturing to drive operational cost savings and efficiencies</li> <li>Focus on improved supply chain to increase stock turns and reduce working capital requirements</li> </ul>	<ul style="list-style-type: none"> <li>Increases in input costs (both materials and labour)</li> <li>Reduction in safety and/or product quality</li> </ul>	Pharmaceutical production efficiency <b>10</b> 56% <b>11</b> 73%

# OUR BRANDS

## CELEBRITY SLIM

A meal replacement program for people wanting to achieve and sustain weight loss. Celebrity Slim adds the important personal touch of educating consumers in a consultation environment. This winning approach has been achieved through a unique partnership with a major retail chain.



PHARMACEUTICALS	WEIGHT MANAGEMENT	SPORTS
<b>BRANDS</b> <div>   </div> <div>   </div> <div>   </div> <div>   </div>	<b>BRANDS</b> <div>  </div> <div>  </div> <div>  </div>	<b>BRANDS</b> <div>  </div> <div>  </div> <div>  </div> <div>  </div>
<b>PROPORTION OF TOTAL REVENUE</b>	<b>PROPORTION OF TOTAL REVENUE</b>	<b>PROPORTION OF TOTAL REVENUE</b>
<b>29%</b>	<b>36%</b>	<b>4%</b>
<b>STRATEGY</b> <p>Continue to develop innovative new products in major categories along with expanding distribution, both domestically and internationally.</p>	<b>STRATEGY</b> <p>Develop and position our ranges as the easy, efficacious way to manage your weight. Obtain penetration into the medical referral and treatment segment of the weight loss category.</p>	<b>STRATEGY</b> <p>Revitalise and expand our ranges leveraging off our substantial manufacturing capabilities for foods, supplements and pharmaceutical products.</p>
<b>PROGRESS</b> <p>16 pharmaceutical products currently in the development and/or registration phase. 3 pharmaceutical products released in late FY2011.</p>	<b>PROGRESS</b> <p>Revitalisation of Celebrity Slim range completed in FY2011. The Company has recently secured the Biggest Loser meal replacement license in its own right for a 5-year term (subject to conditions). Clinical trial to enable enhanced efficacy claims to be made is being progressed with the TGA (regulatory body for pharmaceutical products).</p>	<b>PROGRESS</b> <p>Redbak and Ladybird ranges relaunched in November 2010 with improving sales performance being achieved. Expanding distribution points whilst continuing to refine and improve the product range.</p>
<b>GROWTH FOCUS</b> <p>Development and commercialisation of pharmaceutical products combined with increased distribution in domestic and international markets.</p>	<b>GROWTH FOCUS</b> <p>Short-term focus on recovering domestic sales position along with increasing distribution points and performance throughout Europe, particularly the United Kingdom. Long-term focus on capturing increased proportion of referral and medical treatment market.</p>	<b>GROWTH FOCUS</b> <p>Short-term focus on increasing domestic distribution and sales performance. Long-term focus on increasing breadth of product range and expanding into export markets.</p>

## Financials

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# CORPORATE GOVERNANCE

## 1. Probiotec's approach to corporate governance

### Overview

The Board is committed to maintaining a high standard of corporate governance.

The Board believes that its corporate governance values and behaviours underpin the company's everyday activities to ensure transparency, fair dealing and protection of the interests of stakeholders. Consistent with this belief, the Board's approach is to consider corporate governance within the broader framework of corporate responsibility and regulatory oversight.

In pursuing its commitment to best practice governance standards, the Board will continue to:

- review and improve its governance practices; and
- monitor developments in best practice corporate governance.

In Australia, we have examined the 'Principles of Good Corporate Governance and Best Practice Recommendations' first published in March 2003 and the second edition published in August 2007 by the Australian Securities Exchange's Corporate Governance Council, the Commonwealth Government's CLERP 9 legislation and the Australian Standard AS8000 Good Governance Principles. We have analysed these developments and adapted practices where appropriate to ensure Probiotec remains at the forefront in protecting stakeholder interests.

The Board's approach has been to be guided by the principles and practices that are in our stakeholders' best interests while ensuring full compliance with legal requirements.

### Compliance with the ASX best practice recommendations

Probiotec considers its governance practices comply with all ASX best practice recommendations.

As required by the ASX best practice recommendations, Probiotec has copies of each corporate governance practice described below on its website at [www.probiotec.com.au](http://www.probiotec.com.au). Probiotec also publishes on its website the annual reports, profit announcements, CEO and executive briefings, economic updates, notices of meeting, media releases and meeting transcripts.

## 2. Date of this statement

This statement reflects our corporate governance policies and procedures as at 1 October 2011.

## 3. The Board of Directors

### Membership and expertise of the Board

The Board has a broad range of relevant financial and other skills, experience and expertise to meet its objectives. The current Board composition, with details of individual Director's backgrounds, is set out in the attached Directors report.

### Board role and responsibility

The Board is accountable to shareholders for Probiotec's performance.

The Board has formalised its roles and responsibilities into a Charter, which defines the matters that are reserved for the Board and those that the Board has delegated to management.

In summary, the Board's responsibilities include:

- providing strategic direction and approving corporate strategic initiatives;
- selecting and evaluating future Directors, the Chief Executive Officer ('CEO') and the Chief Financial Officer ('CFO');
- planning for Board and executive succession;
- setting CEO and Director remuneration within shareholder approved limits;
- approving Probiotec's budget and monitoring management and financial performance;
- considering and approving Probiotec's Annual Financial Report and the interim and final financial statements;
- approving Probiotec's risk management strategy, monitoring its effectiveness and maintaining a direct and ongoing dialogue with Probiotec's auditors and regulators; and
- considering and reviewing the social and ethical impact of Probiotec's activities, setting standards for social and ethical practices and monitoring compliance with Probiotec's social responsibility policies and practices.

The Board has delegated to management responsibility for:

- developing and implementing corporate strategies
- and making recommendations on significant corporate strategic initiatives;
- maintaining an effective risk management framework and keeping the Board and market fully informed about material risks;
- developing Probiotec's annual budget, recommending it to the Board for approval and managing day-to-day operations within the budget and in accordance with standards for social and ethical practices which have been set by the Board; and
- making recommendations for the appointment of senior management, determining terms of appointment, evaluating performance, and developing and maintaining succession plans for senior management roles.

### Corporate Governance (continued)

#### Board size and composition

The Board determines its size and composition, subject to the limits imposed by Probiotec's Constitution, a copy of which is available on Probiotec's website. The Constitution requires a minimum of three and a maximum of seven Directors. At the date of this report, there are four Non-executive Directors and two Executive Director on the Board.

#### The selection and role of the Chairman

The Chairman is selected by the Board.

The current Chairman, Maurice Van Ryn, is a Non-executive independent Director appointed by the Board. He has been a Director and Chairman of Probiotec since July 2006. The Chairman is a member of the Audit and Risk Committee.

#### Directors' independence

The Board assesses each of the Directors against specific criteria to decide whether they are in a position to exercise independent judgement.

Directors are considered to be independent if they are independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their unfettered and independent judgement. Materiality is assessed on a case-by-case basis by reference to each Director's individual circumstances rather than general materiality thresholds.

In assessing independence, the Board considers whether the Director has a business or other relationship with Probiotec, directly or as a partner, shareholder or officer of a company or other entity that has an interest, or a business or other relationship, with Probiotec or another Probiotec group member.

It is the Board's view that each of its Non-executive Directors, Maurice Van Ryn, Graham Buckeridge, Robert (Max) Johnston and Richard Kuo is independent.

#### Meetings of the Board and their conduct

The Board meets formally approximately twelve times a year. In addition, it meets whenever necessary to deal with specific matters needing attention between the scheduled meetings. The Chairman and the CEO establish meeting agendas to ensure adequate coverage of financial, strategic and major risk areas throughout the year. In addition to its formal meetings, the Board undertakes regular and relevant workshops. These meetings will include workshops on executive and senior management succession planning, corporate governance, Probiotec's risk/reward approach, customer experience and segmentation projects and other major strategic initiatives.

Directors are always encouraged to participate with a robust exchange of views and to bring their independent judgements to bear on the issues and decisions at hand.

Executive management regularly attends Board meetings and are also available to be contacted by Directors between meetings. The Board also meets without executive management (other than the CEO and any Executive Directors) at each meeting. The Board meets without the CEO and any Executive Directors once a year or as required.

#### Review of Board performance

The Board regularly reviews its overall performance, as well as the performance of Committees, individual Directors and executive management. The performance of Non-executive Directors (including the Chairman) is subject to annual peer and executive management review. The process includes written surveys of Directors, the Company Secretary and a selection of Group Executives. The survey results are independently collated and the Chairman formally discusses the results with individual Directors and Committee chairs.

#### Retirement and re-election of Directors

Probiotec's Constitution states that one-third of our Directors must retire each year. A Director will hold office until such time as they vacate the office or are removed under the Constitution. The Constitution also states that any Director who has been appointed during the year must retire at the next annual general meeting. Eligible Directors who retire each year may offer themselves for re-election by shareholders at the next annual general meeting.

The Board Nomination and Remuneration Committee evaluates the contribution of retiring Directors prior to the Board endorsing their candidature.

#### Board access to information and advice

All Directors have unrestricted access to company records and information and receive regular detailed financial and operational reports from executive management to enable them to carry out their duties. The Board collectively, and each Director individually, has the right to seek independent professional advice at Probiotec's expense to help them carry out their responsibilities. While the Chairman's prior approval is needed, it may not be unreasonably withheld and, in its absence, Board approval may be sought.



## 4. Board committees

### Board committees and membership

There are currently two Board Committees whose powers and procedures are governed by Probiotec's Constitution and the relevant Committee's Charters, as approved by the Board. The two Board Committees and their membership are set out below:

- Audit and Risk Management Committee
- Nomination and Remuneration Committee

Other separate Committees, such as the Corporate Social Responsibility Committee, may be established from time to time to consider matters of special importance.

### Committee Charters

The roles and responsibilities of each Committee are set out in the Committee Charters.

### Committee procedures

#### *Operation of the Committees and reporting to the Board*

The Board Committees meet twice yearly in conjunction with the release of financial results or more frequently as circumstances dictate. Each Committee is entitled to the resources and information it requires, including direct access to employees and advisers. The CEO, senior executives and other employees are invited to attend Committee meetings. All Directors receive all Committee papers and can attend all Committee meetings.

#### *Composition and independence of the Committees*

Committee members are chosen for the skills, experience and other qualities they bring to the Committees. All committees are currently composed of a majority of independent Non-executive Directors.

#### *How the Committees report to the Board*

As soon as possible following each Committee meeting, the Board is given a verbal report by each Committee Chair and all Committee minutes are tabled at Board meetings.

#### *How Committees' performance is evaluated*

The performance of Committees is discussed and reviewed initially within each Committee and then reviewed as part of the Board's performance review. The performance of each member of the Committees is evaluated as part of the performance review of each Director.

### Board Audit and Risk Management Committee

#### *Role of the Committee*

The Board Audit and Risk Management Committee (ARM) will:

- be the focal point of the communication between the Board, management and the external auditor;
- recommend and supervise the engagement of the external auditor and monitor auditor performance;
- review the effectiveness of management information and other systems of internal control;
- review all areas of significant credit, market, operational and compliance risk and arrangements in place to contain those to acceptable levels;
- review significant transactions that are not a normal part of the Company's business;
- review the year end and interim financial information and ASX reporting statements;
- monitor the internal controls and accounting compliance with the Corporations Act, ASX Listing Rules, review external audit reports and ensure prompt remedial action;
- review the Company's financial statements (including interim reports) and accounting procedures; and
- review and approve the framework for the management of operational risks including compliance with the provisions of the Therapeutic Goods Administration Act (TGA), requirement of the Australian Quarantine Inspection Service (AQIS) and other relevant legislation.

#### *Integrity of the financial statements*

ARM considers whether the accounting methods applied by management are consistent and comply with accounting standards and concepts. ARM reviews and assesses any significant estimates and judgements in financial reports and monitors the methods used to account for unusual transactions. In addition it assesses the processes used to monitor and ensure compliance with laws, regulations and other requirements relating to external reporting of financial and non-financial information.

### Corporate Governance (continued)

#### *External audit*

ARM is responsible for making recommendations to the Board concerning the appointment of our external auditors and the terms of their engagement. ARM reviews the performance of the external auditors and annually reviews policy on maintaining independence of the external auditor. The independent external auditor reports directly to ARM and the Board. ARM meets with the external auditor in the absence of management with ARM members being able to contact the external auditor directly at any time.

#### *Operational Risk*

ARM reviews the appropriateness of the framework adopted for managing operational risk and reviews operational risk issues and action plans to address control improvement areas.

#### *Compliance with legal and regulatory requirements*

ARM ensures conformity with applicable legal and regulatory requirements and the Code of Conduct. ARM also establishes procedures for the receipt, retention and treatment of complaints, including accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of concerns regarding accounting or auditing matters. ARM also discusses with management and the external auditor correspondence with regulators or government agencies and published reports which raise material issues. ARM discusses with the Quality Control Manager matters that may have a material impact on product regulatory compliance and with the Company Secretary matters that have a material impact on the financial statements or the compliance with reporting and disclosure policies. The Quality Control Manager reports directly to the Chairman on matters covered by the Therapeutic Goods Administration Act (TGA) and the Australian Quarantine Inspection Service (AQIS) and forwards copies of all matters covered under either TGA or AQIS reports to the chair of ARM.

#### *Composition of ARM*

ARM membership is three Non-executive, independent Directors who possess an understanding of the industry in which Probiotec operates: Richard Kuo (Chairman) (who is financially literate), Graham Buckeridge (who has financial expertise) and Maurice Van Ryn (who has financial expertise).

#### **Board Nomination and Remuneration Committee**

##### *Role of the Committee*

The Board Nomination and Remuneration Committee (NRC) develops and reviews policies on:

- Director tenure;
- Board composition, strategic function and size;
- eligibility criteria for nominating Directors;
- the effectiveness of the Board and Board committees;
- makes recommendations to the Board on the CEO's remuneration;
- approves the reward levels for our senior management group;
- approves merit recognition arrangements and long and short-term incentive arrangements; &
- makes recommendations to the Board on Directors' fees.

NRC periodically reviews our criteria for appointing Directors and considers and recommends to the Board Directors who are retiring by rotation, candidates to be nominated as Directors and reviews periodically the process for orientation and education of new Directors.

The CEO determines the remuneration packages for the senior executives of the Company in accordance with compensation guidelines set by the Board. The Board remuneration policy has been developed to ensure that remuneration packages properly reflect each person's duties and responsibilities and that remuneration is competitive in attracting, retaining and motivating people of the highest quality.

NRC may engage independent remuneration consultants to ensure that our pay and reward practices are consistent with the market practice.

##### *Composition of NRC*

NRC membership is: Robert (Max) Johnston (Chairman), Graham Buckeridge and Wayne Stringer.

#### **Board Corporate Social Responsibility Committee**

##### *Role of the Committee*

A separate Board Corporate Social Responsibility Committee (CSR) has not been formed. These matters are considered by the Board who review the social and ethical impacts of our policies and practices and to oversee initiatives to enhance Probiotec's reputation as a socially responsible corporate citizen. CSR matters are monitored for compliance with Probiotec's published social responsibility policies and practices to ensure Probiotec meets its obligations to its stakeholders. Details of Probiotec's corporate responsibility objectives are addressed in section 8.

## 5. Audit governance and independence

### Approach to audit governance

Best practice in financial and audit governance is changing rapidly. The Board is committed to three basic principles:

- Probiotec must produce true and fair financial reports;
- its accounting methods are comprehensive and relevant and comply with applicable accounting rules and policies; and
- the external auditors are independent and serve shareholder interests by ensuring that shareholders know Probiotec's true financial position.

### Engagement and rotation of external auditor

Probiotec's independent external auditor is BDO Audit (NSW-VIC) Pty Ltd (BDO). BDO were appointed by shareholders at the 2007 Annual General Meeting in accordance with the provisions of the Corporations Act.

The Board has adopted a policy that the lead signing and review audit partners' responsibilities can be performed by the same person for no longer than 5 years. The present lead BDO partner for Probiotec's audit is Nick Michael. The Board also requires a minimum five-year 'cooling off' period before an audit partner is allowed back onto the audit team.

### Certification and discussions with external auditor on independence

The Board Audit and Risk Management Committee (ARM) requires the external auditor to confirm that they have maintained their independence.

Probiotec's external auditor gives annual assurance to ARM and to the Board that they have complied with the independence standards, promulgated by regulators and professional bodies. Periodically ARM meets separately with the external auditor.

### Relationship with external auditor

Probiotec's current policies on employment and other relationships with our external auditor are:

- the audit partners and any audit firm employee on the Probiotec audit are prohibited from being an officer of Probiotec;
- an immediate family member of an audit partner or any audit firm employee on the Probiotec audit is prohibited from being a Director or an officer in a significant position at Probiotec;
- a former audit firm partner or employee on the Probiotec audit is prohibited from becoming a Director or officer in a significant position at Probiotec for at least five years and after the five years, can have no continuing financial relationship with the audit firm;

- members of the audit team and firm are prohibited from having a business relationship with Probiotec or any officer of Probiotec unless the relationship is clearly insignificant to both parties;
- the audit firm, its partners, its employees on the Probiotec audit and their immediate family members are prohibited from having loans or guarantees with Probiotec;
- the audit firm, its partners, its employees on the Probiotec audit and their immediate family members are prohibited from having a direct or material indirect investment in Probiotec;
- officers of Probiotec are prohibited from receiving any remuneration from the audit firm;
- the audit firm is prohibited from having a financial interest in any entity with a controlling interest in Probiotec; and
- the audit firm engagement team in any given year cannot include a person who had been an officer of Probiotec during that year.

### Restrictions on non-audit services by the external auditor

The external auditor is not able to carry out the following types of non-audit services for Probiotec:

- preparation of accounting records;
- information technology systems design and implementation;
- valuation services and other corporate finance activities;
- internal audit services;
- temporary senior staff assignments or management functions;
- legal services;
- litigation services;
- actuarial services; and
- recruitment services for senior management.

For all other non-audit services, use of the external audit firm must be assessed in accordance with Probiotec's policy requiring an independence assessment be done by the business manager requiring the service. The approval of the ARM Chairman must also be obtained.

### Attendance at Annual General Meeting

Probiotec's external auditor attends the annual general meeting and is available to answer shareholder questions.

Corporate Governance (continued)

## 6. Controlling and managing risk

### Approach to risk management

Taking and managing risk are central to business and to building shareholder value. Probiotec's approach is to identify, assess and control the risks which affect its business. This enables the risks to be balanced against appropriate rewards for the taking and managing of the risks. The risk management approach links Probiotec's vision and values, objectives and strategies, and procedures and training.

Probiotec recognises three main types of risk:

- credit risk, being the risk of financial loss from the failure of customers to honour fully the terms of their contract;
- market risk, being the risk to earnings from changes in market factors such as interest and foreign exchange rates, or our liquidity and funding profiles; and
- operational and compliance risk, which arises from inadequate or failed internal processes, people and systems or from external events and include compliance with regulations that govern Probiotec's work practices and information technology.

These risk categories are interlinked and therefore we attempt to take an integrated approach to managing them through the work of the Board Audit and Risk Management Committee (ARM) including copies of all TGA reports issued by the Quality Assurance Manager to the Chairman.

### Risk management roles and responsibilities

ARM is responsible for approving and reviewing Probiotec's risk management strategy and policy. Executive management is responsible for implementing ARM-approved risk management strategy and developing policies, controls, processes and procedures to identify and manage risks in all of Probiotec's activities.

### CEO and CFO assurance

The Board receives regular reports about the financial condition and operational results of Probiotec and its controlled entities.

The CEO and the CFO periodically provide formal statements to the Board that in all material respects:

- the company's financial statements present a true and fair view of Probiotec's financial condition and operational results, and
- the risk management and internal compliance and control systems are sound, appropriate and operating efficiently and effectively.

## 7. Remuneration framework

### Overview

Probiotec has a robust framework in place to ensure that the level and composition of remuneration is sufficient and reasonable and linked to performance. Details of framework and policies and practices are set out in the Directors' Report including a description of the broad structure and objectives of the remuneration philosophy and the measures used to continually link reward to performance.

### Non-executive Directors

Non-executive Directors' fees and payments are reviewed annually by the Board. The Board may access the advice of independent remuneration consultants to ensure Non-executive Directors' fees and payments are appropriate and in line with the market.

### Executives

The objective of Probiotec's executive reward framework is to ensure reward for performance is competitive and appropriate for the results delivered. The framework is designed to follow best practice for the alignment of executive reward with shareholder value as measured by economic profit.

### Equity-related reward and performance plans overview

All equity-related reward and performance plans are reviewed and assessed by the Board Nomination and Remuneration Committee before considered and approved by the Board.

## 8. Corporate social responsibility

### Approach to corporate social responsibility

Probiotec's aim is to manage its business in a way that produces positive outcomes for all stakeholders and maximises economic, social and environmental value simultaneously. In doing so, Probiotec accepts that the responsibilities flowing from this go beyond both strict legal obligations and just the financial bottom line.

Transparency, the desire for fair dealing, responsible treatment of staff and of customers, and positive links into the community underpin our everyday activities and corporate social responsibility practices.

Probiotec's approach reflects the many legal, regulatory and prudential requirements applying to our industry.

### Probiotec's Code of Conduct and responsibility codes

Probiotec's Code of Conduct applies to all Directors, executives, management and employees without exception. The Code governs workplace and human resource practices, risk management and legal compliance and is reviewed periodically and has been specifically reviewed to reflect the ASX best practice recommendations.

Beyond the Code of Conduct, Probiotec has a series of further responsibility policies and codes including:

- Securities Trading policy;
- Market Disclosure policy;
- Whistleblower Protection policy; and
- Corporate Social Responsibility policy.

### Compliance policy and practices

Probiotec's compliance approach focuses on: ensuring strict adherence to all laws and regulations; maintaining the quality control of practices and processes; identifying any weaknesses; and moving to fix any gaps while enhancing the processes and practices.

A separate compliance governance framework operates involving the Board Audit and Risk Management Committee (ARM), to the Quality Control Manager and Company Secretary (who both report regularly to ARM), and individual line businesses. The prime responsibility for compliance resides with line management, who are required to demonstrate that they have effective processes in place consistent with Probiotec's compliance principles and practices.

### Concern reporting and whistle blowing

Employees are actively encouraged to bring any problems to the attention of management or the Board, including activities or behaviour which may not be in accord with the Code of Conduct, Securities Trading Policy, other Probiotec policies, or other regulatory requirements or laws.

Concerns can be raised directly with senior management through the concern raising process, including the CEO and CFO's intranet site or via the CEO's telephone hotline. Concerns can also be raised anonymously by phone and online through the concern reporting system, and are directed to the Quality Assurance Manager in relation to products and operational matters, and to the Company Secretary in relation to financial matters. This concern reporting system protects individuals who, in good faith, report any apparent or actual violations of our codes. The concern reporting system is being reviewed against the Australian standard AS 8004 (Whistleblower protection programs).

### Securities trading policy

Directors and employees are subject to restrictions under the law relating to dealing in Probiotec's securities if they are in possession of inside information. Inside information is information that is not generally available and, if it were generally available, a reasonable person would expect it to have a material effect on the price or value of the securities of the company. In addition and subject always to the above legal restrictions, Probiotec has policies in place which restrict the dates when Directors (and employees who have access to inside information) can deal in Probiotec's securities.

The key aspects of the policy are:

- Trading whilst in the possession of price sensitive information is prohibited.
- Trading is permitted without approval in the 6 week period after the release to the ASX of the half-yearly and annual results, the end of the AGM or at any time the Company has a prospectus open, but only if they have no inside information and the trading is not for short term or speculative gain.
- Trading in other circumstances is only permitted if the person is personally satisfied that they are not in possession of inside information and they have obtained the requisite approval. Permission will be given for such trading only if the approving person is satisfied that the transaction would not be contrary to law, for speculative gain or to take advantage of inside information.

### Market disclosure policy and practices

Probiotec is committed to giving all shareholders equal access to material information about our activities, and to fulfill continuous disclosure obligations to the broader market. The Board-approved market disclosure policy governs how Probiotec communicates with shareholders and the market. This policy is designed to ensure compliance with ASX Listing Rules continuous disclosure requirements so as to ensure any information that a reasonable person would expect to have a material effect on the price of Probiotec's securities is disclosed. The CEO is responsible for making decisions on what should be disclosed publicly under the market disclosure policy, and for developing and maintaining relevant guidelines, including guidelines on information that may be price sensitive. The Company Secretary has responsibility for ensuring compliance with the continuous disclosure requirements in the ASX Listing Rules, and overseeing and coordinating information disclosure to the ASX, analysts, brokers, shareholders, the media and the public.

## DIRECTORS' REPORT

The directors submit the financial report of Probiotec Limited and its controlled entities ('the Group') for the financial year ended 30 June 2011.

### Directors

The names of the directors in office at any time during or since the end of the year are:

Maurice Van Ryn	Chairman
Charles Wayne Stringer	Executive Director
Wesley Stringer	Executive Director
Graham Harry Buckridge	Non-Executive Director
Richard David Kuo	Non-Executive Director
Robert Maxwell Johnston	Non-Executive Director

Directors have been in office to the date of this report unless otherwise stated.

### Company Secretary

The name of the company secretary in office at any time during or since the end of the year was:

Jared Stringer

The company secretary has been in office to the date of this report unless otherwise stated.

### Principal Activities

The Group's principal activities in the course of the financial year were the development, manufacture and sale of pharmaceuticals, foods and nutraceutical products in Australian and international markets.

### Operating Results

The consolidated loss of the Group attributable to the shareholders for the financial year was \$10,337,787 (2010: profit of \$9,480,873).

### Dividends

On 24 August 2010, the directors declared a final dividend for the financial year ended 30 June 2010 of 2.0 cents per fully paid ordinary share, fully franked, which was paid on 1 October 2010. No dividend has been declared or paid in regards to the financial year ended 30 June 2011.

### Review of operations

For the year ended 30 June 2011, the Group's sales revenue from continuing operations for the period was \$71,770,144 representing a decrease of 4.0% compared to the prior corresponding period's sales revenue of \$74,769,246. The Group's net profit from continuing activities attributable to members for the financial year (excluding non-recurring impairment costs) was \$1,032,878, which represents a decrease of 90.3% over the previous financial year of \$10,635,575.

The Group's net loss attributable to members for the financial year was \$10,337,787 and was impacted by a range of adjustments made following a strategic review of the Group. This strategic review resulted in a range of initiatives to improve the strategic focus, business operations and the financial performance of the Group. Full details of the initiatives (and their impact on the financial performance of the Group) can be found in Note 6 of the financial report of the Group for the year ended 30 June 2011 and are also explained in further detail below.

For the year ended 30 June 2011, the Group generated \$6,319,066 in cash flow from operating activities, an increase of 28.3% over the prior corresponding period. This cashflow has been used to fund the investment and working capital requirements of the Group and to reduce debt levels. The Group generated free cash flows of \$2,892,755 during the year ended 30 June 2011 (2010: -\$13,877,317).

Total interest bearing liabilities, net of cash, as at 30 June 2011 was \$28,366,119, a decrease of 6.8% from the same date in the previous year. The Group's gearing ratio reduced as at 30 June 2011 to 43.7%, down from 45.6% at the same date in the previous year (see Note 24(a) for further details).

The Group's sales revenue and profitability have decreased considerably over the past 12 to 18 months. The difficult economic conditions, highlighted by continued weakness in the retail environment, have placed continued pressure on a number of the Group's revenue lines. Sales revenue has been most significantly impacted by a decline in sales of the Group's meal replacement weight loss ranges along with a moderate decline in the group's contract manufacturing operations.

At the same time as this decline in revenue occurred, the Group pursued the development of its manufacturing and distribution activities in the United Kingdom, Ireland, Germany, Hong Kong and China. These activities required a substantial level of capital investment and materially increased the cost structure of the Group. This increase in cost structure was expected to be initially offset, and later surpassed, by sales revenues that would deliver future profitability from these international operations. Unfortunately, several of these export operations have failed to achieve forecast profitability and consequently on return on capital invested. The Directors continue to consider that several of these markets, most notably the United Kingdom and Ireland, provide good long term opportunities and the Group will continue with these activities. However the Germany, Hong Kong and China operations will be discontinued or substantially restructured to remove the costs associated with these activities (see strategic review section below).



## Strategic review

The combination of declining sales revenue and increasing cost structure, and therefore declining profitability for the Group, led to the Board commissioning a comprehensive strategic and operational review of the Group's business operations, assets and financial position. The objective of this strategic review was to identify non-performing and non-core operations and assets, and inefficiencies in the business operations of the Group. As the Group reported to ASX on 1 June 2011, this review resulted in the following initiatives being undertaken:

- Disposal of non-core assets – The review determined that the Group owns and operates assets which are not consistent with its core business strategy and which do not provide sufficient returns. These assets include the Group's Queensland manufacturing site (located in Bundaberg) and its manufacturing site located in Bomaderry (New South Wales). The Board is also investigating the potential sale of several other non-core assets.
- Closure of loss making operations – Several business operations were forecast to continue to be loss making and impact on the overall financial performance and cash flow of the Group. These businesses will be closed within a timeframe and within a manner to ensure that these activities cease the negative impact on the Group as soon as possible. The Group's Hong Kong and German sales and distribution operations are currently being closed down.
- Business improvement initiatives – Rationalisation and consolidation of selected activities in manufacturing, sales and operations were identified and initiatives to improve the utilisation of these assets and operations have been planned and are underway. These initiatives will improve both financial performance and operational efficiencies and will likely result in some additional asset sales. These rationalisations include the Group's China based sales and distribution operations. The closure of several regional offices, rationalisation of product offering and reduced headcount will materially reduce the expenses of these operations and align them with revised sales forecasts to achieving future profitability.

These combined initiatives are expected to provide significant improvements in the Group's ability to generate attractive earnings and cash flow from its ongoing operations. Funds received from the divestment of assets and the associated release of working capital from discontinued operations will be used to reduce the debt levels of the Group.

## Review of ongoing operational segments

The Group's pharmaceutical and consumer health segment fell by 2.6% over the previous year to \$38,307,241. Growth in the Group's established pharmaceutical ranges and sports nutrition brands was offset by declines in the Group's meal replacement ranges.

The Group's contract manufacturing continued to experience good demand, with a greater level of focus and resources allocated to this segment. Contract manufacturing activity decreased by 4.1% from the prior corresponding period to \$16,779,503. However, this segment experienced a material increase in demand in the second half of the 2011 financial year with sales of \$10,902,503 over this period, an increase of 18.1% over the corresponding period in the prior year. Encouragingly, the Group is continuing to experience strong demand in contract manufacturing and has a growing order book for the 2012 financial year. The majority of contract manufacturing activity was on behalf of major pharmaceutical companies.

As a result of the strategic review detailed above, the Group has restructured and refocused its export activities. The Group is now focusing primarily on its manufacturing and distribution businesses in the United Kingdom and Ireland whilst maintaining a substantially reduced and controlled presence in China. Export sales revenue remained at similar levels to the prior year, however sales from the Group's United Kingdom and Ireland business grew to \$7,671,060, during the 2011 financial year, an increase of 16.1% over the prior corresponding period. This increase in revenue was achieved despite a significant strengthening of the Australian dollar against both the Euro and Great Britain pound.

The nutritional products business experienced growth of 12.3% on the prior corresponding period to \$7,184,150. This growth in sales was achieved despite difficult trading conditions, several extraordinary weather events and a shortage of available raw materials.

## Significant Changes in State of Affairs

Significant changes in the state of affairs of the Group comprised the strategic review and associated activities as outlined in the review of operations and expanded upon in note 6 of the financial report for the year ended 30 June 2011.

There was no other significant change in the state of affairs of the Group other than that referred to in the financial statements or notes thereto and elsewhere in the financial report of the company and its controlled entities for the year ended 30 June 2011.

## Significant After Reporting Date Events

There has not been any matter or circumstance, other than that referred to in the financial statements or notes thereto, that has arisen since the end of the financial year, that has significantly affected, or may significantly affect, the operations of the Group, the results of those operations, or the state of affairs of the Group in future financial years.

## Directors' Report (continued)

## Future Developments

The Group will continue to operate its business consistent with its stated business strategy of growing both its pharmaceutical and nutritional/nutraceutical business segments. The Board will continue to monitor the progress of the business improvement initiatives and the intended improvement in the Group's operating and financial performance. Should further decisions and actions become necessary, then these will be made and within the framework of growing both profitability and cashflow of the Group.

## Environmental Issues

The Group monitors its environmental legal obligations and has its own self imposed policies. We believe that the Group complies with all aspects of the environmental laws.

## Occupational Health and Safety

The Group's Occupational Health and Safety Committee meet monthly and monitor the business by conducting regular audits of the premises. Any safety matters raised either by staff, the audits or from an investigation of any workers' compensation claims are reviewed and, where appropriate, changes made to operating procedures. Staff are encouraged to make safety suggestions to their departmental representatives. All committee members are given the necessary training for the position.

## Directors' Benefits

No director has received or become entitled to receive a benefit other than directors' remuneration. Full details of the level of remuneration received by Directors can be found in the Remuneration Report on page 23.

## Meetings of Directors

Probiotec Limited became a public company on 17th February 2006 and listed on the Australian Stock Exchange on the 14th November 2006. Directors hold meetings every month. The board also comprises the Audit and Risk Management and Remuneration and Nominations Sub-Committees. The number of meetings of the company's board of directors held during the year ended 30 June 2011, and the numbers of meetings attended by each director were:

Director	Board of Directors Meetings		Audit & Risk Management Committee meetings		Remuneration & Nominations Committee meetings	
	No. Held*	No. Attended	No. Held**	No. Attended	No. Held**	No. Attended
Maurice Van Ryn	11	10	3	3	-	-
Charles Wayne Stringer	11	10	-	-	-	-
Graham Harry Buckeridge	11	9	1	1	1	1
Richard David Kuo	11	11	3	3	-	-
Wesley Stringer	11	11	-	-	-	-
Robert Maxwell Johnston	11	11	-	-	1	1

\* Number of board meetings held while director eligible to attend.

\*\* Number of meetings for members of respective board or committee only.

## Information on Directors and Officers

### Maurice Van Ryn

Role	- Chairman (Non-executive)
Qualifications	- Bachelor of Business (RMIT)
Experience	- Appointed Chairman in July 2006. Previously held the position of CEO of Bega Cheese and is currently Bega Cheese's General Manager – Sales and Marketing. Maurice has 31 years experience in direct management of food companies in the Australian manufacturing sector.
Special Responsibilities	- Member of Audit and Risk Committee.
Other Directorships	- Non-executive Director of Medical Development International Limited (since October 2003).

### Graham Harry Buckeridge

Role	- Non-Executive Director
Qualifications	- Dip Bus, CPA, FFIN
Experience	- Co-founder and executive director of BG Capital Corp Ltd (BGC) a relationship based firm providing corporate advisory and investment banking services. Previously joint founder and Managing Director of Burdett Buckeridge and Young, a member corporation of ASX. Graham has extensive experience in all aspects of international and domestic financial markets.
Special Responsibilities	- Member of Remuneration and Nominations Committee.
Other Directorships	- Executive Director of BG Capital Corp Limited Executive Chairman of Abacus Film Fund

### Richard David Kuo

Role	- Non-Executive Director
Qualifications	- B.Com, LLB, MAICD
Experience	- Holds Commerce and Law degrees with post graduate qualifications in applied finance and investment. Brings with him 25 years experience in law, investment banking and corporate strategy. Currently manages Pier Capital, a privately owned investment banking firm which provides corporate advice to a broad range of corporations and has extensive experience in mergers and acquisitions, capital markets and strategic planning.
Special Responsibilities	- Responsibilities include Chairman of the Audit and Risk Management Committee.
Other Directorships	- Non-Executive Director of Glenorchy Art and Sculpture Park Limited

### Robert Maxwell Johnston

Role	- Non-Executive Director
Qualifications	- FCDA, MAICD
Experience	- A former senior executive with Johnson & Johnson, the world's largest Medical, Pharmaceutical and Consumer Healthcare company. Mr. Johnston was president and CEO of Johnson & Johnson Pacific, while also concurrently leading several Asia Pacific Franchise and Functional working group. Brings extensive overseas experience during his career in leading businesses in both Western and Central-Eastern Europe and Africa. Prior to joining Johnston & Johnson, Max's career also included senior roles with Diageo and Unilever.
Special Responsibilities	- Chairman of Remuneration and Nominations Committee.
Other Directorships	- Non-Executive Director of Photon Group Limited

**Directors' Report** (continued)

**Charles Wayne Stringer**

Role	- Chief Executive Officer (Executive Director)
Qualifications	- Dip. Bus, ACA
Experience	- CEO of Probiotec since it was founded in 1997. Overseen the development of a series of joint ventures and commercial opportunities and acquisition of Pharmaction in the 2004 financial year and the Biotech Milton Pharmaceutical company in 2005. Wayne also spent several years as a CEO and director of companies involved in manufacturing, retailing, finance, mining and waste management.
Special Responsibilities	- Responsibilities include strategic management, remuneration and operational oversight.
Other Directorships	- Nil

**Jared Stringer**

Role	- Company Secretary
Qualifications	- B.Comm (Accounting, Finance), BIT, CPA
Experience	- Began employment with Probiotec in 2002 and accepted role of Financial Accountant in May 2005.
Special Responsibilities	- None
Other Directorships	- Nil

**Wesley Stringer**

Role	- Chief Operation Officer
Qualifications	- B.Comm (Accounting, Finance), LLB (hons), CPA
Experience	- Prior to joining Probiotec, Wesley was employed by KPMG in Taxation and Finance. He has also worked internationally for Deutsche Bank and BNP Paribas Investment Bank in London.
Special Responsibilities	- None
Other Directorships	- Nil

**Insurance of Officers**

During the financial year the company insured its directors and officers against liabilities for all costs and expenses incurred by them in defending any legal proceedings arising out of their conduct while acting in the capacity as directors and officers of the company, other than conduct involving a willful breach of duty in relation to the company. The total premium paid was \$49,790.

# REMUNERATION REPORT (AUDITED)

This report is prepared in accordance with section 300A of the Corporations Act 2001 for the Group for the financial year ended 30 June 2011. This report is audited.

## 1. Remuneration

### 1.1 Remuneration & Nominations Committee

The primary function of the Board Remuneration and Nominations Committee ('Committee') is to assist the Board of Directors ('Board') in fulfilling its oversight responsibility to shareholders by ensuring that:

- the Board comprises individuals best able to discharge the responsibilities of directors having regard to the law and the highest standards of governance; and
- the Group has coherent remuneration policies and practices that fairly and responsibly reward executives having regard to performance, the law and the highest standards of governance.

The Committee's purpose in relation to remuneration is to:

- review and approve executive remuneration policy;
- make recommendations to the Board in relation to the remuneration of the Chief Executive Officer and Non-executive Directors;
- review and make recommendations to the Board on corporate goals and objectives relevant to the remuneration of the Chief Executive Officer, and the performance of the Chief Executive Officer in light of these objectives;
- approve remuneration packages for Probiotec's executives;
- review and approve all equity based plans;
- approve all merit recognition expenditure; and
- oversee general remuneration practices.

The Committee will primarily fulfill these responsibilities by carrying out the activities outlined in its Charter.

The Committee membership and the Chairman of the Committee will be as determined from time to time by the Board. Each of the members will be independent directors and free from any business or other relationship that, in the opinion of the Board, would materially interfere with the exercise of their independent judgement as a member of the Committee. New Committee members will receive induction training from the Chairman of the Committee, the Chief Financial Officer's and Quality Control Manager's teams and the Company Secretary. Committee members receive continuous training.

#### Members of Remuneration and Nominations Committee

	Position	Appointed	Resigned
Robert Maxwell Johnston	Chairman	29 July 2010	
Maurice Van Ryn	Chairman	28 July 2006	29 July 2010
Graham Buckeridge	Member	28 July 2006	

### 1.2 Remuneration Policy - Non-Executive Directors

The level of remuneration for the company's non-executive directors is set to reflect the scope of the director's responsibilities, the size of the company's operations and the workload demanded. Probiotec believes that the current remuneration packages for non-executive directors are appropriate having considered the factors above.

The current annualised total remuneration for the company's non-executive directors is \$234,000. The Nomination & Remuneration Committee reviews non-executive remuneration annually and makes recommendations to the Board. The Committee considers current market rates of remuneration for similar sized companies and obtains advice from independent professional firms if required. Shareholders will be periodically asked to approve increases in the fee level of non-executive directors if the size, scope, complexity or demands made on the directors increases.

Non-executive directors do not receive any performance related remuneration and are not entitled to receive performance shares, rights or options.

Remuneration levels for non-executive directors for the 2011 financial year are set out on page 26 of this report.

Remuneration Report (Audited) (continued)

### 1.3 Remuneration Policy - Executive Directors and Key Management Personnel

The Remuneration and Nominations Committee has structured the Group's executive remuneration policies to ensure:

- the policy motivates executives to pursue the long term growth and success of Probiotec within an appropriate control framework;
- the policy demonstrates a clear relationship between individual performance and remuneration; and
- the policy involves an appropriate balance between fixed and variable remuneration, reflecting the short and long term performance objectives appropriate to Probiotec's circumstances and goals.

The Group's remuneration framework for executive directors and key management personnel comprises fixed annual remuneration, short-term incentives and long-term incentives. The Group structures remuneration packages to balance between base incomes and 'at risk' incomes to ensure that key personnel are retained, whilst still providing strong incentives to maximise the potential long-term growth of the Group.

#### Short-term Incentives

Executive directors and key management are eligible to receive short-term incentive payments, in the form of cash bonuses, based on the achievement of set Key Performance Indicators (KPIs). KPIs are based on financial measures targeted at maximising Group performance and returns to shareholders.

#### Long-term Incentives

The Group provides long-term incentives to key management personnel to reward sustained performance by the organisation as a whole. Long-term incentives are in the form of options over Probiotec Limited shares issued under the company's Exempt Share and Option Plan, which was adopted by a resolution of members on 5 November 2008, or by the issue of shares under the company's Employee Share Plan, which was also adopted by members on 5 November 2008. The issue of shares and/or options is based on a review of the contributions and value of management personnel undertaken by the Nomination and Remuneration Committee.

At the date of this report, Wayne Stringer and Wesley Stringer are the only executive directors of Probiotec Limited. Both are paid a fixed annual remuneration. Along with his fixed annual remuneration, Mr. Wayne Stringer is also eligible to receive equity-based compensation, in the form of share options, based on the achievement of set milestones stipulated in his contract of employment. Mr. Wesley Stringer is entitled to receive shares under the Probiotec Limited Employee Share Plan.

### Termination Arrangements

All key management personnel are employed subject to employment contracts. These employment contracts specify notice period of between one and three months (unless a greater period is required by law). The Group may choose to make a payment in lieu of the notice period.

### 1.4 Remuneration Policy - Employees

All salaried positions are evaluated based on the size of the role, the level of accountability and experience required, amongst other factors. Economic and market factors are also taken into consideration when evaluating the remuneration level for a specified role.

### 2. Linking remuneration to Probiotec's performance

Probiotec has structured its remuneration policies to increase goal congruence between shareholders, directors and executives. The company believes that this will have a positive effect on shareholder wealth.

The company is committed to innovation and growth, whilst continuing to focus on maximising profitability and long-term shareholder value.

There is no formal policy linking remuneration policy and company performance.

### 3. Review of remuneration

The Remuneration and Nominations Committee meets one to two times per year in conjunction with the release of the financial results or more frequently as circumstances dictate to review the total remuneration paid to the CEO and senior executives of the company. In addition to the members of the Committee, such Executives and/or external parties as the Chairman and members of that Committee think fit may be invited to attend meetings.

All Directors may attend Committee meetings; however, the Chief Executive Officer will have no voting rights and must not be present during discussions on his own remuneration.



#### 4. Remuneration details of directors & key management personnel

For the purposes of this report, 'Key Management Personnel' are defined as those persons that have authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

##### Directors

The following persons were directors of Probiotec Limited during the financial year:

Maurice Van Ryn	Non-executive chairman
Richard David Kuo	Non-executive director
Graham Harry Buckeridge	Non-executive director
Robert Maxwell Johnston	Non-executive director
Charles Wayne Stringer	Executive director
Wesley Stringer	Executive director

##### Other key management personnel

The following persons also had responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, during the financial year:

Name	Position	Employer
Alan Hong	Chief Financial Officer	Probiotec Limited
Jared Stringer	Company Secretary	Probiotec Limited
Mark Chatfield	GM - Sales & Marketing	Probiotec Limited
David Erasmus	Group Engineering Manager	Biotech Pharmaceuticals Pty Ltd
Matthew Dalton	National sales manager	Biotech Pharmaceuticals Pty Ltd
Dustin Stringer	GM - Europe	Probiotec Limited
Humera Ahmad	GM - Quality	Probiotec Pharma Pty Ltd

No persons, who were not considered Key Management Personnel during the financial year ended 30 June 2010, were considered Key Management Personnel during this financial year.

The following persons who were considered Key Management Personnel during the financial year ended 30 June 2010, were no longer considered Key Management Personnel during this financial year:

Name	Position	Employer
David McClure	Supply Chain Manager	Probiotec Limited
Steve Morrison	Production Manager	Probiotec Pharma Pty Ltd

## Remuneration Report (Audited) (continued)

The Directors and identified Key Management Personnel received the following amount of compensation for their services as Directors and executives of the company and the group during the year:

2011	Position	Short-Term Benefits			Post Employment Benefits		Equity-Based Benefits	Total \$	Proportion of Remuneration that is performance based (options) %
		Salary, Fees & Commissions \$	Short-Term Incentives \$	Non-Cash Benefits \$	Long Service Leave \$	Super-annuation Contribution \$	Options \$		
Directors & Secretaries									
Maurice Van Ryn	Chairman	68,807	-	-	-	6,193	-	75,000	-
Charles Wayne Stringer	CEO/Managing Director	617,273	-	-	10,688	55,555	9,415	692,931	1.4
Wesley Stringer	COO/Executive Director	263,238	-	27,952	2,278	22,500	5,556	321,524	1.7
Richard David Kuo	Non-Executive Director	55,000	-	-	-	-	-	55,000	-
Graham Harry Buckeridge	Non-Executive Director	-	-	-	-	48,000	-	48,000	-
Robert Maxwell Johnston	Non-Executive Director	51,376	-	-	-	4,624	-	56,000	-
Jared Stringer	Company Secretary	155,963	-	-	1,381	14,037	4,167	175,548	2.4
		1,211,657	-	27,952	14,347	150,909	19,138	1,424,003	
Other Key Management Personnel									
Alan Hong	CFO	127,209	-	-	1,191	24,683	1,389	154,472	0.9
David Erasmus	Group Engineering Manager	121,831	-	4,149	895	13,381	2,315	142,571	1.6
Dustin Stringer <sup>1</sup>	GM - Europe	178,381	-	-	1,462	3,716	5,556	189,115	2.9
Humera Ahmad	GM Quality	139,947	-	-	3,912	21,606	1,389	166,854	0.8
Mark Chatfield	GM - Sales & Marketing	109,809	-	10,340	1,098	16,714	2,315	140,276	1.7
Matthew Dalton	National Sales Manager	161,550	-	-	1,723	14,450	5,556	183,279	3.0
		838,727	-	14,489	10,281	94,550	18,520	976,567	

<sup>1</sup> During the year, Dustin Stringer was employed predominantly in the United Kingdom and paid in British pounds. Amounts in this report have been converted into AUD at the average exchange rate for the period of employment.

2010	Position	Short-Term Benefits			Post Employment Benefits	Equity-Based Benefits	Total \$	Proportion of Remuneration that is performance based (options) %
		Salary, Fees & Commissions \$	Short-Term Incentives \$	Non-Cash Benefits \$	Super-annuation Contribution	Options		
					\$	\$		
Directors & Secretaries								
Maurice Van Ryn	Chairman	68,807	-	-	6,193	-	75,000	-
Charles Wayne Stringer	CEO/Managing Director	673,395	-	-	60,606	125,886	859,887	14.6
Wesley Stringer	COO/Executive Director <sup>1</sup>	256,555	-	-	23,090	12,346	291,991	4.2
Richard David Kuo	Non-Executive Director	55,000	-	-	-	-	55,000	-
Graham Harry Buckeridge	Non-Executive Director	48,000	-	-	-	-	48,000	-
Robert Maxwell Johnston	Non-Executive Director <sup>1</sup>	-	-	-	-	-	-	-
Jared Stringer	Company Secretary	139,969	-	-	12,597	8,894	161,460	5.5
		1,241,726	-	-	102,486	147,126	1,491,338	
Other Key Management Personnel								
Alan Hong	CFO	128,626	-	13,028	12,749	4,442	158,845	2.8
David Erasmus <sup>2</sup>	Group Engineering Manager	123,397	-	25,287	17,882	5,496	172,062	3.2
David McClure	GM – Supply Chain	143,762	-	-	12,939	5,750	162,451	3.5
Dustin Stringer	GM – Europe	166,969	-	-	12,914	11,529	191,412	6.0
Humera Ahmad	GM Quality	132,234	-	39,805	14,850	4,442	191,331	2.3
Mark Chatfield	GM – Sales & Marketing	118,857	-	22,548	14,346	6,103	161,854	3.8
Matthew Dalton	National Sales Manager	138,000	-	12,000	13,500	12,654	176,154	7.2
Steve Morrison <sup>2</sup>	Production Manager	138,819	-	9,560	13,354	7,467	169,200	4.4
		1,090,664	-	122,228	112,534	57,883	1,383,309	

<sup>1</sup> Appointed 1 May 2010

<sup>2</sup> Classified as Key Management Personnel since 1 July 2010

#### Table 2: Directors & Key Management Personnel Remuneration details

No long-term employee benefits, other than equity-based benefits have been provided to Directors, Secretaries or Key Management personnel during the year.

#### Options issued to Chief Executive Officer (CEO)

The CEO was appointed in the year 1997. As part of the CEO's remuneration package, options are granted upon the achievement of certain performance targets as set out below. These options are either governed by the Probiotec Limited Exempt Share and Option Plan and vest at the completion of three years of employment from the grant date or are on terms and conditions approved by members in a general meeting. If the CEO resigns prior to the vesting date of the options then the options will be forfeited.

## Remuneration Report (Audited) (continued)

The CEO's contract of employment entitles him to share options in accordance with the Exempt Share and Option Plan and such options shall be exercisable at \$1.00 for each fully paid ordinary share during the applicable Exercise Period on the terms set forth below:

- (a) If Probiotec Limited achieves a NPAT of \$4.3 million for the financial year ending 30 June 2007 then effective 1 July 2007 the CEO will be granted 400,000 options for fully paid ordinary shares.
- (b) If Probiotec Limited achieves a minimum growth of 10% in EPS for the financial year ending 30 June 2008 then effective 1 July 2008 the CEO will be granted 400,000 options for fully paid ordinary shares.
- (c) If Probiotec Limited achieves a minimum growth of 10% in EPS for the financial year ending 30 June 2009 over the 08 financial year then effective 1 July 2009 the CEO will be granted 400,000 options for fully paid ordinary shares.
- (d) If at 30 June 2009 Probiotec Limited has achieved a NPAT of \$4.3 million for the financial year 2006/2007 and has achieved EPS growth of 20% between the period 1 July 2007 and 30 June 2009 then effective 1 July 2009 the CEO will be granted 300,000 options for fully paid ordinary shares.
- (e) Terms (a), (b), (c) and (d) will be measured excluding any effects related to the NSI Dental Pty Ltd legal case.

On 5 November 2008, the issue of 1,500,000 options to the CEO was approved at a general meeting on the terms set forth below -

The 1,500,000 options vest as follows:

- (a) 500,000 options with an exercise price of \$1.50 per share, if the Company's earnings per share (EPS) increases by at least 10% during the financial year ending 30 June 2010 (**2010 Options**);
- (b) 500,000 options with an exercise price of \$1.75 per share, if the Company's EPS increases by at least 10% during the financial year ending 30 June 2011 (**2011 Options**);
- (c) 500,000 options with an exercise price of \$2.00 per share, if the Company's EPS increases by at least 10% during the financial year ending 30 June 2012 (**2012 Options**);
- (d) Options not vesting as 2010 Options, 2011 Options or 2012 Options do not lapse, but may still vest in 2012 with an exercise price of \$2.00 per share if in the 3 year period from 1 July 2009 to 30 June 2012, the Company's EPS has increased by at least 30% (**First Shortfall Options**),
- (e) Options not vesting as 2010 Option, 2011 Options, 2012 Options or First Shortfall Options do not lapse, but may still vest in 2012 with an exercise price of \$2.00 per share if in the 4 year period from 1 July 2008 to 30 June 2012, the Company's EPS has increased by at least 65% (**Second Shortfall Options**),

Regardless of when they vest, the options must be exercised by no later than 30 June 2013.

## CEO Employment options

Name	Grant date	Vesting date	Exercise price (\$)	Balance at start of the year number	Options granted during the year number	Fair value per option at grant Date (\$)
Charles Wayne Stringer	01.07.2008	30.06.2011	1.00	400,000	-	0.14
	05.11.2008	30.06.2010	1.50	500,000	-	0.31
	05.11.2008	30.06.2011	1.75	500,000	-	0.26
	05.11.2008	30.06.2012	2.00	500,000	-	0.22
	01.07.2009	30.06.2012	1.00	300,000	-	0.09
	01.07.2009	30.06.2012	1.00	400,000	-	0.06
				2,600,000	-	

No options were exercised and 400,000 options were forfeited during the year ended 30 June 2011.

## 5. Interest In shares & options

The number of shares and options held by directors and key management personnel is as follows:

Name	No. of fully paid ordinary shares	Grant Date	Vesting Date	Expiry Date	Exercise Price	Balance at start of the year number	Option Granted during the year number	Option Vested during the year number	Balance vested at end of the year number	Balance unvested at end of the year number	Fair Value per options <sup>1</sup> at grated date
Maurice Van Ryn	281,101	-	-	-	-	-	-	-	-	-	
Richard David Kuo	74,726	-	-	-	-	-	-	-	-	-	-
Graham Henry Buckeridge	1,348,684	-	-	-	-	-	-	-	-	-	-
Robert Maxwell Johnston	203,000	-	-	-	-	-	-	-	-	-	-
Charles Wayne Stringer	7,828,643	01.7.2008	30.6.2011	30.6.2011	\$1.00	400,000	-	-	-	-	\$0.14
		01.7.2009	30.6.2012	30.6.2012	\$1.00	400,000	-	-	-	400,000	\$0.06
		01.7.2009	30.6.2012	30.6.2012	\$1.00	300,000	-	-	-	300,000	\$0.09
		05.11.2008	30.6.2010	30.6.2014	\$1.50	500,000	-	-	500,000	-	\$0.21
		05.11.2008	30.6.2011	30.6.2014	\$1.75	500,000	-	500,000	500,000	-	\$0.17
		05.11.2008	30.6.2012	30.6.2014	\$2.00	500,000	-	-	-	500,000	\$0.16
Wesley Stringer	272,811	30.6.2006	30.6.2009	30.6.2011	\$0.80	137,503	-	-	-	-	\$0.16
		01.7.2007	30.6.2010	30.6.2012	\$1.50	25,000	-	-	25,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	50,000	-	50,000	50,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	60,000	-	-	-	60,000	\$0.41
Dustin Stringer	98,000	30.6.2006	30.6.2009	30.6.2011	\$0.80	75,001	-	-	-	-	\$0.16
		01.7.2007	30.6.2010	30.6.2012	\$1.50	20,000	-	-	20,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	40,000	-	40,000	40,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	60,000	-	-	-	60,000	\$0.41
Mark Chatfield	-	30.6.2006	30.6.2009	30.6.2011	\$0.80	100,003	-	-	-	-	\$0.16
		01.7.2007	30.6.2010	30.6.2012	\$1.50	25,000	-	-	25,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	25,000	-	25,000	25,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	25,000	-	-	-	25,000	\$0.41

## Remuneration Report (Audited) (continued)

Name	No. of fully paid ordinary shares	Grant Date	Vesting Date	Expiry Date	Exercise Price	Balance at start of the year number	Option Granted during the year number	Option Vested during the year number	Balance vested at end of the year number	Balance unvested at end of the year number	Fair Value per options at granted date
Humera Ahmad	-	30.6.2006	30.6.2009	30.6.2011	\$0.80	65,001	-	-	-	-	\$0.16
		01.7.2007	30.6.2010	30.6.2012	\$1.50	25,000	-	-	25,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	20,000	-	20,000	20,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	15,000	-	-	-	15,000	\$0.41
Alan Hong	-	30.6.2006	30.6.2009	30.6.2011	\$0.80	100,002	-	-	-	-	\$0.16
		01.7.2007	30.6.2010	30.6.2012	\$1.50	25,000	-	-	25,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	20,000	-	20,000	20,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	15,000	-	-	-	15,000	\$0.41
David Erasmus	-	01.7.2007	30.6.2010	30.6.2012	\$0.80	25,000	-	-	25,000	-	\$0.34
		01.7.2007	30.6.2010	30.6.2012	\$1.50	30,000	-	-	30,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	10,000	-	10,000	10,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	25,000	-	-	-	25,000	\$0.41
Matthew Dalton	-	30.6.2006	30.6.2009	30.6.2011	\$0.80	50,001	-	-	-	-	\$0.16
		01.7.2007	30.6.2010	30.6.2012	\$0.80	10,000	-	-	10,000	-	\$0.34
		01.7.2007	30.6.2010	30.6.2012	\$1.50	20,000	-	-	20,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	40,000	-	40,000	40,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	60,000	-	-	-	60,000	\$0.41
Jared Stringer	91,610	30.6.2006	30.6.2009	30.6.2011	\$0.80	62,501	-	-	-	-	\$0.16
		01.7.2007	30.6.2010	30.6.2012	\$1.50	20,000	-	-	20,000	-	\$0.15
		01.7.2008	30.6.2011	30.6.2013	\$1.50	30,000	-	30,000	30,000	-	\$0.17
		30.6.2009	30.6.2012	30.6.2014	\$2.35	45,000	-	-	-	45,000	\$0.41
						3,955,012	-	735,000	1,460,000	1,505,000	

\* The executives have no access to the shares until expiry of 36 months of their employment with the company or an Associated Body Corporate from the date of grant of the shares. All shares are forfeited if the grantee resigns from the company prior to the expiry of 36 from the date of grant of the shares.

\*\* All options have been valued using the Black-Scholes option model. The values of the options calculated under this method are allocated evenly over the vesting period.



## 6. Share options exercised or lapsed during the year

No share options issued to directors or Key Management Personnel were exercised, lapsed or forfeited during the year ended 30 June 2011, other than:

Name	Grant date	Vesting date	Exercise Price (\$)	Forfeited during the year Number	Lapsed during the year Number	Value of Shares at Forfeited/ lapsed Date (\$)
Humera Ahmad	30.6.2006	30.6.2009	0.80	-	65,001	0.355
Mark Chatfield	30.6.2006	30.6.2009	0.80	-	100,003	0.355
Dustin Stringer	30.6.2006	30.6.2009	0.80	-	75,001	0.355
Matthew Dalton	30.6.2006	30.6.2009	0.80	-	50,001	0.355
Alan Hong	30.6.2006	30.6.2009	0.80	-	100,002	0.355
Jared Stringer	30.6.2006	30.6.2009	0.80	-	62,501	0.355
Wesley Stringer	30.6.2006	30.6.2009	0.80	-	137,503	0.355
Wayne Stringer	01.7.2008	30.6.2011	1.00	400,000*	-	0.670

\* The fair value of these options at the date forfeited was \$0.02 per option.

The board has no formal policy in place for limiting the risk to the directors or other key management personnel in relation to the options issued.

## 7. Contracts of employment

All executive staff employed by the Group are subject to employment contracts, which set out the terms and conditions of their employment. These contracts define their level of remuneration, length of contract (if for fixed period) and termination events amongst other areas. The standard notice period for employees of the Group is one month; however, this may be varied to be up to one year in limited instances.

### End of remuneration report.

#### Proceedings on Behalf of the Company

No person has applied for leave of court to bring proceedings on behalf of the company or intervene in any proceedings to which the company is a party for the purpose of taking responsibility on behalf of the company for all or any part of those proceedings.

#### Non-audit Services

The board of directors is satisfied that the provision of non-audit services during the year is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The directors are satisfied that the services disclosed below did not compromise the external auditor's independence for the following reasons:

- all non-audited services are reviewed and approved by the board prior to commencement to ensure that they do not adversely affect the integrity and objectivity of the auditor; and
- the nature of the services provided do not compromise the general principles relating to auditors independence as set out in Code of Conduct APES 110 Code of Ethics for professional accountants issued by the Accounting professional & ethical standards board, including reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the company, acting as advocate for the company or jointly sharing economic risks and rewards.

**Remuneration Report (Audited)** (continued)

The following fees for non-audit services were paid/payable to the external auditors during the year ended 30 June 2011:

	2011 \$	2010 \$
BDO Audit (NSW-VIC) Pty Ltd:		
General advice	-	1,515

**Auditor's Independence Declaration**

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 33 of this report.

Signed in accordance with a resolution of Board of Directors.



Director  
Richard Kuo

Signed at Laverton this 31st day of August 2011

## AUDITOR'S INDEPENDENCE DECLARATION



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Australia

### DECLARATION OF INDEPENDENCE BY NICK MICHAEL TO THE DIRECTORS OF PROBIOTEC LIMITED

As lead auditor of Probiotec Limited for the year ended 30 June 2011, I declare that, to the best of my knowledge and belief, there have been no contraventions of:

- the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Probiotec Limited and the entities it controlled during the year.

A handwritten signature in blue ink, appearing to read 'Nick Michael', is written over a light blue horizontal line.

Nick Michael  
Director

BDO Audit (NSW-VIC) Pty Ltd

Melbourne, Victoria

Dated this 31<sup>st</sup> day of August 2011

BDO Audit (NSW-VIC) Pty Ltd ABN 17 114 673 540  
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# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2011

		CONSOLIDATED GROUP	
	NOTE	2011 \$	2010 \$
Sales revenue from continuing operations	2	71,770,144	74,769,246
Cost of goods sold		(37,840,561)	(35,909,781)
Gross profit		33,929,583	38,859,465
Other revenue	2	111,716	52,225
Other income	2	493,338	5,690,834
Warehousing & distribution expenses		(5,286,986)	(4,922,481)
Sales and marketing expenses		(15,426,901)	(15,389,415)
Impairment expenses		(3,115,527)	-
Finance costs		(2,277,535)	(1,781,141)
Legal costs		(215,923)	(2,733,717)
Administration and other expenses	4	(9,948,790)	(8,561,277)
<b>Profit/(loss) from continuing activities before income tax expense</b>		<b>(1,737,025)</b>	<b>11,214,493</b>
Income tax expense relating to continuing activities	5	(345,624)	(578,919)
<b>Profit/(loss) from continuing activities for the period attributable to members of the parent entity</b>		<b>(2,082,649)</b>	<b>10,635,574</b>
Loss from discontinued operations	6	(8,255,138)	(1,154,701)
<b>Profit for the period attributable to members of the parent entity</b>	3	<b>(10,337,787)</b>	<b>9,480,873</b>
<b>Other comprehensive income</b>			
Foreign currency translation differences		(965,379)	284,073
Income tax on items of other comprehensive income		-	-
Other comprehensive income for the year, net of tax		(965,379)	284,073
<b>Total comprehensive income for the year</b>		<b>(11,303,166)</b>	<b>9,764,946</b>
<b>Total comprehensive income for the year attributable to members of the parent entity</b>		<b>(11,303,166)</b>	<b>9,764,946</b>
<b>Earnings per share for profit attributable to members of the parent entity</b>			
Basic earnings per share (cents)	31	(19.5)	18.5
Diluted earnings per share (cents)	31	(19.5)	18.2

The Consolidated Statement of Comprehensive Income is to be read in conjunction with the attached notes.

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2011

		CONSOLIDATED GROUP	
	NOTE	2011 \$	2010 \$
<b>Current Assets</b>			
Cash and cash equivalents	11	938,107	2,816,415
Trade and other receivables	12	10,250,305	12,016,612
Inventories	13	14,813,261	22,484,232
Other current assets	14	415,305	389,004
<b>Total Current Assets</b>		<b>26,416,978</b>	<b>37,706,263</b>
<b>Non-Current Assets</b>			
Loans receivable	16	596,817	1,116,316
Property, plant and equipment	17	48,583,593	52,181,878
Intangible assets	18	29,558,853	31,724,060
Deferred tax assets	19	1,405,515	3,518,855
<b>Total Non-Current Assets</b>		<b>80,144,778</b>	<b>88,541,109</b>
<b>Total Assets</b>		<b>106,561,756</b>	<b>126,247,372</b>
<b>Current Liabilities</b>			
Trade & other payables	20	11,471,790	11,406,272
Short-term interest bearing liabilities	21	27,178,140	13,718,581
Current tax liabilities	5	3,071	314,924
Short-term provisions	22	894,791	911,433
<b>Total Current Liabilities</b>		<b>39,547,792</b>	<b>26,351,210</b>
<b>Non-Current Liabilities</b>			
Long-term interest bearing liabilities	21	2,126,086	19,521,751
Deferred tax liabilities	23	3,291,532	6,735,258
Long-term provisions	22	280,993	185,677
<b>Total Non-Current Liabilities</b>		<b>5,698,611</b>	<b>26,442,686</b>
<b>Total Liabilities</b>		<b>45,246,403</b>	<b>52,793,896</b>
<b>Net Assets</b>		<b>61,315,353</b>	<b>73,453,476</b>
<b>Equity</b>			
Contributed equity	24	36,581,517	36,360,891
Shares held by equity compensation plan	25	(2,894,998)	(2,894,998)
Reserves	26	3,842,079	4,807,458
Retained earnings		23,786,755	35,180,125
<b>Total Equity</b>		<b>61,315,353</b>	<b>73,453,476</b>

The Consolidated Statement of Financial Position is to be read in conjunction with the attached notes.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2011

	NOTE	ORDINARY SHARE CAPITAL \$	SHARES HELD BY EQUITY COMPENSATION PLAN \$	RESERVES \$	RETAINED EARNINGS \$	TOTAL \$
<b>Balance as at 1 July 2009</b>		23,159,728	(3,004,500)	4,523,385	27,605,566	52,284,179
<b>Total comprehensive income for the year</b>						
Profit for the year		-	-	-	9,480,873	9,480,873
Other comprehensive income		-	-	(50,752)	-	(50,752)
Total comprehensive income for the year as presented in the 30 June 2010 financial statements		-	-	(50,752)	9,480,873	9,430,121
Prior period error	1(w)	-	-	334,825	-	334,825
<b>Restated total comprehensive income for the year</b>		-	-	<b>284,073</b>	<b>9,480,873</b>	<b>9,764,946</b>
<b>Transactions with owners in their capacity as owners</b>						
Shares issued during the year		13,535,988	(23,500)	-	-	13,512,488
Prior period error	1(w)	(334,825)	-	-	-	(334,825)
Shares vested from Employee Share Plan		-	133,002	-	-	133,002
Dividends paid or provided for		-	-	-	(1,906,314)	(1,906,314)
<b>Balance as at 30 June 2010</b>		<b>36,360,891</b>	<b>(2,894,998)</b>	<b>4,807,458</b>	<b>35,180,125</b>	<b>73,453,476</b>
<b>Total comprehensive income for the year</b>						
Loss for the year		-	-	-	(10,337,787)	(10,337,787)
Other comprehensive income		-	-	(965,379)	-	(965,379)
<b>Total comprehensive income for the year</b>		-	-	<b>(965,379)</b>	<b>(10,337,787)</b>	<b>(11,303,166)</b>
<b>Transactions with owners in their capacity as owners</b>						
Shares issued during the year		220,626	-	-	-	220,626
Dividends paid or provided for		-	-	-	(1,055,583)	(1,055,583)
<b>Balance as at 30 June 2011</b>		<b>36,581,517</b>	<b>(2,894,998)</b>	<b>3,842,079</b>	<b>23,786,755</b>	<b>61,315,353</b>

The Consolidated Statement of Changes in Equity is to be read in conjunction with the attached notes.

# CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2011

	NOTE	CONSOLIDATED GROUP 2011 \$	2010 \$
<b>Cash Flows From Operating Activities</b>			
Receipts from customers		75,510,809	75,510,146
Payments to suppliers and employees		(66,796,732)	(66,991,602)
Interest received		111,716	59,929
Interest and other costs of finance paid		(2,277,535)	(1,781,184)
Income tax paid		(229,192)	(1,873,088)
Net cash provided by operating activities	30(b)	6,319,066	4,924,201
<b>Cash Flows From Investing Activities</b>			
Payment for property, plant and equipment		(2,012,157)	(3,147,894)
Cash payments for investments, net of cash acquired		-	(3,328,680)
Receipts relating to loans receivable		519,499	-
Payments relating to loans receivable		-	(1,616,320)
Purchase of intangible assets		(1,933,653)	(10,708,624)
Net cash used in investing activities		(3,426,311)	(18,801,518)
<b>Cash Flows From Financing Activities</b>			
Proceeds from issues of shares		220,626	13,645,490
Dividends Paid		(1,055,583)	(1,906,314)
Proceeds from borrowings		277,124	4,853,595
Repayment of borrowings		(4,213,230)	(1,572,435)
Net cash provided by/(used in) financing activities		(4,771,063)	15,020,336
Net Increase in cash held		(1,878,308)	1,143,019
<b>Cash at beginning of financial year</b>		<b>2,816,415</b>	<b>1,673,396</b>
<b>Cash at end of financial year</b>	11	<b>938,107</b>	<b>2,816,415</b>

The Consolidated Statement of Cash Flows is to be read in conjunction with the attached notes.



# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 30 June 2011

## 1. Statement of significant accounting policies

The financial report covers Probiotec Limited ('company') and controlled entities ('group'). Separate financial statements for Probiotec Limited as an individual entity are no longer presented as a consequence of a change to the *Corporations Act 2001*. However limited financial information for Probiotec Limited as an individual entity is included in Note 35. Probiotec Limited is a listed public company, incorporated and domiciled in Australia. The financial report is for the financial year ended 30 June 2011 and is presented in Australian dollars.

### Basis of Preparation

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board (AASB) and the *Corporations Act 2001*.

The accounting policies set out below have been consistently applied to all years presented.

### Reporting Basis and Convention

The financial report has been prepared on an accrual basis and is applied on historical costs modified by the revaluation of selected non-current assets, financial liabilities and derivative financial instruments for which the fair value basis of accounting has been applied.

### Compliance with IFRS

Australian Accounting Standards include International Financial Reporting Standards as adopted in Australia. Compliance with Australian Accounting Standards ensures that the financial statements and notes of Probiotec Limited comply with International Financial Reporting Standards (IFRS).

### Accounting Policies

#### (a) Principles of Consolidation

The consolidated financial statements are prepared by combining the financial statements of all the entities that comprise the consolidated entity, being Probiotec Limited (the parent entity) and its controlled entities as defined in accounting standard AASB 127 'Consolidated and Separate Financial Statements'. Where a subsidiary either began or ceased to be controlled during the year, the results of its operations are included only from the date control commenced or ceased.

All inter-company balances and transactions between entities in the group, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with those policies applied by the parent entity.

Minority interests in the results and equity of subsidiaries are shown separately in the consolidated statement of comprehensive income and statement of financial position respectively.

Subsidiaries are accounted for by the parent entity at cost, less any impairment charges.

#### (b) Income Tax

##### (i) General

Current tax assets and liabilities for the current and prior periods are measured as the amount expected to be recovered from or paid to the taxation authorities. The income tax expense for the period is the tax payable on the current period's taxable income based on the notional income tax rate of each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax base of assets and liabilities and their carrying amounts in the financial statements, and to unused tax losses.

Deferred tax balances are determined using the balance sheet liability method which calculates temporary differences based on the carrying amounts of an entity's asset and liabilities carried in the financial statements and their associated tax bases. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

The amount of deferred tax provided will be based on the expected manner of realisation of the asset or settlement of the liability, using tax rates enacted on reporting date. Deferred tax is credited in profit or loss except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred tax assets will be recognised only to the extent that it is probable that future income tax profits will be available against which the assets can be utilised. The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the group will derive sufficient future assessable income to enable the benefit to be realised and to comply with the conditions of the deductibility imposed by law.

The carrying amount of deferred income tax assets is reviewed at each balance date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax to be utilised.

Unrecognised deferred income tax assets are reassessed at each balance date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

***(ii) Capital Gains Tax***

Capital gains tax, expected to be paid, is provided in the period in which an asset is sold.

***(iii) Goods and Services Tax***

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office. In these circumstances the GST is recognised as part the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the statement of financial position are shown inclusive of GST.

Cash flows are included in the statement of cash flows on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority are classified as operating cash flows. Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

***(c) Foreign Currency Translation******(i) Functional and presentation currency***

The functional currency of each of the group's entities is measured using the currency of the primary economic environment in which that entity operates. The consolidated financial statements are presented in Australian dollars which is the parent entity's functional and presentation currency.

***(ii) Foreign Currency Transactions***

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of the transaction. Foreign currency monetary items are translated at the year end exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value in a foreign currency are translated at the date when the fair value was determined.

***(iii) Translation of group companies functional currency to presentation currency***

The results of the New Zealand, British, Chinese, German and Irish subsidiaries are translated into Australian dollars as at the date of the transactions. Assets and liabilities are translated at exchange rates prevailing at balance date.

Exchange variations resulting from the translation are recognised in the foreign currency translation reserve in other comprehensive income.

***(d) Impairment of assets***

The recoverable amount of the Group assets excluding deferred tax assets and goodwill are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset is tested for impairment by comparing its recoverable amount to its carrying amount. Goodwill and intangible assets that have an indefinite useful life and assets not ready for use are tested for impairment at least annually. The recoverable amount is estimated for the individual asset or, if it is not possible to estimate the recoverable amount for the individual asset, the recoverable amount of the cash generating unit (CGU) to which the asset belongs is determined. CGUs have been determined as the smallest identifiable group of assets that generate cash inflows largely independent of the cash flow of other assets.

An impairment loss is recognised as an expense when the carrying amount of an asset or the CGU exceeds its recoverable amount. Recoverable amount is determined as the higher of the fair value less costs to sell and value in use. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then, to reduce the carrying amount of the other assets in the unit on a pro rata basis.

An impairment loss recognised in prior periods for an asset (other than goodwill) is reversed if, and only where there is an indicator that the impairment loss may no longer exist, and there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. The increased carrying amount of an asset due to a reversal of an impairment loss does not exceed the carrying amount that would have been determined (net of amortisation) had no impairment loss been recognised for the asset in prior years.

In calculating the value in use, the cash flow includes projections of cash inflows and outflows from continuing use of the asset and cash flows associated with disposal of the asset. The cash flows are estimated for the assets in their current condition and do not include cash flows and out flows expected to arise from future restructuring which are not yet committed, or from improving or enhancing the asset's performance. In assessing value in use, the estimated cash flows are discounted to their present value effectively using a pre-tax discount rate that reflects the current market assessments of the risk specific to the asset or CGU.

## Notes to the financial statements (continued)

**(e) Inventories**

Inventories, which include raw materials, work in progress and finished goods, are valued at the lower of cost and net realisable value. Costs comprise all cost of purchase and conversion, including material, labour and an appropriate portion of fixed and variable overhead expenses. Costs have been assigned to inventory on hand at reporting date using either the first-in-first-out (F.I.F.O.) basis or the weighted average cost basis, depending on the nature of product being manufactured. Fixed overheads are allocated on the basis of normal operating capacity. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and selling expenses.

**(f) Property, Plant and Equipment**

Each class of property, plant and equipment is carried at historical cost or fair value less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of the item.

**(i) Property**

Freehold land and buildings are stated at fair value (being the amount for which an asset could be exchanged between knowledgeable willing parties in an arm's length transaction), based on periodic valuations by external valuers, less subsequent depreciation for the building. Any accumulated depreciation at the date of valuation is eliminated against the gross carrying amount of the asset and the net amount is reinstated to the revalued amount of the asset. Independent valuations are carried out every three to five years, with internal reviews performed regularly to ensure that the carrying amounts of land and buildings do not differ materially from the fair value at the reporting date.

Increases in the carrying amount arising on revaluation of land and buildings are recognised, net of tax, in other comprehensive income and are credited to a revaluation reserve in equity. Decreases that offset previous increases of the same asset are charged against fair value reserves directly in equity; all other decreases are charged to profit or loss. Each year the difference between depreciation based on the revalued carrying amount of the asset charged to profit or loss and depreciation based on the asset's original cost is transferred from the revaluation reserve to retained earnings. When revalued assets are sold, amounts included in the revaluation reserve relating to the asset are transferred to retained earnings.

**(ii) Plant and Equipment**

Plant and equipment are stated at historical cost, including costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, less depreciation and any impairments.

The carrying amount of plant and equipment is reviewed annually by directors to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed as the higher of fair value less costs to sell or value in use.

The cost of fixed assets constructed within the group includes the cost of materials, direct labour, borrowing costs and an appropriate proportion of fixed and variable overheads. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the profit or loss during the financial year in which they were incurred.

**Depreciation**

The depreciable amount of property, plant and equipment, including capitalised lease assets, but excluding freehold land, is depreciated on a straight line basis over their useful lives to the group commencing from the time the asset is held ready for use. Leasehold improvements are depreciated over the shorter of either the unexpired period of the lease or the estimated useful lives of the improvements.

The depreciation rates used for each class of depreciable assets are:

Buildings	4%
Leased Plant, Equipment and Other	5% to 12.5%
Plant, Equipment and Other	5% to 20%

The assets' residual value and useful life are reviewed, and adjusted if appropriate, at each balance date. An asset's carrying value amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These gains and losses are included in profit or loss.

**(g) Leases**

Leases where substantially all the risks and benefits incidental to the ownership of the asset, but not the legal ownership, are transferred to the entities within the group are classified as finance leases. Finance lease are capitalised at the lower of the fair value of the leased property and the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in the current and non-current interest bearing liabilities. Each lease payment is allocated between the liability and the finance charges. The interest element of the lease payment is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the asset's useful life or the lease term, unless it is reasonably certain that ownership will be obtained by the end of the lease term where it is depreciated over the period of the expected use which is the useful life of the asset.

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses on a straight line basis over the period of the lease.

**(h) Investments in Associates**

Associates comprise entities over which the parent entity or the Group have significant influence and hold an ownership interest. Investments in associated companies are recognised in the financial statements by applying the equity method of accounting.

Under the equity method of accounting the carrying amounts of investments in associates are increased or decreased to recognise the Group's share of the post-acquisition profits or losses and other changes in net assets of the associates. The Group's share of the post-acquisition profits or losses of associates is included in the consolidated profit and loss.

The financial statements of the associate are used to apply the equity method. The reporting dates of the associate and the parent are identical and both use consistent accounting policies.

Associates are accounted for in the parent entity financial statements at cost.

**(i) Interests in Joint Venture Entities**

Under AASB 131 'Interests in Joint Ventures' interests in jointly controlled entities can be recognised using either the proportionate consolidation approach or the equity method. Prior to 1 July 2008, the group had accounted for its interests in joint ventures using the equity method. From 1 July 2008, the group has changed its policy to account for interests in joint ventures such that the proportionate consolidation method is adopted.

**(j) Intangibles****(i) Goodwill**

Goodwill on consolidation is initially recorded at the amount by which the purchase price for a business or for an ownership interest in a controlled entity exceeds the fair value attributed to the acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Goodwill is tested annually for impairment. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the group's cash-generating units, or groups of cash-generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the group are assigned to these units or groups of units. Impairment is determined by assessing the recoverable amount of the cash-generating unit, or group of cash-generating units, to which the goodwill relates. Impairment losses recognised for goodwill are not subsequently reversed. Goodwill is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

**(ii) Trademarks, Licenses, product development costs and Product Dossiers**

Trademarks, licenses, product development costs and product dossiers ('Developed Products') are initialled recognised at cost. Developed Products having an indefinite life and are tested at each reporting date for impairment and carried at cost less accumulated impairment losses. Those with a finite life are carried at cost less any accumulated amortisation and accumulated impairment losses. Those developed products with finite lives are amortised on a straight line basis over a useful life of 40 years. Amortisation is included within administration and other expenses in the statement of comprehensive income.

Notes to the financial statements (continued)

**(iii) Research and Development – Internally generated**

Research costs are expensed as incurred. Development expenditure incurred on an individual project is capitalised if the product or service is technically feasible, adequate resources are available to complete the project, it is probable that future economic benefits will be generated and expenditure attributable to the project can be measured reliably. Expenditure capitalised comprises costs of materials, services, direct labour and directly attributable overheads. Other development costs are expensed when they are incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and any impairment losses and amortised over the period of expected future sales from the related projects. The carrying value of development costs is reviewed annually when the asset is not yet available for use, or when events or circumstances indicate that the carrying value may be impaired.

**(k) Employee Benefits**

**(i) Wages, Salaries & Annual Leave**

Liabilities for employee benefits such as wages, salaries, annual leave, sick leave and other current employee entitlements represent present obligations resulting from employees' services provided to reporting date, and are measured at the amount expected to be paid when the liabilities are settled.

**(ii) Long Service Leave**

Liabilities relating to Long Service Leave are measured as the present value of the estimated future cash outflows to be made in respect to services provided by employees, up to the reporting date. Consideration is given to expected future wage levels, experience of employee departures and period of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity that match, as closely as possible, the estimated future cash outflows.

**(iii) Superannuation**

Contributions are made by the entity to employee superannuation funds and are charged as expenses when incurred. The consolidated entity does not maintain any retirement benefit funds.

**(iv) Employee share based payments**

Shares issued pursuant to an employee share plan, which are facilitated by means of a loan with recourse only to the shares, are treated as an option grant. The loan is shown as a reduction in equity until the shares are either cancelled or settled in accordance with the terms of the plan. The fair value of options granted is recognised as an employee benefit expense with a corresponding increase in the share-based payments reserve in equity. The fair value is measured at grant date taking into account market performance conditions only, and spread over the vesting period during which the employees become unconditionally entitled to the options. The fair value of options granted is measured using the Black Scholes model. The amount recognised as an expense is adjusted to reflect the actual number of options that vest, except where forfeiture is due to market related conditions.

At each subsequent reporting date until vesting, the cumulative change to profit or loss is the product of:

- The grant date fair value.
- The current best estimate of the number of securities that will vest, taking into account factors such as the likelihood of employee turnover during the vesting period and the likelihood of non-market performance conditions not being met.
- The expired portion of the vesting period.

**(l) Financial Instruments**

**Recognition**

Financial instruments are initially measured at fair value plus directly attributable transaction costs. Subsequent to initial recognition these instruments are measured as set out below.

**Financial assets at fair value through profit and loss**

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term with the intention of making a profit or if so designated by management and within the requirements of AASB 139: Financial Instruments: Recognition and Measurement. Derivatives are also categorised as held for trading unless they are designated as hedges. Realised and unrealised gains and losses arising from derivatives and changes in the fair value of these assets are included in profit or loss in the period they arise.

**Loan and Receivables**

Loan and Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest method. Loans and receivables are initially measured at fair value and are subsequently measured at amortised cost less any allowance for impairment. Trading terms are between 7 days to 60 days. An allowance for impairment is recognised when it becomes improbable that the all or part of the loan or receivable will be recoverable. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired.

**Held to maturity Investments**

These investments have fixed or determinable payments and fixed maturities, and it is the group's intention to hold these investments to maturity. Any held-to-maturity investments held by the group are stated at amortised cost using the effective interest method.

**Available for sale financial assets**

Available for sale financial assets include any non-derivative financial assets that are designated as available for sale or that are not included in the above categories. Available for sale financial assets are reflected at fair value. After initial recognition available-for-sale assets are measured at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity.

**Trade and other payables**

Trade and other payables represent liabilities for goods and services provided to the group prior to the year end and which are unpaid. These amounts are unsecured and have 30 - 90 day payment terms. Trade and other payables are carried at amortised cost, yet due to their short term nature, they are not discounted.

**Interest bearing liabilities**

All loans and borrowings are initially recognised at fair value, net of directly attributable transaction costs incurred. Borrowings are subsequently measured at amortised cost using the effective interest method.

**Fair Value**

Fair value is determined based on current bid prices of all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arm's length transactions, reference to similar instruments and option pricing models.

**Impairment**

At each reporting date, the group assesses whether there is objective evidence that a financial instrument has been impaired.

**Derivative financial instruments**

The group uses derivative financial instruments such as forward foreign currency contracts and interest rate swaps to hedge its risk associated with interest rate and foreign currency fluctuations. Such derivatives are stated at fair value on the date which the derivative contract is entered into and is subsequently remeasured at fair value. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swap contracts is determined by reference to market values for similar instruments.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to net profit or loss for the year where they are material.

**(m) Government Grants**

Grants from government are recognised at the fair value when there is a reasonable assurance that the grant will be received and the consolidated entity has complied with the required conditions. Grants relating to expense items are recognised as income over the periods necessary to match the grant to the costs they are compensating. Grants relating to assets are credited to deferred income and are amortised on a straight line basis over the expected lives of the assets.

**(n) Revenue Recognition**

Revenue is measured at the fair value of the consideration received or receivable to the extent it is probable that the economic benefits will flow to the group and the revenue can be measured reliably. Amounts disclosed as revenue are net of returns, allowances and discounts. Sales revenue comprises revenue earned from the provision of products and services to entities outside the consolidated entity. Sales revenue is recognised when the risks and rewards of ownership have transferred to the customer and can be measured reliably. Risks and rewards are considered passed to the buyer when goods have been delivered to the customer.

Interest income is recognised as it accrues using the effective interest method. This method uses the effective interest rate which is the rate that exactly discounts the estimated future cash receipts over the expected life of the financial asset to the net carrying amount of the financial asset. Interest income is included as financial income in profit or loss. Dividends are recognised when the group's right to receive payment is established.

All revenue is stated net of the amount of goods and services tax (GST).

Notes to the financial statements (continued)

(o) Financing costs

Financing costs include interest income and expense, amortisation of discounts or premiums relating to borrowings, amortisation of ancillary costs incurred in connection with the arrangement of borrowings and lease finance charges. Borrowing costs are expensed as incurred except when directly attributable to the acquisition, construction or production of a qualifying asset, in which case they form part of the cost of the asset.

(p) Provisions

A provision is recognised when there is a legal or constructive obligation as a result of a past event and it is probable that a future sacrifice of economic benefits will be required to settle the obligation, and the amount can be reliably estimated. Provisions are not recognised for future operating losses. Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the reporting date using a discounted cash flow methodology.

(q) Cash

For purposes of the statement of cash flows, cash includes deposits at call with financial institutions which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value, net of outstanding bank overdrafts.

(r) Comparative Figures

Comparative figures have been adjusted to conform to changes in presentation for the current year.

(s) Earnings per share

Basic earnings per share is determined by dividing the net profit attributable to members of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares, adjusted for any bonus elements.

Diluted earnings per share is determined by dividing the net profit attributable to members of the Company, by the weighted average number of ordinary shares and dilutive potential ordinary shares adjusted for any bonus elements.

(t) Contributed equity

Issued and paid up capital is recognised at the fair value of the consideration received by the Company.

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

(u) Shares held by equity compensation plan

If shares are issued pursuant to an employee share plan, which are facilitated by means of a loan with recourse only to the shares, they are treated as an option grant. The loan is recognised in the shares held by equity compensation plan account (shown as a reduction in equity) until the shares are either cancelled or settled in accordance with the terms of the plan, upon which the shares held by equity compensation plan account is credited.

(v) Business combinations

The acquisition method of accounting is used to account for all business combinations, including business combinations involving entities or businesses under common control, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. The consideration transferred also includes the fair value of any contingent consideration arrangement and the fair value of any pre-existing equity interest in the subsidiary. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are, with limited exceptions, measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net identifiable assets.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquire and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the subsidiary acquired and the measurement of all amounts has been reviewed, the difference is recognised directly in profit or loss as a bargain purchase.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.



**(w) Prior period error**

In the financial statements for the year ended 30 June 2010, an amount of \$334,825 relating to the translation of foreign based subsidiaries was incorrectly included in contributed equity. To correct this error, the group has decreased other contributed equity by \$334,825 and increased the foreign currency translation reserve by the same amount. There is no impact on profit but it has increased other comprehensive income by \$334,825. As this error is isolated to the 30 June 2010 reporting date, no opening statement of financial position has been presented as it is not applicable.

**(x) Working capital deficiency**

As presented in the statement of financial position, the group has a net working capital deficiency of \$13,130,814. This is caused by \$14,649,038 worth of liabilities which exist under a facility due to expire on dates subsequent to 30 June 2012 being classified as current due to an annual review clause included in the finance facility which would require the group to repay the debt if the bank was not satisfied with the financial condition of the group. The group has complied with all financial covenants within the finance facility and there have been no indications given by the financier that they intend to recall any portion of the debt prior to the expiry date of the finance facility. Excluding these loans, the group has a net working capital balance of \$1,518,224 and believes that it will continue as a going concern for a period of 12 months from the date of the director's declaration.

**(y) New Accounting Standards**

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2011 reporting periods, and have not yet been adopted by the Group. The Group's and the parent entity's assessment of the impact of these new standards and interpretations is set out below.

- AASB 124 (revised December 2009) *Related Party Disclosures*, AASB 2009-12 *Amendments to Australian Accounting Standards* simplifies the definition of related parties, clarifying its intended meaning and eliminating inconsistencies from the definition. AASB 124 (revised December 2009) become mandatory for the Group's 30 June 2012 financial statements but is not expected to have any impact on the Group's financial statements.
- AASB 9 *Financial Instruments*, AASB 2009-11 *Amendments to Australian Accounting Standards* arising from the AASB 9 sets out requirements for the classification and measurement of financial assets. AASB 2008-6 will become mandatory for the Group's 30 June 2014 financial statements. The Group will apply this revised AASB 2009-11 from 30 June 2014 but it is not expected to have any impact on the Group's financial statements.
- AASB 2009-14 *Amendments to Australian Interpretation - Prepayments of a Minimum Funding Requirement* makes amendments to Interpretation 14 AASB 119 - *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. AASB 2009-14 will become mandatory for the Group's 30 June 2012 financial statements. The Group will apply this revised AASB 101 from 30 June 2012 but it is not expected to have any impact on the Group's financial statements.
- AASB 2010-6 *Amendment to Australian Accounting Standards - Disclosures in Transfers of Financial Assets* adds and amends disclosure requirements about transfers of financial assets, including in respect of the nature of the financial assets involved and the risks associated with them. AASB 2010-6 will become mandatory for the Group's 30 June 2012 financial statements. The Group will apply this revised AASB 2010-6 from 30 June 2012 but it is not expected to have any impact on the Group's financial statements.
- AASB 2010-8 *Amendment to Australian Accounting Standards - Deferred Tax: Recovery of Underlying Assets* provide a practical approach for measuring deferred tax liabilities and deferred tax assets when investment property is measured using the fair value model in AASB 140 *Investment Property*. AASB 2010-8 will become mandatory for the Group's 30 June 2013 financial statements. The Group will apply this revised AASB 2010-8 from 30 June 2013 but it is not expected to have any impact on the Group's financial statements.
- AASB 1053 *Application of Tiers of Australian Accounting Standards* and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements* (effective from 1 July 2013). On 30 June 2010 the AASB officially introduced a revised differential reporting framework in Australia. Under this framework, a two-tier differential reporting regime applies to all entities that prepare general purpose financial statements. Webfirm Group Limited is listed on the ASX and is not eligible to adopt the new Australian Accounting Standards - Reduced Disclosure Requirements. The two standards will therefore have no impact on the financial statements of the entity.

## Notes to the financial statements (continued)

	2011 \$	2010 \$
<b>2. Revenue and other income</b>		
<b>Revenue from:</b>		
Interest received	111,716	52,225
Sale of goods	71,770,144	74,769,246
<b>Total Revenue</b>	<b>71,881,860</b>	<b>74,821,471</b>
Government subsidies received	224,147	1,432,417
Loan forgiveness	-	4,059,912
Sundry income	269,191	198,505
Total other income	493,338	5,690,834
<b>Total revenue and other income from continuing operations</b>	<b>72,375,198</b>	<b>80,512,305</b>
Sales revenue from discontinued operations	1,713,260	72,895
Interest income from discontinued operations	493	7,704
<b>Total revenue and other income from discontinued operations</b>	<b>1,713,753</b>	<b>80,599</b>
<b>3. Profit for the year</b>		
Net profit has been arrived at after including:		
Finance cost - non related parties	2,277,535	-
Foreign currency translation losses	223,664	-
Bad and doubtful debts expense - trade receivables	347,500	(100,344)
Rental on operating lease expenses - minimum lease payments	774,996	527,514
Inventory write-offs	2,685,676	-
Professional and consulting expenses	278,579	409,995
Employee benefits expenses	21,365,518	19,465,812
Repairs and maintenance expenses	871,443	927,234
Research and development cost	3,494,615	4,163,018
Depreciation of property, plant and equipment	3,566,216	3,025,655
Amortisation of intangibles	324,384	60,000
Impairment costs - intangibles	3,774,476	-
Impairment costs - property, plant and equipment	2,041,031	-
Defined contribution superannuation expense	1,288,457	1,286,978
<b>4. Administration &amp; other expenses</b>		
Administration & other expenses comprises:		
Insurance	867,850	916,549
Office expenses	931,913	651,885
Travel and entertainment	398,327	514,746
Compliance costs	391,698	235,401
Other expenses	7,359,002	6,242,696
	<b>9,948,790</b>	<b>8,561,277</b>

	2011 \$	2010 \$
<b>5. Income tax expense</b>		
<b>(a) Components of Tax Expense:</b>		
Current income tax	83,015	219,409
Deferred income tax	(1,330,386)	421,333
Over provision for income tax in prior years	(86,401)	-
	<b>(1,333,772)</b>	<b>640,742</b>
Income tax is attributable to:		
(Loss)/profit from continuing operations	345,624	578,919
(Loss)/profit from discontinued operations	(1,679,396)	61,823
	<b>(1,333,772)</b>	<b>640,742</b>
<b>(b) Reconciliation of income tax expense to prima facie tax payable on profit/(loss)</b>		
Profit/(loss) from continuing operations	(1,737,025)	11,214,493
Profit/(loss) from discontinued operations	(9,934,534)	(1,092,878)
	<b>(11,671,559)</b>	<b>10,121,615</b>
Prima facie tax expense on profit/(loss) before income tax at 30% (2010: 30%)	(3,501,468)	3,036,485
Add Tax effect of:		
Non-assessable loan forgiveness	-	(1,217,974)
Impairment of intangibles	934,658	-
Impairment of fixed assets	672,193	-
Recoupment of prior losses not yet booked	(570,537)	(722,754)
Research and development tax concession	(168,773)	(677,595)
Tax losses not recognised	1,679,396	61,822
Other non allowable or assessable items	(379,241)	160,758
<b>Income tax expense/(benefit)</b>	<b>(1,333,772)</b>	<b>640,742</b>
<b>Current tax payable</b>	<b>3,071</b>	<b>314,924</b>

Notes to the financial statements (continued)

## 6. Discontinued operations

On 1 June 2011, the directors announced that Probiotec Limited ('the Company') had undertaken a comprehensive strategic and operational review of the Company's business operations, assets and financial position. The review resulted in a number of planned initiatives to improve the strategic focus, business operations and financial performance of the Company.

The initiatives outlined above included the closure of a number of the Company's operations and the subsequent disposal of non-core assets. As a result, a number of the operations to be closed have been classified as discontinued operations as at 30 June 2011.

A description of each of the operations classified as discontinued as at 30 June 2011 is set out below.

### **Manufacturing site: Bundaberg, QLD**

Probiotec operates a manufacturing site in Bundaberg, QLD that produces a range of ingredients for use primarily in animal nutrition applications. As a result of the strategic review, it was decided that this operation was not consistent with the Company's core business strategy and did not provide sufficient returns.

### **Manufacturing site: Bomaderry, NSW**

Probiotec operates a manufacturing site in Bomaderry NSW that produces a range of ingredients for use in food and pharmaceutical applications. As a result of the strategic review, it was decided that this operation was not consistent with the Company's core business strategy and did not provide sufficient returns.

### **Probiotec Pharma GmbH (Germany)**

In 2008, the Company established a German subsidiary named Probiotec Pharma GmbH. The purpose of this entity was to market and distribute the Company's weight loss and pharmaceutical products in Germany. Since incorporation, Probiotec Pharma GmbH has failed to expand its revenue and market share to a level that achieves profitability. Following the strategic review, it was determined that this operation did not show a reasonable probability of achieving acceptable returns in the future and as a result it was decided that this operation would be discontinued.

### **Hong Kong operations**

In 2009, the Company established a Hong Kong subsidiary named Probiotec (Hong Kong) Limited. The purpose of this entity was to market and distribute the Company's weight loss and pharmaceutical products in Hong Kong. Since incorporation, Probiotec (Hong Kong) Limited has failed to expand its revenue and market share to a level that achieves profitability. Following the strategic review, it was determined that this operation did not show a reasonable probability of achieving acceptable returns in the future and as a result it was decided that this operation would be discontinued.

### China operations

During the 2010 financial year, the Company acquired the 100% of shares held in the Hangzhou Probiotec Trading Co Ltd ('HPTC'), a operating entity incorporated in the Peoples Republic of China. HPTC primary purpose was to distribute and market the Company's products throughout China. HPTC's operations were separated into a number of geographical regions with the establishment of independent offices and staff ('regional offices'). The outcome of the strategic review was that the regional offices were not generating sufficient returns and that they should be closed. Going forward, HPTC will operate from its head office located in Hangzhou only to reduce the ongoing operating costs of the entity and subsequently deliver profitability to the Company.

The Comprehensive income of the discontinued operations was:

	2011 \$	2010 \$
Revenue	1,713,753	80,599
Impairment costs	(2,699,980)	-
Expenses	(8,948,307)	(1,173,477)
Loss from discontinued operations before income tax	(9,934,534)	(1,092,878)
Income tax benefit/(expense)	1,679,396	(61,823)
Loss from discontinued operations after income tax	(8,255,138)	(1,154,701)
The cash flow of the discontinued operations was:		
Net cash flow used in operating activities	(770,985)	(261,635)
Net cash flow used in investing activities	(121,985)	(225,611)
Net cash flow used in financing activities	-	-
Net decrease in cash held	(892,970)	(487,246)

## Notes to the financial statements (continued)

**7. Critical accounting estimates and judgements**

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

(a) The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

**(i) Value in use calculation assumptions**

The recoverable amount of each cash-generating unit used for impairment testing is determined based on value-in-use calculations. Value-in-use is calculated based on the present value of cash flow projections over a 5-year period. The discounted cash flows for each cash-generating unit is calculated based on management forecasts for sales, gross profit and resultant earnings. The assumed growth rate beyond the forecast cash flow period and discount rate used in the determination of value in use were 5% and 13.8% respectively. The discounted rate used is the Weighted Average Cost of Capital (WACC) of the Group at the reporting date. These value-in-use calculations are sensitive to changes in the key assumptions used. Changes in the nature or quantum of key assumptions would alter the value-in-use calculations and could potentially result in certain cash-generating units being subject to impairment.

**(ii) Fair value of land and buildings**

As disclosed in Note 17, the group has land and buildings worth \$18,103,171 measured at fair value. Fair value has been determined based on a director's valuation in reference to the last independent valuation that occurred on 30 June 2007 and based on current market information available. Fair value estimations are inherently complex and require significant assumptions in relation to market rentals, land values and market yields for each individual property held. If any of the key assumptions made change, the fair value of land and buildings differ materially from the value recorded in the financial statements.

**(iii) Amortisation of intangibles**

As detailed in Note 1 (j), the group has a policy of amortising intangible assets with a finite useful life over a period of 40 years and the remainder have been determined to have an indefinite useful life. The carrying value of those assets with a finite useful life is \$16,528,470 and those with an indefinite useful life is \$13,030,383 (refer to Note 18). The determination of the useful life of each intangible asset, which comprises capitalised product development costs, is based on the group's knowledge of each major category of intangible assets and the future economic benefits expected to be received from each. The group reassesses the useful life of intangible assets at each reporting date and at any future period may change the useful life of an intangible asset based on information available at that date. The group recognised amortisation of \$324,384 relating to assets with a finite useful life during the current year.

## 8. Key management personnel and their related parties disclosures

Full details of Key Management Personnel and their related party disclosures are set out in the Remuneration Report section of the Directors Report.

### (a) Key management personnel compensation:

	2011 \$	2010 \$
Short-term employee benefits	2,092,825	2,454,618
Post-employment benefits	270,087	215,020
Termination benefits	-	-
Share-based payments	37,658	205,009
Total compensation	2,400,570	2,874,647

### (b) The number of options<sup>1</sup> held by directors and key management personnel for the year ended 30 June 2011 is as follows:

	BALANCE AT START OF THE YEAR NUMBER	GRANTED AS COMPENSATION DURING THE YEAR NUMBER	EXERCISED DURING THE YEAR NUMBER	FORFEITED/ LAPSED DURING THE YEAR NUMBER	BALANCE AT END OF THE YEAR NUMBER	BALANCE VESTED AND EXERCISABLE AT END OF THE YEAR NUMBER	BALANCE UNVESTED AT END OF THE YEAR NUMBER
Maurice Van Ryn	-	-	-	-	-	-	-
Richard David Kuo	-	-	-	-	-	-	-
Graham Henry Buckeridge	-	-	-	-	-	-	-
Robert Maxwell Johnston	-	-	-	-	-	-	-
Charles Wayne Stringer	2,600,000	-	-	400,000	2,200,000	1,000,000	1,200,000
Wesley Stringer	272,503	-	-	137,503	135,000	75,000	60,000
Dustin Stringer	195,001	-	-	75,001	120,000	60,000	60,000
Mark Chatfield	175,003	-	-	100,003	75,000	50,000	25,000
Humera Ahmad	125,001	-	-	65,001	60,000	45,000	15,000
Alan Hong	160,002	-	-	100,002	60,000	45,000	15,000
Matthew Dalton	180,001	-	-	50,001	130,000	70,000	60,000
David Erasmus	90,000	-	-	-	90,000	65,000	25,000
Jared Stringer	157,501	-	-	62,501	95,000	50,000	45,000
	3,955,012	-	-	990,012	2,965,000	1,460,000	1,505,000

<sup>1</sup> The executives have no access to the shares until expiry of 36 months of their employment with the company or an Associated Body Corporate from the date of grant of the shares. All shares are forfeited if the grantee resigns from the company prior to the expiry of 36 from the date of grant of the shares.



## Notes to the financial statements (continued)

Option<sup>1</sup> Holdings of Key Management Personnel for the year ended 30 June 2010:

	BALANCE AT START OF THE YEAR NUMBER	GRANTED AS COMPENSATION DURING THE YEAR NUMBER	EXERCISED DURING THE YEAR NUMBER	FORFEITED/ LAPSED DURING THE YEAR NUMBER	BALANCE AT END OF THE YEAR NUMBER	BALANCE VESTED AND EXERCISABLE AT END OF THE YEAR NUMBER	BALANCE UNVESTED AT END OF THE YEAR NUMBER
Maurice Van Ryn	-	-	-	-	-	-	-
Richard David Kuo	-	-	-	-	-	-	-
Graham Henry Buckeridge	-	-	-	-	-	-	-
Robert Maxwell Johnston	-	-	-	-	-	-	-
Charles Wayne Stringer	2,300,000	700,000	(205,000)	(195,000)	2,600,000	500,000	2,100,000
Wesley Stringer	322,503	-	(50,000)	-	272,503	162,503	110,000
Dustin Stringer	195,001	-	-	-	195,001	95,001	100,000
Mark Chatfield	225,003	-	(50,000)	-	175,003	125,003	50,000
Humera Ahmad	160,002	-	(35,001)	-	125,001	90,001	35,000
Alan Hong	160,002	-	-	-	160,002	125,002	35,000
Matthew Dalton	180,001	-	-	-	180,001	80,001	100,000
Steve Morrison	95,000	-	-	-	95,000	-	95,000
David McClure	100,000	-	-	-	100,000	-	100,000
David Erasmus	90,000	-	-	-	90,000	55,000	35,000
Jared Stringer	157,501	-	-	-	157,501	82,501	75,000
	3,985,013	700,000	(340,001)	(195,000)	4,150,012	1,315,012	2,835,000

### Ordinary share holdings of Key Management Personnel

DIRECTORS	BALANCE AT 1/07/2009	SHARE ACQUISITIONS THROUGH EXERCISE OF SHARE OPTIONS	CEO OPTIONS EXERCISED	OTHER PURCH- ASES DURING THE YEAR*	SOLD DURING THE YEAR	BALANCE AT 30/06/10	SHARE ACQUISITIONS THROUGH EXERCISE OF SHARE OPTIONS	CEO OPTIONS EXER- CISED	OTHER PURCHASES DURING THE YEAR*	SOLD DURING THE YEAR	BALANCE AT 30/06/11
<b>Directors</b>											
Maurice Van Ryn	377,502	-	-	10,000	(200,000)	187,502	-	-	93,599	-	281,101
Charles Wayne Stringer	8,035,954	-	205,000	-	(900,000)	7,340,954	-	-	487,689	-	7,828,643
Wes Stringer	312,811	50,000	-	-	(90,000)	272,811	-	-	-	-	272,811
Graham Harry Buckeridge	1,818,684	-	-	30,000	(500,000)	1,348,684	-	-	-	-	1,348,684
Robert Maxwell Johnston	7,500	-	-	8,000	-	15,500	-	-	187,500	-	203,000
Richard David Kuo	101,423	-	-	1,578	(29,542)	73,459	-	-	1,267	-	74,726
Total for Directors	10,653,874	50,000	205,000	49,578	(1,719,542)	9,238,910	-	-	770,055	-	10,008,965
<b>Key Executive Personnel</b>											
Alan Hong	1,000	-	-	128	(1,128)	-	-	-	-	-	-
Jared Stringer	81,689	-	-	8,475	-	90,164	-	-	1,446	-	91,610
Mark Chatfield	-	50,000	-	-	(50,000)	-	-	-	-	-	-
Matthew Dalton	-	-	-	-	-	-	-	-	-	-	-
Dustin Stringer	77,000	-	-	5,700	-	82,700	-	-	15,300	-	98,000
Humera Ahmad	-	35,001	-	-	(35,001)	-	-	-	-	-	-
Total for Key Executive Personnel	159,689	85,001	-	14,303	(86,129)	172,864	-	-	16,746	-	189,610

\* Includes on market purchases and dividend reinvestment plan allotments.

<sup>1</sup> The term Option includes unvested fully paid ordinary shares issues and the associated loans with recourse to the shares which are issued under the Probiotec Limited Employee Share Plan (ESP). These shares and loans together have substantially similar financial and economic dynamics to options. Other than the options issued to Wayne Stringer, all other 'options' referred to in this table are shares and associated loans issued under the ESP.

## Notes to the financial statements (continued)

## 9. Remuneration of auditors

	2011 \$	2010 \$
<b>(a) Remuneration of auditor of the parent entity:</b>		
Auditing or reviewing the financial report	96,163	109,014
Other assurance procedures and advice	-	1,515
	96,163	110,529
<b>(b) Related practice of the auditor for non-assurance services:</b>		
General advice and services from BDO Ireland**	26,701	14,297
General advice and services from BDO LLP*	4,234	3,833

For the year ended 30 June 2011, the auditor of Probiotec Limited is BDO Audit (NSW-VIC) Pty Ltd.

\* BDO LLP is a United Kingdom based practice affiliated with the auditor.

\*\* BDO Ireland is an Ireland based practice affiliated with the auditor.

## 10. Dividends

The directors declared an interim dividend on 17 February 2010, which was paid on 18 March 2010. The directors declared a final dividend for the year ended 30 June 2010 on 24 August 2010 of 2 cents per fully paid ordinary share. No dividend has been declared or paid in relation to the financial year ended 30 June 2011.

	2011 CENTS PER SHARE	TOTAL \$	2010 CENTS PER SHARE	TOTAL \$
<b>Recognised Amounts</b>				
Fully Paid Ordinary Shares				
Interim dividend for half year ended 31 December fully franked at 30% corporate tax rate	-	-	1.50	463,820
<b>Unrecognised Amounts</b>				
Fully paid ordinary shares				
Final dividend for year ended 30 June, fully franked at 30% corporate tax rate	-	-	2.00	1,051,483

	2011 \$	2010 \$
Dividend franking account		
Amount of franking credits available for subsequent years	1,039,753	1,263,034

## 11. Cash and cash equivalents

Cash on hand and at bank	938,107	2,816,415
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Interest rate risk exposure

The Group's and the parent entity's exposure to interest rate risk is discussed in note 34.

## 12. Trade and other receivables

	2011 \$	2010 \$
<b>Current</b>		
Trade accounts receivable - third parties	8,846,118	9,953,108
Trade accounts receivable - subsidiaries	-	-
Less: allowance for impairment of receivables	(218,401)	(323,511)
Total current trade receivables	8,627,717	9,629,597
GST receivable	845,171	1,121,798
Other receivables	777,417	1,265,217
<b>Total current trade and other receivables</b>	<b>10,250,305</b>	<b>12,016,612</b>

**(a) An analysis of trade receivables that are past due but not impaired at the reporting date:**

	2011		2010	
	GROSS \$	ALLOWANCE \$	GROSS \$	ALLOWANCE \$
Not past due	7,847,260	-	9,280,291	-
Past due 1 - 30 days	455,502	-	325,104	-
Past due 31 - 60 days	268,299	-	97,292	(73,090)
Past due 61 - 90 days	133,130	(90,667)	119,703	(119,703)
Past 91 days	141,927	(127,734)	130,718	(130,718)
	<b>8,846,118</b>	<b>(218,401)</b>	<b>9,953,108</b>	<b>(323,511)</b>

**(b) Impaired trade receivables**

Trade debtors are generally extended on credit terms of between 14 days to 60 days. As at 30 June 2011, current trade receivables of the Group with a nominal value of \$275,057 (2010 - \$374,742) were impaired. The amount of the allowance was \$218,401 (2010 - \$323,511). The individually impaired receivables mainly relate to customers, which are in unexpectedly difficult economic situations.

Trade receivables that are neither past due or impaired relate to long standing customers with a good payment history.

Other receivables are expected to be recoverable in full and are due from reputable companies.

## Notes to the financial statements (continued)

Movements in the provision for impairment of receivables are as follows:

	2011 \$	2010 \$
At 1 July	323,511	278,604
Provision for impairment recognised during the year	242,390	145,251
Receivables written off during the year as uncollectible	(347,500)	(100,344)
At 30 June	218,401	323,511

Payment terms on receivables past due but not considered impaired have not been renegotiated. The Group has been in direct contact with the relevant customers and are reasonably satisfied that payment will be received in full.

**(c) Fair value and credit risk**

Due to the short term nature of these receivables, their carrying value is assumed to approximate their fair value.

**(d) Foreign exchange and interest rate risk**

Information about the Group's and the parent entity's exposure to foreign currency risk and interest rate risk in relation to trade and other receivables is provided in note 34.

	2011 \$	2010 \$
<b>13. Inventories</b>		
<b>Current</b>		
Raw material – at cost	7,429,608	9,725,144
Work in progress – at cost	1,426,772	1,901,632
Finished goods – at cost	5,956,881	10,857,456
	14,813,261	22,484,232
<b>14. Other current assets</b>		
Prepayments	415,305	389,004

**15. Interests in joint venture entities****(a) Interests are held in the following joint venture company:**

NAME	DOMICILE	OWNERSHIP INTEREST	
		2011	2010
Probiotec BLC Pty Limited ('PBLC')	Australia	50%	50%

PBLC is a joint venture entity between Probiotec Limited and SP Health Co Pty Ltd and is involved in the marketing and distribution of a range of health products. The reporting date is 30 June 2011. The voting power of Probiotec Ltd is 50.0%. The entity is accounted for as a jointly controlled entity as the shareholders agreement specifies that all significant financial and operating decisions require unanimous approval.

(b) Interest in the joint venture entity accounted for using the proportionate consolidation method are comprised as follows:

SHARE OF FINANCIAL POSITION AND FINANCIAL RESULTS:	PBLC	
	2011 \$	2010 \$
<b>Financial Position</b>		
Current Assets		
Cash at bank	5,368	352,151
Trade debtors	652,961	255,941
Inventory	406,556	468,053
Other current assets	28,752	-
<b>Total Current Assets</b>	<b>1,093,637</b>	<b>1,076,145</b>
<b>Non-Current Assets</b>		
Property, plant and equipment	1,583	5,408
<b>Total Non-Current Assets</b>	<b>1,583</b>	<b>5,408</b>
<b>Total Assets</b>	<b>1,095,220</b>	<b>1,081,553</b>
<b>Current Liabilities</b>		
Trade and other payables	540,368	584,875
<b>Total Current Liabilities</b>	<b>540,368</b>	<b>584,875</b>
<b>Non-Current Liabilities</b>		
Long term loans and borrowings	-	123,900
<b>Total Non-Current Liabilities</b>	<b>-</b>	<b>123,900</b>
<b>Total Liabilities</b>	<b>540,368</b>	<b>708,775</b>
<b>Net Assets</b>	<b>554,852</b>	<b>372,778</b>
<b>Financial Results</b>		
Revenues	5,252,510	7,288,743
Cost of goods sold	(3,349,115)	(4,707,165)
Finance costs	-	-
Sales & marketing expenses	(1,230,225)	(1,837,261)
Warehouse & distribution expenses	(338,440)	(325,099)
Other expenses	(38,140)	(46,219)
<b>Profit before Income Tax</b>	<b>296,590</b>	<b>372,999</b>
<b>Income tax expense</b>	<b>(1,501)</b>	<b>(113,015)</b>
<b>Profit after income tax</b>	<b>295,089</b>	<b>259,984</b>
<b>16. Loans receivable</b>		
Loans receivable	596,817	1,116,316

Loans receivable are due from commercial partners with which the Group has a long standing relationship. All loans receivable are secured by a fixed and floating charge over the assets of the commercial partner and are supported by a directors guarantee.

## Notes to the financial statements (continued)

## 17. Property, plant and equipment

	PBLC	
	2011 \$	2010 \$
Freehold land – at valuation	4,337,775	4,337,775
Building – at independent valuation	16,129,560	16,129,560
Less: Accumulated depreciation	(2,364,164)	(1,718,982)
	<b>13,765,396</b>	<b>14,410,578</b>
Plant & equipment – at cost	41,368,655	40,946,557
Less: Accumulated depreciation	(15,663,975)	(13,136,393)
	<b>25,704,680</b>	<b>27,810,164</b>
Leased plant & equipment	6,200,358	7,597,487
Less: Accumulated depreciation	(1,424,616)	(1,974,126)
	<b>4,775,742</b>	<b>5,623,361</b>
<b>Total property, plant and equipment</b>	<b>48,583,593</b>	<b>52,181,878</b>

All of the Group's freehold land and buildings were revalued by an independent valuer in June 2007 and resulted in a net revaluation increase of \$2,588,608. Valuations were made on the basis of weighted depreciated values and open market values. The revaluation surplus net of applicable deferred income taxes was credited to an asset revaluation reserve in shareholders' equity. As at 30 June 2011, if the cost model had been applied, the carrying value of the Group's freehold land and buildings would have been \$3,290,199 and \$10,934,571 respectively.

The directors have reviewed the fair values as at balance date and are satisfied that there have been no significant changes since the most recent independent valuation.

MOVEMENTS DURING THE YEAR	FREEHOLD LAND \$	BUILDINGS \$	PLANT, EQUIPMENT & OTHER \$	LEASED PLANT, EQUIPMENT & OTHER \$	TOTAL \$
<b>Consolidated Group</b>					
Carrying amount at 1 July 2009	4,337,775	14,429,576	21,201,956	6,343,332	46,312,639
Additions	-	605,490	2,584,797	-	3,190,287
Acquisitions through business combinations	-	-	5,747,015	-	5,747,015
Reclassification	-	-	199,679	(199,679)	-
Disposals	-	-	(16,890)	(25,518)	(42,408)
Depreciation and amortisation	-	(624,488)	(1,906,393)	(494,774)	(3,025,655)
Carrying amount at 30 June 2010	4,337,775	14,410,578	27,810,164	5,623,361	52,181,878
Carrying amount at 1 July 2010	4,337,775	14,410,578	27,810,164	5,623,361	52,181,878
Additions	-	-	1,924,418	277,123	2,201,541
Impairment	-	-	(2,041,031)	-	(2,041,031)
Reclassification	-	-	716,549	(716,549)	-
Disposals	-	-	(179,224)	(13,355)	(192,579)
Depreciation and amortisation	-	(645,182)	(2,526,196)	(394,838)	(3,566,216)
Carrying amount at 30 June 2011	4,337,775	13,765,396	25,704,680	4,775,742	48,583,593

## 18. Intangible assets

### (a) Intangible summary and reconciliation

	2011 \$	2010 \$
Acquired intangible assets – indefinite life:		
Goodwill – at cost	2,079,000	5,444,527
Developed products – at cost	6,912,634	6,951,269
	<b>8,991,634</b>	<b>12,395,796</b>
Acquired intangible assets – finite life:		
Goodwill – at cost	-	-
Developed products – at cost	11,729,541	11,729,541
Accumulated amortisation	(243,606)	(120,000)
	11,485,935	11,609,541
Capitalised development costs – indefinite life:		
Developed products – at cost	2,678,194	4,766,298
Products under development – at cost	1,360,555	946,543
	4,038,749	5,712,841
Capitalised development costs – finite life:		
Developed products – at cost	5,309,205	2,071,774
Accumulated amortisation	(266,670)	(65,892)
	5,042,535	2,005,882
<b>Total intangible assets</b>	<b>29,558,853</b>	<b>31,724,060</b>

Probiotec Ltd has both acquired and capitalised trademarks, licenses, product development costs and product dossiers ('Developed Products'). Product dossiers incorporate formulations, registrations, Therapeutic Goods Administration (TGA) listings, stability and validation data, and manufacturing and testing procedures.

#### Reconciliation of Intangible Assets:

	GOODWILL	DEVELOPED PRODUCTS	PRODUCTS UNDER DEVELOPMENT	TOTAL
Opening balance as at 1 July 2009	250,000	14,031,065	1,375,371	15,656,436
Acquisitions	5,194,527	8,494,486	-	13,689,013
Additions	-	957,975	1,480,636	2,438,611
Transfer of commercialised product	-	1,909,464	(1,909,464)	-
Amortisation	-	(60,000)	-	(60,000)
<b>Closing balance as at 30 June 2010</b>	<b>5,444,527</b>	<b>25,332,990</b>	<b>946,543</b>	<b>31,724,060</b>
Opening balance as at 1 July 2010	5,444,527	25,332,990	946,543	31,724,060
Acquisitions	-	-	-	-
Additions	-	-	1,933,653	1,933,653
Transfer of commercialised product	-	1,519,641	(1,519,641)	-
Impairment	(3,365,527)	(408,949)	-	(3,774,476)
Amortisation	-	(324,384)	-	(324,384)
<b>Closing balance as at 30 June 2011</b>	<b>2,079,000</b>	<b>26,119,298</b>	<b>1,360,555</b>	<b>29,558,853</b>



## Notes to the financial statements (continued)

**Estimated useful life of intangible assets**

Intangible assets, comprising Developed Products and goodwill, have indefinite useful lives apart from Developed Products which are subject to a license with a specified term. Developed Products with a finite life have a term of 40 years. Developed Products with indefinite lives comprise trademarks and product dossiers. Developed Products with finite useful lives are amortised on a straight line basis over their effective life. The current amortisation charges for intangible assets are included under depreciation and amortisation expense in the income statement. The directors consider intangibles to have an indefinite life when, based on an analysis of all relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cashflows for the group.

**Goodwill**

	2011 \$	2010 \$
Breakdown of goodwill at year end:		
Golden Life	-	250,000
Australian Dairy Proteins Pty Ltd	2,079,000	2,079,000
Hangzhou Probiotec Trading Co Ltd	-	3,115,527
	<b>2,079,000</b>	<b>5,444,527</b>

**Impairment of Goodwill****Hangzhou Probiotec Trading Co Ltd**

As at 30 June 2011, an impairment charge in the amount of \$3,115,527 was incurred in relation to the goodwill balance applicable to Hangzhou Probiotec Trading Co Ltd, a Chinese trading entity previously acquired by Probiotec Limited. The future cash flow projections did not provide adequate surety in order to justify the goodwill balance held. Following this impairment, there is no remaining goodwill balance in regards to Hangzhou Probiotec Trading Co Ltd.

**Golden Life**

As at 30 June 2011, an impairment charge in the amount of \$250,000 was incurred in relation to the goodwill balance applicable to Golden Life Australia Pty Ltd, an entity incorporated in Australia involved in the manufacture and distribution of vitamins and supplement products, which had been previously acquired by Probiotec Limited. The future cash flow projections did not provide adequate surety in order to justify the goodwill balance held. Following this impairment, there is no remaining goodwill balance in regards to Golden Life Australia Pty Ltd. The impairment charge has been disclosed in loss from discontinued operations in the statement of comprehensive income.

**Developed products**

As at 30 June 2011, impairment charges in the amount of \$408,949 were incurred in relation to developed products which were discontinued and will no longer generate future cash flows. These developed products were specifically related to the discontinued operations as set out in note 6. The impairment charge has been disclosed in loss from discontinued operations in the statement of comprehensive income.

### Impairment Disclosures

Goodwill is tested annually for impairment, based on value-in-use calculations conducted using the assumptions outlined in note 7.

The amount of goodwill and intangible assets with indefinite useful lives allocated to each cash-generating unit for the purposes of annual impairment testing are:

	PHARMACEUTICALS AND CONSUMER HEALTH	CONTRACT MANUFACTURING	NUTRITIONAL PRODUCTS	EXPORT SALES	RESEARCH AND DEVELOPMENT	TOTAL
<b>Year ended 30 June 2011</b>						
Goodwill	2,079,000	-	-	-	-	2,079,000
Intangibles with indefinite useful lives	9,807,711	-	-	1,143,672	-	10,951,383
<b>Year ended 30 June 2010</b>						
Goodwill	2,329,000	-	-	3,115,527	-	5,444,527
Intangibles with indefinite useful lives	11,520,438	-	-	1,143,672	-	12,664,110

The discount rates used to determine the value-in-use are:

	2011	2010
Golden Life	13.8%	13.8%
Australian Dairy Proteins Pty Ltd	13.8%	13.8%
Hangzhou Probiotec Trading Co Ltd	13.8%	13.8%
Intangibles with indefinite useful lives	13.8%	13.8%

	2011 \$	2010 \$
<b>19. Deferred tax assets</b>		
Deferred tax assets is comprised as follows:		
Temporary differences - provisions	399,384	760,968
Temporary differences - Property, plant & equipment	580,475	407,556
Temporary differences - leases	813,860	1,015,866
Temporary differences - other	203,637	203,150
Offset against deferred tax liabilities	(2,390,115)	-
Tax losses	1,798,274	1,131,315
	1,405,515	3,518,855

<b>20. Trade and other payables</b>		
Trade accounts payable	7,657,040	7,862,028
Sundry creditors & accruals	2,533,864	3,011,057
GST payable	1,280,886	533,187
	11,471,790	11,406,272

### (a) Fair value

Due to the short term nature of these payables, their carrying value is assumed to approximate their fair value.

## Notes to the financial statements (continued)

**(b) Foreign exchange risk**

AMOUNTS PAYABLE IN FOREIGN CURRENCIES	2011 \$	2010 \$
<b>Current</b>		
Euro	150,473	250,322
Great British Pounds	362,945	554,334
US Dollars	53,592	70,105
NZD	9,515	28,478
HKD	90,289	2,030
CNY	131,487	-
	<b>798,301</b>	<b>905,269</b>

Detailed information about the Group's and the parent entity's exposure to foreign currency risk in relation to trade and other payables is provided in note 34.

**21. Interest-bearing liabilities**

	2011 \$	2010 \$
<b>Current</b>		
Secured borrowings		
Bank loans	26,341,358	12,859,691
Lease liabilities	836,782	858,890
	<b>27,178,140</b>	<b>13,718,581</b>
<b>Non-Current</b>		
Secured borrowings		
Bank loans	250,000	16,994,422
Lease liabilities	1,876,086	2,527,329
	<b>2,126,086</b>	<b>19,521,751</b>
<b>(a) Total current and non-current secured liabilities:</b>		
Bank loans	26,591,358	29,854,113
Lease liabilities	2,712,868	3,386,219
	<b>29,304,226</b>	<b>33,240,332</b>
<b>(b) The carrying amount of the assets secured by a first registered mortgage:</b>		
Freehold land and building (Note 16)	18,103,171	18,748,353

**(c)** The bank loans are provided by Rabo Australia Limited and are secured by a registered first mortgage over certain freehold property of the parent entity and the subsidiaries which has a carrying amount of \$18,103,171 at 30 June 2011.

The bank covenants require tangible net worth to exceed \$32 million, an equity ratio of greater than 50%, debt service to EBITDA to exceed 1.25 and the ratio of financial indebtedness to EBITDA of less than 4 as at 30 June 2011. The Group is in compliance with the bank covenants.

The bank loans provided by Commonwealth Bank and Rabo Australia Limited are secured by cross guarantees between Probiotec Limited and its controlled entities.

**(d) Finance lease liabilities:**

Weighed average interest rate of 7.56%

Secured by leased plant/assets

Finance leases are entered into with the Commonwealth Bank of Australia and Rabo Australia Limited. The lease terms are from 3 to 5 years. Finance leases may be extended at the expiry of their term by negotiation with the lease finance provider.

**(e) Interest rate risk exposure**

The Group's and the parent entity's exposure to interest rate risk is discussed in note 34.

**22. Provisions**

	2011 \$	2010 \$
<b>Current</b>		
Leave entitlements (a)	894,791	911,433
<b>Non-Current</b>		
Leave entitlements (a)	280,993	185,677
<b>Total provisions</b>	<b>1,175,784</b>	<b>1,097,110</b>

(a) Provision for leave entitlements represents accrued annual leave along with an allowance for long service leave either earned by employees and not yet taken or partly earned. For partly earned long service leave, historical retention rates are used to determine likelihood of achieving fully vested long service leave.

	2011 \$	2010 \$
<b>23. Deferred taxes</b>		
Deferred taxes is comprised as follows:		
Deferred tax assets (note 19)	1,405,515	3,518,855
Deferred tax liabilities – temporary differences (a)	(3,291,532)	(6,735,258)
Net deferred tax liabilities	(1,886,017)	(3,216,403)
<b>Deferred tax expense debit/(credit) to income tax expense</b>	<b>(1,330,386)</b>	<b>421,333</b>
<b>Deferred tax expense charged to equity</b>	<b>-</b>	<b>-</b>
<b>(a) Deferred tax liabilities comprises:</b>		
Temporary differences – property, plant & equipment	(2,811,727)	(4,057,136)
Temporary differences – capitalised development costs	(2,313,064)	(2,003,682)
Temporary differences – other	1,833,259	(674,440)
	<b>(3,291,532)</b>	<b>(6,735,258)</b>
Reconciliation of net deferred tax liabilities:		
Opening as at 1 July 2009	(2,795,070)	
Less: deferred tax expense charge (credit) to income	(421,333)	
Less: deferred tax expense charged to equity	-	
Closing as at 30 June 2010	(3,216,403)	
Less: deferred tax benefit	1,330,386	
Less: deferred tax expense charged to equity	-	
<b>Closing as at 30 June 2011</b>	<b>(1,886,017)</b>	

## Notes to the financial statements (continued)

## 24. Contributed equity

	2011 \$	2010 \$
52,929,356 (2010: 52,779,127) fully paid ordinary shares	36,581,517	36,360,891
<b>Reconciliation of fully paid ordinary shares</b>		
Balance at beginning of the financial year	36,360,891	23,159,728
Issue of shares	220,626	13,677,778
Equity raising expenses	-	(476,615)
<b>Balance at end of financial year</b>	<b>36,581,517</b>	<b>36,360,891</b>
	2011 NO.	2010 NO.
<b>Reconciliation of ordinary shares</b>		
Balance at the beginning of reporting period	52,779,127	47,091,229
Shares issued during the year	150,229	5,687,898
<b>Balance at end of the report date</b>	<b>52,929,356</b>	<b>52,779,127</b>

Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the numbers of shares.

At the shareholders meeting each ordinary share is entitled to one vote when a poll is called, otherwise each shareholders has one vote on a show of hands.

**(a) Capital management**

The Group's objective is to maintain a strong capital base to ensure the Group continues as a going concern as well as to maintain optimal returns to shareholders and benefits for other stakeholders. Management also aims to maintain an optimal capital structure to reduce the cost of capital.

The Group's debt and capital includes ordinary share capital and financial liabilities, supported by financial assets. The Group is not subject to externally imposed capital requirements.

The Group effectively manages the Group's capital by monitoring its gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the balance sheet plus net debt.

The level of gearing in the Group is periodically reviewed by the Board to ensure that a responsible level of gearing is maintained. The directors consider that the Group is currently operating at a responsible gearing level. The gearing ratios at 30 June 2011 and 30 June 2010 were as follows:

	2011 \$	2010 \$
Total borrowings	29,304,226	33,240,332
Less cash and cash equivalents	(938,107)	(2,816,415)
Net debt	28,366,119	30,423,917
Total contributed equity	36,581,517	36,360,891
<b>Total capital employed</b>	<b>64,947,636</b>	<b>66,784,808</b>
Gearing ratio	43.7%	45.6%

There were no changes to the Group's approach to capital management from 2010.

## 25. Shares held by equity compensation plan

	2011 \$	2010 \$
Balance at beginning of report period	(2,894,998)	(3,004,500)
Employee share plan issue	-	(23,500)
Employee share plan payments	-	133,002
Balance at the end of the reporting period	(2,894,998)	(2,894,998)
RECONCILIATION OF SHARES HELD BY EQUITY COMPENSATION PLAN:	NO.	NO.
Opening balance	2,142,517	2,298,769
Shares issued	-	10,000
Shares forfeited	-	-
Shares sold	-	(166,252)
Closing Balance	2,142,517	2,142,517

The shares held in the 'Equity Compensation' account is used to record the balance of Probiotec Limited ordinary shares which as at the end of the financial period have not vested to Group employees, and are therefore controlled by the Group. 2,142,517 (2010: 2,142,517) shares have been issued and are held by the Probiotec Limited Employee Share Plan (ESP).

## 26. Reserves

	2011 \$	2010 \$
Asset revaluation reserve	4,523,385	4,523,385
<b>Foreign currency translation reserve</b>	<b>(681,306)</b>	<b>284,073</b>
Reconciliation of foreign currency translation reserve		
Balance at beginning of financial year	284,073	-
Translation of net investment in foreign entities	(965,379)	284,073
Revaluation of non-current assets	-	-
<b>Balance at end of financial year</b>	<b>(681,306)</b>	<b>284,073</b>

Asset revaluation reserves arise on the revaluation of non-current assets.

Where a revalued asset is sold that portion of the reserve which relates to that asset, and is effectively realised, is transferred to retained earnings.

Foreign currency translation reserves arise upon the translation of net investments in foreign entities at balance date.

## Notes to the financial statements (continued)

## 27. Commitments

	2011 \$	2010 \$
<b>Lease commitments</b>		
<b>Operating leases</b>		
Non-cancellable operating leases contracted for but not capitalised in the financial statement.		
Payable - minimum lease payments:		
Within one year	245,721	49,442
Later than one year but not later than 5 years	256,082	-
Commitments not recognised in the statement of financial position	501,803	49,442
<b>Finance leases commitments</b>		
Payable - minimum lease payments:		
Within one year	838,279	796,532
Later than one year but not later than 5 years	2,243,326	2,932,467
Minimum lease payments	3,081,606	3,728,999
Less: Future finance charges	(368,737)	(342,780)
	<b>2,712,868</b>	<b>3,386,219</b>
<b>Representing lease liabilities (Note 24):</b>		
Current	836,782	858,890
Non-current	1,876,086	2,527,329
	<b>2,712,868</b>	<b>3,386,219</b>

The weighted average interest rate implicit in the leases is 7.56%. The carrying value of assets purchased via leases is \$4,775,742 (2010: \$5,623,361)

Leases are entered into with terms between 3 to 5 years. Leased property is held at all of the group's Australian based manufacturing sites. Leases may be renewed by negotiation. No contingent rents are payable under any lease contract entered into. The group also entered into a lease for the rental of its manufacturing site in Dundalk, Ireland. This is a 20 year lease with a right for the group to terminate at any time after the expiry of the third year of the lease without penalty.

## 28. Share based payments

## (a) Incentive Option Scheme

The Group has in place an option incentive scheme to encourage employees to share in the ownership of the company in order to promote the long-term success of the company as a goal shared by the employees. This scheme is designed to attract, motivate and retain eligible employees. These options are governed by the Probiotec Limited Employee Share Plan ('the plan'). Under the plan, participants may be granted options which vest if the participant remains in the employment of the group for a period of three years from the grant date. Participation in the plan is at the Board's discretion and no individual has a contractual right to participate in the plan or to receive any guaranteed amount of options. For details of options of options issued to key management personnel refer to the remuneration report.

## CEO Employment Options for the year ended 30 June 2011

GRANT DATE	VESTING DATE	EXPIRY DATE	EXERCISE PRICE (\$)	BALANCE AT START OF YEAR NUMBER	OPTIONS GRANTED NUMBER	OPTIONS FORFEITED/ EXERCISED NUMBER	BALANCE AT END OF YEAR NUMBER	VESTED AND EXERCISABLE AT END OF YEAR
05.08.2008	30.06.2010	30.06.2013	1.50	500,000	-	-	500,000	500,000
05.08.2008	30.06.2011	30.06.2013	1.75	500,000	-	-	500,000	500,000
05.08.2008	30.06.2012	30.06.2013	2.00	500,000	-	-	500,000	-
01.07.2008	30.06.2010	30.06.2011	1.00	400,000	-	(400,000)	-	-
01.07.2009	30.06.2012	30.06.2012	1.00	300,000	-	-	300,000	-
01.07.2009	30.06.2012	30.06.2012	1.00	400,000	-	-	400,000	-
				2,600,000	-	(400,000)	2,200,000	1,000,000
Weighted average exercise price				\$1.31	\$-	\$-	\$1.51	\$1.63

The weighted average contractual life remaining on CEO options outstanding is 615 days as at balance date.

## CEO Employment Options for the year ended 30 June 2010

GRANT DATE	VESTING DATE	EXPIRY DATE	EXERCISE PRICE (\$)	BALANCE AT START OF YEAR NUMBER	OPTIONS GRANTED NUMBER	OPTIONS FORFEITED/ EXERCISED* NUMBER	BALANCE AT END OF YEAR NUMBER	VESTED AND EXERCISABLE AT END OF YEAR
01.07.2007	30.06.2010	30.06.2010	1.00	400,000	-	(400,000)	-	-
01.07.2008	30.06.2011	30.06.2011	1.00	400,000	-	-	400,000	-
05.08.2008	30.06.2010	30.06.2013	1.50	500,000	-	-	500,000	500,000
05.08.2008	30.06.2011	30.06.2013	1.75	500,000	-	-	500,000	-
05.08.2008	30.06.2012	30.06.2013	2.00	500,000	-	-	500,000	-
01.07.2009	30.06.2011	30.06.2012	1.00	-	300,000	-	300,000	-
01.07.2009	30.06.2011	30.06.2012	1.00	-	400,000	-	400,000	-
				2,300,000	700,000	(400,000)	2,600,000	500,000
Weighted average exercise price				\$1.59	\$1.00	\$1.00	\$1.31	\$1.50

\* During the year, 205,000 options were exercised and 195,000 options were forfeited. At the time of exercise the share value was \$1.31 per share.

The weighted average contractual life remaining on CEO options outstanding is 885 days as at balance date.



## Notes to the financial statements (continued)

## Employee incentive scheme options for the year ended 30 June 2011

The following incentive scheme options were issued to eligible employees:

GRANT DATE	VESTING DATE	EXPIRY DATE	EXERCISE PRICE (\$)	BALANCE AT START OF YEAR NUMBER	OPTIONS GRANTED DURING THE YEAR NUMBER	OPTIONS EXERCISED/ LAPSED DURING THE YEAR NUMBER	BALANCE AT END OF YEAR NUMBER	VESTED AND EXERCISABLE AT END OF YEAR
30.06.2006	30.06.2009	30.06.2011	0.80	927,517	-	(927,517)	-	-
01.07.2007	30.06.2010	30.06.2012	1.50	240,000	-	-	240,000	240,000
01.07.2008	30.06.2011	30.06.2013	1.50	325,000	-	(20,000)	305,000	305,000
30.06.2009	30.06.2012	30.06.2014	2.35	420,000	-	(35,000)	385,000	-
01.07.2007	30.06.2010	30.06.2012	0.80	50,000	-	-	50,000	50,000
05.08.2008	05.08.2011	05.08.2013	1.50	70,000	-	(70,000)	-	-
05.08.2008	06.05.2011	06.05.2013	1.50	100,000	-	(100,000)	-	-
01.07.2009	30.06.2012	30.06.2014	2.35	10,000	-	-	10,000	-
				2,142,517	-	(1,152,517)	990,000	595,000
Weighted average exercise price				\$1.35	\$-	\$0.96	\$1.35	\$1.16

## Employee incentive scheme options for the year ended 30 June 2010

The following incentive scheme options were issued to eligible employees:

GRANT DATE	VESTING DATE	EXPIRY DATE	EXERCISE PRICE (\$)	BALANCE AT START OF YEAR NUMBER	OPTIONS GRANTED DURING THE YEAR NUMBER	OPTIONS EXERCISED DURING THE YEAR NUMBER	BALANCE AT END OF YEAR NUMBER	VESTED AND EXERCISABLE AT END OF YEAR
30.06.2006	30.06.2009	30.06.2011	0.80	1,093,769	-	(166,252)	927,517	927,517
01.07.2007	30.06.2010	30.06.2012	1.50	240,000	-	-	240,000	240,000
01.07.2008	30.06.2011	30.06.2013	1.50	325,000	-	-	325,000	-
30.06.2009	30.06.2012	30.06.2014	2.35	420,000	-	-	420,000	-
01.07.2007	30.06.2010	30.06.2012	0.80	50,000	-	-	50,000	50,000
05.08.2008	05.08.2011	05.08.2013	1.50	70,000	-	-	70,000	-
05.08.2008	06.05.2011	06.05.2013	1.50	100,000	-	-	100,000	-
01.07.2009	30.06.2012	30.06.2014	2.35	-	10,000	-	10,000	-
				2,298,769	10,000	(166,252)	2,142,517	1,217,517
Weighted average exercise price				\$1.57	\$2.35	\$0.80	\$1.35	\$0.94

<sup>1</sup> The term Option includes unvested fully paid ordinary shares issues and the associated loans with recourse to the shares which are issued under the Probiotec Limited Employee Share Plan (ESP). These shares and loans together have substantially similar financial and economic dynamics to options. Other than the options issued to Wayne Stringer, all other 'options' referred to in this note are shares and associated loans issued under the ESP.

The weighted average contractual life remaining on employee incentive scheme options outstanding is 437 days as at balance date.

The fair value at grant date of the options issued as part of the employee incentive scheme were calculated internally using the Black Scholes pricing model that takes into account the term of the option, the underlying value of the shares, the exercise price, the expected dividend yield, the impact of dilution and the risk-free interest rate.

The inputs used in the valuation of these options were:

Exercise price:	as per table above.
Expected volatility of company shares:	42% for options granted on 30.06.2006, 38% for options granted on 01.07.2007 and 01.07.2008, 48% for options granted on 30.06.2009 and 01.07.2009.
Risk-free interest rate:	5.7% for options issued on 30.06.2006, 01.07.2007 and 01.07.2008, 5% for options issued on 30.06.2009 and 01.07.2009.
Vesting period:	3 years
Projected dividend yield:	4%
Share price:	weighted average share price for 5 trading days preceding grant date.

For options issued prior to 30 June 2008, the expected volatility during the term of the options was based around assessments of the volatility of similar-sized listed entities and entities in similar industries. For options issued after 30 June 2008, the volatility during the term of the options was calculated from the standard deviation of day to day logarithmic historical price changes. The value of the options has been expensed to remuneration on a proportionate basis over the period from the grant date to the vesting date.

#### (b) Expenses arising from share-based payments

	2011 \$	2010 \$
Options issued under incentive option scheme	38,892	93,738
Options issued to CEO	9,415	106,948
	<b>48,307</b>	<b>200,686</b>

## 29. Related party transactions and balances

Transactions between related parties are on normal commercial terms and conditions no favourable than those available to other parties unless otherwise stated. No balances have been written off and no provision for doubtful debts has been made against any balances with related parties.

	2011 \$	2010 \$
<b>Associated companies</b>		
Payments were made to Pier Capital Pty Ltd, an entity associated with Mr Richard Kuo (director). These payments were for the provision of financial modelling services performed	35,000	-
Purchases of lactoferrin by Probiotec Limited and its subsidiaries	-	123,598

#### Key Management personnel

There were no transactions between Key Management Personnel and Probiotec Limited or any of its subsidiaries during the year ended 30 June 2011 other than as disclosed in note 7.

#### Identification of Related Parties - Ultimate Parent Entity

The ultimate parent company is Probiotec Limited which is incorporated in Australia.

## Notes to the financial statements (continued)

## 30. Notes to the statement of cash flows

	2011 \$	2010 \$
<b>(a) Financing facilities with banks</b>		
Secured bank overdraft facility:		
Facility balance	500,000	500,000
Amount used	-	-
Amount unused	500,000	500,000
Secured term loan and working capital facilities with banks:		
Facility balance	33,224,040	37,413,500
Amount used	(26,591,358)	(29,854,133)
Amount unused	6,632,682	7,559,367
Lease finance facilities:		
Facility balance	12,000,000	12,000,000
Amount used	(2,712,868)	(3,386,219)
Amount unused	9,287,132	8,613,781
Bank bill acceptance facility, reviewed annually:		
Facility balance	350,000	450,000
Amount used	(350,000)	(450,000)
Amount unused	-	-
<b>(b) Reconciliation of Profit from Ordinary Activities After Related Income Tax to Net Cash Flows From Operating Activities:</b>		
Profit after related income tax	(10,337,787)	9,480,873
Depreciation and amortisation	3,890,600	3,085,655
Loss (profit) on sale of plant and equipment	3,195	18,099
Impairment costs	5,815,507	-
Non-cash other income	-	(3,972,885)
Equity translation	(965,379)	284,073
(Decrease)/increase in net deferred taxes	(1,330,386)	421,333
(Increase)/decrease in inventories	7,670,971	960,042
(Increase)/decrease in trade and other receivables	1,766,307	(1,435,433)
(Increase)/decrease in other current assets	(26,301)	204,900
Increase/(decrease) in trade and other payables	65,518	(466,865)
Increase/(decrease) in tax liabilities	(311,853)	(1,653,679)
Increase/(decrease) in provisions	78,674	(2,001,912)
Net cash from operating activities	6,319,066	4,924,201

## Non-cash financing and investing activities:

During the year the economic entity acquired plant and equipment with an aggregate value of \$277,123 (2010: \$0) by means of finance leases. These acquisitions are not reflected in the statement of cash flows.

### 31. Earnings per share

	2011 \$	2010 \$
Profit	(10,337,787)	9,480,873
Earnings used in the calculation of basic EPS	(10,337,787)	9,480,873
Earnings used in the calculation of dilutive EPS	(10,337,787)	9,480,873
Weighted average number of ordinary shares outstanding during the year used in calculation of basic EPS	52,891,490	51,304,218
Weighted average number of options outstanding	-	735,522
Weighted average number of ordinary shares outstanding during the year used in calculation of dilutive EPS	52,891,490	52,039,740
Earnings per share:		
Basic earnings per share (cents)	(19.5)	18.5
Diluted earnings per share (cents)	(19.5)	18.2

### 32. Business combinations

No acquisition of any going concern was undertaken by Probiotec Limited in the year ended 30 June 2011.

### 33. Company details

The registered office of the company is:

Probiotec Limited, 83 Cherry Lane, Laverton North VIC 3026

The principal places of businesses are:

83 Cherry Lane, Laverton VIC

36 Bolong Road, Bomaderry NSW

35 Norfolk Avenue, South Nowra NSW

47 Production Street, Bundaberg QLD

Finnabair Industrial Park, Dundalk, IRE

### 34. Financial instruments

#### Financial risk management

The Group's financial instruments consist mainly of receivables, payables, bank loans and overdrafts, finance leases, loans from related parties, cash and short-term deposits.

The Board of Directors has overall responsibility for establishment and oversight of the risk management framework. The Board has established the Audit and Risk Management Committee, which is responsible for approving and reviewing the Group's financial risk management strategy and policy. The Group manages its exposure to key financial risks in accordance with the Group's risk management policy approved by the Board of Directors to enable the risks to be balanced against appropriate rewards for the taking and managing of the risks.

Risk management policies are established to identify, assess and control the risks which affects its business and are reviewed regularly to reflect changes in market conditions and the Group's activities.

The Audit and Risk Committee oversees how management monitors compliance with the Group's risk management policies and procedures including the review of the adequacy of the risk management framework with respect to the risks faced by the Group.

## Notes to the financial statements (continued)

## Financial risks

The main risks the Group is exposed to through its financial instruments are foreign currency risk, interest rate risk, liquidity risk and credit risk.

*(a) Market risk**(i) Foreign exchange risk*

The Group is exposed to foreign exchange risk arising from various currency exposures when it undertakes sale and purchase of goods and services in currencies other than the Group's measurement currency, primarily with respect to the British Pound, US dollar and the Euro. The Group seeks to mitigate the effect of its foreign currency exposure by maintaining foreign currency bank accounts that match the cash flows generated from and used by the underlying foreign currency transactions.

There has been no change to the Group's exposure to foreign currency risk or the manner in which the Group manages and measures the risk from previous period.

The Group's exposure to foreign currency risk at the reporting date was as follows:

	CONSOLIDATED GROUP					
	GBP \$	NZD \$	USD \$	EUR \$	CNY \$	HKD \$
<b>2011</b>						
<b>Financial Assets</b>						
Trade and other receivables	754,710	65,826	174,902	166,342	80,651	181,781
<b>Financial Liabilities</b>						
Trade and other payables	362,945	9,515	53,592	150,473	131,487	90,289
Net exposure	391,765	56,311	121,310	15,869	(50,836)	91,492
<b>2010</b>						
<b>Financial Assets</b>						
Trade and other receivables	1,525,407	283,487	342,538	416,327	105,133	53,854
<b>Financial Liabilities</b>						
Trade and other payables	528,641	28,478	70,105	250,322	-	2,030
Net exposure	996,766	255,009	272,433	166,005	105,133	51,824

*Sensitivity analysis*

Based on the financial instruments held as at 30 June 2011, a 10% strengthening of Australian dollar against GBP, 15% strengthening of Australian dollar against the New Zealand dollar (NZD), 10% strengthening of Australian dollar against US dollar, 10% strengthening of Australian Dollar against EUR, 10% strengthening of Australian dollar against Hong Kong Dollar (HKD) and 10% strengthening of Australian dollar against Chinese Yuan (CNY) at 30 June would have increased/(decreased) profit or loss and equity by the amounts shown below. This analysis assumes that all other variables remain constant. The analysis is performed on the same basis for 2010.

	PROFIT \$	EQUITY \$
<b>2011</b>		
GBP	(35,615)	-
NZD	(7,345)	-
US dollars	(11,028)	-
EUR	(1,443)	-
HKD	(8,318)	-
CNY	4,621	-
<b>2010</b>		
GBP	(90,615)	-
NZD	(33,262)	-
US dollars	(24,767)	-
EUR	(15,091)	-
HKD	(4,711)	-
CNY	123,455	-

A 10% weakening of Australian dollar against GBP, 15% weakening of Australian dollar against NZD, 10% weakening of Australian dollar against US dollar, 10% weakening of Australian dollar against EUR, 10% weakening of Australian dollar against Hong Kong dollar (HKD) and 10% weakening of Australian dollar against Chinese Yuan (CNY) at 30 June would have the equal but opposite effect on GBP, US dollar and NZD to the amount shown above on the basis that other variables remain constant.

*(ii) Interest rate risk*

The Group's exposure to market interest rates relates primarily to the Group's long-term debt obligations. The level of debt is disclosed in note 20. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk.

The Group constantly analyses its interest rate exposure. The Group's current approach is to maintain approximately 10% - 50% of its borrowings at fixed rate using floating-to-fixed interest rate swaps and/or fixed rate leasing to achieve this. Generally, the Group raises long-term borrowings at floating rates and swaps them into fixed rates that are lower than those available if the Group borrowed at fixed rates directly. Under the interest rate swaps, the Group agrees with other parties to exchange, at specified intervals (mainly quarterly), the difference between fixed contract rates and floating-rate interest amounts calculated by reference to the agreed notional principal amounts. These swaps are designated to hedge the underlying debt obligations. During 2010 and 2011, the Group's borrowings at variable rates were denominated in Australian Dollars.

## Notes to the financial statements (continued)

As at the reporting date, the Group had the following financial assets and liabilities exposed to variable interest rate risk:

		FLOATING INTEREST RATE MATURING			
	WEIGHTED AVERAGE INTEREST RATE %	1 YEAR OR LESS \$	OVER 1 TO 5 YEARS \$	MORE THAN 5 YEARS \$	TOTAL \$
<b>2011</b>					
Financial assets:					
Cash	2.90	938,107	-	-	938,107
Total financial assets		938,107	-	-	938,107
Financial Liabilities:					
Loans and overdraft	6.70	26,341,358	250,000	-	26,591,358
Total financial liabilities		26,341,358	250,000	-	26,591,358
Net exposure		(25,403,251)	(250,000)	-	(25,653,251)
<b>2010</b>					
Financial assets:					
Cash	2.90	2,816,415	-	-	2,816,415
Total financial assets		2,816,415	-	-	2,816,415
Financial Liabilities:					
Loans and overdraft	5.10	12,859,691	16,994,422	-	29,854,113
Total financial liabilities		12,859,691	16,994,422	-	29,854,113
Net exposure		(10,043,276)	(16,994,422)	-	(27,037,698)

**(b) Liquidity risk**

Liquidity risk is the risk that the Group may encounter difficulties raising funds to meet commitments associated with financial instruments such as borrowing repayments.

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of available funding through an adequate amount of committed credit facilities such as bank overdrafts, bank loans and finance leases.

The Group manages liquidity risk by continuously monitoring forecast and actual cash flows and to have sufficient liquidity to meet its liabilities when due.

In addition, the Group had access to approximately \$16 million undrawn credit facilities available for immediate use at the reporting date which would further reduce the liquidity risk. For further details see note 30(a).

*Maturities of financial liabilities*

	CONSOLIDATED GROUP				
	CARRYING AMOUNT \$	TOTAL CONTRACTUAL CASH FLOWS \$	LESS THAN 6 MONTHS \$	6 - 12 MONTHS \$	1 - 5 YEARS \$
<b>2011</b>					
<b>Non-derivatives financial liabilities</b>					
Trade and other payables	11,471,790	11,471,790	11,471,790	-	-
Fixed borrowings	2,712,868	3,081,605	419,140	419,140	2,243,325
Variable borrowings	26,591,358	31,032,116	7,287,556	7,287,556	16,457,004
	40,776,016	45,585,511	19,178,486	7,706,696	18,700,329
<b>2010</b>					
<b>Non-derivatives financial liabilities</b>					
Trade and other payables	11,406,272	11,406,272	11,406,272	-	-
Fixed borrowings	3,386,219	3,728,999	398,266	398,266	2,932,467
Variable borrowings	29,854,113	34,838,305	8,176,311	8,176,311	18,485,683
	44,646,604	49,973,576	19,980,849	8,574,577	21,418,150

*(c) Credit risk*

Credit risk arises from the financial assets of the Group, which comprise cash and cash equivalents as well as credit exposures to customers, including outstanding receivables from subsidiaries and financial guarantees given to entities within the Group. The Group's exposure to credit risk arises from potential default of the counter party, with a maximum exposure equal to the carrying amount of these instruments. Exposure at reporting date is addressed in Note 12.

The Group's policy is to trade with recognised and credit-worthy third parties and as such no collateral is required. The Group manages its credit risk by assessing the credit quality and financial position of its customers including past experience and other factors. In addition, receivable balances are monitored on an ongoing basis minimising the exposure to bad debts. The Group has also taken out a credit insurance policy that applies to all approved debtors. This policy provides insurance for 90% of the invoiced value outstanding based on pre-defining maximum credit limits agreed between the group and the insurer.

*(d) Price risk*

The Group is not exposed to any commodity and equity securities price risk. Most of the raw materials are sourced through importing agents and major suppliers in the local milk powder industry and the Group does not actively trade in equity investments.

*(e) Net fair values*

The net fair values of loans and amounts due are determined by discounting the cash flows, at market interest rates of similar borrowings, to their present value. For forward exchange contracts the net fair value is the recognised unrealised gain or loss at reporting date determined from the current forward exchange rates for contracts with similar maturities.

For other assets and other liabilities the net fair value approximates their carrying value. No financial assets and financial liabilities are readily traded on organised markets in standardised form other than listed investments, forward exchange contracts and interest rates swaps. Financial assets where the carrying amount exceeds net fair values have not been written down as the economic entity intends to hold these assets to maturity.



## Notes to the financial statements (continued)

	2011		2010	
	CARRYING AMOUNT \$	NET FAIR VALUE \$	CARRYING AMOUNT \$	NET FAIR VALUE \$
<b>Financial Assets</b>				
Trade & other current receivables	10,250,305	10,250,305	9,629,597	9,629,597
Cash	938,107	938,107	2,816,415	2,816,415
	11,188,412	11,188,412	12,446,012	12,446,012
<b>Financial Liabilities</b>				
Trade & others payables	11,471,790	11,471,790	11,406,272	11,406,272
Short term borrowings	26,341,358	26,341,358	12,859,691	12,859,691
Long term borrowings	250,000	250,000	16,994,422	16,994,422
Lease liability	2,712,868	2,712,868	3,386,219	3,386,219
	40,776,016	40,776,016	44,646,604	44,646,604

Fair values are materially in line with carrying values for all financial assets and liabilities.

### 35. Parent entity information

The following details information related to the parent entity, Probiotec Limited, at 30 June 2011.

The information presented here has been prepared using consistent financial statements.

	2011 \$	2010 \$
Current assets	39,726,609	32,751,319
Non-current assets	20,292,336	47,849,273
Total Assets	60,018,945	80,600,592
Current Liabilities	26,091,111	14,880,869
Non-current liabilities	5,483,849	20,001,358
Total Liabilities	31,574,960	34,882,227
Contributed equity	36,581,517	36,360,891
Retained earnings	(9,652,138)	7,728,668
Equity Compensation Plan	(2,894,998)	(2,894,998)
Other reserve	4,409,605	4,523,804
Total equity	28,443,986	45,718,365
Profit/(loss) for the year	(16,437,907)	3,321,607
Other Comprehensive income for the year	-	-
Total comprehensive income for the year	(16,437,907)	3,321,607

The parent company has not guaranteed any loans held by its subsidiaries other than as part of the cross guarantees set out in Note 21 (d).

The parent entity is subject to contractual obligations in regards to the group's interest bearing liabilities as detailed in note 21. All finance leased held by the group (see note 27) are held by the parent entity.

## 36. Subsequent events

There has not been any matter or circumstance that has arisen since the end of the financial year that has significantly affected or may significantly affect, the consolidated entity's operations, the results of those operations, or the consolidated entity's state of affairs in financial years after the financial year.

## 37. Segment information

### (a) Description of segments

Management has determined the operating segments based on reports reviewed by the executive management committee for making strategic decision. The executive management committee comprises the chief executive officer, chief financial officer and divisional managers. The committee monitors the business based on product and geographic factors and have identified 5 reportable segments.

#### Pharmaceuticals and consumer health

The pharmaceuticals and consumer health segment involves the sale branded pharmaceutical products (both owned and licensed brands) along with the sale of a range of weight management products throughout Australia.

#### Contract manufacture

The Contract manufacturing segment involves the contract manufacturing of pharmaceutical, food and animal nutrition products on behalf on domestic and international pharmaceutical and food companies.

#### Nutritional products

The nutritional products segment is involved in the sale of human and animal nutrition products along with the sale of ingredients and additives for use in the pharmaceutical and food industries.

#### Export sales

The export sales segment is involved in the sale of products to markets outside of Australia. Product sales included in this segment are excluded from other segment figures.

#### Research and Development

The Research and Development segment is involved in the research and development of a range of innovative products and drugs for both domestic and international markets. This segment also involves the development of intellectual property to support the commercialisation of product in development by undertaking research, clinical trials, registrations and other activities.

Business Segments	Segment name
Segment 1	Pharmaceuticals and consumer health
Segment 2	Contract manufacturing
Segment 3	Nutritional products
Segment 4	Export sales
Segment 5	Research & Development

## Notes to the financial statements (continued)

	SEGMENT 1 (\$ '000)	SEGMENT 2 (\$ '000)	SEGMENT 3 (\$ '000)	SEGMENT 4 (\$ '000)	SEGMENT 5 (\$ '000)	CONSOLIDATED (\$ '000)
<b>Year ended 30 June 2011</b>						
Revenue from discontinued operations	-	-	-	1,713,753	-	1,713,753
Revenue from external customers	38,307,241	16,779,503	7,184,150	9,499,251	-	71,770,145
Total segmental revenue	38,307,241	16,779,503	7,184,150	11,213,004	-	73,483,898
Loss from discontinued operations	(250,000)	-	(3,754,667)	(5,929,867)	-	(9,934,534)
Impairment costs – continuing operations	-	-	-	(3,115,527)	-	(3,115,527)
Segmental profit from continuing operations	6,971,517	2,252,274	518,451	(536,009)	(1,560,962)	7,645,271
Total segmental profit	6,721,517	2,252,274	(3,236,216)	(9,581,403)	(1,560,962)	(5,404,790)
Interest						(2,277,535)
Unallocated other income						365,894
Unallocated corporate expenses						(4,355,128)
Total unallocated income/(expense)						(6,266,769)
Loss from continuing activities before income tax						(1,737,025)
Loss from discontinued operations before income tax						(9,934,534)
						(11,671,559)
<b>Year ended 30 June 2010</b>						
Revenue from discontinued operations	-	-	-	80,599	-	80,599
Revenue from external customers	39,346,914	17,499,717	6,398,370	11,516,541	-	74,761,542
Total segmental revenue	39,346,914	17,499,717	6,398,370	11,597,140	-	74,842,141
Loss from discontinued operations	-	-	-	(1,092,879)	-	(1,092,879)
Segmental profit from continuing operations	7,474,907	3,112,329	414,143	629,706	(1,582,029)	10,049,056
Total segmental profit	7,474,907	3,112,329	414,143	(463,173)	(1,582,029)	8,956,177
Interest						(1,492,373)
Unallocated other income						5,494,539
Unallocated corporate expenses						(2,836,727)
Total unallocated income/(expense)						1,165,439
Profit from continuing activities before income tax						11,214,495
Loss from discontinued operations before income tax						(1,092,879)
						10,121,616

**(b) Reconciliation of segmental revenue to total revenue**

	2011 \$	2010 \$
Segmental revenue	73,483,898	74,842,141
Interest received	111,716	59,929
Total revenue	73,595,614	74,902,070

**(c) Segment revenue**

Sales between segments (if they occur) are carried out at arm's length and are eliminated on consolidation. The revenue from external parties reported to the board is measured in a manner consistent with that in the statement of comprehensive income.

Revenues from external customers are derived from the sale of products on both a wholesale and business-to-business basis from each of the business segments outlined earlier in this note. A breakdown of revenue is provided in the tables above.

**(d) Segment profit**

The board assesses the performance of the operating segments based on a measure of adjusted EBIT. This measurement basis excludes the effects of non-recurring expenditure from the operating segments such as restructuring costs, legal expenses and goodwill impairments when the impairment is the result of an isolated, non-recurring event. This measurement basis also excludes the effects of any non-recurring items of revenue or income. Interest income and expenditure are not allocated to segments, as this type of activity is driven by the central treasury function, which manages the cash position of the group.

**(e) Entity wide information**

The gross revenue in each region where significant export revenue is achieved for the year was:

	AUSTRALIA \$	NEW ZEALAND \$	EUROPEAN UNION \$	UNITED STATES OF AMERICA \$	OTHER \$
Gross Revenue for year ended 30 June 2011	61,886,812	2,076,093	7,671,060	384,081	1,465,852
Gross Revenue for year ended 30 June 2010	62,389,848	1,317,204	6,563,687	1,384,719	3,186,683

Revenues of approximately \$10,611,068 and \$7,751,536 (2010: \$13,612,992 and \$8,385,223) are derived from two major external customers included in the pharmaceutical and consumer health and contract manufacturing segments respectively.

**(f) Segment assets**

No disclosure of segment assets has been made as this information is not provided to the chief decision maker on a regular basis.

## DIRECTORS' DECLARATION

### Probiotec Limited and its controlled entities

#### ACN 075 170 151

The directors of the company declare that:

1. The financial statements, comprising the statement of comprehensive income, statement of financial position, statement of cash flows, statement of changes in equity, accompanying notes, are in accordance with the Corporations Act 2001 and:
  - (a) comply with Accounting Standards and the Corporations Regulations 2001; and
  - (b) give a true and fair view of the financial position as at 30 June 2011 and of the performance for the year ended on that date of the consolidated entity.
2. The company has included in the notes to the financial statements an explicit and unreserved statement of compliance with International Financial Reporting Standards.
3. In the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.
4. The remuneration disclosures included in pages 23 to 31 of the directors' report (as part of audited Remuneration Report), for the year ended 30 June 2011, comply with section 300A of the Corporations Act 2001.
5. The directors have been given the declarations by the chief executive officer and chief financial officer required by section 295A.

This declaration is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the directors by:



Director  
Richard Kuo

Dated at Laverton this 31st day of August 2011

# INDEPENDENT AUDITOR'S REPORT

To the members of Probiotec Limited



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Melbourne VIC 3000  
GPO Box 4736 Melbourne VIC 3001  
Australia

## INDEPENDENT AUDITOR'S REPORT

To the members of Probiotec Limited

### Report on the Financial Report

We have audited the accompanying financial report of Probiotec Limited, which comprises the consolidated statement of financial position as at 30 June 2011, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

### Directors' Responsibility for the Financial Report

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

### Auditor's Responsibility

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

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

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

### Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of Probiotec Limited, would be in the same terms if given to the directors as at the time of this auditor's report.

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Independent Auditor's Report (continued)



**Opinion**

In our opinion:

- (a) the financial report of Probiotec Limited is in accordance with the *Corporations Act 2001*, including:
  - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2011 and of its performance for the year ended on that date; and
  - (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- (b) the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 1.

**Report on the Remuneration Report**

We have audited the Remuneration Report included in pages 23 to 31 of the directors' report for the year ended 30 June 2011. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

**Opinion**

In our opinion, the Remuneration Report of Probiotec Limited for the year ended 30 June 2011 complies with section 300A of the *Corporations Act 2001*.

A handwritten signature in blue ink, appearing to read 'BDO', is written above the printed name of the auditor.

BDO Audit (NSW-VIC) Pty Ltd

A handwritten signature in blue ink, appearing to read 'Nick Michael', is written above the printed name of the auditor.

Nick Michael  
Director

Melbourne, Victoria

Dated this 31<sup>st</sup> day of August 2011

## OTHER INFORMATION REQUIRED BY ASX LISTING RULES

The information in this section is current as at the 19th September 2011.

### Substantial Holders in the entity, as disclosed in substantial holding notices given to the entity

Charles Wayne Stringer	7,940,721 fully paid ordinary shares
Vintage Capital Pty Ltd (ACN 116 337 592)	2,947,481 fully paid ordinary shares

### Holders of each class of equity securities

SECURITY CLASSES	HOLDERS	TOTAL UNITS
Fully Paid Ordinary	1,678	52,929,356

### Voting rights attached to each class of equity securities

Each fully paid ordinary share is entitled to one vote when a poll is called, otherwise each member present at a meeting or by proxy has one vote on a show of hands.

### Distribution schedule of number of holders of each class of equity securities

SECURITY CLASSES	HOLDINGS RANGES	HOLDERS	TOTAL UNITS	%
Fully Paid Ordinary	1-1,000	273	154,928	0.293
	1,001-5,000	661	1,758,839	3.323
	5,001-10,000	288	2,255,775	4.262
	10,001-100,000	394	11,719,644	22.142
	100,001-99,999,999,999	62	37,040,170	69.980
	<b>Totals</b>	<b>1,678</b>	<b>52,929,356</b>	<b>100.000</b>

### Holders with less than a marketable parcel of the main class of securities

At the date of this report, a marketable parcel of fully paid ordinary shares was 1,450 or more shares.

SECURITY CLASSES	HOLDINGS RANGES	HOLDERS	TOTAL UNITS	%
Fully Paid Ordinary	1-1,450	413	323,095	0.61043
	1,450-99,999,999,999	1,265	52,606,261	99.38957
	<b>Totals</b>	<b>1,678</b>	<b>52,929,356</b>	<b>100.000</b>

### Company secretaries

The secretary of Probiotec Limited is:

Mr. Jared Stringer

Full details and qualifications for the secretary can be found in the Directors' Report.



## Other information required by ASX Listing Rules (continued)

## 20 largest holders of each class of quoted equity securities

At the date of this report, there is only one class of quoted equity securities, being fully paid ordinary shares. The 20 largest holders of this class at the date of this report were:

HOLDER NAME	HOLDING	%
INSTON PTY LTD <STRINGER FAMILY A/C>	4,866,676	9.195
VINTAGE CAPITAL PTY LTD	3,600,000	6.802
UBS NOMINEES PTY LTD	2,566,638	4.849
MR CHARLES WAYNE STRINGER	2,438,574	4.607
GANTER CORPORATION PTY LTD <GANTER FAMILY A/C>	1,993,015	3.765
NATIONAL NOMINEES LIMITED	1,560,322	2.948
VBS INVESTMENTS PTY LTD	1,204,260	2.275
TRIFERN PTY LTD <SUPER FUND ACCOUNT>	1,171,589	2.213
MR SCOTT JOHNSTON <JOHNSTON FAMILY S/F A/C>	1,018,255	1.924
INGOT CAPITAL INVESTMENTS PTY LTD	1,000,000	1.889
J P MORGAN NOMINEES AUSTRALIA LIMITED	853,754	1.613
BRAZIL FARMING PTY LTD	760,581	1.437
HOLTEX PTY LIMITED <BUCKERIDGE SUPER FUND A/C>	754,924	1.426
TRUST COMPANY SUPERANNUATION SERVICES LIMITED <SPARXX S/F A/C>	712,069	1.345
KOONTA PTY LTD <KOONTA SUPER FUND ACCOUNT>	651,224	1.230
TAYLOR CO PTY LTD <PETER TAYLOR SUPER FUND A/C>	636,883	1.203
INSTON PTY LTD <STRINGER SUPER FUND A/C>	599,711	1.133
HOLTEX PTY LTD <BUCKERIDGE S/F A/C>	593,761	1.122
MR HENRY ATHOLL CUNNINGHAM ROBERTSON	506,277	0.957
MF CUSTODIANS LIMITED	500,000	0.945
	<b>27,488,513</b>	<b>52.879</b>

## Registered Office and principal administrative office

The registered office and principal administrative office for Probiotec Limited is:

83 Cherry Lane  
Laverton North  
Victoria 3026  
Ph: (03) 9278 7555

## Register of securities, register of depositary receipts and other facilities for registration or transfer

All registers of securities, registers of depositary receipts and other facilities for registration or transfer are kept at:

Boardroom Limited  
Level 7, 207 Kent Street  
Sydney NSW 2000  
Ph: (02) 9290 9600  
Fax: (02) 9279 0664

### Other stock Exchanges on which entity's securities are quoted

Securities in Probiotec Limited are not quoted on any other stock exchange other than the Australian Stock Exchange (ASX).

### Restricted and Escrowed Securities

At the date of this report no securities were subject to escrow.

### Unquoted Equity Securities

SECURITY CLASSES	HOLDERS	TOTAL UNITS
Fully Paid Ordinary – issued under Employee incentive schemes	16	3,190,000

### On market buy-back

As at the date of this report, there is no current on market buy-back.

## Probiotec Annual Report 2011

### Head office

Probiotec Limited  
83 Cherry Lane, Laverton North,  
VIC, Australia, 3026

[www.probiotec.com.au](http://www.probiotec.com.au)

