pharmaxis

# Breathe...

2010 Statutory Annual Report

## IMPORTANT INFORMATION

This Statutory Annual Report will be lodged with the Australian Securities Exchange and the Australian Securities and Investments Commission and is available from our website www.pharmaxis.com.au

Information contained in or otherwise accessible through the websites mentioned in this Statutory Annual Report does not form part of the report unless specifically stated to incorporate the information by reference thereby forming part of the report. All other references in this report to websites are inactive textual references and the information contained therein is not incorporated by reference into this report.

In this Statutory Annual Report, the terms 'we,' 'our,' 'us,' 'Pharmaxis', 'Group' and 'Company' refer to Pharmaxis Ltd ABN 75 082 811 630 and its subsidiaries unless the context clearly means just Pharmaxis Ltd.

# ...better with Pharmaxis

### Forward Looking Statements

This Statutory Annual Report contains statements that constitute forward-looking statements. Forward-looking statements appear in a number of places in this Statutory Annual Report. In some cases, you can identify forward-looking statements by terminology such as 'may,' 'will,' 'should,' 'expects,' 'plans,' 'anticipates,' 'believes,' 'estimates,' 'predicts,' 'potential,' or 'continue,' or the negative of these terms or other comparable terminology. These statements are only current predictions and are subject to known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from those anticipated by the forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Except as required by law, we are under no duty to update or revise any of our forward-looking statements, whether as a result of new information, future events or otherwise, after the date of this Statutory Annual Report.

### Currency of Presentation

We publish our consolidated financial statements in Australian dollars. In this Statutory Annual Report, unless otherwise stated or the context otherwise requires, references to 'dollar amounts', '$', 'AUD' or 'A$' are to Australian dollars.

# Contents

# 1. Directors' Report

Your Directors present their report on the consolidated entity (referred to hereafter as the Group) consisting of Pharmaxis Ltd and the entities it controlled at the end of, or during, the year ended 30 June 2010.

## 1.1 Information on Directors

The following persons were Directors of Pharmaxis Ltd during the financial year and up to the date of this report, except for Dr Peter Farrell who retired at the 2009 annual general meeting:

*Alan D. Robertson, Ph.D. (age 54),* has been our Chief Executive Officer since December 1999 and a member of our Board of Directors since July 2000. Dr. Robertson has more than two decades of experience in drug discovery and product development with leading pharmaceutical companies, including spending 8 years with Wellcome plc in London and thereafter with two Australian companies, Faulding Ltd and Amrad Ltd. Dr. Robertson has been actively involved in the discovery, development and marketing of various compounds, including new treatments for migraine and cardiovascular disease. Dr. Robertson is a non-executive director of Patrys Ltd. Dr. Robertson is the co-inventor of 18 patents and author of more than 35 scientific papers, and was the inventor of the migraine therapeutic Zomig that is marketed worldwide by AstraZeneca. Dr. Robertson holds a B.Sc. and a Ph.D. in Synthetic Organic Chemistry from the University of Glasgow.

*Denis M. Hanley (age 63)* has been the Chairman of our Board of Directors since October 2001. From 1983 to 1997, Mr. Hanley served as Chief Executive Officer of Memtec Limited, a leader in the design and manufacture of microfiltration membrane systems. From 1971 to 1982, Mr. Hanley held various positions within Baxter Healthcare, most recently as Australian Managing Director. Mr. Hanley has served on the Australian Industry Research and Development Board and various technology councils and roundtables. Mr. Hanley serves on the board of directors of Universal Biosensors, Inc., CathRx Ltd and PFM Cornerstone Limited, and was a member of the Australian Government's Cooperative Research Centre Committee. Mr. Hanley holds an M.B.A. with high distinction from the Harvard Graduate School of Business Administration, where he was named a Baker Scholar. Mr Hanley is Chairman of the Remuneration and Nomination Committee and a member of the Audit Committee.

*Peter C. Farrell, Ph.D. (age 68),* has been a member of our Board of Directors from March 2006 until his retirement from the Board on 21 October 2009. Dr. Farrell has more than two decades of experience in developing and commercializing medical products in the U.S., Europe, Japan and Australia. Dr. Farrell began his commercial career with Baxter Healthcare, Inc. in Japan as Director and Vice President of Research and Development, then as Managing Director of the Baxter Center for Medical Research. He left Baxter in 1989 to establish ResMed, Inc., a company that develops treatments for sleep-disordered breathing and respiratory failure. Dr. Farrell is currently founding Chairman and Chief Executive Officer of ResMed Inc. and the non-executive chairman of QRxPharma Ltd. Dr. Farrell serves on the Executive Councils of Harvard Medical School and the University of California at San Diego, and is visiting Professor at the University of Sydney. Dr. Farrell has written more than 150 papers covering topics from engineering applications in medicine to focusing technology to meet business objectives. Dr. Farrell holds bachelor and masters degrees in chemical engineering from the University of Sydney and the Massachusetts Institute of Technology, a Ph.D. in bioengineering from the University of Washington, Seattle and a Doctor of Science from the University of New South Wales for research related to dialysis and renal medicine. Dr Farrell was a member of our Remuneration and Nomination Committee until 18 June 2009.

*Malcolm J. McComas (age 55)* has been a member of our Board of Directors since July 2003. Malcolm McComas is a company director and a former investment banker and commercial lawyer. Mr McComas is the principal of McComas Capital and was previously a consultant and a director of Grant Samuel, the investment banking, property services and funds management group, from 1999 to 2009. Mr McComas previously served for 10 years as Managing Director of Investment Banking at County NatWest and its successor organization Salomon Smith Barney (now Citigroup) and in various executive roles with Morgan Grenfell (now Deutsche Bank) in Melbourne, Sydney and London.

Mr McComas has worked with many high growth companies across various industry sectors and has experience in equity and debt finance, acquisitions and divestments and privatisations. Mr McComas has led more than 50 initial public offerings and significant secondary offerings for companies, institutions and governments. Between 2004 and 2008, Mr McComas wa the non-executive chairman of Sunshine Heart, Inc. Mr McComas is President of Finsia (the

Financial Services Institute of Australia) and a director of Ocean Capital Limited (the North Queensland tourism and hotels group) and ALLG (the Australian Leukaemia and Lymphoma Group). Mr McComas is chairman of our Audit Committee.

*Richard A. van den Broek (age 44),* has been a member of our Board of Directors since April 2009. Mr. van den Broek is a life science investment manager with over 18 years experience in the biotech industry. Mr van den Broek is founder and managing partner of HSMR Advisors LLC, a U.S. based fund manager with an investment emphasis on small and mid-cap biotech public companies. Prior to this Mr. van den Broek was a Partner at Cooper Hill Partners, LLC, an investment fund focused on the healthcare sector and earlier in his career worked as a biotech analyst, at Oppenheimer & Co., then Merrill Lynch, and finally at Hambrecht & Quist. Mr van den Broek is a Chartered Financial Analyst, and is a graduate of Harvard University. Mr. van den Broek is a member of our Remuneration and Nomination Committee.

*John Villiger, Ph.D. (age 56),* has been a member of our Board of Directors since November 2006. Dr. Villiger is executive chairman of Proacta Inc. Dr. Villiger co-founded The Medicines Company, a Nasdaq listed company in 1996. Dr. Villiger was Senior Vice President of Development until February 2006. The Medicines Company has a significant marketed product with two other products in late stage clinical development. From 1986 to 1996 Dr. Villiger held various positions in product development at Roche in both New Zealand and Switzerland, including International Project Director from 1991 to 1995 and Head of Global Project Management from 1995 to 1996. As Head of Global Project Management, he oversaw the development of Roche's pharmaceutical portfolio, with programs in Switzerland, the UK, U.S. and Japan. Dr. Villiger holds a Ph.D. in psychopharmacology from the University of Otago. Dr Villiger is a member of our Remuneration and Nomination Committee.

*William L. Delaat (age 59),* has been a member of our Board of Directors since June 2008. Mr Delaat has 35 years experience in the global pharmaceutical industry, most recently as the managing director of the Australian subsidiary of Merck & Co., a position he held from 1997 until his retirement in 2008. During his career Mr Delaat has held executive positions in both Europe and Australia for Merck and AstraZeneca. Mr Delaat is experienced in sales and marketing and has been responsible for international product launches and commercialisation of respiratory products. Mr Delaat is chairman of the Australian pharmaceutical industry's peak body, Medicines Australia, and is chairman of the Pharmaceuticals Industry Council. Mr Delaat holds a Bachelor of Science, Physiology & Chemistry from the University of London. Mr Delaat is a member of our Audit Committee.

There are no family relationships between any of our Senior Executive Officers or Directors.

### 1.2 Meetings of Directors

The number of meetings of the Company's Board of Directors and of each Board committee held during the year ended 30 June 2010, and the number of meetings attended by each Director was:

| | Board Meetings | | Meetings of Committees | | | |
|---|---|---|---|---|---|---|
| | | | Audit | | Remuneration & Nomination | |
| | **A** | **B** | **A** | **B** | **A** | **B** |
| DM Hanley | 9 | 9 | 4 | 4 | 2 | 2 |
| AD Robertson | 9 | 7 | | | | |
| WL Delaat | 9 | 9 | 4 | 4 | | |
| MJ McComas | 9 | 9 | 4 | 4 | | |
| PC Farrell | 3 | 1 | | | | |
| RA van den Broek | 9 | 9 | | | 2 | 2 |
| J Villiger | 9 | 9 | | | 2 | 2 |

A = Number of meetings held during the time the Director held office or was a member of the committee during the year

B = Number of meetings attended

### 1.3 Indemnification and Insurance of Directors

Our Constitution provides that, except to the extent prohibited by the *Corporations Act 2001*, each of our officers shall be indemnified out of our funds against any liability incurred by such person in his or her capacity as an officer in defending any legal proceedings, whether civil or criminal, in which judgment is given in such person's favor or where such officer is acquitted in connection with any application under the *Corporations Act 2001* and relief is granted to such officer by a court.

We have entered into Deeds of Access to Documents and Indemnity agreements to indemnify our Directors and certain of our executive officers and to provide contractual indemnification in addition to the indemnification provided for in our Constitution. We believe that these provisions and agreements are necessary to attract and retain qualified directors and executive officers.

At present, there is no pending litigation or proceeding involving any of our Directors, officers, employees or agents where indemnification by us will be required or permitted, and we are not aware of any threatened litigation or proceeding that may result in a claim for such indemnification.

We maintain directors' and officers' liability insurance providing for the indemnification of our Directors and officers against certain liabilities incurred as a director or officer, including costs and expenses associated in successfully defending legal proceedings. We intend to continue to maintain this insurance in the future. During the financial year, we paid a premium of $130,000 to insure the directors and officers of the Group for the policy year ended 25 September 2010. The liabilities insured are legal costs that may be incurred in defending civil or criminal proceedings that may be brought against the officers in their capacity as officers of the Group, and any other payments arising from liabilities incurred by the officers in connection with such proceedings. Policy exclusions include: liabilities that arise out of conduct involving a willful breach of duty by the officers or the improper use by the officers of their position or of information to gain advantage for themselves or someone else or to cause detriment to the Group; pollution that could reasonably be known to management; and, bodily injury and property damage. It is not possible to apportion the premium between amounts relating to the insurance against legal costs and those relating to other liabilities.

### 1.4 Company Secretary

The Company Secretary is *Mr. David M McGarvey, CA,* who was appointed to the position of Company Secretary in 2002. Before joining Pharmaxis Ltd he held similar positions with both listed and unlisted companies, including Memtec Limited, which was listed on the Australian Securities Exchange, NASDAQ and the New York Stock Exchange.

### 1.5 Principal Activities

During the year the principal continuing activities of the Group consisted of the research, development and commercialization of human healthcare products for the treatment and management of respiratory diseases.

### 1.6 Review and Results of Operations

A review of the operations of the Group for the financial year ended 30 June 2010 is set out in Section 5 of this Statutory Annual Report.

### 1.7 Remuneration Report, Shares Under Option and Shares Issued on the Exercise of Options

Refer to Section 2 of this Statutory Annual Report

### 1.8 Dividends

No dividends were paid during the year and the Directors have not recommended the payment of a dividend.

We have never declared or paid any cash dividends on our ordinary shares and we do not anticipate paying any cash dividends in the foreseeable future.

### 1.9 Significant Changes in the State of Affairs

Refer also to Section 5 of this Statutory Annual Report.

### 1.10 Matters Subsequent to the End of the Financial Year

No matter or circumstance has arisen since 30 June 2010 that has significantly affected, or may significantly affect:

(a) the Group's operations in future financial years, or

(b) the results of those operations in future financial years, or

(c) the Group's state of affairs in future financial years.

**1.11 Likely Developments and Expected Results of Operations**

Information on likely developments in the operations of the Group and the expected results of operations have not been included in this report because the Directors believe it would prejudice the interests of the Group.

**1.12 Environmental Regulation**

The Group is subject to environmental regulation in respect of its manufacturing activities including the Clean Air Act 1961, Clean Waters Act 1970, Pollution Control Act 1970, Noise Control Act 1975 and Waste Minimisation & Management Act 1995. The Group is currently applying for a trade waster discharge licence which will be required when its expanded manufacturing capacity commences commercial production.

**1.13 Rounding**

The Group is of a kind referred to in Class Order 98/100, issued by the Australian Securities and Investments Commission, relating to the 'rounding off' of amounts in the Directors' Report. Amounts in the Directors' Report have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, to the nearest dollar.

**1.14 Non Audit Services**

The Group may decide to employ the auditor on assignments additional to their statutory audit duties where the auditors' expertise and experience with the Group are important.

Details of the amounts paid to the auditor (PricewaterhouseCoopers) for audit and non-audit services provided during the year are set out in note 22 to the Annual Financial Report included in Section 6 of this Statutory Annual Report.

The Board of Directors has considered the position and, in accordance with the advice received from the Audit Committee, is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The Directors are satisfied that the provision of non-audit services by the auditor did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- All non-audit services have been reviewed by the Audit Committee to ensure they do not impact the integrity and objectivity of the auditor
- None of the services undermine the general principles relating to auditor independence as set out in Professional Statement APES110, including reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Group, acting as advocate for the Group or jointly sharing economic risk and rewards.

**1.15 Auditors' Independence Declaration**

A copy of the auditors' independence declaration as required under section 307C of the *Corporations Act 2001* is below.

# Auditors' Independence Declaration

As lead auditor for the audit of Pharmaxis Ltd for the year ended 30 June 2010, I declare that to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Pharmaxis Ltd and the entities it controlled during the period.

**Mark Dow**
Partner
PricewaterhouseCoopers

Sydney
12 August 2010

**1.16 Auditor**

PricewaterhouseCoopers continue in office in accordance with section 327 of the *Corporations Act 2001*.

**1.17 Resolution of the Board**

This report is made in accordance with a resolution of directors.

**Alan D Robertson**
Director

Sydney
12 August 2010

# 2 Remuneration Report

**Remuneration Report**

The remuneration report is set out under the following main headings:

2.1 Principles used to determine the nature and amount of remuneration paid to Directors and Senior Executive Officers

2.2 Details of remuneration paid to Directors and Senior Executive Officers

2.3 Service agreements with Senior Executive Officers

2.4 Share based compensation paid to Directors and Senior Executive Officers

2.5 Additional information on compensation paid to Directors and Senior Executive Officers

2.6 Equity Remuneration.

## 2.1 Principles Used to Determine the Nature and Amount of Remuneration Paid to Directors and Senior Executive Officers

***Introduction:***

As an Australian company building an international speciality pharmaceutical business, we require a board and senior management team that have both the technical capability and relevant experience to execute each aspect of the Group's business plan. The Directors therefore, focus on the appropriate amount, and structure, of remuneration packages required to attract, retain, incentivise and reward the executives and directors Pharmaxis requires in this endeavour. To assist its deliberations, the Directors make use of surveys of Australian companies in the life science area and advice of consultants who provide their analysis and understanding of the broader Australian healthcare and general listed company markets.

In reviewing comparative data concerning remuneration the Directors note that:

- While generally grouped with biotech companies, Pharmaxis seeks to build an integrated, international pharmaceutical business where the full value of our lead product portfolios is retained exclusively for the benefit of our shareholders.
- Pharmaxis is well advanced in developing its products through the clinical and regulatory and approval process. To date, Pharmaxis has completed five Phase 3 clinical trials and have further Phase 3 trials in process. We have constructed a commercial scale manufacturing facility from which we can launch these products to world markets.
- In order to obtain the experience we require, we have found it necessary to recruit both directors and management from the international marketplace. Our most recent appointments to the Board and Senior Executive management were both recruited from overseas.

Director and Senior Executive Officer remuneration includes a mix of short and long-term components. Remuneration of Executive Directors and Senior Executive Officers include a meaningful proportion that varies with individual performance. Variable cash incentives are subject to performance assessment by the Remuneration and Nomination Committee. Performance targets in the main relate to objectives and milestones assigned to individual executives from the Group's annual business plan. At this stage of the Group's development, shareholder wealth is enhanced by the achievement of milestones in the development of the Group's products, within a framework of prudent financial management. The Group's earnings have not been a component of enhancing shareholder wealth and therefore do not form a significant measure of executive performance. Individual and overall performance targets are agreed by the Remuneration and Nomination Committee and the full Board each year. Annual performance of Senior Executive Officers is reviewed by the Remuneration and Nomination Committee each year.

Non-Executive Directors do not have a variable component of their remuneration directly related to performance.

### 2.1 Principles Used to Determine the Nature and Amount of Remuneration Paid to Directors and Senior Executive Officers (continued)

***Equity Remuneration:***

Equity remuneration has been an important tool in attracting and retaining talented individuals to the Board and wider management team while staying within the fiscal constraints of a growing group. As a consequence of the Group's growth, increasing employee numbers, change in shareholder base and upcoming transformation into an operating business, the Group commenced a review of its equity-based remuneration policies in 2009. The review was completed during the current financial year after changes to the Australian taxation of equity-based remuneration were legislated and enacted.

The Directors assessed the ongoing value of equity grants in attracting Non-executive Directors and reviewed current Australian and international practices. Historically, Non-executive Directors were issued 200,000 options on becoming a Director of the Company, subject to shareholder approval, with the options vesting equally over the four years subsequent to grant.

At this stage of the Group's development the Board considers it appropriate for Non-executive Directors to be granted equity in the Group on becoming a director. However, after a review of equity remuneration the Board decided to change the type of equity granted, the quantum granted, the resale restrictions imposed and the vesting schedule. The Board adopted the policy of granting newly appointed directors 30,000 fully paid restricted shares in the Group, subject to shareholder approval in each instance. The shares are issued for nil consideration, are restricted from sale by the Director without prior Board approval, and are further restricted from sale by the Director for three years from the date of grant; except in the case of a takeover offer being made for the Group – in which case the shares are available for sale. The restricted shares are forfeited should the Non-executive Director cease to be a Director before the three year post grant period expires. The directors were pleased to note support from over 95% of shareholders voting at the 2009 annual general meeting on the grant of restricted shares to a newly appointed Non-executive Director.

Senior Executives have historically received annual grants of options under our Employee Option Plan, a plan in which all employees of the Group have participated. The options have typically vested over a four-year time frame and, for options granted after 1 January 2003 the number of an individual executive's options vesting is subject to achievement of the performance targets set and approved by the Remuneration and Nomination Committee. The Committee may approve the vesting of all, or a portion, of the relevant options.

As a result of its review of equity remuneration for all Group employees, including the Senior Executives, the Board determined to discontinue granting of options on these terms and has established two equity remuneration plans to provide for the long term reward and retention of all employees in the Pharmaxis Group:

- The Pharmaxis Performance Rights Plan enables the grant of employee options with a zero grant price and a zero exercise price, known commonly as 'Performance Rights' or 'ZEPOs' to eligible employees of the Group. Senior Executives will, together with other eligible employees be invited by the Remuneration and Nomination Committee to participate in this plan.
- The Pharmaxis Share Plan will grant up to A$1,000 of fully paid Pharmaxis ordinary shares to eligible employees of the Group. For employees outside of Australia, depending upon local laws, Pharmaxis may grant A$1,000 of performance rights in place of ordinary shares. Senior Executives will not participate in this plan.

Both performance rights plans and share plans are widely accepted in the Australian context to provide equity remuneration to management and employees of listed companies. Performance rights plans typically provide lower potential returns when compared to traditional options, but by also reducing the risk for employees they provide a stable equity remuneration instrument to reward and retain employees over the longer term.

Key features of the Pharmaxis Performance Rights Plan are as follows:

- Grant price and exercise price of zero, with a life of 10 years from grant date.
- The number of performance rights to be granted will be determined by the Board taking into account the employee's position and responsibility, the employee's performance, the employee's salary, and the Pharmaxis share price. All other factors being unchanged, the number of performance rights to be granted is approximately equivalent to 25% of the number of traditional market based exercise priced options.

- The performance rights will vest three years from the date of grant, provided the employee remains an employee of the Group. The performance rights will lapse in the event the employee ceases to be an employee before the three year vesting date. The Board has not imposed additional performance criteria at the point of vesting in recognition of the initial grant reflecting assessed performance, the restrictions on resale discussed below, and the current stage of the Group's development.
- Shares issued upon exercise of performance rights are restricted from sale by the employee for a further twelve months. Shares issued upon exercise of performance rights to Senior Executive Officers are restricted from sale by the officer as long as they are employed by the Group, without prior approval of the Board. The guidelines under which the Board will determine whether to give its approval include the progress of the Group in achieving its stated goals over the period since grant, the impact of a sale on the market in the Group's shares, the Pharmaxis share price, and whether it is an appropriate time for such a sale, amongst other criteria.

No options have yet been granted under the Pharmaxis Performance Rights Plan and no shares have yet been issued under the Pharmaxis Share Plan.

***Non-executive Directors:***

Fees and payments to Non-Executive Directors reflect the demands that are made on, and the responsibilities of, the Directors. Non-Executive Directors' fees and payments are reviewed annually by the Remuneration and Nomination Committee of the Board. Based on its current year review as discussed above, the Directors believe fees paid are close to the average of those within the Group's sector.

When fees were last adjusted in 2006, the Group engaged an external consultant to assist in the determination of independent Non-Executive Directors' fees appropriate to the Group's stage of development.

There are two components to the fees of independent Non-Executive Directors:

- a base fee, currently $110,000 for the chairman and $60,000 for other Non-Executive Directors. Non-Executive Directors are permitted to package their remuneration to include superannuation and, until 30 June 2007, options in the Group granted under our Employee Option Plan.
- a flat annual fee for Non-Executive Directors serving on committees, currently $5,000 as a committee member and $10,000 as a committee chairman;

In addition:

- the chairman is paid an office allowance of $2,400.
- Non-executive Directors are granted restricted fully paid shares in the Group on first joining the Board, as discussed above.

Non-Executive Directors' fees (including statutory superannuation) are determined within an aggregate directors' fee pool limit, which is periodically recommended for approval by shareholders. The pool currently stands at a maximum of $600,000 per annum in total.

*Retirement Allowances for Directors*
Termination payments apply only to Executive Directors, as discussed below.

***Executive Directors and Senior Executive Officers:***

There are four components to the remuneration of Executive Directors and Senior Executive Officers:

- a base salary paid in cash or packaged at the executive's discretion within Australia Fringe Benefit's Tax guidelines as a total cost package. Base salaries are reviewed by the Remuneration and Nomination Committee effective 1 January each year.
- superannuation of 9 percent of base salary;
- a variable cash incentive component payable annually dependent upon achievement of performance targets set and approved by the Remuneration and Nomination Committee. Individual and overall performance targets are set by reference to the components of the Group's annual business plan for which the individual executive is responsible. The Directors believe the Group's approach to variable cash incentive is consistent with the Group's industry sector;
- equity remuneration as discussed above.

## 2.1 Principles Used to Determine the Nature and Amount of Remuneration Paid to Directors and Senior Executive Officers (continued)

Base pay for Senior Executive Officers is reviewed annually to ensure the executive's pay is commensurate with the responsibilities and contribution of the executive. An executive's pay is also reviewed on promotion. The typical increase in base salary as 1 January 2010 was 4%, compared to nil at 1 January 2009.

In 2010 the variable incentive pay of our Senior Executives was an average of 21% of base salary. Our Senior Executives achieved 80% of their target variable cash incentive payment in 2010 compared to 80% in 2009. In assessing 2010 performance the Remuneration and Nomination Committee assessed the performance of the Senior Executive Officers in achieving the nine key milestones from the Group's 2010 business plan, approved by the Board in June 2009. These milestones related to the filing for approval for cystic fibrosis in Europe, preparation for the commercial launch of cystic fibrosis in Europe, the expansion of manufacturing capacity, the commercial launch of Aridol in the United States, and the completion of certain clinical trials. The milestones achieved by the Group are discussed in Section 5.2 of this Statutory Annual Report. The Remuneration and Nomination Committee also considered the overall progress of the Group during the year and the Group's response to opportunities and challenges not anticipated when the 2010 business plan was originally set. Given the inter-relationship of the key milestones, the Remuneration and Nomination Committee assessed the performance of the Senior Executive Officers as a team.

### Termination payments

Termination payments apply only to Executive Directors and Senior Executive Officers. The employment contracts for each of the Executive Directors and Senior Executive Officers can be terminated immediately by us for serious misconduct and with three months notice without cause. Unless otherwise required by law, no additional payments apply on termination.

### Equity Remuneration

Information on the Equity Remuneration is set out in Note 34 to the Annual Financial Report included in Section 6 of this Statutory Annual Report. The Remuneration and Nomination Committee concluded that the Group's progress in 2010 supported the Committee approving the vesting of all options due to vest at 30 June 2010.

## 2.2 Details of Remuneration Paid to Directors and Senior Executive Officers

Details of the remuneration of the Directors and the Senior Executive Officers ('key management personnel' as defined in AASB 124 *Related Party Disclosures*) of Pharmaxis Ltd and the Group are set out in the following tables.

The Senior Executive Officers and the Chief Executive Officer of the Group and the entity are:

| *Name* | *Position* | *Employer* |
|---|---|---|
| Alan Duncan Robertson | Chief Executive Officer | Pharmaxis Ltd |
| Brett Charlton | Medical Director | Pharmaxis Ltd |
| John Francis Crapper | Operations Director | Pharmaxis Ltd |
| Howard George Fox | Chief Medical Officer | Pharmaxis Ltd |
| Ian Alexander McDonald | Chief Scientific Officer | Pharmaxis Ltd |
| David Morris McGarvey | Chief Financial Officer and Company Secretary | Pharmaxis Ltd |
| Gary Jonathan Phillips | Chief Operating Officer | Pharmaxis Ltd |

Included in the above are the five highest remunerated Group and entity executives.

The payment of cash bonuses are dependent on the satisfaction of performance conditions as discussed in Section 2.1 of this Statutory Annual Report, and the options are not granted or vested unless approved by the Remuneration and Nomination Committee. All other elements of remuneration are not directly related to performance.

| 2010 | Short-term benefits | | | Post-employment benefits | Long-term benefits | Share-based payment | |
|---|---|---|---|---|---|---|---|
| Name | Cash salary or Directors' fees A$ | Cash bonus/ incentive A$ | Non-monetary benefits A$ | Super-annuation A$ | Long service leave A$ | Value[1] A$ | Total A$ |
| *Non-Executive Directors* | | | | | | | |
| DM Hanley *Chairman* | 117,079 | – | – | 10,321 | – | – | 127,400 |
| WL Delaat | 65,000 | – | – | – | – | 52,806 | 117,806 |
| MJ McComas | 70,000 | – | – | – | – | – | 70,000 |
| PC Farrell[2] | 19,441 | – | – | – | – | (51,718) | (32,277) |
| J Villiger | 65,000 | – | – | – | – | 30,386 | 95,386 |
| R van den Broek | 65,000 | – | – | – | – | 26,299 | 91,299 |
| **Sub-total Non-Executive Directors** | **401,520** | **–** | **–** | **10,321** | **–** | **57,773** | **469,614** |
| *Executive Director* | | | | | | | |
| A D Robertson | 360,981 | 88,334 | – | 32,488 | 10,186 | 250,201 | 742,190 |
| *Senior Executive Officers* | | | | | | | |
| B Charlton | 275,515 | 44,947 | – | 24,796 | 7,774 | 221,667 | 574,699 |
| JF Crapper | 258,646 | 42,195 | – | 23,278 | 7,987 | 221,239 | 553,345 |
| HG Fox | 232,875 | 38,520 | – | 20,959 | 543 | 178,805 | 471,702 |
| IA McDonald | 208,080 | 33,946 | – | 18,727 | 4,503 | 221,239 | 486,495 |
| DM McGarvey | 286,761 | 46,781 | – | 25,809 | 9,277 | 221,239 | 589,867 |
| GJ Phillips | 281,138 | 45,864 | – | 25,302 | 7,675 | 221,239 | 581,218 |
| **Totals** | **2,305,516** | **340,587** | **–** | **181,680** | **47,945** | **1,593,402** | **4,469,130** |

1 The fair value of options granted was estimated on the date of each grant using the Black-Scholes option pricing model and recognised as option expense and remuneration over the vesting period.

2 Dr Peter Farrell resigned as a Director on 21st October 2009.

### 2.2 Details of Remuneration Paid to Directors and Senior Executive Officers (continued)

| 2009 | Short-term benefits | | | Post-employment benefits | Long-term benefits | Share-based payment | |
|---|---|---|---|---|---|---|---|
| Name | Cash salary or Directors' fees A$ | Cash bonus/ incentive A$ | Non-monetary benefits A$ | Super-annuation A$ | Long service leave A$ | Value[1] A$ | Total A$ |
| *Non-Executive Directors* | | | | | | | |
| DM Hanley *Chairman* | 117,079 | – | – | 10,321 | – | 4,298 | 131,698 |
| WL Delaat | 65,000 | – | – | – | – | 78,885 | 143,885 |
| MJ McComas | 70,000 | – | – | – | – | 2,149 | 72,149 |
| PC Farrell | 65,000 | – | – | – | – | 45,807 | 110,807 |
| J Villiger | 64,996 | – | – | – | – | 79,165 | 144,161 |
| R van den Broek[2] | 14,151 | – | – | – | – | – | 14,151 |
| **Sub-total Non-Executive Directors** | **396,226** | **–** | **–** | **10,321** | **–** | **210,304** | **616,851** |
| *Executive Director* | | | | | | | |
| A D Robertson | 353,903 | 88,000 | – | 32,441 | 983 | 288,166 | 763,493 |
| *Senior Executive Officers* | | | | | | | |
| B Charlton | 270,113 | 40,000 | – | 24,310 | 751 | 228,096 | 563,270 |
| JF Crapper | 253,575 | 40,000 | – | 22,822 | 175 | 223,590 | 540,162 |
| HG Fox[3] | 102,388 | 13,500 | – | 7,595 | 190 | 30,737 | 154,410 |
| IA McDonald | 204,000 | 40,000 | – | 18,360 | 257 | 223,010 | 485,627 |
| DM McGarvey | 281,138 | 40,000 | – | 25,302 | (220) | 223,590 | 569,810 |
| GJ Phillips | 275,625 | 40,000 | – | 24,807 | (255) | 223,979 | 564,156 |
| **Totals** | **2,136,968** | **301,500** | **–** | **165,958** | **1,881** | **1,651,472** | **4,257,779** |

1 The fair value of options granted was estimated on the date of each grant using the Black-Scholes option pricing model and recognised as option expense and remuneration over the vesting period.

2 Mr van den Broek was appointed as a Director on 7th April 2009.

3 Dr Fox commenced employment on 16th February 2009.

*Remuneration subject to risk*

Of the total amount of remuneration paid to the Chief Executive Officer and other Senior Executive Officers, both the payment of the bonus and the granting and vesting of options (excluding sign on options) are subject to the individual employee performance. Section 2.5 of the Remuneration Report highlights the risk associated with the bonus this year.

## 2.3 Service Agreements with Senior Executive Officers

The following Executive Directors and Senior Executive Officers have employment agreements with us. Each of these agreements provides for the provision of performance-related cash incentives and participation, when eligible, in our employee equity remuneration plans. These agreements also contain certain confidentiality, intellectual property and non competition provisions that serve to protect our intellectual property rights and other proprietary information.

The employment agreements can only be terminated by us without notice if for serious misconduct. For any other termination without cause, we are required to provide the employee three months advance notice. During the above noted notice periods, the employee is entitled to his base salary and other benefits. Upon termination, the employee is also entitled to payment of any accrued annual leave benefits.

In addition to their respective base salaries, each of the following Senior Executive Officers may be awarded an annual performance bonus upon satisfaction of certain milestones upon the sole discretion of our Remuneration and Nomination Committee.

Other material terms of each of these agreements are identified below.

| Senior Executive Officer | Contract Expiry Date[1] | Annual Base Salary Effective 1 January 2010[2] $ | Superannuation Contributions at 9% of Base Salary[3] $ |
|---|---|---|---|
| Alan D. Robertson, Ph.D., *Chief Executive Officer and Managing Director* | 30 June 2011 | A$368,059 | A$33,125 |
| Brett Charlton, Ph.D., *Medical Director* | 30 June 2011 | A$280,918 | A$25,283 |
| John F. Crapper, *Operations Director* | 30 June 2011 | A$263,718 | A$23,735 |
| Howard G. Fox, MB, BS *Chief Medical Officer* | 30 June 2012 | A$240,750 | A$21,668 |
| Ian A. McDonald, Ph.D., *Chief Scientific Officer* | 30 June 2013 | A$212,160 | A$19,094 |
| David M. McGarvey, C.A., *Chief Financial Officer and Company Secretary* | 30 June 2011 | A$292,384 | A$26,315 |
| Gary J. Phillips, *Chief Operating Officer* | 30 June 2011 | A$286,650 | A$25,799 |

1 Subject to earlier termination by us, the terms of a Senior Executive Officer's employment will last until the date stated, unless the term of the employment agreement is either extended or the Senior Executive Officer enters into a new employment agreement with us;

2 Annual base salaries may be subject to increase upon review annually by our Remuneration and Nomination Committee; and

3 We make superannuation fund contributions equal to 9% of the annual base salary per year for the benefit of the Senior Executive Officer.

## 2.4 Share Based Compensation Paid to Directors and Senior Executive Officers

***Equity Granted to Directors and Senior Executive Officers***

Equity Remuneration is described in Note 34 to the Annual Financial Report included in Section 6 of this Statutory Annual Report.

*Grants of Equity under the Employee Option Plan*

For options granted to Senior Executive Officers and employees after 1 January 2003 the annual vesting is subject to approval by the Remuneration and Nomination Committee of the Board. The Committee gives its approval for vesting based on the achievement of individual employee's personal annual objectives.

The terms and conditions of each grant of options affecting remuneration of Directors and Senior Executive Officers in this or future reporting periods are as follows:

| Grant date | Expiry date | Exercise price | Value per option at grant date | Number of options granted | Number of option grantees | Date exercisable |
|---|---|---|---|---|---|---|
| 15 August 2006 | 14 August 2016 | $1.9170 | $1.3277 | 505,000 | 5 | 25% at each of 30 June 2007, 2008, 2009 and 2010, 255,000 of which are subject to Remuneration and Nomination Committee annual approval. |
| 26 October 2006 | 14 August 2016 | $1.9170 | $1.3167 | 278,957 | 5 | 25% at each of 30 June 2007, 2008, 2009 and 2010, 255,000 of which are subject to Remuneration and Nomination Committee annual approval. |
| 10 August 2007 | 9 August 2017 | $3.3890 | $1.6678 | 1,400,000 | 6 | 25% at each of 30 June 2008, 2009, 2010 and 2011, subject to Remuneration and Nomination Committee annual approval. |
| 5 November 2007 | 9 August 2017 | $3.3890 | $1.6932 | 150,000 | 1 | 25% at each of 30 June 2008, 2009, 2010 and 2011, subject to Remuneration and Nomination Committee annual approval. |
| 5 November 2007 | 14 November 2016 | $3.2258 | $1.6117 | 200,000 | 1 | 25% at each of 30 June 2007, 2008, 2009 and 2010. |

| Grant date | Expiry date | Exercise price | Value per option at grant date | Number of options granted | Number of option grantees | Date exercisable |
|---|---|---|---|---|---|---|
| 23 October 2008 | 22 June 2018 | $1.5990 | $0.8537 | 200,000 | 1 | 25% at each of 30 June 2009, 2010, 2011 and 2012, subject to Remuneration and Nomination Committee annual approval. |
| 12 August 2008 | 11 August 2018 | $1.8170 | $1.0064 | 750,000 | 5 | 25% at each of 30 June 2009, 2010, 2011 and 2012, subject to Remuneration and Nomination Committee annual approval. |
| 23 October 2008 | 11 August 2018 | $1.8170 | $0.9701 | 200,000 | 1 | 25% at each of 30 June 2009, 2010, 2011 and 2012, subject to Remuneration and Nomination Committee annual approval. |
| 5 February 2009 | 4 February 2019 | $1.3380 | $0.6949 | 250,000 | 1 | 25% at each of 30 June 2010, 2011, 2012 and 2013, subject to Remuneration and Nomination Committee annual approval. |
| 23 June 2009 | 22 June 2019 | $2.5498 | $1.3873 | 900,000 | 6 | 25% at each of 30 June 2010, 2011, 2012 and 2013, subject to Remuneration and Nomination Committee annual approval. |
| 21 October 2009 | 22 June 2019 | $2.5498 | $1.4660 | 200,000 | 1 | 100% at 30 June 2012, subject to Remuneration and Nomination Committee annual approval. |

*No option holder has any right under the options to participate in any other share issue of the Company or of any other entity.*

*Our Corporate Governance Framework prohibits Directors and Senior Executive Officers from trading in Pharmaxis derivatives.*

## 2.4 Share Based Compensation Paid to Directors and Senior Executive Officers (continued)

### *Grants of Restricted Shares*

The terms and conditions of each grant of restricted shares affecting remuneration of Directors and Senior Executive Officers in this or future reporting periods are as follows:

Subsequent to shareholder approval on 21 October 2009, the Group issued 30,000 restricted shares to a Non-executive Director, Mr Richard van den Broek on the following terms:

| | |
|---|---|
| Grant date | 21 October, 2009 |
| Number of restricted shares | 30,000 |
| Grant consideration | Nil |
| Value at grant date | $78,897 |
| Restrictions | • The shares are restricted from sale by the Director without prior Board approval<br>• The shares are further restricted from sale by the Director for three years from the date of grant |
| Forfeiture | The restricted shares are forfeited should the Director cease to be a Director before the three year post grant period expires |

### *Equity Grants in 2010 to Directors and Senior Executive Officers*

Details of options over our ordinary shares and restricted shares provided as remuneration to each of our Directors and each of our Senior Executive Officers are set out below. When exercisable, each option is convertible into one of our ordinary shares. Options are issued at a zero purchase price. Vesting details are set out in the subsequent table. Further information on the options is set out in this Remuneration Report and in Note 34 to the Annual Financial Report in Section 6 of this Statutory Annual Report.

Subsequent to changes in the Australian taxation of employee options effective 30 June 2009, the Group moved the timing of the 2009 annual equity grants from August to June 2009. The two equity grants to Directors requiring subsequent shareholder approval and therefore not made before 30 June 2009 are the only equity grants in the 2010 financial year. The 2009 comparatives therefore represent two years of option grants, with the exception of Dr Howard Fox who joined the Group in February 2009.

| Name | Options granted during the year | | | | Number of equity vested during the year | |
|---|---|---|---|---|---|---|
| | **2010** | | | 2009 | **2010** | 2009 |
| | Expiration Date | Exercise Price | Number | Number | | |
| ***Directors of Pharmaxis Ltd*** | | | | | | |
| DM Hanley *Chairman* | **–** | **–** | **–** | – | **–** | 10,000 |
| AD Robertson *Chief Executive Officer* | **22 June 2019** | **$2.5498** | **200,000** | 200,000 | **162,500** | 200,000 |
| MJ McComas | **–** | **–** | **–** | – | **–** | 5,000 |
| PC Farrell | **–** | **–** | **–** | – | **50,000** | 50,000 |
| J Villiger | **–** | **–** | **–** | – | **50,000** | 50,000 |
| WL Delaat | **–** | **–** | **–** | 200,000 | **50,000** | 50,000 |
| R van den Broek | **–** | **–** | **–** | – | **–** | – |
| ***Senior Executive Officers*** | | | | | | |
| B Charlton | **–** | **–** | **–** | 300,000 | **163,750** | 152,500 |
| JF Crapper | **–** | **–** | **–** | 300,000 | **162,500** | 150,000 |
| HG Fox | **–** | **–** | **–** | 400,000 | **100,000** | – |
| IA McDonald | **–** | **–** | **–** | 300,000 | **162.500** | 167,500 |
| DM McGarvey | **–** | **–** | **–** | 300,000 | **162,500** | 150,000 |
| GJ Phillips | **–** | **–** | **–** | 300,000 | **162,500** | 151,250 |

The assessed fair value at grant date of options granted to the individuals is allocated equally over the period from grant date to vesting date, and the amount is included in the remuneration tables above. Fair values at grant date are determined using a Black Scholes option pricing model that takes into account the exercise price, the term of the option, the share price at grant date and expected price volatility of the underlying share, and the risk free interest rate for the term of the option.

***Shares Provided on Exercise of Remuneration Options***

Details of ordinary shares in the Company provided as a result of the exercise of remuneration options to each Director of Pharmaxis Ltd and Senior Executive Officers of the Group are set out below. Further information on Directors' shareholdings can be found in Note 21 to the Annual Financial Report in Section 6 of this Statutory Annual Report.

### 2.4 Share Based Compensation Paid to Directors and Senior Executive Officers (continued)

| Name | Date of exercise of options | Number of ordinary shares issued on exercise of options during the year | |
|---|---|---|---|
| | | **2010** | 2009 |
| ***Directors of Pharmaxis Ltd*** | | | |
| AD Robertson | 26 November 2009 | **1,120,000** | – |
| ***Senior Executive Officers of the Group*** | | | |
| B Charlton | 23 April 2010 | **50,000** | – |
| J Crapper | 24 July 2009 | **180,000** | – |
| G Phillips | 23 March 2010 | **40,000** | – |
| G Phillips | 30 April 2010 | **20,000** | – |

The amounts paid per ordinary share by each Director and Senior Executive Officers on the exercise of options at the date of exercise were as follows:

| Exercise date | Amount paid per share |
|---|---|
| 24 July 2009 | $0.3125 |
| 26 November 2009 | $0.1250 |
| 23 March 2010 | $0.3760 |
| 23 April 2010 | $0.3125 |
| 30 April 2010 | $0.3760 |

No amounts are unpaid on any shares issued on the exercise of options.

## 2.5 Additional Information on Compensation Paid to Directors and Senior Executive Officers

*Details of Director and Senior Executive Officer Remuneration: Cash Bonuses and Options*

For each cash bonus and grant of options included in the tables above, the percentage of the available bonus or grant that was paid, or that vested, in the financial year, and the percentage that was forfeited because the person did not meet the service and performance criteria is set out below. No part of the bonuses are payable in future years. The options vest over four years, provided the vesting conditions are met. No options will vest if the conditions are not satisfied, hence the minimum value of the option yet to vest is nil. The maximum value of the options yet to vest has been determined as the portion of the grant date fair value that has not been expensed as at 30 June 2010.

| | Cash bonus | | Options | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Name** | **Paid** | **Forfeited** | **Year granted** | **Vested** | **Forfeited** | **Financial years in which options may vest** | **Minimum total value of grant yet to vest** | **Maximum total value of grant yet to vest** |
| | % | % | | % | % | | $ | $ |
| DM Hanley | – | – | – | – | – | – | – | – |
| AD Robertson | 80 | 20 | 2010 | 25 | | 2012 | – | 195,467 |
| | | | 2009 | 25 | | 2011 to 2012 | – | 44,372 |
| | | | 2008 | 25 | – | 2011 | – | 33,462 |
| MJ McComas | – | – | – | – | – | – | – | – |
| PC Farrell | – | – | – | – | – | – | – | – |
| J Villiger | – | – | – | – | – | – | – | – |
| W L Delaat | – | – | 2009 | 25 | – | 2011 to 2012 | – | 39,048 |
| B Charlton | 80 | 20 | 2009 | 25 | – | 2011 to 2013 | – | 99,001 |
| | | | 2009 | 25 | | 2011 to 2012 | – | 32,523 |
| | | | 2008 | 25 | – | 2011 | – | 26,793 |
| JF Crapper | 80 | 20 | 2009 | 25 | – | 2011 to 2013 | – | 99,001 |
| | | | 2009 | 25 | | 2011 to 2012 | – | 32,523 |
| | | | 2008 | 25 | – | 2011 | – | 26,793 |
| HG Fox | 80 | 20 | 2009 | – | – | 2011 to 2013 | – | 99,001 |
| | | | 2009 | | | 2011 to 2013 | – | 73,277 |
| IA McDonald | 80 | 20 | 2009 | 25 | – | 2011 to 2013 | – | 99,001 |
| | | | 2009 | 25 | | 2011 to 2012 | – | 32,523 |
| | | | 2008 | 25 | – | 2011 | – | 26,793 |
| DM McGarvey | 80 | 20 | 2009 | 25 | – | 2011 to 2013 | – | 99,001 |
| | | | 2009 | 25 | | 2011 to 2012 | – | 32,523 |
| | | | 2008 | 25 | – | 2011 | – | 26,793 |
| GJ Phillips | 80 | 20 | 2009 | 25 | – | 2011 to 2013 | – | 99,001 |
| | | | 2009 | 25 | | 2011 to 2012 | – | 32,523 |
| | | | 2008 | 25 | – | 2011 | – | 26,793 |

## 2.5 Additional Information on Compensation Paid to Directors and Senior Executive Officers (continued)

The Remuneration and Nomination Committee has determined that performance targets set by the Committee in relation to options vesting at 30 June 2010 have been achieved by all executives.

***Share Based Compensation Paid to Directors and Senior Executive Officers: Options***

Further details relating to options granted to Directors and Senior Executive Officers are set out below.

| Name | A<br>Remuneration consisting of options | B<br>Value at grant date<br>$ | C<br>Value at exercise date<br>$ | D<br>Value at lapse date<br>$ |
|---|---|---|---|---|
| AD Robertson | 37% | 293,200 | 2,581,600 | – |
| MJ McComas | – | – | – | – |
| PC Farrell | – | – | – | 310,414 |
| WL Delaat | – | – | – | – |
| J Villiger | – | – | – | – |
| R van den Broek | – | – | – | – |
| B Charlton | – | – | 142,875 | – |
| JF Crapper | – | – | 393,750 | – |
| HG Fox | – | – | – | – |
| IA McDonald | – | – | – | – |
| DM McGarvey | – | – | – | – |
| GJ Phillips | – | – | 144,040 | – |

A = The percentage of the value of remuneration consisting of options, based on the value at grant date set out in column B.

B = The value at grant date calculated in accordance with AASB 2 Share based Payment of options granted during the year as part of remuneration.

C = The difference between the market price of shares and the exercise price of options at exercise date that were granted as part of remuneration and were exercised during the year.

D = The value at lapse date of options that were granted as part of remuneration and that lapsed during the year because a vesting condition was not satisfied. The value is determined at the time of lapsing, but assuming the condition was satisfied.

**Loans to Directors and executives**
Nil. Not permitted under Pharmaxis Corporate Governance Framework

## 2.6 Equity Remuneration

***Shares Under Option***

Total unissued ordinary shares in us under option at the date of this report are as follows:

| Date options granted | Expiry date | Issue price of shares | Number under option |
|---|---|---|---|
| Total unissued ordinary shares under option at 30 June 2010 – refer Note 34 to the Annual Financial Report included in Section 6 of this Statutory Annual Report | | | 13,155,250 |
| Options granted during the period from 1 July 2010 to 12 August 2010: | | | Nil |
| Options exercised (shares issued) during the period from 1 July 2010 to 12 August 2010: | | | |
| 23 April 2009 | 22 April 2019 | $1.9574 | 1,250 |
| 12 August 2008 | 11 August 2018 | $1.8170 | 250 |
| 2 December 2001 | 30 November 2011 | $0.1250 | 85,000 |
| 12 May 2003 | 30 June 2012 | $0.3125 | 200,000 |
| 5 August 2005 | 4 August 2015 | $1.7900 | 25,000 |
| Options lapsed during the period from 1 July 2010 to 12 August 2010: | | | |
| 11 December 2008 | 10 December 2018 | $1.1607 | 15,000 |
| 23 June 2009 | 22 June 2019 | $2.5498 | 875 |
| 12 August 2008 | 11 August 2018 | $1.8170 | 250 |
| 10 August 2007 | 9 August 2017 | $3.3890 | 1,250 |
| | | | 12,826,375 |

No option holder has any right under the options to participate in any other share issue of the Company or any other entity.

***Shares issued on the exercise of options***

The following of our ordinary shares were issued during the year ended 30 June 2010 on the exercise of options granted under our Employee Option Plan. No amounts are unpaid on any of the shares.

| Date options granted | Issue price of shares | Number of shares issued |
|---|---|---|
| 1 December 1999 | $0.1250 | 1,120,000 |
| 2 December 2001 | $0.1250 | 15,000 |
| 12 May 2003 | $0.3125 | 50,000 |
| 12 May 2003 | $0.3125 | 16,000 |
| 1 July 2003 | $0.3125 | 180,000 |
| 9 December 2003 | $0.3760 | 60,000 |
| 2 February 2005 | $0.8340 | 10,000 |
| 5 August 2005 | $1.7900 | 7,500 |
| 13 February 2006 | $2.1940 | 25,000 |
| 15 August 2006 | $1.9170 | 1,250 |
| 20 September 2006 | $1.8918 | 1,875 |
| 23 June 2008 | $1.5990 | 625 |
| 12 August 2008 | $1.8170 | 28,875 |
| 23 October 2008 | $1.6060 | 5,000 |
| | | 1,521,125 |

# 3 Corporate Governance

## 3.1 Introduction

We have adopted a Corporate Governance Framework. In preparing the framework, we have been mindful of the revised Corporate Governance Principles and Recommendations (second edition) issued by ASX Limited's Corporate Governance Council in August 2007 ('ASX Governance Principles'). Compliance with the recommendations set out in the ASX Governance Principles are not mandatory however departures from the recommendations are required to be disclosed in our Statutory Annual Report. ASX Listing Rule 12.7 requires that we must comply with the recommendation in relation to the composition, operation and responsibility of our audit committee set out in Principle 4 of the ASX Governance Principles.

The Board reviews and updates as necessary our Corporate Governance Framework as required and at least annually.

This statement reflects our Corporate Governance Framework, policies and procedures as at 12 August 2010. The documents referred to in this section, are available in the corporate governance section of our website (unless otherwise stated) at www.pharmaxis.com.au

## 3.2 ASX Disclosures

A description of our Corporate Governance Framework and supporting policies are available on our website. The disclosures required by the ASX Governance Principles are set out below. For ease of reference, this section is structured within the context of the ASX Governance Principles.

***Principle 1: Lay Solid Foundations for Management and Oversight***

Companies should establish and disclose the respective roles and responsibilities of board and management.

*Recommendation 1.1*
Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.

This is disclosed on our website.

*Recommendation 1.2 & 1.3*
*Companies should disclose the process for evaluating the performance of senior executives and provide the information required in the guide to Principle 1.*

The performance of our Senior Executive Officers was evaluated in the current year in accordance with the process described below.

The Remuneration and Nomination Committee is specifically responsible for reviewing the ongoing performance of the Chief Executive Officer ('CEO') and ensuring there is an appropriate process to review the performance of Senior Executive Officers and for setting and approving performance objectives of Senior Executive Officers in relation to bonus payments and options. In June of each year the Remuneration and Nomination Committee:

- approves individual milestone objectives for the CEO and Senior Executive Officers for the coming financial year, the milestones being based on our business plan approved by the Board;
- evaluates the performance of the CEO compared to milestone objectives set at the beginning of the year and approves the payment of any bonus and/or the grant and vesting of any options related to the CEO's performance;
- in relation to Senior Executive Officers, reviews recommendations, considers and approves the payment of any bonus and/or the grant and vesting of any options based on performance of milestone objectives for the current financial year.

*Principle 2: Structure the Board to Add Value*

*Companies should have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties*

*Recommendation 2.1*
*A majority of the board should be independent directors.*

Our Board of Directors currently consists of six directors, including five non-executive directors, one of whom is the non-executive chairman. Details of the skills, experience and expertise of each of our directors are set out in the Section 1.1 of this Statutory Annual Report.

Under our constitution, the number of Directors will not, unless otherwise determined by an ordinary resolution of our shareholders, be less than three or more than nine. A Director need not be a shareholder of Pharmaxis Ltd. Only a person over the age of 18 may be appointed as a director.

We regard our five non-executive Directors, Messrs. Delaat, Hanley, McComas, van den Broek and Villiger as independent for the purposes of the ASX Governance Principles. The Board regularly assesses director independence having regard to the criteria outlined in the ASX Governance Principles. In relation to Directors serving on the Audit Committee, the Director and/or their associates may not receive any fees from the Company other than those related to Director or Committee fees.

We do not regard Dr. Robertson as an independent Director as he is an executive officer.

The Board has an agreed procedure for Directors and Board Committees to obtain independent professional advice at the Company's expense.

*Recommendation 2.2*
*The chair should be an independent director.*

The Chairman of our Board is an independent director. Our Corporate Governance Framework requires the Chairman to be independent.

*Recommendation 2.3*
*The roles of the chair and the chief executive officer should not be exercised by the same individual.*

The role of Chairman and Chief Executive Officer are exercised by different individuals. Our Corporate Governance Framework requires the Chairman to be a different individual to the Chief Executive Officer.

*Recommendation 2.4*
*The board should establish a nomination committee.*

We have a Remuneration and Nomination Committee. The combined role is considered appropriate for a company of our size. A copy of the Remuneration and Nomination Committee Charter is available on our website. The purpose of our Remuneration and Nomination Committee is:

- monitor the ongoing development of the Board consistent with our growth and development;
- make recommendations for the appointment and removal of Directors to the Board;
- assist the Board evaluate the performance and contribution of individual directors, the Board and Board Committees; and
- assist the Board in establishing remuneration policies and practices that enable us to attract, retain and motivate executives and Directors who will pursue our long-term growth and success.

The Remuneration and Nomination Committee consisted entirely of independent directors. The chairman of the Remuneration and Nomination Committee is an independent Director.

The names of the members of the Remuneration and Nomination Committee, the number of meetings held in the financial year ended 30 June 2010 and the number of meetings attended by each member is detailed in Section 1.2 of this Statutory Annual Report.

## 3.2 ASX Disclosures (continued)

*Recommendation 2.5*
*Companies should disclose the process for evaluating the performance of the board, its committees and individual directors*

Our Remuneration and Nomination Committee is responsible for overseeing the process for evaluating the performance of the Board, Board Committees and individual Directors. Evaluations were conducted in the current year in accordance with the process described below.

Our Remuneration and Nomination Committee conducts an annual survey of Directors.

A Board performance survey is used to:

- review our current corporate governance practices and identify any requirements that required to be changed;
- review the respective roles of the Board and management;
- review the mix of experience and skills required by the Board;
- assess the performance of the Board as a whole over the previous 12 months
- assess the effectiveness of Board processes; and
- examine ways of assisting the Board in performing its duties more effectively and efficiently.

The Board performance surveys are collated by the Company Secretary and discussed at a subsequent Board meeting where the implementation of recommendations is agreed.

Board committee performance is assessed using the Board performance survey, separately completed by committee members in relation to their respective committee. Individual committees are then asked to:

- review recommendations and comments arising from the survey and implement changes considered appropriate; and
- review their committee charter annually, and recommend changes to the Board.

Review of individual director performance is considered and assessed by the relevant Board or Committee chair.

***Principle 3: Promote Ethical and Responsible Decision-making***

*Companies should actively promote ethical and responsible decision-making*

*Recommendation 3.1*
*Companies should establish a code of conduct and disclose the code or a summary of the code as to:*

- *the practices necessary to maintain confidence in the company's integrity*
- *the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders*
- *the responsibility and accountability of individuals for reporting and investigating reporting and investigating reports of unethical practices.*

A copy of our Code of Conduct is available on our website.

*Recommendation 3.2*
*Companies should establish a policy concerning trading company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy.*

A copy of our Share Trading Policy is available on our website.

***Principle 4: Safeguard Integrity in Financial Reporting***

*Companies should have a structure to independently verify and safeguard the integrity of their financial reporting*

*Recommendation 4.1*
*The board should establish an audit committee*

We have an Audit Committee.

*Recommendation 4.2*
*The audit committee should be structured so that it:*

- *consists only of non-executive directors*
- *consists of a majority of independent directors*
- *is chaired by an independent chair, who is not chair of the board*
- *has at least three members*

The structure of our Audit Committee complies with the above recommendation. Our Audit Committee is responsible for:

- the integrity of the financial reporting process and all other financial information published by the us;
- the integrity of the our financial reporting system, including the management of risk and systems of internal control;
- our internal and external audit process, including appointing the external auditor and overseeing the independence of the external auditor; and
- our process for monitoring compliance with laws and regulations and our own Code of Conduct.

The names of the members of the Audit Committee, their qualifications, the number of meetings held in the financial year ended 30 June 2010 and the number of meetings attended by each member is detailed in Section 1.2 of this Statutory Annual Report.

*Recommendation 4.3*
*The audit committee should have a formal charter*

Our Audit Committee Charter is available on our website. The Audit Committee Charter provides information on procedures for the selection and appointment of our external auditor.

***Principle 5: Make Timely and Balanced Disclosure***

*Companies should promote timely and balanced disclosure of all material matters concerning the company*

*Recommendation 5.1*
*Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies*

We have a Continuous Disclosure and Shareholder Communications Policy, which is available on our website.

We have a Disclosure Committee to oversee the implementation of the policies and procedures in relation to communications with the market.

The Disclosure Committee consists of the:

- Chief Executive Officer;
- Chief Financial Officer/Company Secretary;
- Chairman of the Board;
- Medical Director;
- Chief Medical Officer; and
- Chief Operating Officer.

***Principle 6: Respect the Rights of Shareholders***

*Companies should respect the rights of shareholders and facilitate the effective exercise of those rights*

*Recommendation 6.1*
*Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy*

Our Continuous Disclosure and Shareholder Communication Policy is available on our website. In addition to our continuous disclosure and statutory reporting requirements, we provide shareholders with quarterly updates of our progress across all areas of the business and utilize our website to disclose useful and relevant information about us.

## 3.2 ASX Disclosures (continued)

***Principle 7: Recognise and Manage Risk***

*Companies should establish a sound system of risk oversight and management and internal control*

*Recommendation 7.1*
*Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies*

The Audit Committee is responsible to the Board for oversight of material business risks and internal controls. Our Risk Management Statement is available on our website and provides an overview of our risk profile, management strategies and internal controls.

*Recommendation 7.2*
*The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks*

The Audit Committee, as part of its oversight in this area, requires management to establish appropriate systems and procedures to manage our material business risks and to report on the effective management of those risks. Management has provided the Board in the current year with a report that attested to the effective management of our material business risks.

*Recommendation 7.3*
*The board should disclose whether it has received assurance from the chief executive officer and the chief financial officer that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks*

This recommendation is a requirement of our Corporate Governance Framework. The Board has received such assurances in writing from the chief executive officer and chief financial officer.

***Principle 8: Remunerate Fairly and Responsibly***

*Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear*

*Recommendation 8.1*
*The board should establish a remuneration committee*

We have a Remuneration and Nomination Committee. A copy of our Remuneration and Nomination Committee Charter is available on our website.

Our Remuneration and Nomination Committee consists exclusively of independent directors. None of our executive officers serve as a member of the board of directors or compensation committee of any entity that has one or more executive officers who serve on our Board of Directors or Remuneration and Nomination Committee.

*Recommendation 8.2*
*Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives*

As non-executive Directors assess individual and Company performance, their remuneration does not have any variable incentive component. Only the Executive Director and Senior Executive Officer remuneration includes a variable component linked to the achievement of performance targets.

Note that Directors, Senior Executive Officers and other persons designated by the Board are not permitted to trade in derivatives of our securities or enter into transactions which operate to limit the economic risk of holding unvested securities in Pharmaxis. For further details in relation to our remuneration framework, refer to the Remuneration Report set out in Section 2 of this Statutory Annual Report.

# 4 Senior Management

**Executive Director and Senior Executive Officers**

The following table presents information about our Executive Director and Senior Executive Officers as of 12 August 2010.

| Name | Age | Position |
|---|---|---|
| Alan D. Robertson, Ph.D. | 54 | Chief Executive Officer and Managing Director |
| Brett Charlton, Ph.D. | 54 | Medical Director |
| John F. Crapper | 58 | Operations Director |
| Howard G. Fox | 47 | Chief Medical Officer |
| Ian A. McDonald, Ph.D. | 63 | Chief Scientific Officer |
| David M. McGarvey | 54 | Chief Financial Officer and Company Secretary |
| Gary J. Phillips | 49 | Chief Operating Officer |

***Executive Director and Senior Executive Officers***

*Alan D. Robertson, Ph.D.,* Refer to Directors' Report.

*Brett Charlton, Ph.D.,* is a co-founder of Pharmaxis and has been our Medical Director and was a member of our Board of Directors from June 1998 to March 2006. Dr. Charlton is the author of more than 60 scientific papers and has over 15 years of experience in clinical trial design and management. Dr. Charlton was founding Medical Director of the National Health Sciences Centre and established its Clinical Trials Unit. Prior to joining us, Dr. Charlton held various positions with the Australian National University, Stanford University, the Baxter Centre for Medical Research, Royal Melbourne Hospital, and the Walter and Eliza Hall Institute. Dr. Charlton holds a M.B.B.S. with honors from the University of New South Wales and a Ph.D. from the University of New South Wales.

*John F. Crapper* has been our Operations Director since July 2003. Mr. Crapper has over three decades of experience in manufacturing and operations. From 1987 to 2003, Mr. Crapper held various positions within the Memtec Limited/Memcor organization most recently as Senior Vice-President and General Manager of Memcor International, and Managing Director of Memcor Australia Pty Ltd, a leader in the design and manufacture of microfiltration membranes and systems. During his 15 years at Memcor, Mr. Crapper managed the scale-up of manufacturing equipment and processes from the Company's research and development group, created full-scale production operations, and managed the establishment of Quality Assurance and Enterprise Resource Planning systems. From 1980 to 1987, Mr. Crapper served as Operations Director of the Animal Health Division at Syntex Pharmaceutical. From 1971 to 1980, Mr. Crapper served as Production Manager at VR Laboratories, a private veterinary pharmaceutical company. Mr. Crapper holds a B.S. in Applied Chemistry from the University of Technology, Sydney and an M.B.A from Macquarie University.

*Howard G. Fox* joined Pharmaxis as Chief Medical Officer on 16th February 2009. Dr Fox assumed responsibility for regulatory affairs, pharmacovigilance and medical affairs. Dr Fox has more than 15 years experience in the international pharmaceutical industry, the last ten of which have been in respiratory product development. He was most recently with Novartis as a Global Brand Medical Director and previously held the positions of Senior Clinical Research Physician and Principle Medical Expert for Novartis.

## 4 Senior Management (continued)

*Ian A. McDonald, Ph.D.,* has been our Chief Scientific Officer since September 2006, having previously served as Chief Technical Officer from his joining us in April 2005. Dr. McDonald has over 25 years of experience in managing drug discovery and design teams in Europe and the U.S. From 2002 to 2004, Dr. McDonald served as Vice President of Drug Discovery at Structural GenomiX, Inc. (now SGX Pharmaceuticals Inc.). From 2001 to 2002, Dr. McDonald served as Vice President of Drug Discovery at Structural Bioinformatics Inc. (now Cengent Therapeutics). From 1993 to 2000, Dr. McDonald served as Director, then Vice President of Chemistry at SIBIA Neuroscience (now part of Merck Research Laboratories) and was responsible for medicinal and bio-chemistry research. From 1978 to 1993, Dr. McDonald served in various capacities as a research chemist at Merrell Dow (now part of Sanofi-Aventis). Dr. McDonald is the co-inventor of 39 U.S. patents and co-author of 77 peer-reviewed manuscripts and book chapters. Dr. McDonald holds B.S. and Ph.D. degrees in Organic Chemistry from the University of Western Australia.

*David M. McGarvey, C.A., C.P.A.,* has been our Chief Financial Officer and Company Secretary since December 2002. Mr. McGarvey has two decades of experience in overseeing the financial affairs of different Australian companies. From 1998 to 2002, Mr. McGarvey served as Chief Financial Officer of the Filtration and Separations Group of U.S. Filter. From 1985 to 1997, Mr. McGarvey served as Chief Financial Officer of Memtec Limited. While at Memtec, Mr. McGarvey oversaw the U.S. listing of Memtec on the Nasdaq Global Market and the New York Stock Exchange and managed numerous international merger and acquisition transactions, including the acquisition of Memtec by U.S. Filter. From 1975 to 1985, Mr. McGarvey held various positions at PricewaterhouseCoopers. Mr. McGarvey holds a B.A. in Accounting from Macquarie University and was admitted to the Institute of Chartered Accountants in Australia in 1981, and to the membership of CPA Australia in 1993.

*Gary J. Phillips* has been our Chief Operating Officer since June 2008, having previously served as Commercial Director from his joining us in December 2003. Mr. Phillips has over two decades of operational management experience in the pharmaceutical and healthcare industry in Europe, Asia and Australia. From 1998 to 2003, Mr. Phillips held various positions within Novartis Asia, most recently as Chief Executive Officer of Novartis Pharmaceuticals Australia Pty Ltd, where he successfully launched leading oncology and ophthalmology products and relaunched newly acquired primary care products. From 1992 to 1998, Mr. Phillips served as Chief Executive Officer at Ciba Geigy in Hungary. Mr. Phillips holds a B. Pharm. in Pharmacy with honors from Nottingham University in the U.K. and an M.B.A. from Henly Management College.

# 5 Operating and Financial Review And Prospects

The following discussion and analysis should be read in conjunction with our financial statements and related notes included elsewhere in this report. This discussion and analysis contains forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results and the timing of events could differ materially from those anticipated in these forward-looking. Our financial year ends on 30 June. We designate our financial year by the year in which that financial year ends; e.g., in this section '2010' refers to our financial year ended 30 June 2010, unless noted otherwise.

## 5.1 Operating Results

***Overview***

We are a specialty pharmaceutical company focused on the development of new products for the diagnosis and treatment of chronic respiratory and immune disorders. We are most advanced in the development of products for asthma, cystic fibrosis and chronic obstructive pulmonary disease, or COPD, including bronchiectasis and chronic bronchitis.

We were incorporated in May 1998 and in October 1999 obtained a license to a series of patents in the autoimmune area owned by the Australian National University, or ANU. We issued 11.2 million ordinary shares valued at A$1.4 million to acquire the license. Our area of focus remained the autoimmune diseases area until October 2001 when we licensed a series of patents from the Sydney South West Area Health Service, or SSWAHS, covering new treatments for chronic lung diseases and for the measurement of lung function. Our license with the ANU requires us to pay royalties based on sales revenue for products incorporating the licensed technology. Our current lead projects in the immune area do not fall within the scope of the license with ANU. Our license agreement with the SSWAHS requires us to pay royalties based on gross profit on product sales for products incorporating the licensed technology. Our products Aridol and Bronchitol fall within the scope of the SSWAHS license.

On 9 February 2010 we acquired the Canadian based private biopharmaceutical company Topigen Pharmaceuticals Inc. to enhance our respiratory drug development portfolio. We issued 3.2 million ordinary shares on completion of the transaction and 3.0 million upon the successful completion of a clinical trial in March 2010. An additional 2.0 million shares may be issued upon the successful completion of a remaining development milestone. Topigen has developed a number of innovative therapeutic candidates for respiratory disorders based on its multi-targeted oligonucleotide technology. The lead drug candidate, ASM8, is in Phase II clinical development for the management of moderate to severe asthma. A second drug candidate, TPI 1100, is in preclinical development for Chronic Obstructive Pulmonary Disease. In March 2010 we reported successful results from a Phase IIa trial in ASM8 and plan to commence an additional Phase II study in ASM8 later this year.

We reported positive results from our first Phase III clinical trial of Bronchitol in cystic fibrosis in May 2009 and filed a marketing application in Europe in October 2009. We have established a sales and marketing infrastructure in Europe and upon receipt of marketing approval intend to commence the sale of Bronchitol for cystic fibrosis in Europe. We reported results from our second Phase III clinical trial of Bronchitol in cystic fibrosis in June 2010 and plan to meet with the US Food and Drug Administration within the next six months to discuss the filing a new drug application.

We are actively recruiting a Phase III trial with Bronchitol in bronchiectasis the clinical trial protocol design for which has been agreed with both the U.S. FDA and the European Medicines Agency.

We have received marketing approval of Aridol in Australia, South Korea, Switzerland, Germany, France, the United Kingdom, Italy, the Netherlands, Belgium, Denmark, Greece, Spain, Finland, Ireland, Norway, Sweden and Portugal. We submitted a marketing application for Aridol in the U.S. in March 2009. The U.S. FDA advised us they will provide a complete response in October 2010. We have commenced sales in the large market of South Korea and expect to commence sales in the other large markets of Germany, and the U.S. during the 2011 financial year.

We have one early stage research project (PXS25) which has commenced clinical evaluation, targeting pulmonary fibrosis. We have one project undergoing pre-clinical evaluation (prior to being administered to volunteers or patients). Our development program has been designed to produce a series of products for world markets over the coming years.

## 5.1 Operating Results (continued)

***Research and Development***

Our research and development expenses consist primarily of salaries and related employee benefits, costs associated with our clinical trials, non-clinical activities such as toxicology testing and scale-up synthesis, regulatory activities, the manufacture of material for clinical trials, development of manufacturing processes and research-related overhead expenses. Our most significant costs are for clinical trials, preclinical development and regulatory filings. These expenses include regulatory consultants, clinical supplies and payments to external vendors such as hospitals and investigators. We expense all research and development costs as they are incurred.

We classify our research and development expenses into four components:

1. Our drug discovery units based in Sydney and Montreal. These units are focused on respiratory drug discovery.
2. Our preclinical development group which is managing the outsourced safety/toxicology studies of lead compounds.
3. Our clinical trials group, which designs and monitors our clinical trials.
4. Our Australian Therapeutic Goods Administration, or TGA, registered manufacturing facility is primarily focused on producing material for clinical trials, producing and analyzing material in support of regulatory filings and developing enhanced manufacturing processes. It is therefore classified as research and development expenditure.

We make determinations as to which research and development projects to pursue and how much funding to direct to each project on an on-going basis in response to the scientific and clinical success of each product candidate and available funds.

***Administration***

Administration expenses consist primarily of salaries and related expenses and professional services fees and includes accounting, administration, office and public company costs. We anticipate that administration expenses will increase as a result of the expected expansion of our operations, facilities and other activities associated with the planned expansion of our business.

***Commercial***

Our commercial expenses consist of salaries and professional fees related to developing and delivering the commercial strategy and capability to sell Aridol and Bronchitol. We anticipate that commercial expenses will increase as we prepare to launch Bronchitol, as we launch Aridol in additional jurisdictions, and as we incur other selling and marketing costs.

***Finance Costs***

Finance costs represent the ongoing finance charge associated with the capitalised finance lease of our new facility at Frenchs Forest.

## 5.2 Review of 2010 Operations

***Bronchitol***

We are developing Bronchitol for the management of chronic obstructive lung diseases including cystic fibrosis, bronchiectasis and other acute and chronic pulmonary conditions. Bronchitol is a proprietary formulation of mannitol administered as a dry powder in a hand-held inhaler. It is designed to hydrate the lungs, restore normal lung clearance mechanisms, and help patients clear mucus more effectively.

Major milestones achieved during the year include:

- We closed and reported top line results of our second Phase III clinical trial of Bronchitol in CF. The trial involved 300 patients with CF and was conducted across 53 sites in seven countries from North America, South America and Europe. Based on this trial we plan to meet with the US Food and Drug Administration within the next six months to discuss the filing a new drug application.

- We filed a submission to market Bronchitol for the treatment of cystic fibrosis with the European Medicines Agency and the Australian Therapeutics Goods Administration. Responses are expected in the second half of 2010.
- We reported both 12 and 18 month data from our first Phase III clinical trial of Bronchitol in people living with cystic fibrosis. Bronchitol was found to have a sustained benefit over time.
- We commenced dosing of our pivotal international Phase III clinical trial in patients with bronchiectasis. The clinical trial is being conducted in 9 countries including Australia, the United Kingdom and the United States.

***Aridol***

Aridol is our first product. It is a simple-to-use airways inflammation test administered as a dry powder in a hand-held inhaler. Doctors can use the results of this test to identify airway hyper-responsiveness – a hallmark of asthma.

Major milestones achieved during the year include:

- Aridol was granted reimbursement approval in South Korea at a premium price to other tests in the market, and was commercially launched there in October.
- In November, Aridol received a positive recommendation from the Pulmonary and Allergy Advisory Committee of the US FDA. Following the receipt of an action letter from the FDA in December 2009 we resubmitted our new drug application in February 2010 and believe we have fully addressed items listed in the FDA action letter. The matter is scheduled to conclude in the second half of 2010.
- We received growing repeat orders from our European distributors and UK sales team, with pricing approval also granted in Italy and Spain during the year.

***Other milestones***

- We completed installation and commissioning of our new manufacturing equipment including the spray drier, water plant, powder blender, automatic capsule filler and blister packager. Validation of our expanded manufacturing capacity commenced during the year and is scheduled to be complete in the second half of 2010.
- We successfully completed a Phase IIa dose profiling study with our new anti-inflammatory agent ASM8 in patients with allergic asthma.
- We completed the first Phase I clinical trial in healthy volunteers with our new drug candidate, PXS25. The trial was designed to determine the tolerance and pharmacokinetic profile of PXS25 following intravenous administration. PXS25 was found to be safe and well tolerated with a pharmacokinetic profile consistent with a drug that could be delivered once per day.
- We voluntarily de-listed from the Nasdaq Global Market following a review of the demand from existing and potential international investors for the secondary listing, the volume of our trading on the secondary Nasdaq market, and the costs of retaining the listing.
- In February 2010 we enhanced our respiratory drug development portfolio with the acquisition of Topigen Pharmaceuticals Inc. In March 2010 we announced successful results from a Phase II clinical trial of ASM8 – the lead product in Topigen's multi-targeted oligonucleotide technology, under development for the management of moderate to severe asthma.

## 5.3 Results of Operations

***Comparison of financial years ended 30 June 2010 and 30 June 2009***

Sales and Gross Profit. Sales were A$0.8 million in 2010 compared to A$0.6 million in 2009 and relate to sales of our first product, Aridol. Aridol has been approved and launched in Australia, various European countries and South Korea. In addition we sell Aridol to pharmaceutical companies for use in clinical trials. Sales by region are made up as follows:

| Year ended 30 June | 2010 A$ | 2009 A$ |
|---|---|---|
| *In thousands* | | |
| Australia | **268** | 232 |
| Europe | **398** | 267 |
| Korea | **162** | 32 |
| Clinical trials | **–** | 64 |
| | **828** | 595 |

Gross profit was approximately 63 percent and 74 percent of sales in 2010 and 2009 respectively, the decrease in 2010 reflecting the change in mix of Aridol sold through distributors and lower prices in Korea.

*Other revenue – interest*. Interest income decreased from A$5.3 million in 2009 to A$3.9 million in 2010. The decrease in interest income is attributable to both the lower level of funds invested during 2010 and lower prevailing interest rates. We started 2010 with cash and bank accepted commercial bills of $125 million to which was added approximately $0.4 million from exercise of employee share options. By contrast we started 2009 with $111.8 million of cash and bank accepted commercial bills to which was added approximately $51.2 million in June 2009. Average interest rates on bank accepted commercial bills during 2010 were significantly less than during 2009.

*Other income.* The main component of other income in 2010 related to amounts paid to us under a contract with pharmaceutical companies for services performed by our sales representatives promoting products of the pharmaceutical companies to respiratory specialists. This amounted to $0.28 million (2009: $0.39 million). In 2010 we also received an Export Market Development Grant from the Australian government of A$0.14 million (2009: $0.15 million) and our Canadian subsidiary accrued R&D tax credits of $0.13 million (2009: $Nil).

*Research and Development Expenses.* Research and development expenses were $35.1 million in 2010 compared to $29.3 million in 2009.

1. Our drug discovery group accounted for approximately 9 percent of our total research and development expenditure in the current year and increased by approximately 65 percent or A$1.3 million compared to 2009. This group is focused on respiratory and inflamatory disorders drug discovery. The higher level of expenditure is primarily related to the additional costs from our research facility in Canada which was acquired as part of the Topigen acquisition.
2. Our preclinical development group accounted for approximately 3 percent of our total research and development expenditure in the current year and decreased by approximately 47 percent or A$0.8 million compared to 2009. In the prior year there was a large expenditure on toxicology studies in PXS4159 and PXS25.
3. Our clinical group accounted for approximately 62 percent of our total research and development expenditure in 2010 and increased by approximately 16 percent or A$2.9 million compared to 2009. The clinical group designs and monitors the clinical trials run by us. The majority of the expenditures of this group are directed at hospitals and other services related to the conduct and analysis of clinical trials. This increase in expenditure reflects the number and size of clinical trials in the active dosing stage during 2010, including two Phase III clinical trials in CF and a Phase III clinical trial in bronchiectasis.
4. Our manufacturing facility at Frenchs Forest is predominantly focused on producing material for clinical trials, producing and analyzing material in support of regulatory filings and developing enhanced manufacturing products and processes. Manufacturing expenses for the current year have therefore mainly been classified as research and

development expenditure. Costs associated with the Aridol product sold are classified as cost of sales. Manufacturing accounted for approximately 26 percent of our total research and development expenditure in 2010 and increased by approximately 36 percent or A$2.4 million compared to 2009. The drivers for this increase related to increased employee costs associated with operating two facilities and a higher level of occupancy costs related to the new manufacturing facility which opened in May 2009, and early development work on new inhalation devices.

*Commercial expenses.* Commercial expenses were A$5.7 million in 2010 compared to A$6.2 in 2009. During 2010 and 2009 we incurred expenditure in preparation for the commercial launch of Bronchitol for CF in Europe and the U.S. and in preparation for the commercial launch of Aridol in the U.S. The level of commercial expenditure was comparable with 2009 with FX rates contributing to a lower AUD cost.

*Administration Expenses.* Administration expenses were A$9.7 million in 2010 and A$5.8 million in 2009. The increase of $3.9 million relates to restructuring costs associated with the Topigen acquisition.

*Finance Costs.* Finance costs represent the finance charge associated with the capitalised finance lease of our facility at Frenchs Forest. These costs commenced in May 2009 and the increase in 2010 reflects a full years charge.

*Income Tax Expense.* Income tax expense was A$0.05 million in 2010 and A$0.05 million in 2009. The expense relates to income generated by our UK and US subsidiaries which are currently reimbursed for their expenditures on a cost plus basis upon which tax is payable.

*Loss.* Our loss increased from A$35.2 million in 2009 to A$46.3 million in 2010 due to the significant increase in operating expenses discussed above.

*Basic and diluted net loss per share.* Basic and diluted net loss per share increased from A$0.180 in 2009 to A$0.210 in 2010 predominantly because of the increase in research and development expenses in 2010 and the restructuring costs incurred as part of the Topigen acquisition.

### 5.4 Liquidity and Capital Resources

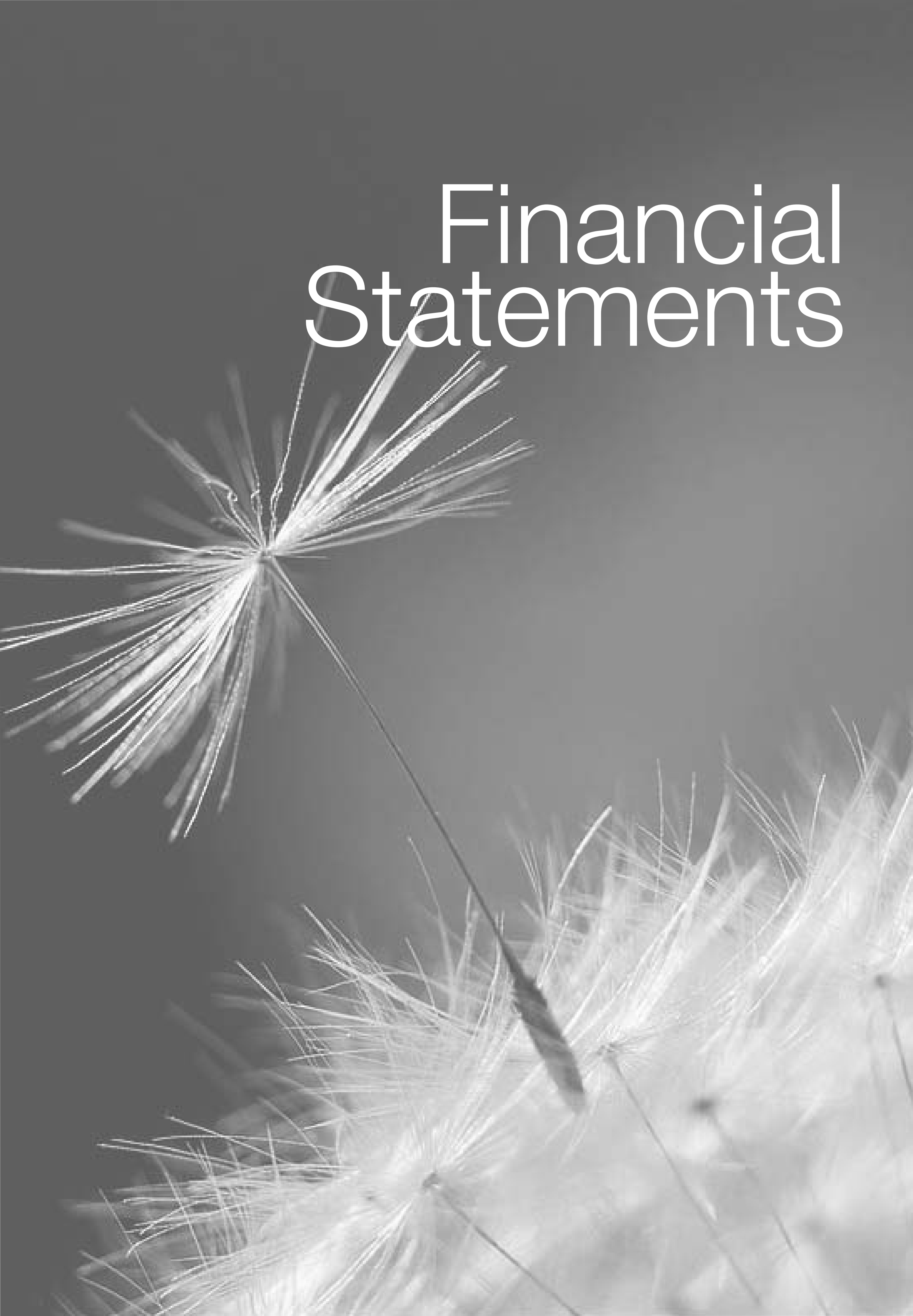
Since our inception, our operations have mainly been financed through the issuance of equity securities and convertible redeemable preference shares. Additional funding has come through research grants, interest on investments and the exercise of options. With the commercial launch of our first product Aridol in Australia in June 2006 our operations also generated sales revenue. Through 30 June 2010, we had received net cash proceeds from the issue of ordinary and convertible redeemable preference shares of A$249.4 million and approximately A$10.6 million in research grants. We have incurred significant losses since our inception. We incurred losses of A$20.4 million, A$35.2 million and A$46.3 million in the financial years ended 30 June 2008, 2009 and 2010 respectively. As of 30 June 2010 we had cash and cash equivalents of A$85.8 million.

In 2010, we used net cash of A$39.7 million for operating activities. This consisted of a net loss for the period of A$46.3 million, which included A$3.0 million of non-cash depreciation and amortization, and non-cash stock option expense of A$2.5 million, and positive other working capital movements of A$0.2 million. Net cash inflow for investing activities during 2010 was A$1.1 million, which related to net cash acquired on the acquisition of Topigen offset by payments for plant and equipment of $2.9 million related to ongoing fit out of the facility constructed for us and new manufacturing equipment being installed in the facility. Net cash used by financing activities during 2010 was A$0.8 related to cash outflows on the facility finance lease payments offset by cash inflows from exercise of employee options.

In 2009, we used net cash of A$26.5 million for operating activities. This consisted of a net loss for the period of A$35.2 million, which included A$1.3 million of non-cash depreciation and amortization, and non-cash stock option expense of A$2.4 million, and positive other working capital movements of A$4.7 million. Net cash used in investing activities during 2009 was A$11.5 million, which predominantly related to the fit out of the facility constructed for us and new manufacturing equipment being installed in the facility. Net cash provided by financing activities during 2009 was A$51.1 million primarily resulting from the issue and sale of our ordinary shares in a share placement and share purchase plan.

At 30 June 2010, we had cash and cash equivalents of A$85.8 million as compared to A$125.0 million as of 30 June 2009.

# Financial Statements



# 6 Financial Statements

This financial report covers Pharmaxis Ltd as the consolidated entity consisting of Pharmaxis Ltd and its subsidiaries. The financial report is presented in the Australian currency.

Pharmaxis Ltd is a company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

Pharmaxis Ltd
20 Rodborough Road
Frenchs Forest, NSW Australia 2086.

A description of the nature of the consolidated entity's operations and its principal activities is included in the review of operations and activities in the directors' report which is not part of this financial report.

The financial report was authorised for issue by the directors on 12th August 2010. The company has the power to amend and reissue the financial report.

Through the use of the internet, we have ensured that our corporate reporting is timely, complete, and available globally at minimum cost to the company. Press releases, financial reports and other information are available at our website: www.pharmaxis.com.au.

# Income Statement For the year ended 30 June 2010

| | Notes | 2010 $'000 | 2009 $'000 |
|---|---|---|---|
| **Revenue from continuing operations** | | | |
| Revenue from sale of goods | 2 | **828** | 595 |
| Cost of sales | | **(307)** | (153) |
| **Gross profit** | | **521** | 442 |
| Other revenue | 2 | **3,935** | 5,347 |
| Other income | 3 | **616** | 523 |
| Other expenses from ordinary activities | 4 | | |
| Research & development expenses | | **(35,140)** | (29,308) |
| Commercial expenses | | **(5,657)** | (6,202) |
| Administration expenses | | **(9,715)** | (5,800) |
| Finance expenses | | **(854)** | (122) |
| **Loss before income tax** | | **(46,294)** | (35,120) |
| Income tax expense | 5 | **(51)** | (51) |
| **Loss for the year** | | **(46,345)** | (35,171) |
| **Earnings per share:** | | **Cents** | Cents |
| Basic earnings / (loss) per share | 32 | **(21.0)** | (18.0) |
| Diluted earnings / (loss) per share | 32 | **(21.0)** | (18.0) |

*The above income statement should be read in conjunction with the accompanying notes.*

## Statement of Comprehensive Income For the year ended 30 June 2010

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| **Loss for the financial year** | **(46,345)** | (35,171) |
| **Other comprehensive income** | | |
| Exchange differences on translation of foreign operations | **83** | 31 |
| **Other comprehensive income for the year, net of tax** | **83** | 31 |
| **Total comprehensive income for the year** | **(46,262)** | (35,140) |
| Total comprehensive income for the year is attributable to: | | |
| Owners of Pharmaxis Ltd | **(46,262)** | (35,140) |

*The above statement of comprehensive income should be read in conjunction with the accompanying notes.*

# Balance Sheet As at 30 June 2010

| | Notes | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 6 | **85,787** | 124,993 |
| Trade and other receivables | 7 | **2,711** | 1,219 |
| Inventories | 8 | **424** | 254 |
| Total current assets | | **88,922** | 126,466 |
| **Non current assets** | | | |
| Receivables | 9 | **1,606** | 3,392 |
| Other financial assets | 10 | **–** | 248 |
| Property, plant and equipment | 11 | **32,537** | 32,698 |
| Intangible assets | 12 | **17,702** | 1,193 |
| Total non current assets | | **51,845** | 37,531 |
| **Total assets** | | **140,767** | 163,997 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 13 | **8,511** | 8,587 |
| Borrowings | 14 | **371** | 316 |
| Other liabilities | 15 | **239** | 239 |
| Current tax liabilities | | **48** | 55 |
| Total current liabilities | | **9,169** | 9,197 |
| **Non current liabilities** | | | |
| Borrowings | 16 | **13,158** | 13,559 |
| Other liabilities | 17 | **3,069** | 3,307 |
| Provisions | 18 | **355** | 243 |
| Total non current liabilities | | **16,582** | 17,109 |
| **Total liabilities** | | **25,751** | 26,306 |
| **Net assets** | | **115,016** | 137,691 |
| **EQUITY** | | | |
| Contributed equity | 19 | **267,050** | 245,958 |
| Reserves | 20(a) | **12,480** | 9,902 |
| Accumulated losses | 20(b) | **(164,514)** | (118,169) |
| **Total equity** | | **115,016** | 137,691 |

*The above balance sheet should be read in conjunction with the accompanying notes.*

# Statement of Changes in Equity For the year ended 30 June 2010

| | Notes | 2010 $'000 | 2009 $'000 |
|---|---|---|---|
| **Total equity at the beginning of the financial year** | | **137,691** | 119,121 |
| Total comprehensive income for the year | | **(46,262)** | (35,140) |
| **Transactions with owners in their capacity as owners** | | | |
| Contributions of equity, net of transaction costs | 19(a) | **21,092** | 51,278 |
| Employee share options | 20(a) | **2,495** | 2,432 |
| **Total equity at the end of the financial year** | | **115,016** | 137,691 |

*The above statement of changes in equity should be read in conjunction with the accompanying notes.*

# Cash Flow Statement For the year ended 30 June 2010

| | Notes | 2010 $'000 | 2009 $'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Receipts from customers (inclusive of goods and services tax) | | **1,314** | 963 |
| Payments to suppliers and employees (inclusive of goods and services tax) | | **(45,943)** | (36,747) |
| | | **(44,629)** | (35,784) |
| Lease incentive receipt | | **–** | 3,578 |
| Grant receipts from government | | **1,069** | 443 |
| Interest received | | **3,935** | 5,321 |
| Income tax paid | | **(58)** | (27) |
| **Net cash outflow from operating activities** | 30 | **(39,683)** | (26,469) |
| **Cash flows from investing activities** | | | |
| Payment for acquisition of subsidiaries, net of cash acquired (net receipt) | 26 | **4,104** | – |
| Payments for property, plant and equipment | | **(2,894)** | (12,516) |
| Instalment payments to acquire plant and equipment | | **–** | (362) |
| Release of security deposits to acquire plant and equipment | | **–** | 1,498 |
| Proceeds from disposal of plant and equipment | | **16** | 7 |
| Payments for intangible assets | | **(84)** | (169) |
| **Net cash inflow/(outflow) from investing activities** | | **1,142** | (11,542) |
| **Cash flows from financing activities** | | | |
| Net proceeds from issues of shares | | **428** | 51,278 |
| Finance lease payments | | **(1,200)** | (163) |
| **Net cash (outflow)/inflow from financing activities** | | **(772)** | 51,115 |
| **Net (decrease) / increase in cash and cash equivalents** | | **(39,313)** | 13,104 |
| Cash and cash equivalents at the beginning of the financial year | | **124,993** | 111,842 |
| Effects of exchange rate changes on cash and cash equivalents | | **107** | 47 |
| **Cash and cash equivalents at the end of the financial year** | 6 | **85,787** | 124,993 |
| Non-cash investing and financing activities | 31 | | |

*The above cash flow statement should be read in conjunction with the accompanying notes.*

# Notes to the Financial Statements As at 30 June 2010

## 1. Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial statements are for the consolidated entity consisting of Pharmaxis Ltd and its subsidiaries.

### (a) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Interpretations and the *Corporations Act 2001.*

*Compliance with IFRSs*
The financial report of Pharmaxis Ltd also complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

Historical cost convention

These financial statements have been prepared under the historical cost convention.

*Critical accounting estimates*
The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. Management believe that any estimation uncertainty would not have a significant risk of causing a material adjustment to the carrying values of assets and liabilities and no judgements were made that could have significant effects on the amounts recognised in the financial report.

*Financial statement presentation*
The group has applied the revised AASB 101 Presentation of Financial Statements which became effective on 1 January 2009. The revised standard requires the separate presentation of a statement of comprehensive income and a statement of changes in equity. All non-owner changes in equity must now be presented in the statement of comprehensive income. As a consequence, the group had to change the presentation of its financial statements. Comparative information has been re-presented so that it is also in conformity with the revised standard.

### (b) Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Pharmaxis Ltd ('company' or 'parent entity') as at 30 June 2010 and the results of all subsidiaries for the year then ended. Pharmaxis Ltd and its subsidiaries together are referred to in this financial report as the Group or the consolidated entity.

Subsidiaries are all those entities over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Investments in subsidiaries are accounted for at cost in the individual financial statements of Pharmaxis Ltd.

### (c) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, which is responsible for allocating resources and assessing performance of the operating segments, has been identified as the chief executive officer.

## 1. Summary of significant accounting policies (continued)

*Change in accounting policy*

The group has adopted AASB 8 Operating Segments from 1 July 2009. AASB 8 replaces AASB 114 Segment Reporting. The new standard requires a 'management approach', under which segment information is presented on the same basis as that used for internal reporting purposes. In addition, the segments are reported in a manner that is consistent with the internal reporting provided to the chief operating decision maker.

**(d) Foreign currency translation**

*(i) Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Australian dollars, which is Pharmaxis Ltd's functional and presentation currency.

*(ii) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

*(iii) Group companies*

The results and financial position of all the Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- income and expenses for each income statement are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of any net investment in foreign entities, and of borrowings and other financial instruments designated as hedges of such investments, are taken to other comprehensive income. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences are recognised in the income statement, as part of the gain or loss on sale where applicable.

**(e) Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns and trade allowances. Revenue is recognised for the major business activities as follows:

*(i) Sale of goods*

Sales revenue is measured at the fair value of the consideration received or receivable. Revenue from the sale of goods is recorded when goods have been dispatched and the risk and rewards have passed to the customer.

*(ii) Service income*

Service income relates to revenue received from other pharmaceutical companies for use of the Groups sales force to promote their products. Service income is recognised in the period the service is performed.

*(iii) Interest income*

Interest income is recognised on a time proportion basis using the effective interest method, see note 1(j).

### (f) Government grants

Grants from the government are recognised at their fair value where there is a reasonable assurance that the grant will be received and the company will comply with all attached conditions. When the company receives income in advance of incurring the relevant expenditure, it is treated as deferred income as the company recognises the income only when the relevant expenditure has been incurred.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to the purchase of plant and equipment are included in non current liabilities as deferred income and are credited to the income statement on a straight line basis over the expected lives of the related assets.

### (g) Income tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and unused tax losses.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

### (h) Leases

Leases of property where the Group, as lessee, has substantially all the risks and rewards of ownership are classified as finance leases (note 24). Finance leases are capitalised at the lease's inception at the fair value of the leased property or, if lower, the present value of the minimum lease payments. The corresponding rental obligations, net of finance charges, are included in other short-term and long-term payables. Each lease payment is allocated between the principal repayment and the finance cost. The finance cost is charged to the income statement 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 acquired under the finance lease is depreciated over the asset's useful life or over the shorter of the asset's useful life and the lease term if there is no reasonable certainty that the Group will obtain ownership at the end of the lease term. Any lease incentive received is recognised in the income statement on a straight-line basis over the lease term.

Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Group as lessee are classified as operating leases (note 24). Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

Lease income from operating leases where the Group is a lessor is recognised in income on a straight-line basis over the lease term.

## 1. Summary of significant accounting policies (continued)

### (i) 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 acquiree 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. Contingent consideration is classified either as equity or a financial liability. Amounts classified as a financial liability are subsequently remeasured to fair value with changes in fair value recognised in profit or loss.

### (j) Impairment of assets

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash generating units). Non financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

### (k) Cash and cash equivalents

For purposes of the statement of cash flows, cash includes cash on hand, deposits at call and bank accepted commercial bills, which are subject to an insignificant risk of changes in value.

Bank accepted commercial bills are short-term deposits held with banks with maturities of three months or less, which are acquired at a discount to their face value. The bills are carried at cost plus a portion of the discount recognised as income on an effective yield basis. The discount brought to account each period is accounted for as interest received.

### (l) Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. Trade receivables are due for settlement between 30 – 60 days from date of invoice.

Collectability of trade receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off by reducing the carrying amount directly. An allowance account (provision for impairment of trade receivables) is used when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments (more than 30 days overdue) are considered indicators that the trade receivable is impaired. The amount of the impairment allowance is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial.

The amount of the impairment loss is recognised in the income statement within administration expenses. When a trade receivable for which an impairment allowance had been recognised becomes uncollectible in a subsequent period, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against administration expenses in the income statement.

**(m) Inventories**

Raw materials, work in progress and finished goods are stated at the lower of cost and net realisable value. Cost comprises direct materials, direct labour and an appropriate proportion of variable and fixed overhead expenditure, the latter being allocated on the basis of normal operating capacity. Costs are assigned to individual items of inventory on the basis of weighted average costs. Costs of purchased inventory are determined after deducting rebates and discounts. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

**(n) Property, plant and equipment**

Property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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 income statement during the financial period in which they are incurred.

Depreciation on other assets is calculated using the straight line method to allocate their cost, net of their residual values, over their estimated useful lives, as follows:

| | |
|---|---|
| Plant and equipment | 5 – 15 years |
| Computer equipment | 4 years |
| Leased building and improvements | 15 years |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 1(j)).

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

**(o) Intangible assets**

*(i) Patents*
Patents have a finite useful life and are carried at cost less accumulated amortisation and impairment losses. Amortisation is calculated using the straight line method to allocate the cost of the patents over their estimated useful lives, which vary from 5 to 20 years.

*(ii) Trademarks*
Trademarks have a finite useful life and are carried at cost less accumulated amortisation and impairment losses. Amortisation is calculated using the straight line method to allocate the cost of the trademarks over their estimated useful lives, which are assessed as 20 years.

*(iii) Research and development*
Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technical feasibility and its costs can be measured reliably. Other development expenditures that do not meet these criteria are recognised as an expense as incurred.

## 1. Summary of significant accounting policies (continued)

*(iv) Software*

Software licenses are carried at cost less accumulated amortisation and impairment losses. Amortisation is calculated using the straight line method to allocate the cost of the software over their estimated useful lives, which vary from 3 to 5 years.

**(p) Trade and other payables**

These amounts represent liabilities for goods and services provided to the Group prior to the end of financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition and receipt of a valid invoice.

**(q) Employee benefits**

*(i) Wages and salaries and annual leave*

Liabilities for wages and salaries, including non monetary benefits and annual leave expected to be settled within 12 months of the reporting date are recognised in other payables in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

*(ii) Long service leave*

The liability for long service leave is recognised as a provision for employee benefits and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

*(iii) Retirement benefit obligations*

Contributions to defined contribution funds are recognised as an expense as they become payable.

*(iv) Share based payments*

Share-based compensation benefits are provided to employees via the Pharmaxis Employee Option Plan. Information relating to these schemes is set out in note 34. The fair value of options granted under the option plan is recognised as an employee benefit expense with a corresponding increase in equity. The fair value is measured at grant date and recognised over the period during which the employees become unconditionally entitled to the options.

The fair value at grant date is determined using a Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option.

The fair value of the options granted excludes the impact of any non-market vesting conditions (for example, performance targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the Company revises its estimate of the number of options that are expected to become exercisable. The employee benefit expense recognised each period takes into account the most recent estimate.

*(v) Bonus plans*

The Group recognises a liability and an expense for bonuses where contractually obliged or where there is a past practice that has created a constructive obligation.

*(vi) Termination benefits*

Termination benefits are payable when employment is terminated before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are discounted to present value.

**(r) Other liabilities**

Other liabilities comprises a deferred lease incentive which relates to a cash incentive received pursuant to the ‘Put and Call Option to Lease’ agreement. The deferred incentive is amortised to the income statement over the lease term of 15 years.

### (s) Contributed equity

Ordinary shares are classified as equity.

Incremental costs directly attributable to the issue of new shares or options (net of recognised tax benefits) are shown in equity as a deduction from the proceeds. Incremental costs directly attributable to the issue of new shares or options for the acquisition of a business are not included in the cost of the acquisition as part of the purchase consideration.

### (t) Earnings per share

*(i) Basic earnings per share*

Basic earnings per share is calculated by dividing net result after income tax attributable to equity holders of the company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year.

*(ii) Diluted earnings per share*

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares. At present, the potential ordinary shares are anti-dilutive, and have therefore not been included in the dilutive earnings per share calculations.

### (u) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the taxation authority. In this case it is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net amount of GST recoverable from, or payable to, the taxation authority is included with other receivables or payables in the balance sheet.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flow.

### (v) Rounding of amounts

The Company is of a kind referred to in Class order 98/0100, issued by the Australian Securities and Investments Commission, relating to the ''rounding off'' of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, the nearest dollar.

### (w) Parent entity financial information

The financial information for the parent entity, Pharmaxis Ltd, disclosed in note 35 has been prepared on the same basis as the consolidated financial statements.

### (x) New accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2010 reporting periods. The Group's assessment of the impact of these new standards and interpretations is set out below.

*AASB 2009-8 Amendments to Australian Accounting Standards - Group Cash-Settled Share-based Payment Transactions* [AASB 2] (effective for annual periods commencing on or after 1 January 2010)

The amendments made by the AASB to AASB 2 confirm that an entity receiving goods or services in a group share-based payment arrangement must recognise an expense for those goods or services regardless of which entity in the group settles the transaction or whether the transaction is settled in shares or cash. They also clarify how the group share-based payment arrangement should be measured, that is, whether it is measured as an equity or a cash-settled transaction. The Group will apply these amendments retrospectively for the financial reporting period commencing on 1 July 2010. However, as the amendments only affect the accounting in the individual entities there will be no impact on the financial statements of the Group.

## 1. Summary of significant accounting policies (continued)

*AASB 9 Financial Instruments and AASB 2009-11 Amendments to Australian Accounting Standards arising from AASB 9* (effective for annual reporting periods beginning on or after 1 January 2013).
AASB 9 addresses the classification and measurement of financial assets and is likely to affect the group's accounting for its financial assets. The standard is not applicable until 1 January 2013 and the group is yet to assess its full impact.

*AASB 1053 Application of Tiers of Australian Accounting Standards and AASB 2010-2 Amendments to Australian Accounting* Standards arising from Reduced Disclosure Requirements (effective 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. Pharmaxis Ltd is listed on the ASX and is therefore not eligible to adopt the new Australian Accounting Standards – Reduced Disclosure Requirements. As a consequence, the two standards will have no impact on the financial statements of the entity.

## 2. Revenue

| | **2010** | 2009 |
|---|---|---|
| | **$'000** | $'000 |
| Sales revenue | | |
| Sale of goods | **828** | 595 |
| Other revenue | | |
| Interest | **3,935** | 5,347 |

## 3. Other income

| | **2010** | 2009 |
|---|---|---|
| | **$'000** | $'000 |
| Government grants | **274** | 93 |
| Service income | **342** | 430 |
| | **616** | 523 |

## 4. Expenses

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| **Loss before income tax includes the following specific expenses:** | | |
| Depreciation (note 11) | | |
| Plant and equipment | **627** | 566 |
| Computer equipment | **249** | 196 |
| Leased building and improvements | **1,508** | 300 |
| Total depreciation | **2,384** | 1,062 |
| Amortisation (note 12) | | |
| Patents | **514** | 96 |
| Trademarks | **6** | 5 |
| Software | **117** | 102 |
| Total amortisation | **637** | 203 |
| *Impairment losses – financial assets* | | |
| Trade receivables | **(27)** | 150 |
| Other financial assets | **–** | 39 |
| Net gain on disposal of plant and equipment | **(4)** | – |
| Net loss on write down of plant and equipment | **291** | – |
| Rental expense relating to operating leases | **1,324** | 774 |
| Net foreign exchange losses | **180** | 12 |
| Employee benefits expense | | |
| Defined contribution superannuation | **921** | 761 |
| Other employee benefits expenses | **16,478** | 14,272 |

## 5. Income tax expense

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| **(a) Numerical reconciliation of income tax expense to prima facie tax payable** | | |
| Loss before income tax expense | **(46,294)** | (35,120) |
| Tax at the Australian tax rate 30% (2009:30%) | **(13,888)** | (10,536) |
| Tax effect of amounts which are not deductible (taxable) in calculating taxable income: | | |
| Share-based payments | **748** | 730 |
| Government research tax incentives | **(2,078)** | (2,331) |
| Sundry items | **8** | 8 |
| | **(15,210)** | (12,129) |
| Over provision in prior years | **475** | 563 |
| Difference in overseas tax rates | **(13)** | (12) |
| Total | **(14,748)** | (11,578) |
| Deferred tax benefits not recognised | **14,799** | 11,629 |
| Income tax expense | **51** | 51 |

This represents current income tax expense.

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| **(b) Deferred tax balances** | | |
| Deferred tax asset comprises temporary differences attributable to the following: | | |
| Interest and grant receivables | **(387)** | (56) |
| Lease balances | **200** | 26 |
| Deferred lease incentive | **992** | 1,064 |
| Employee benefits | **605** | 323 |
| Share capital raising costs | **843** | 1,625 |
| Other | **(26)** | 101 |
| | **2,227** | 3,083 |
| Deferred tax assets attributable to temporary differences which are not recognised | **(2,227)** | (3,083) |
| | **–** | – |
| **(c) Tax losses** | | |
| Unused tax losses for which no deferred tax asset has been recognised | **185,609** | 139,200 |
| Potential tax benefit @ 30% | **55,683** | 41,760 |

All unused tax losses were incurred by the parent entity.

## 6. Current assets – Cash and cash equivalents

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| Cash at bank and in hand | **3,791** | 627 |
| Deposits at call | **1,049** | 9,773 |
| Bank accepted commercial bills | **80,947** | 114,593 |
| | **85,787** | 124,993 |

**Interest rate risk exposure**

The Group's exposure to interest rate risk is discussed in note 33. The maximum exposure to credit risk at the reporting date is the carrying amount of each class of cash and cash equivalents above.

## 7. Current assets – Trade and other receivables

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| Trade receivables | **374** | 408 |
| Provision for impairment of receivables (note (b)) | **(123)** | (150) |
| | **251** | 258 |
| Government research grants receivable | **992** | – |
| Prepayments (note (c)) | **331** | 519 |
| Other receivables (note (d)) | **892** | 52 |
| Tax related receivables | **245** | 390 |
| | **2,711** | 1,219 |

**(a) Past due but not impaired**

As of 30 June 2010, trade receivables of $67,531 (2009: $60,366) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The aging analysis of these trade receivables is as follows:

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| Up to 1 month | **28** | 54 |
| 1 to 2 months | **39** | 3 |
| Over 2 months | **1** | 3 |
| | **68** | 60 |

The other classes within trade and other receivables do not contain impaired assets and are not past due. Based on the credit history of these other classes, it is expected that these amounts will be received when due. The group does not hold any collateral in relation to these receivables.

## 7. Current assets – Trade and other receivables (continued)

### (b) Impaired trade receivables

As of 30 June 2010, trade receivables of $122,829 (2009: $149,645) were impaired. These relate to one distributor which is having difficulty repaying due to limited financial resources given current economic conditions.

### (c) Prepayments

Prepayments relate to insurance premiums and other advance payments. The balance in 2009 primarily related to advance payments for items of plant and equipment.

### (d) Other receivables

Other receivables primarily represent cash held at bank to cover bank guarantee facilities related to finance lease commitments which are due to expire within the next 12 months.

### (e) Foreign exchange and interest rate risk

Information about the Group's exposure to foreign currency risk and interest rate risk in relation to trade and other receivables is provided in note 33.

### (f) Fair value and credit risk

Due to the short-term nature of these receivables, their carrying amount is assumed to approximate their fair value. The maximum exposure to credit risk at the reporting date is the carrying amount of each class of receivables mentioned above. Refer to note 33 for more information on the risk management policy of the Group and the credit quality of the entity's trade receivables.

## 8. Current assets – Inventories

| | **2010 $'000** | 2009 $'000 |
|---|---|---|
| Raw materials at cost | **174** | 122 |
| Work-in-progress at cost | **189** | 70 |
| Finished goods at cost | **61** | 62 |
| | **424** | 254 |

## 9. Non-current assets – Receivables

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| Other receivables (note (a)) | **1,589** | 3,307 |
| Prepayments | **17** | 85 |
| | **1,606** | 3,392 |

### (a) Other receivables

Other receivables primarily represents cash held at bank to cover bank guarantee facilities related to finance and operating lease commitments, corporate credit card and local payment clearing house facilities.

### (b) Fair value

The carrying amount of the non-current receivables approximates their fair value.

### (c) Risk exposure

Information about the Group's exposure to credit risk, foreign exchange and interest rate risk is provided in note 33.

## 10. Non-current assets – Other financial assets

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| Shares in subsidiaries (note 27) | **–** | – |
| Other | **–** | 248 |
| | **–** | 248 |

## 11. Non-current assets – Property, plant and equipment

| | Plant and equipment $'000 | Computer equipment $'000 | Leased buildings & improvements $'000 | Total $'000 |
|---|---|---|---|---|
| **At 1 July 2008** | | | | |
| Cost | 5,395 | 768 | 1,024 | 7,187 |
| Accumulated depreciation and impairment | (2,881) | (353) | (285) | (3,519) |
| Net book amount | 2,514 | 415 | 739 | 3,668 |
| **Year ended 30 June 2009** | | | | |
| Opening net book amount | 2,514 | 415 | 739 | 3,668 |
| Exchange differences | – | 8 | – | 8 |
| Additions | 7,903 | 317 | 21,871 | 30,091 |
| Disposals | (6) | (1) | – | (7) |
| Depreciation charge | (566) | (196) | (300) | (1,062) |
| Closing net book amount | 9,845 | 543 | 22,310 | 32,698 |
| **At 30 June 2009** | | | | |
| Cost | 13,276 | 1,089 | 22,895 | 37,260 |
| Accumulated depreciation and impairment | (3,431) | (546) | (585) | (4,562) |
| Net book amount | 9,845 | 543 | 22,310 | 32,698 |
| **Year ended 30 June 2010** | | | | |
| Opening net book amount | 9,845 | 543 | 22,310 | 32,698 |
| Exchange differences | (3) | (5) | – | (8) |
| Additions | 1,867 | 330 | 328 | 2,525 |
| Disposals | (96) | (1) | (197) | (294) |
| Depreciation charge | (627) | (249) | (1,508) | (2,384) |
| Closing net book amount | 10,986 | 618 | 20,933 | 32,537 |
| **At 30 June 2010** | | | | |
| Cost | 14,846 | 1,300 | 23,022 | 39,168 |
| Accumulated depreciation and impairment | (3,860) | (682) | (2,089) | (6,631) |
| Net book amount | 10,986 | 618 | 20,933 | 32,537 |

### (a) Assets in the course of construction

The carrying amount of the assets disclosed above include the following expenditure recognised in relation to property, plant and equipment which is in the course of construction:

| | **2010 $'000** | 2009 $'000 |
|---|---|---|
| Plant and equipment | **–** | 6,599 |

### (b) Leased assets

Leased building and improvements includes the following amounts where the Group is a lessee under a finance lease:

| | **2010** **$'000** | 2009 $'000 |
|---|---|---|
| Cost | **13,916** | 13,916 |
| Accumulated amortisation | **(1,054)** | (126) |
| Net book amount | **12,862** | 13,790 |

## 12. Non-current assets – Intangible assets

| | **Patents $'000** | **Trademarks $'000** | **Software $'000** | **Total $'000** |
|---|---|---|---|---|
| **At 1 July 2008** | | | | |
| Cost | 1,624 | 100 | 399 | 2,123 |
| Accumulated amortisation and impairment | (763) | (6) | (127) | (896) |
| Net book amount | 861 | 94 | 272 | 1,227 |
| **Year ended 30 June 2009** | | | | |
| Opening net book amount | 861 | 94 | 272 | 1,227 |
| Additions | 43 | 13 | 113 | 169 |
| Amortisation charge | (96) | (5) | (102) | (203) |
| Closing net book amount | 808 | 102 | 283 | 1,193 |
| **At 30 June 2009** | | | | |
| Cost | 1,667 | 113 | 512 | 2,292 |
| Accumulated amortisation and impairment | (859) | (11) | (229) | (1,099) |
| Net book amount | 808 | 102 | 283 | 1,193 |
| **Year ended 30 June 2010** | | | | |
| Opening net book amount | 808 | 102 | 283 | 1,193 |
| Additions | 17,032 | – | 122 | 17,154 |
| Disposals | – | (1) | (7) | (8) |
| Amortisation charge | (514) | (6) | (117) | (637) |
| Closing net book amount | 17,326 | 95 | 281 | 17,702 |
| **At 30 June 2010** | | | | |
| Cost | 18,699 | 112 | 604 | 19,415 |
| Accumulated amortisation and impairment | (1,373) | (17) | (323) | (1,713) |
| Net book amount | 17,326 | 95 | 281 | 17,702 |

## 13. Current liabilities – Trade and other payables

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| Trade payables | **1,086** | 1,582 |
| Other payables (note (a)) | **5,684** | 7,005 |
| Purchase consideration payables (note (b)) | **1,741** | – |
| | **8,511** | 8,587 |

### (a) Other payables

Other payables include accruals for annual leave. The entire obligation is presented as current, since the Group does not have an unconditional right to defer settlement.

### (b) Purchase consideration payables

Purchase consideration payable relates to deferred consideration owing on the acquisition of Technology Innovation Limited. The entire obligation is presented as current, since the consideration will be due and payable within the next 12 months. Refer to note 26 for additional information.

### (c) Risk exposure

Information about the Group's exposure to foreign exchange risk is provided in note 33.

## 14. Current liabilities – Borrowings

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| **Secured** | | |
| Lease liabilities (note 24) | **371** | 316 |

### (a) Security and fair value disclosures

Information about the security relating to each of the secured liabilities and the fair value of each of the borrowings is provided in note 16.

### (b) Risk exposure

Information about the Group's exposure to risks arising from current and non-current borrowings is provided in note 33.

## 15. Current liabilities – Other liabilities

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| Deferred lease incentive | **239** | 239 |

Information about the deferred lease incentive is provided in note 17.

## 16. Non-current liabilities – Borrowings

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| **Secured** | | |
| Lease liabilities (note 24) | **13,158** | 13,559 |

**Secured liabilities and assets pledged as security**

Lease liabilities are effectively secured, as the rights to the leased assets recognised in the financial statements revert to the lessor in the event of default.

## 17. Non-current liabilities – Other liabilities

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| Deferred lease incentive | **3,069** | 3,307 |

The deferred lease incentive relates to a cash incentive received pursuant to the 'Put and Call Option to Lease' agreement. The deferred incentive is amortised over the 15 year lease term on a straight-line basis.

## 18. Non-current liabilities – Provisions

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| Employee benefits long service leave | **355** | 243 |

## 19. Contributed equity

| | Notes | Consolidated and Parent Entity 2010 Shares | Consolidated and Parent Entity 2009 Shares | Consolidated and Parent Entity 2010 $'000 | Consolidated and Parent Entity 2009 $'000 |
|---|---|---|---|---|---|
| **(a) Share capital** | | | | | |
| Ordinary shares | (b),(c) | | | | |
| Fully paid | | **225,410,234** | 217,659,109 | **267,050** | 245,958 |

**Movements in ordinary share capital:**

| Date | Details | Number of shares | Issue price | $'000 |
|---|---|---|---|---|
| 1 July 2008 | Opening balance | 194,514,762 | | 194,680 |
| 7 August 2008 | Exercise of employee options | 22,500 | $ 0.5080 | 11 |
| 4 June 2009 | Share Placement (initial settlement) | 500,000 | $ 2.3500 | 1,175 |
| 10 June 2009 | Exercise of employee options | 50,000 | $ 2.1940 | 109 |
| 10 June 2009 | Exercise of employee options | 2,500 | $ 1.9170 | 5 |
| 11 June 2009 | Share Placement (main settlement) | 19,500,000 | $ 2.3500 | 45,825 |
| 30 June 2009 | Share Purchase Plan | 3,069,347 | $ 2.3500 | 7,213 |
| | Less: Transaction costs on share issues | | | (3,060) |
| | | 217,659,109 | | 245,958 |
| 1 July 2009 | Exercise of employee options | 25,000 | $ 2.1940 | 55 |
| 1 July 2009 | Exercise of employee options | 1,250 | $ 1.9170 | 3 |
| 1 July 2009 | Exercise of employee options | 18,750 | $ 1.8170 | 34 |
| 24 July 2009 | Exercise of employee options | 180,000 | $ 0.3125 | 56 |
| 4 August 2009 | Exercise of employee options | 5,000 | $ 1.6060 | 8 |
| 14 August 2009 | Exercise of employee options | 625 | $ 1.5990 | 1 |
| 15 September 2009 | Exercise of employee options | 10,000 | $ 0.8340 | 8 |
| 21 October 2009 | Issue of restricted shares | 30,000 | $ 0.0000 | – |
| 27 October 2009 | Exercise of employee options | 7,500 | $ 1.7900 | 13 |
| 27 October 2009 | Exercise of employee options | 1,875 | $ 1.8918 | 4 |
| 27 October 2009 | Exercise of employee options | 125 | $ 1.8170 | – |
| 26 November 2009 | Exercise of employee options | 1,120,000 | $ 0.1250 | 140 |
| 9 December 2009 | Exercise of employee options | 10,000 | $ 1.8170 | 18 |
| 5 February 2010 | Exercise of employee options | 15,000 | $ 0.1250 | 2 |
| 8 February 2010 | Issued on acquisition of subsidiary | 3,200,000 | $ 2.5200 | 8,064 |
| 15 March 2010 | Issued on acquisition of subsidiary | 3,000,000 | $ 2.5200 | 7,560 |
| 23 March 2010 | Exercise of employee options | 40,000 | $ 0.3760 | 15 |
| 23 April 2010 | Exercise of employee options | 50,000 | $ 0.3125 | 16 |
| 30 April 2010 | Exercise of employee options | 20,000 | $ 0.3760 | 8 |
| 31 May 2010 | Exercise of employee options | 16,000 | $ 0.3125 | 5 |
| | Transaction costs on share issues | | | 42 |
| | Shares yet to be issued on acquisition of subsidiary | | | 5,040 |
| | | 225,410,234 | | 267,050 |

### (a) Ordinary shares

Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of and amounts paid on the shares held.

On a show of hands every holder of ordinary shares present at a meeting in person or by proxy, is entitled to one vote, and upon a poll each share is entitled to one vote.

### (b) Shares yet to be issued

Shares yet to be issued relates to contingent equity consideration on the acquisition of Topigen Pharmaceuticals Inc. Refer to note 26 for additional information.

### (c) Options

Information relating to the Pharmaxis Employee Option Plan, including details of options issued, exercised and lapsed during the financial year and options outstanding at the end of the financial year, is set out in note 34.

### (d) Capital risk management

The Group's objectives when managing capital is to safeguard its ability to continue as a going concern and to maintain an optimal capital structure to reduce the cost of capital.

The Group predominately uses equity to finance its projects. In order to maintain or adjust the capital structure, the Group may issue new shares.

## 20. Reserves and accumulated losses

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| **(a) Reserves** | | |
| Share based payments reserve | **12,370** | 9,875 |
| Foreign currency translation reserve | **110** | 27 |
| | **12,480** | 9,902 |
| *Share based payments reserve* | | |
| Balance 1 July | **9,875** | 7,443 |
| Option expense | **2,495** | 2,432 |
| Balance 30 June | **12,370** | 9,875 |
| *Foreign currency translation reserve* | | |
| Balance 1 July | **27** | (4) |
| Currency translation differences arising during the year | **83** | 31 |
| Balance 30 June | **110** | 27 |
| **(b) Accumulated losses** | | |
| Movements in accumulated losses were as follows: | | |
| Balance 1 July | **(118,169)** | (82,998) |
| Net loss for the year | **(46,345)** | (35,171) |
| Balance 30 June | **(164,514)** | (118,169) |

### (c) Nature and purpose of reserves

*(i) Share based payments reserve*

The share based payments reserve is used to recognise the fair value of options granted.

*(ii) Foreign currency translation reserve*

Exchange differences arising on translation of the foreign controlled entities are taken to the foreign currency translation reserve, as described in note 1(d).

## 21. Key management personnel disclosures

### (a) Key management personnel compensation

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| Short term employee benefits | **2,646,103** | 2,438,468 |
| Post-employment benefits | **181,680** | 165,958 |
| Long-term benefits | **47,945** | 1,881 |
| Share based payments | **1,593,402** | 1,651,472 |
| | **4,469,130** | 4,257,779 |

Detailed remuneration disclosures are provided in the remuneration report under section 2.2.

### (b) Equity instrument disclosures relating to key management personnel

*(i) Options provided as remuneration and shares issued on exercise of such options*

Details of options provided as remuneration and shares issued on the exercise of such options, together with terms and conditions of the options, can be found in the remuneration report section of the Directors' Report.

*(ii) Option holdings*

The number of options over ordinary shares in the company held during the financial year by each director of Pharmaxis Ltd and other key management personnel of the Group, including their personally related parties, are set out below.

| 2010<br>Name | Balance at the start of the year | Granted during the year as compensation | Exercised during the year | Other changes during the year | Balance at the end of the year | Vested and exercisable at the end of the year |
|---|---|---|---|---|---|---|
| ***Directors of Pharmaxis Ltd*** | | | | | | |
| DM Hanley | 1,120,000 | – | – | – | 1,120,000 | 1,120,000 |
| AD Robertson | 2,880,000 | 200,000 | (1,120,000) | – | 1,960,000 | 1,585,000 |
| MJ McComas | 240,000 | – | – | – | 240,000 | 240,000 |
| PC Farrell[1] | 220,000 | – | – | (220,000) | – | – |
| J Villiger | 200,000 | – | – | – | 200,000 | 200,000 |
| W Delaat | 200,000 | – | – | – | 200,000 | 100,000 |
| R van den Broek | – | – | – | – | – | – |
| ***Other key management personnel of the Group*** | | | | | | |
| B Charlton | 1,210,000 | – | (50,000) | – | 1,160,000 | 910,000 |
| JF Crapper | 1,110,000 | – | (180,000) | – | 930,000 | 680,000 |
| HG Fox | 400,000 | – | – | – | 400,000 | 100,000 |
| IA McDonald | 870,000 | – | – | – | 870,000 | 620,000 |
| DM McGarvey | 1,710,000 | – | – | – | 1,710,000 | 1,460,000 |
| GJ Phillips | 1,255,000 | – | (60,000) | – | 1,195,000 | 945,000 |

1 Peter Farrell resigned as a director effective 21 October 2009.

## 21. Key management personnel disclosures (continued)

| 2009<br>Name | Balance at the start of the year | Granted during the year as compensation[1] | Exercised during the year | Other changes during the year | Balance at the end of the year | Vested and exercisable at the end of the year |
|---|---|---|---|---|---|---|
| ***Directors of Pharmaxis Ltd*** | | | | | | |
| DM Hanley | 1,120,000 | – | – | – | 1,120,000 | 1,120,000 |
| AD Robertson | 2,680,000 | 200,000 | – | – | 2,880,000 | 2,542,500 |
| MJ McComas | 240,000 | – | – | – | 240,000 | 240,000 |
| PC Farrell | 220,000 | – | – | – | 220,000 | 170,000 |
| J Villiger | 200,000 | – | – | – | 200,000 | 150,000 |
| W Delaat | – | 200,000 | – | – | 200,000 | 50,000 |
| R van den Broek | – | – | – | – | – | – |
| ***Other key management personnel of the Group*** | | | | | | |
| B Charlton | 910,000 | 300,000 | – | – | 1,210,000 | 796,250 |
| JF Crapper | 810,000 | 300,000 | – | – | 1,110,000 | 697,500 |
| HG Fox | – | 400,000 | – | – | 400,000 | – |
| IA McDonald | 570,000 | 300,000 | – | – | 870,000 | 457,500 |
| DM McGarvey | 1,410,000 | 300,000 | – | – | 1,710,000 | 1,297,500 |
| GJ Phillips | 955,000 | 300,000 | – | – | 1,255,000 | 842,500 |

1 Options granted during the year covers two grant issues. The first issue in August 2008 for the financial year ended 30 June 2009 and the second issue in June 2009 for the year ended 30 June 2010.

*(iii) Share holdings*

The numbers of shares in the company held during the financial year by each director of Pharmaxis Ltd and other key management personnel of the Group, including their close family members, are set out below. (Close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity).

## 21. Key management personnel disclosures (continued)

| 2010<br>Name | Balance at the start of the year | Received during the year on the exercise of options | Other changes during the year | Balance at the end of the year |
|---|---|---|---|---|
| *Directors of Pharmaxis Ltd* | | | | |
| **Ordinary shares** | | | | |
| DM Hanley | 798,295 | – | – | 798,295 |
| AD Robertson | 100,000 | 1,120,000 | (75,000) | 1,145,000 |
| MJ McComas | 139,999 | – | – | 139,999 |
| P Farrell[1] | 101,645 | – | (101,645) | – |
| J Villiger | – | – | – | – |
| W Delaat | 25,000 | – | – | 25,000 |
| R van den Broek[2] | 45,000 | – | 30,000 | 75,000 |
| *Other key management personnel of the Group* | | | | |
| **Ordinary shares** | | | | |
| B Charlton | 46 | 50,000 | (50,000) | 46 |
| JF Crapper | 2,000 | 180,000 | (180,000) | 2,000 |
| HG Fox | – | – | – | – |
| IA McDonald | – | – | – | – |
| DM McGarvey | 47,127 | – | (40,000) | 7,127 |
| GJ Phillips | 6,664 | 60,000 | (61,664) | 5,000 |

1 Peter Farrell resigned as a director effective 21 October 2009.

2 Richard van den Broek is associated with HSMR Advisors (QP) L.P, HSMR Advisors (QP) L.P, held 830,000 shares as at 30 June 2010 (2009: 830,000).

| 2009<br>Name | Balance at the start of the year | Received during the year on the exercise of options | Other changes during the year | Balance at the end of the year |
|---|---|---|---|---|
| *Directors of Pharmaxis Ltd* | | | | |
| **Ordinary shares** | | | | |
| DM Hanley | 789,787 | – | 8,508 | 798,295 |
| AD Robertson | 100,000 | – | – | 100,000 |
| MJ McComas | 139,999 | – | – | 139,999 |
| P Farrell | 101,645 | – | – | 101,645 |
| J Villiger | – | – | – | – |
| W Delaat | – | – | 25,000 | 25,000 |
| R van den Broek | – | – | 45,000 | 45,000 |
| *Other key management personnel of the Group* | | | | |
| **Ordinary shares** | | | | |
| B Charlton | 420,000 | – | (419,954) | 46 |
| JF Crapper | 2,000 | – | – | 2,000 |
| HG Fox | – | – | – | – |
| IA McDonald | – | – | – | – |
| DM McGarvey | 45,000 | – | 2,127 | 47,127 |
| GJ Phillips | 6,664 | – | – | 6,664 |

### (c) Other transactions with key management personnel

There were no other transactions with key management personnel during the year ended 30 June 2010.

## 22. Remuneration of auditors

During the year the following fees were paid or payable for services provided by the auditor of the parent entity, its related practices and non related audit firms:

| | 2010<br>$ | 2009<br>$ |
|---|---|---|
| **(a) Audit services** | | |
| PricewaterhouseCoopers Australian firm | | |
| Audit and review of financial reports | **225,877** | 274,421 |
| Non-PricewaterhouseCoopers audit firm for the audit of the financial report of Pharmaxis Pharmaceuticals Limited | **16,556** | 20,467 |
| Total remuneration for audit services | **242,433** | 294,888 |
| **(b) Other assurance services** | | |
| PricewaterhouseCoopers Australian firm | | |
| Control testing | **9,750** | – |
| Assistance in relation to SEC compliance letter | **9,500** | – |
| EMDG revenue forecast review | **3,496** | – |
| | **22,746** | – |
| PricewaterhouseCoopers China firm | | |
| Accounting review services | **18,710** | 23,304 |
| Total remuneration for other services | **41,456** | 23,304 |
| **(a) Tax services** | | |
| PricewaterhouseCoopers Australian firm | | |
| International tax consulting and tax advice | **19,820** | 8,700 |
| Tax compliance services | **21,400** | 12,900 |
| | **41,220** | 21,600 |
| PricewaterhouseCoopers China firm | | |
| Tax compliance services | **10,894** | 13,580 |
| Total remuneration for tax services | **52,114** | 35,180 |

## 23. Contingent liabilities

The Group had contingent liabilities at 30 June 2010 in respect of:

*Government grants*

The Group has received three separate Australian Government research grants under the R&D START Program, all three of which have been completed. The Government may require the Group to repay all or some of the amount of a particular grant together with interest in either of the following circumstances:

a) the Group fails to use its best endeavours to commercialise the relevant grant project within a reasonable time of completion of the project; or

b) upon termination of a grant due to breach of agreement or insolvency.

The Group continues the development and commercialisation of all three projects funded by the START Program. The total amount received under the START Program at 30 June 2010 was $4,707,817 (2009: $4,707,817).

## 23. Contingent liabilities (continued)

The Group completed the Australian Government's Pharmaceuticals Partnerships Program ('P3') at 30 June 2008 and received cash proceeds of $Nil (2009: $297,871) as the final payment during the financial year. The Government may require the Group to repay all or some of the amount of the grant together with interest in any of the following circumstances:

a) the Government determines that expenditure claimed on research projects do not meet the P3 guidelines; or

b) upon termination of the grant due to breach of agreement, change in control of the Group or insolvency.

*Guarantees*

The Group's bankers have issued bank guarantees of $2,023,281 in relation to rental bond deposits for which no provision has been made in the accounts. The rental bond deposits cover the leased building which has been accounted for as a finance lease and other leased premises accounted for as operating leases. These bank guarantees are secured by security deposits held at the bank.

The Group's bankers have provided a corporate credit card facility which is secured by a deposit held at the bank totalling $74,576.

The Group's bankers have issued a bank guarantee of GBP70,000 in relation to corporate credit card facilities provided by an overseas affiliate of the banker to Pharmaxis Pharmaceuticals Limited. This bank guarantee is secured by a deposit held at the bank.

The Group's bankers have issued a bank guarantee of USD175,000 in relation to corporate credit card and local payment clearing house facilities provided by an overseas affiliate of the banker to Pharmaxis, Inc. This bank guarantee is secured by a deposit held at the bank.

## 24. Commitments

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| **(a) Capital Commitments** | | |
| Capital expenditure contracted for at the reporting date but not recognised as liabilities is as follows: | | |
| *Building Fit-out* | | |
| Payable: Within one year | – | 135 |
| *Plant and equipment* | | |
| Payable: Within one year | 156 | 1,357 |

**(b) Lease Commitments**

*(i) Non-cancellable operating leases*

The Group leases various offices and items of plant and equipment under non-cancellable operating leases expiring within one to fifteen years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

| | 2010<br>$'000 | 2009<br>$'000 |
|---|---|---|
| *Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:* | | |
| Within one year | 1,006 | 868 |
| Later than one year but not later than five years | 3,008 | 2,338 |
| Later than 5 years | 4,531 | 5,089 |
| | 8,545 | 8,295 |

## 24. Commitments (continued)

*(ii) Finance leases*

The Group has entered into an agreement concerning the lease of a custom designed manufacturing, warehousing, research and office facility of approximately 7,200 square metres, constructed to our specifications. The lease has a term of 15 years, with two options to renew of a further five years each and the option to break the lease at ten years but with financial penalties attached.

The initial minimum annual rental under the agreement for the finance lease component is $1.2 million. The operating lease component (disclosed in note 24 (b) (i)) is $0.4 million. Both components increase each year for the term of the agreement by 3.25%.

| | **2010 $'000** | 2009 $'000 |
|---|---|---|
| Commitments in relation to finance leases are payable as follows: | | |
| Within one year | **1,237** | 1,198 |
| Later than one year but not later than five years | **5,362** | 5,193 |
| Later than five years | **14,578** | 15,984 |
| Minimum lease payments | **21,177** | 22,375 |
| Future finance charges | **(7,648)** | (8,500) |
| Total lease liabilities | **13,529** | 13,875 |
| Current (note 14) | **371** | 316 |
| Non-current (note 16) | **13,158** | 13,559 |
| | **13,529** | 13,875 |

*(iii) Other commitments*

The company has in place a number of contracts with consultants and contract research organisations in relation to its business activities. The terms of these contracts are for relatively short periods of time and allow for the contracts to be terminated with relatively short notice periods. The actual committed expenditure arising under these contracts is therefore not material.

## 25. Related party transactions

### (a) Parent entities

The parent entity within the Group is Pharmaxis Ltd (incorporated in Australia).

### (b) Subsidiaries

Interests in subsidiaries are set out in note 27.

### (c) Key management personnel

Disclosures relating to key management personnel are set out in note 21.

### (d) Transactions with related parties

The following transactions occurred with related parties:

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2010** | 2009 | **2010** | 2009 |
| | **$** | $ | **$** | $ |
| Marketing, drug discovery, clinical, regulatory and administration services expenditure paid to subsidiaries | **–** | – | **5,697,718** | 4,961,884 |

### (e) Outstanding balances arising from transactions

The following balances are outstanding at the reporting date in relation to transactions with related parties:

| | Consolidated | | Parent Entity | |
|---|---|---|---|---|
| | **2010** | 2009 | **2010** | 2009 |
| Current payables | | | | |
| Subsidiaries | **–** | – | **1,334,902** | 607,108 |

### (f) Terms and conditions

All transactions were made on normal commercial terms and conditions and at market rates pursuant to a Contract for Services. Under the contract the parent entity is required to pay for services within 30 days of receipt, with interest penalty clauses applying after 90 days.

Outstanding balances are unsecured and are repayable in cash.

## 26. Business combinations

### (a) Summary of acquisition

On the 8 February 2010 the parent entity acquired 100% of the issued capital of Topigen Pharmaceuticals Inc., a Canadian based private biopharmaceutical company. The acquisition has expanded the groups drug development portfolio.

Details of the purchase consideration and net assets acquired are as follows:

| | **$'000** |
|---|---|
| Purchase consideration (refer to (c) below): | |
| Share issued | **15,624** |
| Contingent consideration | **5,040** |
| Total purchase consideration | **20,664** |

## 26. Business combinations (continued)

The assets and liabilities recognised as a result of the acquisition are as follows:

| | Fair value $'000 |
|---|---|
| Cash | 5,815 |
| Other receivables | 2,240 |
| Plant and equipment | 472 |
| Intangible assets: Patents | 13,419 |
| Trade and other payables | (1,282) |
| Net assets acquired | 20,664 |

*(i) Contingent consideration*

Pharmaxis Ltd agreed to issue up to 8.2 million shares in consideration for the acquisition of 100% of the securities in Topigen Pharmaceuticals, Inc. 6.2 million of these shares have already been issued as at 30 June 2010 and then up to a further 2 million shares will be issued: i) within 21 days following of the successful completion before 31 December 2010 of a defined preclinical study; or (ii) on January 2011 if Pharmaxis Ltd does not commence the defined preclinical study by 31 December 2010 or the report for the preclinical study is not generated by 31 December 2010.

*(ii) Revenue and loss contribution*

The acquired business contributed revenues of $Nil and net loss of $3,428,278 to the group for the period from 8 February 2010 to 30 June 2010.

If the acquisition had occurred on 1 July 2009, consolidated loss for the year ended 30 June 2010 would have been $53,625,000. This amount has been calculated using the group's accounting policies.

**(b) Summary of acquisition**

On the 26 May 2010 the parent entity acquired 100% of the issued capital of Technology Innovation Limited, a United Kingdom based private company holding patents in relation to inhalation devices.

Details of the purchase consideration and net assets acquired are as follows:

| | $'000 |
|---|---|
| Purchase consideration (refer to (c) below): | |
| Cash paid | 1,959 |
| Committed consideration | 1,711 |
| Total purchase consideration | 3,670 |

The assets and liabilities recognised as a result of the acquisition are as follows:

| | Fair value $'000 |
|---|---|
| Other receivables | 7 |
| Trade and other payables | (7) |
| Net assets acquired | – |
| Add: Patents acquired | 3,670 |
| Net assets acquired | 3,670 |

## 26. Business combinations (continued)

*(i) Committed consideration*

Pharmaxis Ltd is committed to paying a further $1,711,397 (GBP 980,000) on 27 May 2011.

*(ii) Revenue and loss contribution*

The acquired business contributed revenues of $Nil and net loss of $Nil to the group for the period from 26 May 2010 to 30 June 2010.

If the acquisition had occurred on 1 July 2009, consolidated loss for the year ended 30 June 2010 would have been $46,380,000. This amount has been calculated using the group's accounting policies.

**(c) Purchase consideration – cash outflow**

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| Outflow of cash to acquire subsidiaries, net of cash acquired | | |
| Cash consideration | **1,711** | – |
| Less: Cash balances acquired | **(5,815)** | – |
| Inflow of cash – investing activities | **(4,104)** | – |

Acquisition-related costs

Acquisition-related costs of $345,401 are included in other expenses in the profit and loss and in operating cash flows in the consolidated statement of cash flows.

## 27. Subsidiaries

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy described in note 1(b):

| Name of entity | Country of incorporation | Class of shares | Equity holding 2010 % | Equity holding 2009 % |
|---|---|---|---|---|
| Pharmaxis Pharmaceuticals Limited | United Kingdom | Ordinary | **100** | 100 |
| Pharmaxis, Inc. | United States | Ordinary | **100** | 100 |
| Topigen Pharmaceuticals Inc. | Canada | Ordinary | **100** | – |
| Technology Innovation Limited | United Kingdom | Ordinary | **100** | – |

## 28. Events occurring after the balance sheet date

No matter or circumstance has arisen since 30 June 2010 that has significantly affected, or may significantly affect:

(a) the group's operations in future financial years, or

(b) the results of those operations in future financial years, or

(c) the group's state of affairs in future financial years.

## 29. Financial reporting by segments

The company operates predominantly in one industry. The principal activities of the company are the research, development and commercialisation of pharmaceutical products.

The company operates in a number of geographical areas. The operations in overseas jurisdictions are in the early days of establishment and currently do not have a material impact on the overall group operations.

## 30. Reconciliation of loss after income tax to net cash outflows from operating activities

| | **2010**<br>**$'000** | 2009<br>$'000 |
|---|---|---|
| Loss for the year | **(46,345)** | (35,171) |
| Depreciation of property, plant & equipment | **2,384** | 1,062 |
| Amortisation of intangibles | **637** | 203 |
| Amortisation of lease incentive | **(238)** | (32) |
| Impairment losses – financial assets | | |
| Trade receivables | **(27)** | 150 |
| Other financial assets | **–** | 39 |
| Restructuring charges | **332** | – |
| Finance charges | **854** | 122 |
| Non cash employee benefits expense share based payments | **2,495** | 2,432 |
| Net gain on disposal of non current assets | **(4)** | – |
| Change in operating assets and liabilities | | |
| Decrease / (increase) in trade receivables | **34** | (186) |
| (Increase) in inventories | **(170)** | (158) |
| Decrease / (increase) in other operating assets | **2,165** | (178) |
| (Decrease) / increase in trade payables | **(827)** | 1,066 |
| (Decrease) / increase in other operating liabilities | **(1,085)** | 4,127 |
| Increase in other provisions | **112** | 55 |
| Net cash outflow from operating activities | **(39,683)** | (26,469) |

## 31. Non-cash investing and financing activities

| | **2010**<br>**$'000** | 2009<br>$'000 |
|---|---|---|
| Acquisition of leased building and improvements by means of finance leases | **–** | 13,916 |

## 32. Earnings per share

| | 2010 Cents | 2009 Cents |
|---|---|---|
| **(a) Basic earnings per share** | | |
| Loss attributable to the ordinary equity holders of the company | **(21.0)** | (18.0) |
| **(b) Diluted earnings per share** | | |
| Loss attributable to the ordinary equity holders of the company | **(21.0)** | (18.0) |
| **(c) Weighted average number of shares used as the denominator** | | |
| Weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings / (loss) per share | **220,735,745** | 195,588,481 |

**(d) Information concerning the classification of option securities**

Options granted to employees under the Pharmaxis Ltd Employee Option Plan are considered to be potential ordinary shares and have been included in the determination of diluted earnings per share to the extent to which they are dilutive. The options have not been included in the determination of basic earnings per share. Given the entity is currently loss making, the potential ordinary shares are anti-dilutive and have therefore not been included in the diluted earnings per share calculation. Details relating to the options are set out in note 34.

## 33. Financial risk management

The Group's activities expose it to a variety of financial risks: market risk (including currency risk and interest rate risk), credit risk and liquidity risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Group.

The Group uses different methods to measure different types of risks to which it is exposed. These methods include sensitivity analysis in the case of interest rate, foreign exchange and other price risks and aging analysis for credit risk.

Risk management is carried out by the Chief Financial Officer under policies approved by the Board of Directors. The Board provides written principles of overall risk management, as well as policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk and investment of excess liquidity. The Group holds the following financial instruments:

| | 2010 $'000 | 2009 $'000 |
|---|---|---|
| **Financial assets** | | |
| Cash and cash equivalents | **85,787** | 124,993 |
| Trade and other receivables | **2,711** | 1,219 |
| Receivables | **1,606** | 3,392 |
| Other financial assets | **–** | 248 |
| | **90,104** | 129,852 |
| **Financial liabilities** | | |
| Trade and other payables | **8,511** | 8,587 |
| Borrowings | **13,529** | 13,875 |
| Other liabilities | **3,308** | 3,546 |
| | **25,348** | 26,008 |

## 33. Financial risk management (continued)

### (a) Market risk

*(i) Foreign exchange risk*

The Group operates internationally but is only exposed to minimal foreign exchange risk arising from various currency exposures. Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities denominated in a currency that is not the entity's functional currency. The risk is measured using sensitivity analysis and cash flow forecasting.

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

| | **30 June 2010** | | | 30 June 2009 | | |
|---|---|---|---|---|---|---|
| | **USD $'000** | **GBP $'000** | **EUR $'000** | USD $'000 | GBP $'000 | EUR $'000 |
| Cash and cash equivalents | **6** | **2** | **2** | 3 | 6 | 20 |
| Trade receivables | **–** | **–** | **180** | – | – | 198 |
| Prepayments | **–** | **–** | **–** | – | – | 362 |
| Other receivables | **210** | **124** | **–** | 127 | 149 | – |
| Trade payables | **97** | **267** | **207** | 700 | 159 | 75 |
| Other payables | **458** | **2,128** | **456** | 530 | 925 | 649 |

*Group sensitivity*

Based on the financial instruments held at 30 June 2010, had the Australian dollar weakened/strengthened by 10% against the GBP with all other variables held constant, the Group's post-tax loss for the year would have been $206,000 higher/$252,000 lower (2009 GBP: $103,000 higher/$84,000 lower), mainly as a result of foreign exchange gains/losses on translation of GBP denominated financial assets/liabilities as detailed in the above table.

*(i) Cash flow and fair value interest rate risk*

The Group's main interest exposure arises from bank accepted commercial bills held.

As at the reporting date, the Group had the following cash profile:

| | **30 June 2010** | | 30 June 2009 | |
|---|---|---|---|---|
| | **Weighted average interest rate %** | **Balance $'000** | Weighted average interest rate % | Balance $'000 |
| Cash and cash equivalents | **0.93%** | **4,840** | 2.47% | 10,400 |
| Bank accepted commercial bills | **4.80%** | **80,947** | 3.18% | 114,593 |
| Other receivables | **3.95%** | **2,481** | 2.97% | 3,359 |

*Group sensitivity*

The Group's main interest rate risk arises from cash and cash equivalents. At 30 June 2010, if interest rates had changed by +/- 80 basis points from the year-end rates with all other variables held constant, post-tax loss for the year would have been $706,144 lower/higher (2009 – change of 80 bps: $1,026,819 lower/higher), mainly as a result of higher/lower interest income from cash and cash equivalents.

## 33. Financial risk management (continued)

### (b) Credit risk

Credit risk is managed on a group basis. Credit risk arises from cash and cash equivalents and deposits with banks and financial institutions, as well as credit exposures to customers, including outstanding receivables and committed transactions. For banks and financial institutions, only independent rated parties with a minimum short term money market rating of 'A1+' and a long term credit rating of 'AA' are accepted. Credit risk on bank accepted bills is further managed by spreading these bills across four major Australian banks.

Customer credit risk is managed by the establishment of credit limits. The compliance with credit limits by customers is regularly monitored by management, as is the ageing analysis of receivable balances. The maximum exposure to credit risk at the reporting date is the carrying amount of the financial assets as summarised in note 7 and note 9.

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings:

| | **2010 $'000** | 2009 $'000 |
|---|---|---|
| **Cash and cash equivalents** | | |
| A1+ | **85,787** | 124,993 |
| **Other receivables** | | |
| AA | **2,471** | 3,324 |
| Not rated | **10** | 35 |
| | **2,481** | 3,359 |

Other receivables primarily represent bank guarantee facilities related to operating leases, corporate credit card and local payment clearing house facilities.

### (c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and cash equivalents. The Group manages liquidity risk by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities. Surplus funds are generally only invested in instruments that are tradeable in highly liquid markets with short term maturity profiles.

## 33. Financial risk management (continued)

*Maturities of financial liabilities*

The table below analyse the Group's financial liabilities, into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

| | Less than 1 year $'000 | Between 1 and 2 years $'000 | Between 2 and 5 years $'000 | Over 5 years $'000 | Total contractual cash flows $'000 | Carrying Amount (assets)/ liabilities $'000 |
|---|---|---|---|---|---|---|
| **Group at – 30 June 2010** | | | | | | |
| Non-interest bearing | 8,750 | 239 | 716 | 2,114 | 11,819 | 11,819 |
| Fixed rate | 371 | 437 | 1,768 | 10,953 | 13,529 | 13,529 |
| Total non-derivatives | 9,121 | 676 | 2,484 | 13,067 | 25,348 | 25,348 |
| **Group – at 30 June 2009** | | | | | | |
| Non-interest bearing | 8,826 | 239 | 716 | 2,352 | 12,133 | 12,133 |
| Fixed rate | 310 | 371 | 1,533 | 11,661 | 13,875 | 13,875 |
| Total non-derivatives | 9,136 | 610 | 2,249 | 14,013 | 26,008 | 26,008 |

### (d) Fair value estimation

The fair value of financial assets and liabilities must be estimated for recognition and measurement or for disclosure purposes.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values due to their short-term nature. The carrying value of financial liabilities for disclosure purposes is estimated by discounting future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

## 34. Share-based payments

### (a) Employee Option Plan

The Pharmaxis Employee Option Plan ('EOP') was approved by shareholders in 1999 and amended by shareholders in June 2003. The maximum number of options available to be issued under the EOP is 15% of total issued shares including the EOP. All employees and directors are eligible to participate in the EOP, but do so at the invitation of the Board. The terms of option issues are determined by the Board. Options are generally granted for no consideration and vest equally over a four year period. Note however that the only options granted in the current year (21 October 2009: 200,000) vest fully on 30 June 2012. Once vested, the options remain exercisable for up to 10 years from the grant date or termination of employment (whichever is earlier). For options granted after 1 January 2003 the annual vesting is subject to approval by the Remuneration and Nomination Committee of the Board. The Committee gives its approval for vesting based on the achievement of individual employee's personal annual objectives.

Options granted under the EOP carry no dividend or voting rights. When exercisable, each option is convertible into one ordinary share.

The exercise price is set by the Board. Before the company listed on the Australian Stock Exchange in November 2003, the Board set the exercise price based on its assessment of the market value of the underlying shares at the time of grant. From listing until 31 August 2006 the exercise price was set as the average closing price of Pharmaxis Ltd shares on the Australian Securities Exchange on the 5 business days prior to the grant of the options. From 1 September 2006 the exercise price is set as the average of the volume weighted average price of Pharmaxis Ltd shares on the Australian Securities Exchange on the 5 business days prior to the grant of options.

## 34. Share-based payments (continued)

Set out below are details of options exercised during the year and number of shares issued to employees on the exercise of options.

| Year ended 2010 | | | Year ended 2009 | | |
|---|---|---|---|---|---|
| Exercise date | Fair value of shares at issue date | Number | Exercise date | Fair value of shares at issue date | Number |
| 1 July 2009 | $ 2.36 | 45,000 | 7 August 2008 | $ 1.80 | 22,500 |
| 24 July 2009 | $ 2.50 | 180,000 | 10 June 2009 | $ 2.50 | 50,000 |
| 4 August 2009 | $ 2.45 | 5,000 | 10 June 2009 | $ 2.50 | 2,500 |
| 14 August 2009 | $ 2.39 | 625 | | | |
| 15 September 2009 | $ 2.40 | 10,000 | | | |
| 27 October 2009 | $ 2.75 | 9,500 | | | |
| 26 November 2009 | $ 2.43 | 1,120,000 | | | |
| 9 December 2009 | $ 2.73 | 10,000 | | | |
| 5 February 2010 | $ 2.47 | 15,000 | | | |
| 23 March 2010 | $ 2.63 | 40,000 | | | |
| 23 April 2010 | $ 3.17 | 50,000 | | | |
| 30 April 2010 | $ 3.07 | 20,000 | | | |
| 31 May 2010 | $ 3.08 | 16,000 | | | |
| | | 1,521,125 | | | 75,000 |

The fair value of shares issued on the exercise of options is the closing price at which the company's shares were traded on the Australian Securities Exchange on the day of the exercise of the options.

There were 10,108,500 vested options at 30 June 2010 (10,186,188 at 30 June 2009). Set out below are summaries of options granted under the plan:

| Grant date | Expiry date | Exercise price | Balance at start of the year | Granted during the year | Exercised during the year | Forfeited during the year | Balance at end of the year | Vested at end of the year |
|---|---|---|---|---|---|---|---|---|
| **Consolidated 2010** | | | | | | | | |
| 1 Dec 1999 | 30 Nov 2009 | $0.1250 | 1,120,000 | – | 1,120,000 | – | – | – |
| 1 Sept 2001 | 30 August 2011 | $0.3125 | 640,000 | – | – | – | 640,000 | 640,000 |
| 2 Dec 2001 | 30 Nov 2011 | $0.1250 | 100,000 | – | 15,000 | – | 85,000 | 85,000 |
| 12 May 2003 | 30 June 2012 | $0.3125 | 2,490,000 | – | 50,000 | – | 2,440,000 | 2,440,000 |
| 12 May 2003 | 30 Nov 2012 | $0.3125 | 480,000 | – | – | – | 480,000 | 480,000 |
| 12 May 2003 | 30 April 2013 | $0.3125 | 16,000 | – | 16,000 | – | – | – |
| 1 July 2003 | 30 June 2013 | $0.3125 | 360,000 | – | 180,000 | – | 180,000 | 180,000 |
| 4 July 2003 | 3 July 2013 | $0.3125 | 200,000 | – | – | – | 200,000 | 200,000 |
| 9 Dec 2003 | 30 Nov 2013 | $0.3760 | 500,000 | – | 60,000 | – | 440,000 | 440,000 |
| 4 June 2004 | 3 June 2014 | $0.4260 | 15,000 | – | – | – | 15,000 | 15,000 |
| 2 Feb 2005 | 1 Feb 2015 | $0.8340 | 235,000 | – | 10,000 | – | 225,000 | 225,000 |
| 12 May 2005 | 11 May 2015 | $1.1470 | 290,000 | – | – | – | 290,000 | 290,000 |
| 5 Aug 2005 | 4 August 2015 | $1.7900 | 747,500 | – | 7,500 | – | 740,000 | 740,000 |
| 17 Oct 2005 | 16 Oct 2015 | $2.7720 | 52,500 | – | – | 22,500 | 30,000 | 30,000 |
| 13 Feb 2006 | 12 Feb 2016 | $2.1940 | 95,000 | – | 25,000 | 35,000 | 35,000 | 35,000 |
| 1 June 2006 | 31 May 2016 | $2.0340 | 87,500 | – | – | – | 87,500 | 87,500 |
| 15 Aug 2006 | 14 Aug 2016 | $1.9170 | 587,250 | – | 1,250 | 3,750 | 582,250 | 582,250 |
| 26 Oct 2006 | 14 Aug 2016 | $1.9170 | 230,000 | – | – | 20,000 | 210,000 | 210,000 |
| 20 Sept 2006 | 19 Sept 2016 | $1.8918 | 42,500 | – | 1,875 | 625 | 40,000 | 40,000 |

## 34. Share-based payments (continued)

| Grant date | Expiry date | Exercise price | Balance at start of the year | Granted during the year | Exercised during the year | Forfeited during the year | Balance at end of the year | Vested at end of the year |
|---|---|---|---|---|---|---|---|---|
| 26 Oct 2006 | 15 Mar 2016 | $2.0680 | 200,000 | – | – | 200,000 | – | – |
| 14 Dec 2006 | 13 Dec 2016 | $3.0710 | 45,000 | – | – | 12,500 | 32,500 | 32,500 |
| 18 Jun 2007 | 17 Jun 2017 | $3.3155 | 157,500 | – | – | 15,000 | 142,500 | 106,875 |
| 10 Aug 2007 | 9 Aug 2017 | $3.3890 | 1,556,250 | – | – | 84,750 | 1,471,500 | 1,103,625 |
| 5 Nov 2007 | 9 Aug 2017 | $3.3890 | 150,000 | – | – | – | 150,000 | 112,500 |
| 5 Nov 2007 | 14 Nov 2016 | $3.2258 | 200,000 | – | – | – | 200,000 | 200,000 |
| 6 Nov 2007 | 5 Nov 2017 | $4.2900 | 507,000 | – | – | 7,000 | 500,000 | 431,250 |
| 14 Dec 2007 | 13 Dec 2017 | $4.1373 | 2,000 | – | – | – | 2,000 | 1,500 |
| 8 Feb 2008 | 7 Feb 2018 | $3.2666 | 18,500 | – | – | 7,500 | 11,000 | 5,500 |
| 11 Apr 2008 | 10 Apr 2018 | $2.1135 | 14,000 | – | – | – | 14,000 | 7,000 |
| 23 June 2008 | 22 June 2018 | $1.5990 | 61,000 | – | 625 | 6,875 | 53,500 | 26,750 |
| 23 Oct 2008 | 22 June 2018 | $1.5990 | 200,000 | – | – | – | 200,000 | 100,000 |
| 12 Aug 2008 | 11 Aug 2018 | $1.8170 | 1,375,000 | – | 28,875 | 112,125 | 1,234,000 | 612,000 |
| 23 Oct 2008 | 11 Aug 2018 | $1.8170 | 200,000 | – | – | – | 200,000 | 100,000 |
| 23 Oct 2008 | 22 Oct 2018 | $1.6060 | 157,500 | – | 5,000 | 20,000 | 132,500 | 63,750 |
| 11 Dec 2008 | 10 Dec 2018 | $1.1607 | 50,000 | – | – | – | 50,000 | 25,000 |
| 5 Feb 2009 | 4 Feb 2019 | $1.3380 | 276,000 | – | – | – | 276,000 | 69,000 |
| 23 Apr 2009 | 22 Apr 2019 | $1.9574 | 7,500 | – | – | 2,500 | 5,000 | 1,250 |
| 23 Jun 2009 | 22 Jun 2019 | $2.5498 | 1,609,500 | – | – | 48,500 | 1,561,000 | 390,250 |
| 21 October 2009 | 22 Jun 2019 | $2.5498 | – | 200,000 | – | – | 200,000 | – |
| Total | | | 15,075,000 | 200,000 | 1,521,125 | 598,625 | 13,155,250 | 10,108,500 |
| Weighted average exercise price | | | $ 1.562 | $ 2.550 | $ 0.253 | $ 2.347 | $ 1.693 | $ 1.486 |
| **Consolidated 2009** | | | | | | | | |
| 1 Dec 1999 | 30 Nov 2009 | $0.1250 | 1,120,000 | – | – | – | 1,120,000 | 1,120,000 |
| 1 Sept 2001 | 30 August 2011 | $0.3125 | 640,000 | – | – | – | 640,000 | 640,000 |
| 2 Dec 2001 | 30 Nov 2011 | $0.1250 | 100,000 | – | – | – | 100,000 | 100,000 |
| 12 May 2003 | 30 June 2012 | $0.3125 | 2,490,000 | – | – | – | 2,490,000 | 2,490,000 |
| 12 May 2003 | 30 Nov 2012 | $0.3125 | 480,000 | – | – | – | 480,000 | 480,000 |
| 12 May 2003 | 30 April 2013 | $0.3125 | 16,000 | – | – | – | 16,000 | 16,000 |
| 1 July 2003 | 30 June 2013 | $0.3125 | 360,000 | – | – | – | 360,000 | 360,000 |
| 4 July 2003 | 3 July 2013 | $0.3125 | 200,000 | – | – | – | 200,000 | 200,000 |
| 9 Dec 2003 | 30 Nov 2013 | $0.3760 | 500,000 | – | – | – | 500,000 | 500,000 |
| 25 April 2004 | 24 April 2014 | $0.5080 | 22,500 | – | 22,500 | – | – | – |
| 4 June 2004 | 3 June 2014 | $0.4260 | 15,000 | – | – | – | 15,000 | 15,000 |
| 2 Feb 2005 | 1 Feb 2015 | $0.8340 | 235,000 | – | – | – | 235,000 | 235,000 |
| 12 May 2005 | 11 May 2015 | $1.1470 | 290,000 | – | – | – | 290,000 | 290,000 |
| 5 Aug 2005 | 4 August 2015 | $1.7900 | 755,000 | – | – | 7,500 | 747,500 | 747,500 |
| 17 Oct 2005 | 16 Oct 2015 | $2.7720 | 70,000 | – | – | 17,500 | 52,500 | 52,500 |
| 13 Feb 2006 | 12 Feb 2016 | $2.1940 | 245,000 | – | 50,000 | 100,000 | 95,000 | 58,750 |
| 1 June 2006 | 31 May 2016 | $2.0340 | 87,500 | – | – | – | 87,500 | 65,625 |
| 15 Aug 2006 | 14 Aug 2016 | $1.9170 | 604,250 | – | 2,500 | 14,500 | 587,250 | 439,813 |

## 34. Share–based payments (continued)

| Grant date | Expiry date | Exercise price | Balance at start of the year | Granted during the year | Exercised during the year | Forfeited during the year | Balance at end of the year | Vested at end of the year |
|---|---|---|---|---|---|---|---|---|
| 26 Oct 2006 | 14 Aug 2016 | $1.9170 | 230,000 | – | – | – | 230,000 | 192,500 |
| 20 Sept 2006 | 19 Sept 2016 | $1.8918 | 42,500 | – | – | – | 42,500 | 31,875 |
| 26 Oct 2006 | 15 Mar 2016 | $2.0680 | 200,000 | – | – | – | 200,000 | 150,000 |
| 14 Dec 2006 | 13 Dec 2016 | $3.0710 | 45,000 | – | – | – | 45,000 | 33,750 |
| 18 Jun 2007 | 17 Jun 2017 | $3.3155 | 192,500 | – | – | 35,000 | 157,500 | 78,750 |
| 10 Aug 2007 | 9 Aug 2017 | $3.3890 | 1,617,000 | – | – | 60,750 | 1,556,250 | 778,125 |
| 5 Nov 2007 | 9 Aug 2017 | $3.3890 | 150,000 | – | – | – | 150,000 | 75,000 |
| 5 Nov 2007 | 14 Nov 2016 | $3.2258 | 200,000 | – | – | – | 200,000 | 150,000 |
| 6 Nov 2007 | 5 Nov 2017 | $4.2900 | 517,000 | – | – | 10,000 | 507,000 | 366,000 |
| 14 Dec 2007 | 13 Dec 2017 | $4.1373 | 4,000 | – | – | 2,000 | 2,000 | 1,000 |
| 8 Feb 2008 | 7 Feb 2018 | $3.2666 | 18,500 | – | – | – | 18,500 | 4,625 |
| 11 Apr 2008 | 10 Apr 2018 | $2.1135 | 16,000 | – | – | 2,000 | 14,000 | 3,500 |
| 23 June 2008 | 22 June 2018 | $1.5990 | 73,500 | – | – | 12,500 | 61,000 | 15,250 |
| 23 Oct 2008 | 22 June 2018 | $1.5990 | – | 200,000 | – | – | 200,000 | 50,000 |
| 12 Aug 2008 | 11 Aug 2018 | $1.8170 | – | 1,479,500 | – | 104,500 | 1,375,000 | 343,750 |
| 23 Oct 2008 | 11 Aug 2018 | $1.8170 | – | 200,000 | – | – | 200,000 | 50,000 |
| 23 Oct 2008 | 22 Oct 2018 | $1.6060 | – | 162,500 | – | 5,000 | 157,500 | 39,375 |
| 11 Dec 2008 | 10 Dec 2018 | $1.1607 | – | 50,000 | – | – | 50,000 | 12,500 |
| 5 Feb 2009 | 4 Feb 2019 | $1.3380 | – | 276,000 | – | – | 276,000 | – |
| 23 Apr 2009 | 22 Apr 2019 | $1.9574 | – | 7,500 | – | – | 7,500 | – |
| 23 Jun 2009 | 22 Jun 2019 | $2.5498 | – | 1,609,500 | – | – | 1,609,500 | – |
| Total | | | 11,536,250 | 3,985,000 | 75,000 | 371,250 | 15,075,000 | 10,186,188 |
| Weighted average exercise price | | | $ 1.422 | $ 2.052 | $ 1.679 | $ 2.436 | $ 1.562 | $ 1.153 |

There were 598,625 options forfeited during 2010 (371,250 options during 2009).

The weighted average remaining contractual life of share options outstanding at the end of the period was 5.56 years (2009 – 6.06 years).

*Fair value of options granted*

The assessed fair value at grant date of options granted during the year ended 30 June 2010 is detailed in the table below. The fair value at grant date is determined using a Black Scholes option pricing model that takes into account the exercise price, the term of the option, the weighted average share price at grant date and expected price volatility of the underlying share and the risk free interest rate for the term of the option.

The model inputs for options granted during the year ended 30 June 2010 are as follows:

| Grant date | No. of options granted | Exercise Price | Share Price | Time to expiration (days) | Volatility (%) | Annual interest rate (%) | Option value |
|---|---|---|---|---|---|---|---|
| **Consolidated 2010** | | | | | | | |
| 21 Oct 2009 | 200,000 | $2.5498 | $2.63 | 2,190 | 50.00 | 5.49 | $1.4660 |
| | 200,000 | | | | | | |

| Grant date | No. of options granted | Exercise Price | Share Price | Time to expiration (days) | Volatility (%) | Annual interest rate (%) | Option value |
|---|---|---|---|---|---|---|---|
| **Consolidated 2009** | | | | | | | |
| 23 Oct 2008 | 200,000 | $1.5990 | $1.58 | 2,190 | 50.00 | 4.69 | $0.8537 |
| 12 Aug 2008 | 1,479,500 | $1.8170 | $1.93 | 2,190 | 50.00 | 5.78 | $1.0064 |
| 23 Oct 2008 | 200,000 | $1.8170 | $1.58 | 2,190 | 50.00 | 4.69 | $0.9701 |
| 23 Oct 2008 | 162,500 | $1.6060 | $1.58 | 2,190 | 50.00 | 4.69 | $0.8574 |
| 11 Dec 2008 | 50,000 | $1.1607 | $1.05 | 2,190 | 50.00 | 3.75 | $0.6056 |
| 5 Feb 2009 | 276,000 | $1.3380 | $1.13 | 2,190 | 50.00 | 3.60 | $0.6949 |
| 23 Apr 2009 | 7,500 | $1.9574 | $2.14 | 2,190 | 50.00 | 4.05 | $1.0250 |
| 23 Jun 2009 | 1,609,500 | $2.5498 | $2.33 | 2,190 | 50.00 | 5.33 | $1.3873 |
| | 3,985,000 | | | | | | |

The options are issued for no consideration.

The expected price volatility is based on the historic volatility (based on the remaining life of the options), adjusted for any expected changes to future volatility due to publicly available information.

### (b) Expenses arising from share based payment transactions

Total expenses arising from share based payment transactions recognised during the period as part of employee benefit expense were as follows:

| | **2010 $'000** | 2009 $'000 |
|---|---|---|
| Options issued under employee option plan | **2,495** | 2,432 |

## 35. Parent entity financial information

### (a) Summary financial information

The individual financial statements for the parent entity show the following aggregate amounts

| | **2010 $'000** | 2009 $'000 |
|---|---|---|
| **Balance sheet** | | |
| Current assets | **83,388** | 126,157 |
| Total assets | **143,385** | 163,607 |
| Current liabilities | **8,619** | 9,102 |
| Total liabilities | **25,201** | 26,211 |
| *Shareholders' equity* | | |
| Issued capital | **267,050** | 245,958 |
| Reserves | | |
| Share based payments reserve | **12,370** | 9,875 |
| Retained earnings | **(161,236)** | (118,437) |
| | **118,184** | 137,396 |
| **Loss for the year** | **(42,798)** | (35,229) |
| **Total comprehensive income** | **(42,798)** | (35,229) |

### (b) Contractual commitments for the acquisition of property, plant and equipment

As at 30 June 2010, the parent entity had contractual commitments for the acquisition of property, plant or equipment totalling $156,000 (30 June 2009 – $1,492,000). These commitments are not recognised as liabilities as the relevant assets have not yet been received.

## 6.2 Directors' Declaration

In the directors' opinion:

(a) the financial statements and notes set out on pages 35 to 78 are in accordance with the *Corporations Act 2001*, including:

  (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

  (ii) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the financial year ended on that date; and

(b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

Note 1(a) confirms that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The directors have been given the declarations by the chief executive officer and chief financial officer required by section 295A of the *Corporations Act 2001*.

This declaration is made in accordance with a resolution of the directors.

**Alan D Robertson**
Director

Sydney
12th August 2010

## 6.3 Independent Auditor's Report

PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers**
**ABN 52 780 433 757**

Darling Park Tower 2
201 Sussex Street
GPO BOX 2650
SYDNEY NSW 1171
DX 77 Sydney
Australia
Telephone +61 2 8266 0000
Facsimile +61 2 8266 9999
www.pwc.com/au

# Independent auditor's report to the members of Pharmaxis Ltd

### Report on the financial report

We have audited the accompanying financial report of Pharmaxis Ltd (the company), which comprises the balance sheet as at 30 June 2010, and the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for the Pharmaxis Group (the consolidated entity). The consolidated entity comprises 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 and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*.This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1(a), the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards.

*Auditor's responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report 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.

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

PRICEWATERHOUSECOOPERS

## Independent auditor's report to the members of Pharmaxis Ltd (continued)

Our audit did not involve an analysis of the prudence of business decisions made by directors or management.

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

*Independence*

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

*Auditor's opinion*

In our opinion:

(a) the financial report of Pharmaxis Ltd 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 2010 and of its performance for the year ended on that date; and

   (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001;* and

(b) the financial report and notes also comply with International Financial Reporting Standards as disclosed in Note 1(a).

**Report on the remuneration report**

We have audited the remuneration report included under section 2 of the directors' report for the year ended 30 June 2010. 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.

*Auditor's opinion*

In our opinion, the remuneration report of Pharmaxis Ltd for the year ended 30 June 2010, complies with section 300A of the *Corporations Act 2001*.

## Independent auditor's report to the members of Pharmaxis Ltd (continued)

*Matters relating to the electronic presentation of the audited financial report*

This auditor's report relates to the financial report and remuneration report of Pharmaxis Ltd (the company) for the year ended 30 June 2010 included on Pharmaxis Ltd web site. The company's directors are responsible for the integrity of the Pharmaxis Ltd web site. We have not been engaged to report on the integrity of this web site. The auditor's report refers only to the financial report and remuneration report named above. It does not provide an opinion on any other information which may have been hyperlinked to/from the financial report or the remuneration report. If users of this report are concerned with the inherent risks arising from electronic data communications they are advised to refer to the hard copy of the audited financial report and remuneration report to confirm the information included in the audited financial report and remuneration report presented on this web site.

PricewaterhouseCoopers

PricewaterhouseCoopers

Mark Dow
Partner

Sydney
12 August 2010

# 7 Shareholder Information

The shareholder information set out below was applicable as at 12 August 2010.

### A. *Distribution of equity securities*

Analysis of numbers of equity security holders by size of holding:

| Class of equity security Ordinary shares | Shares | Options |
|---|---|---|
| 1 – 1000 | 1,353 | 0 |
| 1,001 – 5,000 | 2,751 | 16 |
| 5,001 – 10,000 | 1,206 | 17 |
| 10,001 – 100,000 | 1,523 | 38 |
| 100,001 and over | 122 | 18 |
| | 6,955 | 89 |

There were 276 holders of less than a marketable parcel of ordinary shares.

### B. *Equity security holders*

*Twenty largest quoted equity security holders*

The names of the twenty largest holders of quoted equity securities are listed below:

| | Ordinary Shares | |
|---|---|---|
| | Number Held | Percentage of issued shares |
| National Nominees Limited | 40,718,032 | 18.0 |
| Citicorp Nominees Pty Limited | 27,273,378 | 12.1 |
| J P Morgan Nominees Australia Limited | 24,109,219 | 10.7 |
| HSBC Custody Nominees (Australia) Limited | 18,448,620 | 8.2 |
| Australian Executor Trustees NSW Ltd | 9,585,920 | 4.3 |
| ANZ Nominees Limited | 7,080,934 | 3.1 |
| Cogent Nominees Pty Limited | 7,064,034 | 3.1 |
| The Australian National University | 1,900,000 | 0.8 |
| UBS Nominees | 1,800,318 | 0.8 |
| AET Structured Finance Services Pty Limited | 1,772,883 | 0.8 |
| Phillip Asset Management Ltd | 1,599,089 | 0.7 |
| KFT Investments Pty Ltd | 1,551,822 | 0.7 |
| RBC Dexia Investor Services Australia Nominees Pty Limited (BKCust a/c) | 1,398,248 | 0.6 |
| Dr Alan Duncan Robertson | 1,045,000 | 0.5 |
| Citicorp Nominees Pty Ltd | 1,043,034 | 0.5 |
| UBS Wealth Management Australia Nominees Pty Ltd | 848,312 | 0.4 |
| MF Custodians Ltd | 800,000 | 0.4 |
| Capital Regional et Cooperatif Desjardins | 697,430 | 0.3 |
| CMG Equity Investment Pty Ltd | 677,752 | 0.3 |
| RBC Dexia Investor Services Australia Nominees Pty Limited (MLCI a/c) | 628,559 | 0.3 |

*Unquoted equity securities*

| | Number Held | Number of Holders |
|---|---|---|
| Options issued under the Pharmaxis Ltd Employee Option Plan | 12,826,375 | 89 |

### *C. Substantial holders*

Substantial holders in the Company are set out below:

| | Number held |
|---|---|
| Orbis Global Equity Fund Limited | 37,675,014 |
| Arnhem Investment Management Pty Ltd | 19,012,549 |

### *D. Voting rights*

The voting rights attaching to each class of equity securities are set out below:

(a) Ordinary shares

On a show of hands every member present at a meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

(b) Options

No voting rights.

# 8 Corporate Directory

**Directors**

Denis Hanley – Chairman
Alan Robertson – Chief Executive Officer
William Delaat
Malcolm McComas
Richard van den Broek
John Villiger

**Company Secretary and Chief Financial Officer**

David McGarvey

**General Counsel**

Cameron Billingsley

**Registered Office**

20 Rodborough Road
Locked Bag 5015
Frenchs Forest NSW 2086
Australia
Telephone: +61 2 9454 7200
Fax: +61 2 9451 3622
Email: info@pharmaxis.com.au

**Web Site**

www.pharmaxis.com.au

**Legal Advisors**

PFM Legal Pty Ltd
Level 12, 117 York Street
Sydney NSW 2000
Australia

Venable LLP
575 7th Street, NW
Washington, DC 20004
United States of America

**Auditor**

PricewaterhouseCoopers
Darling Park Tower 2
201 Sussex Street
Sydney NSW 2000
Australia

**Bankers**

HSBC Bank Australia Ltd
Westpac Banking Corporation

**Securities Exchange Listings**

Pharmaxis shares are listed on the Australian Securities Exchange (Code: PXS)

Pharmaxis American Depositary Receipts (ADRs) are traded on the U.S. over-the-counter market (Code: PXSLY)

**Share Registry**

Computershare Investor Services Pty Ltd
Level 3, 60 Carrington Street
Sydney NSW 2000
Australia
Telephone: +61 3 9415 4000
(within Australia: 1300 855 080)
Fax: +61 3 9473 2500
www.computershare.com

**American Depositary Receipts**

Registrar and Transfer Agent:
BNY Mellon Shareowner Services
480 Washington Blvd., 27th floor
Jersey City, NJ 07310
United States of America
Telephone within the U.S.: (201) 680-4000
Telephone outside the U.S.: +1 201 680 6825

**Incorporation Information**

Incorporated in Australia
Australian Company Number  082 811 630
Australian Business Number  75 082 811 630

pharmaxis

**Pharmaxis Ltd**

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