



Pharmaxis Ltd

ABN 75 082 811 630

ASX Preliminary final report – 30 June 2010

Lodged with the ASX under Listing Rule 4.3A

This report is to be read in conjunction with the Statutory Annual Report dated 14th August 2009 and any public announcements made by during the reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

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Pharmaxis Ltd

ABN 75 082 811 630

Reporting period: Year ended 30th June 2010

(Previous corresponding period: Year ended 30th June 2009)

Results for announcement to the market

| | | | | <u>A\$'000</u> |
|--|------|-----|----|----------------|
| Revenue from ordinary activities | Down | 17% | to | 5,379 |
| Profit / (Loss) from ordinary activities after tax | Up | 32% | to | (46,345) |
| Net profit / (loss) for the year attributable to members | Up | 32% | to | (46,345) |

Dividends

It is not proposed to pay a dividend

Other Appendix 4E information

| | <u>30 June 2010</u> | <u>30 June 2009</u> |
|--|---------------------|---------------------|
| Net tangible assets per ordinary share | \$ 0.43 | \$ 0.63 |

Commentary on results for the period (Appendix 4E item 14)

Overview

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.

Results of Operations

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 | 2009 |
|---------------------------|-------------|-------------|
| <i>In thousands</i> | A\$ | A\$ |
| 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 inflammatory 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 million 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.

General and Administrative Expenses. General and administrative 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.

Status of audit (Appendix 4E items 15 to 17)

This preliminary final report is based on accounts which have been audited. The audit report, which was unqualified, will be made available when the Company lodges its Statutory Annual Report.

**Pharmaxis Ltd
Annual financial report - 30 June 2010****Contents**

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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.

Pharmaxis Ltd
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.

Pharmaxis Ltd

Statement of comprehensive income

For the year ended 30 June 2010

| | 2010 | 2009 |
|---|-----------------|----------|
| | \$'000 | \$'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 consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

Pharmaxis Ltd
Balance sheet
As at 30 June 2010

| | Notes | 2010 \$'000 | 2009 \$'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.

Pharmaxis Ltd

Statement of changes in equity

For the year ended 30 June 2010

| | | 2010 | 2009 |
|---|-------|-----------------|----------|
| | Notes | \$'000 | \$'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.

Pharmaxis Ltd**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.

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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.

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.

1. Summary of significant accounting policies (continued)

(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.

1. Summary of significant accounting policies (continued)

(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.

(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.

1. Summary of significant accounting policies (continued)

(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.

Collectibility 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 |

1. Summary of significant accounting policies (continued)

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.

(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.

1. Summary of significant accounting policies (continued)

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.

1. Summary of significant accounting policies (continued)

(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.

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 |
| <i>Sales revenue</i> | | |
| Sale of goods | 828 | 595 |
| <i>Other revenue</i> | | |
| Interest | 3,935 | 5,347 |

3. Other income

| | | |
|-------------------|------------|-----|
| Government grants | 274 | 93 |
| Service income | 342 | 430 |
| | 616 | 523 |

4. Expenses

| | 2010 | 2009 |
|---|---------------|--------|
| | \$'000 | \$'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 |
| <i>Impairment losses – financial assets</i> | | |
| 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 | 2009 |
|---|-----------------|----------|
| | \$'000 | \$'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.

(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 | 2009 |
|--------------------------------|---------------|---------|
| | \$'000 | \$'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 | 2009 |
|--|---------------|--------|
| | \$'000 | \$'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 | 2009 |
|---------------|---------------|--------|
| | \$'000 | \$'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.

(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.

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

(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 expiry 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 | 2009 |
|----------------------------|---------------|--------|
| | \$'000 | \$'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 | 2009 |
|------------------------------|---------------|--------|
| | \$'000 | \$'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 | 2009 |
|----------------------------------|---------------|--------|
| | \$'000 | \$'000 |
| Shares in subsidiaries (note 27) | - | - |
| Other | - | 248 |
| | - | 248 |

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

| | Plant and equipment | Computer equipment | Leased building and improvements | Total |
|---|------------------------|-----------------------|--|---------|
| | \$'000 | \$'000 | \$'000 | \$'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 | 2009 |
|---------------------|--------|--------|
| | \$'000 | \$'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 | 2009 |
|--------------------------|---------|--------|
| | \$'000 | \$'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 payable

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.

13. Current liabilities – Trade and other payables (continued)

(c) Risk exposure

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

14. Current liabilities – Borrowings

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

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

16. Non-current liabilities – Borrowings

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

19. Contributed equity

| | Notes | Consolidated and Parent entity | | Consolidated and Parent entity | |
|-------------------|---------|-----------------------------------|----------------|-----------------------------------|----------------|
| | | 2010 Shares | 2009 Shares | 2010 \$'000 | 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) |
| | | <u>217,659,109</u> | | <u>245,958</u> |
| 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 |
| | | <u>225,410,234</u> | | <u>267,050</u> |

19. Contributed equity (continued)

(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 | 2009 |
|--|---------------|--------|
| | \$'000 | \$'000 |
| (a) Reserves | | |
| Share-based payments reserve | 12,370 | 9,875 |
| Foreign currency translation reserve | 110 | 27 |
| | 12,480 | 9,902 |
| <i>Share-based payments reserve</i> | | |
| Balance 1 July | 9,875 | 7,443 |
| Option expense | 2,495 | 2,432 |
| Balance 30 June | 12,370 | 9,875 |
| <i>Foreign currency translation reserve</i> | | |
| Balance 1 July | 27 | (4) |
| Currency translation differences arising during the year | 83 | 31 |
| Balance 30 June | 110 | 27 |

20. Reserves and accumulated losses (continued)

(b) Accumulated losses

Movements in accumulated losses were as follows:

| | 2010 | 2009 |
|-----------------------|------------------|------------------|
| | \$'000 | \$'000 |
| Balance 1 July | (118,169) | (82,998) |
| Net loss for the year | (46,345) | (35,171) |
| Balance 30 June | <u>(164,514)</u> | <u>(118,169)</u> |

(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 | 2009 |
|------------------------------|------------------|------------------|
| | \$ | \$ |
| 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 |
| | <u>4,469,130</u> | <u>4,257,779</u> |

Detailed remuneration disclosures are provided in the remuneration report under section 1.5.

(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 | 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 | 220,000 | - | - | 220,000 | - | - |
| J Villiger | 200,000 | - | - | - | 200,000 | 200,000 |
| W Delaat | 200,000 | - | - | - | 200,000 | 100,000 |
| R van den Broek | - | - | - | - | - | - |

21. Key management personnel disclosures (continued)

Other key management personnel of the Group

| 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 |
|-------------|----------------------------------|---|---------------------------|-------------------------------|--------------------------------|---|
| 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.

| 2009 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 | 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 |
|-----------------------------------|----------------------------------|---|-------------------------------|--------------------------------|
| Name | | | | |
| 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 | 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 |
|--|----------------------------------|---|-------------------------------|--------------------------------|
| Name | | | | |
| 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 |

21. Key management personnel disclosures (continued)

(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 | 2009 |
|--|----------------|-----------|
| (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 |
| (c) 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.

23. Contingent liabilities (continued)

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).

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

(a) Capital Commitments

Capital expenditure contracted for at the reporting date but not recognised as liabilities is as follows:

| | 2010 | 2009 |
|----------------------------|---------------|--------|
| | \$'000 | \$'000 |
| <i>Building Fit-out</i> | | |
| Payable: Within one year | - | 135 |
| <i>Plant and equipment</i> | | |
| 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 | 2009 |
|---|---------------|--------|
| | \$'000 | \$'000 |
| <i>Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:</i> | | |
| 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 | 2009 |
|--|----------------|---------|
| | \$'000 | \$'000 |
| <i>Commitments in relation to finance leases are payable as follows:</i> | | |
| 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 |

25. Related party transactions (continued)

(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 |
| | \$ | \$ | \$ | \$ |
| <i>Current payables</i> | | | | |
| 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: | |
| Share issued | 15,624 |
| Contingent consideration | 5,040 |
| Total purchase consideration | <u>20,664</u> |

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 | <u>(1,282)</u> |
| Net assets acquired | <u>20,664</u> |

(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.

26. Business combinations (continued)

(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 |
| | <hr/> |
| Total purchase consideration | 3,670 |

Fair value
\$'000

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

| | |
|--------------------------|--------------|
| Other receivables | 7 |
| Trade and other payables | (7) |
| | <hr/> |
| Net assets acquired | - |
| Add: Patents acquired | 3,670 |
| | <hr/> |
| Net assets acquired | 3,670 |

(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

| | | |
|--|---------------------|--------|
| | Consolidated | |
| Outflow of cash to acquire subsidiaries, net of cash acquired | 2010 | 2009 |
| | \$'000 | \$'000 |
| Cash consideration | 1,711 | - |
| | <hr/> | <hr/> |
| Less: Cash balances acquired | (5,815) | - |

26. Business combinations (continued)

| | Consolidated | |
|---|---------------------|--------|
| | 2010 | 2009 |
| | \$'000 | \$'000 |
| Direct costs relating to the acquisition | - | - |
| (Inflow) / outflow 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 | 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 | 2009 |
|---|-----------------|----------|
| | \$'000 | \$'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 |

30. Reconciliation of loss after income tax to net cash outflows from operating activities (continued)

| | 2010 | 2009 |
|---|-----------------|----------|
| | \$'000 | \$'000 |
| 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 | 2009 |
|--|---------------|--------|
| | \$'000 | \$'000 |
| Acquisition of leased building and improvements by means of finance leases | - | 13,916 |

32. Earnings per share

| | 2010 | 2009 |
|---|--------------------|-------------|
| | Cents | 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 | 2009 |
|------------------------------|---------------|---------|
| | \$'000 | \$'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 |

(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 | GBP | EUR | USD | GBP | EUR |
| | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | \$'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.

33. Financial risk management (continued)

(ii) 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 | Weighted average interest rate | Balance |
| | % | \$'000 | % | \$'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.

(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 | 2009 |
|----------------------------------|--------------|--------------|
| | \$'000 | \$'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 analyses 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 | Between 1 and 2 years | Between 2 and 5 years | Over 5 years | Total contractual cash flows | Carrying Amount (assets)/ liabilities |
|--------------------------------|---------------------|--------------------------|--------------------------|-----------------|------------------------------------|--|
| | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | \$'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.

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

34. Share-based payments (continued)

| 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

| 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 |
|---------------|----------------|----------------|------------------------------|-------------------------|---------------------------|---------------------------|----------------------------|---------------------------|
| 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 | | | | | | |

34. Share-based payments (continued)

| 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 |
| | <u>3,985,000</u> | | | | | | |

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 | <u>2,495</u> | <u>2,432</u> |

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 |
| <i>Shareholders' equity</i> | | |
| Issued capital | 267,050 | 245,958 |
| Reserves | | |
| Share based payments reserve | 12,370 | 9,875 |
| Retained earnings | (161,236) | (118,437) |
| | <u>118,184</u> | <u>137,396</u> |

35. Parent entity financial information (continued)

| | 2010 \$'000 | 2009 \$'000 |
|----------------------------|-----------------|-----------------|
| Loss for the year | <u>(42,798)</u> | <u>(35,229)</u> |
| Total comprehensive income | <u>(42,798)</u> | <u>(35,229)</u> |

(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.