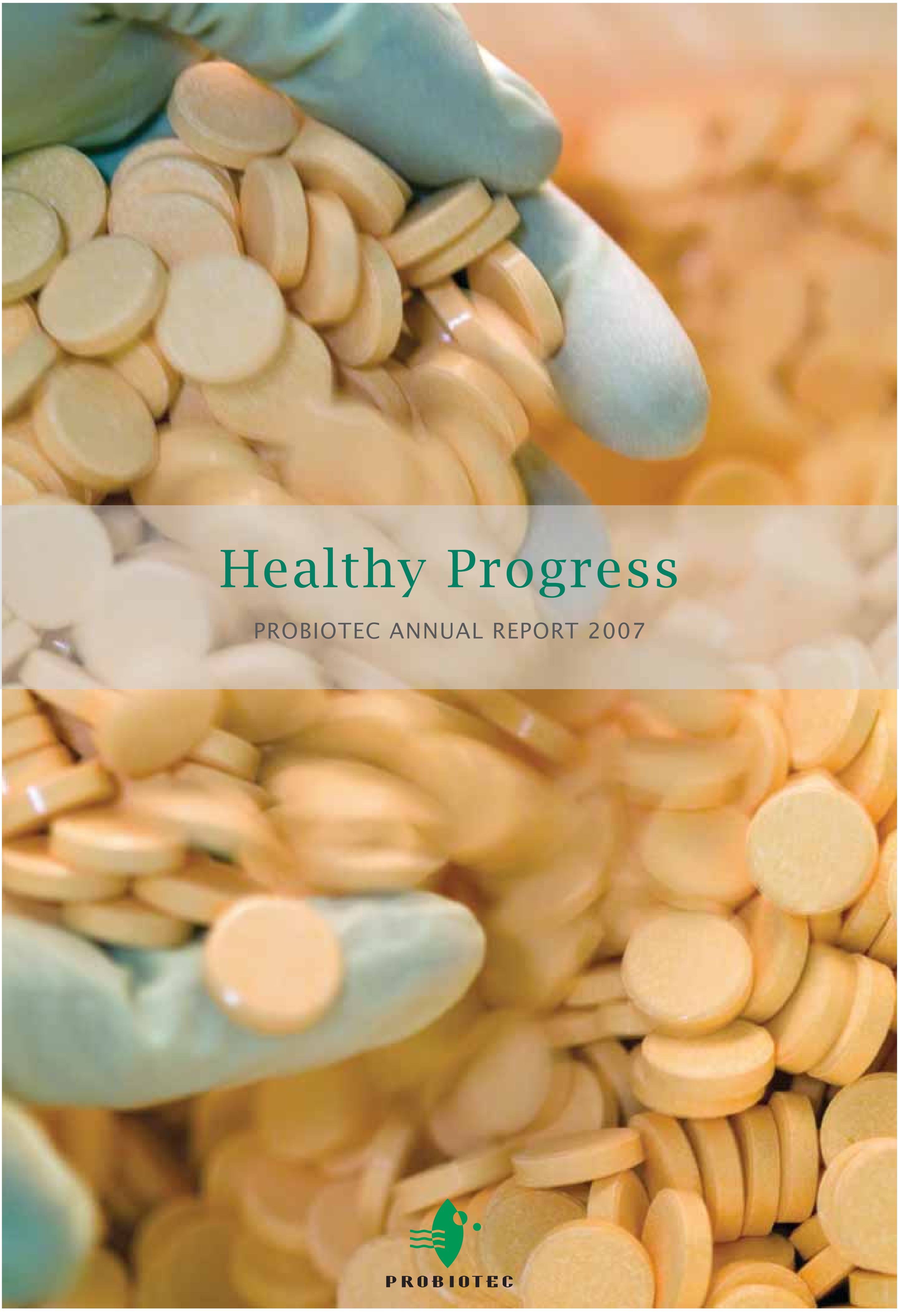
Healthy Progress

PROBIOTEC ANNUAL REPORT 2007



RESULTS SUMMARY

$'000	2007 Forecast	2007 Actual
Revenue	53,748	53,992
EBITDA	9,534	9,769
Profit before tax	6,001	6,061
NPAT	4,321	4,978

CONTENTS

PROBIOTEC LIMITED ABN 91 075 170 151

Healthy progress

CHAIRMAN AND MANAGING DIRECTOR'S REVIEW

Maurice Van Ryn

Wayne Stringer

Dear Shareholder,

It is with a great deal of satisfaction that we present to you this first annual report of Probiotec as a publicly listed company. This is particularly so, in that when we review the hopes and aspirations that we put forward in our Initial Public Offering prospectus, we can say that we have delivered as we promised.

In the nine short months since we listed we have achieved significant business growth and significant net profit generation. This growth and profitability has been driven by the organic growth of the existing business, a value adding acquisition and the launch of exciting new products under our own brands. These developments leave the company well positioned for further significant growth in the years ahead.

For the period ended 30 June 2007, Probiotec turned in a profit after tax of $4.98m, on sales of approximately $54m, demonstrating significant growth on the prior corresponding period. This growth was the result of many positive aspects to the business, inclusive of:

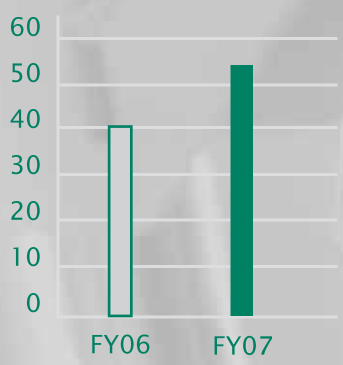
- the full year reflection of the acquisition of the 'Milton' business from the prior year;
- the acquisition of the Vermox®, Lomotil® and Lofenoxal® brands late in the reporting period;
- the development and launch of a range of new products under our 'Biosource' banner as well as under several of our other established brands;
- the continued growth in our contract manufacturing business; and lastly
- the very successful launch part way through the second half of the year of the 'Celebrity Slim' range of products in partnership with the Priceline pharmacy chain.

Because much of this business growth came on stream part way through the reporting period, it is thus reasonable to project that the year ahead will produce continued business growth and improved returns, when a full year reflection of these initiatives is built into next year's result.

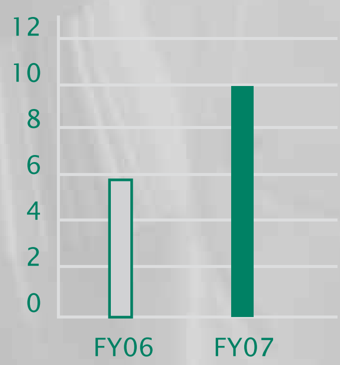
Without doubt, a major part of the strength and success of the business is the quality of the company's major manufacturing assets at its facility situated in Laverton North, Victoria. This TGA approved plant, employing around 300 people, has repeatedly demonstrated its capability to respond quickly to the demands of both the market and of our major contract supply customers. It is an asset of the company that we count amongst our customer base several of the largest pharmaceutical and nutritional companies in the world, and we see good growth potential from these key strategic relationships. In conjunction with our production team, our sales and marketing team have demonstrated a dynamic capability in new product development, product design, market launches, and advertising and promotion, all of which will drive the business to new heights. The biggest marketing project to date has been with the 'Celebrity Slim' weight loss program, and a walk into any Priceline pharmacy will display the capability and effort

PROGRESS SUMMARY

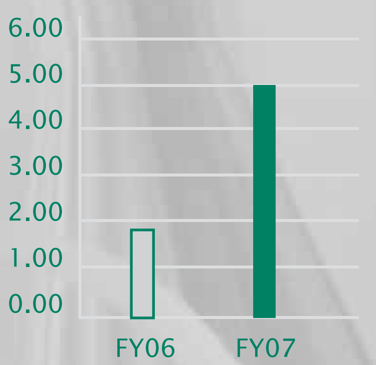
Revenue ($m)



EBITDA ($m)



NPAT ($m)



put in by our marketing staff. As well as this product range, we have launched around half a dozen new products in 2007 under the Biosource banner and our other established brands, all of which will contribute to the future growth of the business.

In order to ensure that the North Laverton facility continues to increase its capability and efficiency moving forward, around $3 million has been earmarked for capital expenditure in the year ahead. This will result in new product presentation formats being introduced to the business, as well as improvements to existing line operations.

Critical to a company of this nature, is a high regard to TGA compliance and quality control. Probiotec has significant resources and IP in our technical, laboratory and quality control areas with around 30 staff employed in this department, who do an excellent job in maintaining our registrations and accreditations.

Another significant development for the business this year has been the emphasis on developing an export sales base and introducing the Company's growing product portfolio to opportune world markets. We have met with good early acceptance and success, and there is no doubt that sales outside of Australia will form a growing percentage of the Company's revenue. The recent successful launch of Celebrity Slim in New Zealand with the Radius Pharmacy chain alone, which consists of over 40 pharmacies, is set to represent significant sales for the exporting division.

Also, late in the reporting period, we commissioned our on-line store, and sales have started to flow through. We would invite shareholders to visit and use our online shopping option at www.pharmaonline.com.au

Given the many seemingly positive influences on the business at this time, we have previously issued to the market profit guidance for 2008 indicating that our expectation is that the Net Profit before Tax for the year ahead should exceed this year's results by at least 30%. As and when we get any further clarity on this number we will update the market accordingly.

The only negative overhanging the business at this time is the 'Phoscal' legal action that had been brought against the Company, of which the market has been kept fully up to date on. The quantum of this legal action is still unknown and at the time of writing this report it is the subject of appeal and cross claims. However, what we would say to shareholders is that whatever the final financial judgment may be as a result of this action, it is unrelated to the Probiotec business of today, and in no way effects the prospects or outcomes for the business moving forward. This action relates to a pre-listing event and whilst unfortunate, is considered more of an irritant and nuisance by the Board, and will have no strategic or operational impact on the business.

In looking at the year ahead we have already made comment about likely business growth and forecast earnings growth, and we have made mention of a continuing investment in capital equipment. However we would also note the current business environment in the pharmaceutical sector of Australia. We see that the continuing restructure and rationalization of the industry will continue to provide good opportunities for further acquisitions, as well as growth in our contract manufacturing business. This, combined with the general boom in the "wellness" market, sees us well placed to maintain this growth momentum. This being the case and barring any unforeseen calamity, it is highly probable that Probiotec will commence dividend payments sometime in 2008.

In closing, we would like to say thank you to all the staff of Probiotec who contribute to the success of the business, and to all the shareholders who have supported the company to this day. To both, we say stick with us, as the journey has only just begun.

Maurice Van Ryn
Chairman
Probiotec Limited

Wayne Stringer
Managing Director
Probiotec Limited

A PROGRESS REPORT

OPERATIONS REVIEW

ACHIEVEMENT OF SALES AND PROFIT FORECASTS

In the 2007 financial year, Probiotec Limited exceeded its prospectus forecasts for Revenue, EBIT, EBITDA and pre-tax and post-tax profit. Net profit after tax for the year was $4,977,524, which represents a 175.7% increase over the previous corresponding period. Earnings per share for the year were 11.15 cents, which represented growth of 139.5% over the previous corresponding period.

Probiotec achieved strong cash flows with $4,459,238 generated from operating activities compared to negative $113,994 in the previous corresponding period. These cash flows have been used to fund the ongoing growth of the company. Significant investment was made in the acquisition of plant and equipment and increases in working capital. The increase in working capital is primarily due to higher levels of inventory to support increased levels of business activities, including the introduction of new products and a decision to increase raw material stock levels to ensure the delivery of products occurred on schedule. The company invested significantly in new product development along with upgrading property, plant and equipment.

ORGANIC GROWTH OF OUR EXISTING PRODUCTS

In the 2007 financial year, Probiotec achieved sales growth of 30% over the previous corresponding period. Growth was experienced in each of the company's product categories, being:

- branded products;
- contract manufacture; and
- nutritionals.

The company's branded product sales grew 40% over the previous corresponding period due to strong growth in its established product range combined with the development and launch of a number of new products, details of which are set out in more detail later in this report. An increased focus on advertising and promotion of branded products yielded significant increases in sales and brand equity and should continue to contribute to the company's future sales growth.

The contract manufacturing division also experienced a strong increase in demand. This was due to the retention and increased workload for its existing customer base as well as securing several major manufacturing contracts with large international pharmaceutical companies. The company's range of state-of-the-art manufacturing capabilities, robust quality systems and committed staff and management team are the significant contributors of growth in this division.

The nutritionals division achieved significant sales growth over the previous financial year. This growth was driven primarily by an increase in demand for the company's animal nutrition range, even through Australia's worst drought on record, along with strong demand for Probiotec's innovative additive products and specialty ingredients.

ACQUISITION AND DEVELOPMENT OF NEW PRODUCTS

In the year, Probiotec made significant investments to increase its product range, notably in relation to the Celebrity Slim range, and also in the wellbeing and preventative medicine categories with the development of products such as Digestion 1-2-3 and Bone Up under the Biosource brand, and our new effervescent arthritis treatment, Arthroflex MAX. These investments will enhance the broadening range of products currently offered by Probiotec and will improve the level of branded product sales.

In April 2007, Probiotec completed the acquisition of the Lomotil®, Lofenoxal® and Vermox® pharmaceutical products for Australia, along with Vermox® for New Zealand. This acquisition was funded predominantly from drawing down funds from the company's existing bank facilities. This acquisition was earnings per share neutral this year but is expected to materially contribute to earnings in the year to 30 June 2008 and beyond.

Lomotil and Lofenoxal are leading anti-diarrhoeal products and Vermox is a leading de-worming product. The manufacture of these three products will be integrated into Probiotec's Laverton manufacturing facility during the 2008 financial year.

This acquisition of drugs represents the continuation of the company's strategy of increasing its portfolio of branded pharmaceutical products. The company's continued investment in its pharmaceutical manufacturing capability in Laverton has

enabled the company to acquire these products and gain the full benefit of manufacturing, marketing and distributing the drugs.

During the year, Probiotec invested approximately $2.24 million in research and development of new products. This expenditure has led to the development of a range of new products, including 10 new products lines that were released in the 2007 financial year and included:

- Celebrity Slim's range of meal replacement and associated weight loss products;
- Milton Antibacterial hand gels;
- Arthroflex MAX;
- Biosource Digestion 1-2-3;
- Biosource Immune Plus 30 pack;
- Biosource Bone Up; and
- Medislim Natural Advance Rapid fat burner.

The launch of the Celebrity Slim branded range of products was a major success for the company. Celebrity Slim is a sophisticated weight loss program that offers a range of meal replacement and other products to assist in weight loss and weight management. The products are being retailed exclusively through Priceline pharmacies and stores and are now one of the largest selling products in these stores.

Celebrity Slim contributed materially to sales in the year to 30 June 2007 and is expected to show significant further growth in the 2008 financial year as a range of new products are developed to further strengthen the brand offering.

Further innovative products are in development in several major health categories which are planned for release throughout the 2008 financial year.

STRATEGIC INVESTMENT IN PHARMACEUTICAL BUSINESS

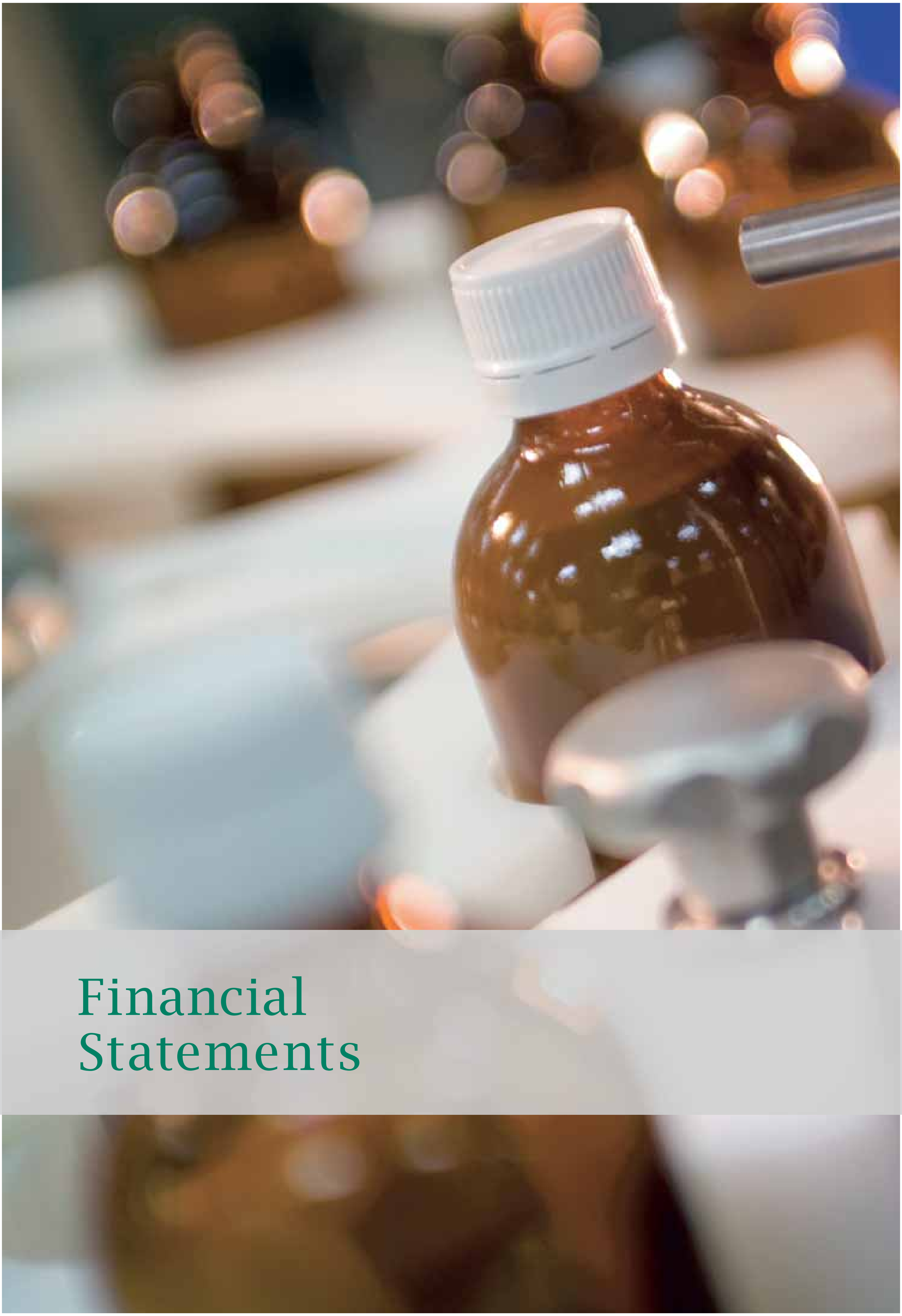
One of the key factors contributing to Probiotec's ability to obtain contracts from major pharmaceutical companies, as well as enabling the company to continue to develop innovative new products, is the quality of its manufacturing, testing, quality control and validation facilities.

The company's pharmaceutical manufacturing activities, both in respect of its own products and products of other pharmaceutical companies, grew materially in the year, necessitating significant investment in plant, equipment and building upgrades in the Laverton facility.

During the year, the company invested approximately $2.5 million to upgrade its manufacturing sites and equipment, and to purchase new items of plant and equipment. Management has implemented initiatives to increase both manufacturing capacity and efficiency in these operations. Several important initiatives have been completed and others continue in accordance with their project plans.

The company has built excess capacity at all of its manufacturing sites, which ensures that it is not capacity constrained in its growth plans for both its own brands and those which it contract manufactures.

The company will continue to invest in its operating assets to ensure that it retains a competitive advantage in product development and manufacturing capability and quality.



Financial Statements

Corporate governance

1. PROBIOTEC'S APPROACH TO CORPORATE GOVERNANCE

Overview

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

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

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

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

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

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

Compliance with the ASX best practice recommendations

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

As required by the ASX best practice recommendations, Probiotec has copies of each corporate governance practice described below on its website at www.probiotec.com.au

Probiotec also publishes on its website the annual reports, profit announcements, CEO and executive briefings, economic updates, notices of meeting, media releases and meeting transcripts.

2. DATE OF THIS STATEMENT

This statement reflects our corporate governance policies and procedures as at 31 August 2007.

3. THE BOARD OF DIRECTORS

Membership and expertise of the Board

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

Board role and responsibility

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

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

In summary, the Board's responsibilities include:

- providing strategic direction and approving corporate strategic initiatives;
- selecting and evaluating future Directors, the Chief Executive Officer ('CEO') and the Chief Financial Officer ('CFO');
- planning for Board and executive succession;
- setting CEO and Director remuneration within shareholder approved limits;
- approving Probiotec's budget and monitoring management and financial performance;
- considering and approving Probiotec's Annual Financial Report and the interim and final financial statements;

Corporate governance

Board role and responsibility continued

- approving Probiotec's risk management strategy, monitoring its effectiveness and maintaining a direct and ongoing dialogue with Probiotec's auditors and regulators; and
- considering and reviewing the social and ethical impact of Probiotec's activities, setting standards for social and ethical practices and monitoring compliance with Probiotec's social responsibility policies and practices.

The Board has delegated to management responsibility for:

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

Board size and composition

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

The selection and role of the Chairman

The Chairman is selected by the Board.

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

Directors' independence

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

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

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

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

Meetings of the Board and their conduct

The Board meets formally approximately nine times a year. In addition, it meets whenever necessary to deal with specific matters needing attention between the scheduled meetings. The Chairman and the CEO establish meeting agendas to ensure adequate coverage of financial, strategic and major risk areas throughout the year. In addition to its formal meetings, the Board undertakes regular and relevant workshops. These meetings will include workshops on executive and senior

Meetings of the Board and their conduct continued

management succession planning, corporate governance, Probiotec's risk/reward approach, customer experience and segmentation projects and other major strategic initiatives.

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

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

Review of Board performance

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

Retirement and re-election of Directors

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

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

Board access to information and advice

All Directors have unrestricted access to company records and information and receive regular detailed financial and operational reports from executive management to enable them to carry out their duties.

The Board collectively, and each Director individually, has the right to seek independent professional advice at Probiotec's expense to help them carry out their responsibilities. While the Chairman's prior approval is needed, it may not be unreasonably withheld and, in its absence, Board approval may be sought.

4. BOARD COMMITTEES

Board committees and membership

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

- Audit and Risk Management Committee
- Nomination & Remuneration Committee

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

Committee Charters

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

Committee procedures

Operation of the Committees and reporting to the Board

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

Corporate governance

Committee procedures continued

to attend Committee meetings. All Directors receive all Committee papers and can attend all Committee meetings.

Composition and independence of the Committees

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

How the Committees report to the Board

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

How Committees' performance is evaluated

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

Board Audit and Risk Management Committee

Role of the Committee

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

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

Integrity of the financial statements

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

External audit

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

Operational Risk

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

Compliance with legal and regulatory requirements

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

Composition of ARM

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

Board Nomination & Remuneration Committee

Role of the Committee

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

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

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

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

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

Corporate governance

Composition of NRC

NOM membership is: Maurice Van Ryn (Chairman), Graham Buckeridge and Wayne Stringer.

Board Corporate Social Responsibility Committee

Role of the Committee

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

5. AUDIT GOVERNANCE AND INDEPENDENCE

Approach to audit governance

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

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

Engagement and rotation of external auditor

Probiotec's independent external auditor is PKF, Gold Coast (PKF). PKF were appointed by shareholders at the 2005 Annual General Meeting in accordance with the provisions of the Corporations Act.

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

Certification and discussions with external auditor on independence

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

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

Relationship with external auditor

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

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

Relationship with external auditor continued

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

Restrictions on non-audit services by the external auditor

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

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

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

Attendance at Annual General Meeting

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

6. CONTROLLING AND MANAGING RISK

Approach to risk management

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

Probiotec recognises three main types of risk:

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

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

Corporate governance

Risk management roles and responsibilities

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

CEO and CFO assurance

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

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

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

7. REMUNERATION FRAMEWORK

Overview

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

Non-executive Directors

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

Executives

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

Equity-related reward and performance plans overview

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

8. CORPORATE SOCIAL RESPONSIBILITY

Approach to corporate social responsibility

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

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

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

Probiotec's Code of Conduct and responsibility codes

Probiotec's Code of Conduct applies to all Directors, executives, management and employees without exception. The Code governs workplace and human resource practices, risk management and legal compliance and is reviewed periodically

Probiotec's Code of Conduct and responsibility codes continued

and has been specifically reviewed to reflect the ASX best practice recommendations.

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

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

Compliance policy and practices

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

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

Concern reporting and whistle blowing

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

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

Securities trading policy

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

The key aspects of the policy are:

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

Corporate governance

Market disclosure policy and practices

Probiotec is committed to giving all shareholders equal access to material information about our activities, and to fulfill continuous disclosure obligations to the broader market. The Board-approved market disclosure policy governs how Probiotec communicates with shareholders and the market. This policy is designed to ensure compliance with ASX Listing Rules continuous disclosure requirements so as to ensure any information that a reasonable person would expect to have a material effect on the price of Probiotec's securities is disclosed.

The CEO is responsible for making decisions on what should be disclosed publicly under the market disclosure policy, and for developing and maintaining relevant guidelines, including guidelines on information that may be price sensitive. The Company Secretary has responsibility for ensuring compliance with the continuous disclosure requirements in the ASX Listing Rules, and overseeing and coordinating information disclosure to the ASX, analysts, brokers, shareholders, the media and the public.

Directors' report

The directors submit the financial report of the Probiotec Limited and its controlled entities for the financial year ended 30 June 2007.

DIRECTORS

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

Maurice Van Ryn	Chairman, appointed on 28/7/2006
Charles Wayne Stringer	Executive Director, appointed on 8/8/1996
Graham Harry Buckeridge	Non-Executive Director, appointed on 28/7/2006
Richard David Kuo	Non-Executive Director, appointed on 28/7/2006
Mark Thomas Chatfield	Executive Director, appointed on 13/1/2006, resigned 28/7/2006
Rudolf Andrew Ganter	Executive Director, appointed on 8/8/1996, resigned on 28/7/2006

Directors have been in office since the start of the financial year to the date of this report unless otherwise stated.

COMPANY SECRETARIES

The company secretaries to the date of this financial report were:

Christopher Brian Blake	appointed on 28/07/2006
Jared Stringer	appointed on 28/07/2006

PRINCIPAL ACTIVITIES

The consolidated entity's principal activity in the course of the financial year was the manufacture and sale of pharmaceuticals and nutraceutical products in Australia and International markets.

OPERATING RESULTS

The consolidated profit of the economic entity attributable to the shareholders for the financial year was $4,977,524 (2006: profit of $1,805,552).

DIVIDENDS

No dividends were declared or paid since the start of the financial year. No recommendation for payment of dividends has been made.

REVIEW OF OPERATIONS

The Group's sales revenue for the period was $53,991,931 representing an increase of 30.2 percent compared to the prior corresponding period's sales revenue of $41,480,394. The Group's net profit attributable to members for the financial year was $4,977,524, which represents an increase of 176% over the previous financial year of $1,805,552. The Group achieved sales growth in all of its main businesses. In its Pharmaceutical segment, comprising Owned Pharmaceutical Products, Licensed Pharmaceutical Products, Contract Manufacturing and Additive Products, sales increased to $34,078,508 in the 2007 year from $26,235,846 in 2006, and in its Nutritional/ Nutraceutical business segment to $19,913,423 in the 2007 year from $15,245,008 in 2006.

This growth in sales revenue and profitability in the year to 30 June 2007 is in accordance with the Group's financial forecasts set out in its prospectus issued for its Initial Public Offering in October 2006. Strong growth in sales and profitability in the second half of the 2007 financial year was realised and, together with the expected contribution from the product acquisitions mentioned below, provides a solid foundation for continued growth in sales and profitability in the 2008 financial year.

Cashflow generated from operations has been used to fund the ongoing growth of the company. Significant investment was made in the acquisition of plant and equipment and increases in working capital. The increase in working capital is primarily due to higher levels of inventory to support increased levels of business activities, including the introduction of new products and a decision to increase raw material stock levels to ensure the scheduled delivery of products occurred on schedule. The group invested significantly in upgrading property, plant and equipment and new product development. It also acquired the Lomotil®, Lofenoxal® and Vermox® pharmaceutical products in April 2007 for Australia, along with Vermox® for New Zealand funded predominantly from drawing down on the Group's existing bank facilities

Total interest bearing liabilities, net of cash, as at 30 June 2007 was $23,851,989, an increase of 5.7% from the same date in the previous year. While net debt has increased marginally, interest cover based on EBIT has increased materially from 2.7 times, in the year to 30 June 2006, to 4.9 times in the year to 30 June 2007. The Group's net debt to equity ratio also reduced materially as at 30 June 2007 to 62.7%, down from 85.0% at the same date in the previous year. The Directors continue to consider that, as the Group can comfortably service its debt obligations and it has favourably renegotiated the terms of its banking facilities, shareholder value can be more effectively increased by maintaining a responsible level of gearing in the Group.

The Group benefited from a full years contribution from the acquisition of the Milton business, which was fully integrated into the Group's Laverton facility in the second half of the 2006 financial year. A new line of Milton products was commercialised in the year and sales, while currently modest, are now being distributed through both pharmacies and major retailers. In addition to these products, new complimentary medicines, developed and owned by Probiotec, were launched during the year. The Group plans to increase marketing activities on its new products to help ensure their success.

The Group had a material new product success with the launch of the Celebrity Slim branded range of weight loss products it has developed in conjunction with a commercial partner. The products are being retailed exclusively through Priceline pharmacies and stores and are now one of the largest selling products in those stores. Celebrity Slim contributed materially to sales in the year to 30 June 2007 and the directors are confident of a significant increase in sales in the year to 30 June 2008 as additional products are added to the range. The directors expect that the weight loss segment will continue to offer a range of opportunities for the Group's product development capabilities.

The Group's pharmaceutical manufacturing activities, both in respect of its own products and products of other pharmaceutical companies grew materially in the year necessitating significant investment in additional plant and equipment in the Laverton facility. The majority of contract manufacturing activity was on behalf of major pharmaceutical companies, from which the Group continues to experience strong demand. The testing, quality control and validation capabilities of the Group, coupled with the expansion of the pharmaceutical manufacturing plant have been major factors in expanding this business unit.

The Additive Products business line experienced a very strong year by virtue of the Group being in a position to leverage opportunities which presented themselves in the 2007 financial year. Price movements in dairy related products, particularly where Probiotec can add value through processing these products and subsequently selling them, has had a positive effect on profitability of this business activity.

A material part of management attention was focused on continuing to implement both increases in manufacturing capacity and in business efficiency initiatives in the manufacturing capability of the Group. Several important initiatives have been completed and others continue in accordance with their project plans. Managing both the significant increase in business activity and implementing business improvement initiatives in parallel is a testament to the quality and capability of operational management within the Group.

During the year the Company was ordered to jointly and severally pay the claimants costs in the case of *NSI Dental Pty Ltd v University of Melbourne* [2007] FTA 523. This unfortunate, one-off event relating back to 2004 was both unexpected and disappointing, however, the company's is currently appealing the decision and has commenced legal proceedings against its former legal advisors. Further details can be found in Note 28(a) of the Notes to the Financial Statements.

SIGNIFICANT CHANGES IN STATE OF AFFAIRS

Significant changes in the state of affairs of the consolidated entity comprised:

- the Company's initial public offering and listing on the Australian Stock Exchange during the year to 30 June 2007; and
- the growth in the scale of the Company's activities, as described in the Review of Operations above.

There was no other significant change in the state of affairs of the consolidated entity other than that referred to in the financial statements or notes thereto and elsewhere in the financial report of the company and its controlled entities for the year ended 30 June 2007.

SIGNIFICANT AFTER BALANCE DATE EVENTS

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

FUTURE DEVELOPMENTS

The Company will continue to operate its business consistent with its stated business strategy of growing both its pharmaceutical and Nutritional/Nutraceutical business segments. Growth will be achieved both organically, by exploiting its existing products and through the development and exploitation of new products, and by acquisitions of new products or synergistic businesses on appropriate terms. The foundation for decisions in these initiatives will be based primarily on growing both profitability and cashflow of the Company which, the directors consider, is the most appropriate way to continue to grow shareholder value.

ENVIRONMENTAL ISSUES

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

OCCUPATIONAL HEALTH AND SAFETY

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

DIRECTORS' BENEFITS

No director has received or become entitled to receive a benefit other than directors' remuneration. Full details of the level of remuneration received by Directors can be found in the Remuneration Report on page 7 of the Directors Report.

Directors' report

MEETINGS OF DIRECTORS

Probiotec Limited became a public company on 17th February 2006 and listed on the Australian Stock Exchange on the 14th November 2006. Directors hold meetings every month. The board also comprises the Audit and Risk Management and Remuneration Sub-Committees. The number of meetings of the company's board of directors held during the year ended 30 June 2007, and the numbers of meetings attended by each director were:

	Board of Directors Meetings		Audit & Risk Management Committee meetings		Remuneration & Nominations Committee meetings	
Director	No. Held*	No. Attended**	No. Held	No. Attended	No. Held	No. Attended
Charles Wayne Stringer	11***	9	–	–	–	–
Rudolf Andrew Ganter	1	1	–	–	–	–
Mark Thomas Chatfield	1	1	–	–	–	–
Graham Harry Buckeridge	11	10	–	–	1	1
Richard David Kuo	11	11	2	2	–	–
Maurice Van Ryn	11	10	2	2	1	1

* Number of board meetings held while director eligible to attend.
** Number of meetings for members of respective board or committee only.
*** Only 11 meetings were held during the year as the June meeting was held in July 2007.

INFORMATION ON DIRECTORS AND OFFICERS

Maurice Van Ryn

Role	–	Chairman (Non-executive)
Qualifications	–	Bachelor of Business (RMIT), CPA
Experience	–	Appointed Chairman in July 2006. Previously held the position of CEO of Bega Cheese and is currently Bega Cheese's International Business Manager as well as the CEO of Tatura Milk Industries Limited. Maurice has 28 years experience in direct management of food companies in the Australian manufacturing sector.
Special Responsibilities	–	Chairman of the Remuneration Committee
Other Directorships	–	Non-executive Director of Medical Development International Limited.
	–	Non-executive Director of Tassal Group Limited (resigned 2007)
	–	Non-executive Director of Freedom Nutritional Foods Limited (resigned 2006)

Graham Harry Buckeridge

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

Richard David Kuo

Role	–	Non-Executive Director
Qualifications	–	B.Com, LLB
Experience	–	Holds Commerce and Law degrees with post graduate qualifications in applied finance and investment. Brings with him 17 years experience in law, investment banking and corporate strategy. Currently jointly manages Pier Capital Pty Ltd, a privately owned investment banking firm which advises a broad range of corporations and has extensive experience in mergers and acquisitions, equity markets and strategic planning.
Special Responsibilities	–	Responsibilities include Risk Management and oversight of the Audit Committee.
Other Directorships	–	Nil

Charles Wayne Stringer

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

Christopher Brian Blake

Role	–	Company Secretary
Qualifications	–	B.Comm, ACA
Experience	–	Brings 33 years of experience in Chartered accountancy firms and industry roles. Began employment with Probiotec Limited in 1997.
Interest in Shares & Options	–	400,000 shares, 187,503 options
Other Directorships	–	Nil

Jared Stringer

Role	–	Company Secretary
Qualifications	–	B.Comm (Accounting, Finance), BIT
Experience	–	Began employment with Probiotec in 2002 and accepted role of Financial Accountant in May 2005.
Interest in Shares & Options	–	80,000 shares, 62,501 options
Other Directorships	–	Nil

INDEMNIFYING OFFICERS OR AUDITORS

During the financial year the company insured its directors and officers against liabilities for all costs and expenses incurred by them in defending any legal proceedings arising out of their conduct while acting in the capacity as directors and officers of the company, other than conduct involving a wilful breach of duty in relation to the company. The total premium paid was $42,000.

REMUNERATION REPORT

This report is prepared in accordance with section 300A of the Corporations Act 2001 for the Company and its subsidiaries for the financial year ended 30 June 2007.

1. REMUNERATION

1.1 Remuneration & Nomination Committee

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

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

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

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

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

The Committee membership and the Chairman of the Committee will be as determined from time to time by the Board. Each of the members will be independent directors and free from any business or other relationship that, in the opinion of the Board, would materially interfere with the exercise of their independent judgement as a member of the Committee.

New Committee members will receive induction training from the Chairman of the Committee, the Chief Financial Officer's and Quality Control Manager's teams and the Company Secretary. Committee members should receive continuous training.

Members of Nomination & Remuneration Committee	Position	Appointed
Maurice Van Ryn	Chairman	28 July 2006
Graham Buckeridge	Member	28 July 2006

1.2 Remuneration Policy – Non-Executive Directors

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

The current annualised total remuneration for the company's non-executive directors is $160,000. The nomination & remuneration committee reviews non-executive remuneration annually and makes recommendations to the board. The committee considers current market rates of remuneration for similar sized companies and obtains advice from independent professional firms if required. Shareholders will be periodically asked to approve increases in the fee level of non-executive directors if the size, scope, complexity or demands made on the directors increases.

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

Remuneration levels for non-executive directors for the 2007 financial year are set out on page 28 of this report.

1.3 Remuneration Policy – Executive Directors and Key Management Personnel

The nomination and remuneration committee has structured the company's executive remuneration policies to ensure:

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

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

Directors' report

Short-term Incentives

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

Long-term Incentives

The company provides long-term incentives to key management personnel to reward sustained performance by the organisation as a whole. Long-term incentives are in the form of options over Probiotec Limited shares issued under the company's Exempt Share and Option Plan, which was adopted by a resolution of members on 3 May 2006. The issue of options is based on a review of the contributions and value of management personnel undertaken by the nomination and remuneration committee.

At the date of this report, Wayne Stringer is the only executive director of Probiotec Limited. Mr. Stringer is paid a Fixed Annual Remuneration. Along with his Fixed Annual Remuneration, Mr. Stringer is also eligible to receive equity-based compensation, in the form of share options, based on the achievement of set milestones stipulated in his contract of employment.

Termination Arrangements

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

1.4 Remuneration Policy – Employees

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

2. LINKING REMUNERATION TO PROBIOTEC'S PERFORMANCE

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

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

Given the performance of the company and its share price since listing on the Australian Stock Exchange (ASX) on 14 November 2006, the board is satisfied that the remuneration policies have been effective in increasing shareholder wealth. The table below illustrates the consistent growth achieved by Probiotec over the past several years.

Table 1: Probiotec performance history

	Half Year Ended 31 Dec 05 $'000	Half Year Ended 30 Jun 06 $'000	Half Year Ended 31 Dec 06 $'000	Half Year Ended 30 Jun 07 $'000
Revenue	18,984	22,496	23,652	30,340
Earnings Before Interest tax Depreciation and amortisation (EBITDA)	2,839	3,076	3,950	5,818
Net Profit After Tax (NPAT)	452	1,353	1,422	3,556
Share Price	–	1.00*	1.14	1.20

*No share price was available as at 30 June 2006, share price shown illustrates price at which the company listed at the time of its Initial Public Offering (IPO) on 14 November 2006.

3. REVIEW OF REMUNERATION

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

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

4. REMUNERATION DETAILS OF DIRECTORS & KEY MANAGEMENT PERSONNEL

For the purposes of this report, "Key Management Personnel" are defined as:

(a) The five executives that receive the highest remuneration within the group and the five executives that receive the highest remuneration within the company for the year ended 30 June 2007;

(b) Any personnel not referred to in (a) that have responsibility and authority over the management or direction of a significant component of the Company's operating expenses or one of the Company's major revenue generating divisions.

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

Table 2: Directors & Key Management Personnel Remuneration details

		Short-Term Benefits			Post Employment Benefits	Equity-Based Benefits	
	Position	Salary, Fees & Commissions $	Short Term Incentives $	Non-Cash Benefits $	Superannuation Contribution $	Shares & Options $	Total $
Directors & Secretary							
Maurice Van Ryn	Chairman	58,869	–	–	5,298	–	64,167
Wayne Stringer	CEO/Managing Director	264,067	–	–	37,787	–	301,854
Richard Kuo	Non-Executive Director	45,833	–	–	–	–	45,833
Graham Buckeridge	Non-Executive Director	–	–	–	36,663	–	36,663
Chris Blake	Secretary	33,749	–	–	30,733	12,959	77,441
		368,769	–	–	79,748	12,959	448,517
Key Management Personnel							
Alan Hong	Chief Financial Officer	115,898	–	–	17,676	6,912	140,486
Mark Chatfield	GM Sales & Marketing	128,357	–	–	9,840	10,368	148,565
Rudi Ganter	Technical/R&D Manager	124,872	–	–	–	–	124,872
Wes Stringer	Chief Operating Officer	112,474	–	–	7,156	12,959	132,589
Humera Ahmad	GM Quality	104,103	–	–	22,284	6,912	133,299
Matthew Dalton	National Sales Manager	116,883	–	–	12,289	3,456	132,628
		702,587	–	–	69,245	40,607	812,439

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

5. INTEREST IN SHARES & OPTIONS

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

Table 3: Interest in Shares & options of Directors and Key Management Personnel

	No. of fully paid ordinary shares	No. of options	Grant Date	Exercise Date	Exercise price	Value of options granted**
Maurice Van Ryn	332,502	–	–	–	–	–
Charles Wayne Stringer	7,945,662	–	–	–	–	–
Graham Harry Buckeridge	1,818,684	–	–	–	–	–
Richard David Kuo	98,501	–	–	–	–	–
Alan Hong	5,000	100,002	30/06/06	30/06/09	$0.80	20,730
Mark Chatfield	25,000	150,003	30/06/06	30/06/09	$0.80	31,096
Rudi Ganter	2,481,800	–	–	–	–	–
Wes Stringer	351,006	187,503	30/06/06	30/06/09	$0.80	38,869
Matthew Dalton	–	50,001	30/06/06	30/06/09	$0.80	10,365
Humera Ahmad	5,000	100,002	30/06/06	30/06/09	$0.80	20,730
	13,063,155	587,511				121,791

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

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

6. SHARE OPTIONS EXERCISED OR LAPSED DURING THE YEAR

No share options were exercised or lapsed during the year ended 30 June 2007.

7. LOANS TO DIRECTORS & KEY MANAGEMENT PERSONNEL

No loans have been made to, or from, any director or employee of the Probiotec Group since the company's listing on the Australian Stock Exchange (ASX). Prior to the listing, loans were advanced to the company by Mr. Rudolf Ganter and Inston Pty Ltd, a party related to Mr. Wayne Stringer. These loans were repaid upon the listing of the company on the ASX.

Loans from Directors or related parties for the year ended 30 June 2007 are as follows:

Table 4: Movement in loans to Directors & Key Management Personnel

	Balance at 1/07/2006 $	Interest Charged $	Increase/ (Decrease) $	Balance at 30/06/2007 $
Inston Pty Ltd	457,207	13,524	(470,731)	0
Rudi Ganter	101,667	5,671	(107,338)	0

Directors' report

8. RETIREMENT BENEFITS

Probiotec provides retirement benefits by way of participation in a number of superannuation funds, which also provide optional insurance arrangements. The company contributes to its default superannuation fund, unless required to provide a choice of fund under the superannuation legislation, in which case the company contributes to the employees' designated fund. Contributions are required to be at least equal to the minimums set down in the superannuation guarantee legislation.

Proceedings on Behalf of the Company

No person has applied for leave of court to bring proceedings on behalf of the company or intervene in any proceedings to which the company is a party for the purpose of taking responsibility on behalf of the company for all or any part of those proceedings. The company was not party to any such proceedings during the year with the exception of the NSI Dental case referred to in Note 28 (a).

Non-audit Services

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

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

The following fees for non-audit services were paid/payable to the external auditors during the year ended 30 June 2007:

	2007 $	2006 $
Auditor		
– AIFRS consultation	19,800	17,000
Related practice of Auditor		
– Investigating Accountants report	78,431	113,245
	98,231	130,245

AUDITOR'S INDEPENDENCE DECLARATION

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 14 of this report.

Signed in accordance with a resolution of Board of Directors.

Charles Wayne Stringer
Director

Richard David Kuo
Director

Signed at Sydney this 28th day of August 2007

Lead audit independence declaration

PKF

Chartered Accountants
& Business Advisers

AUDITOR'S INDEPENDENCE DECLARATION – ANNUAL FINANCIAL REPORT

Auditor's Independence Declaration

As lead auditor for the audit of Probiotec Limited for the year ended 30 June 2007, I declare that, to the best of my knowledge and belief, there have been:

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

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

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

PKF Gold Coast

PKF Gold Coast

Michael J. Sheehy
Partner

28 August 2007

Level 5, RSL Centre
9 Beach Road
Surfers Paradise

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Income Statement For the year ended 30 June 2007

		Economic Entity		Parent Entity	
	Note	2007 $	2006 $	2007 $	2006 $
Sales revenue	2	53,991,931	41,480,394	–	–
Cost of goods sold		(33,814,218)	(26,591,155)	–	–
Gross profit		20,177,713	14,889,239	–	–
Other income	2	373,722	727,991	5,545,237	3,703,424
Warehousing & distribution expenses		(2,980,203)	(1,585,087)	–	–
Sales and marketing expenses		(3,360,570)	(2,511,886)	(283,185)	–
Finance costs		(1,601,512)	(1,520,283)	(1,601,512)	(1,480,940)
Administration and other expenses	4	(6,030,721)	(7,015,420)	(3,120,378)	(2,514,141)
Share of net loss of associates and joint venture entity	14	(516,952)	(372,675)	–	–
Profit/(loss) from ordinary activities before income tax expense	3	6,061,477	2,611,879	540,162	(291,657)
Income tax expense relating to ordinary activities	5	(1,083,953)	(806,327)	(526,783)	221,908
Net profit/(loss) from ordinary activities after income tax expense		4,977,524	1,805,552	13,379	(69,749)
Profit attributable to members of the parent entity		4,977,524	1,805,552	13,379	(69,749)
Basic earnings per share (cents)		11.15	4.66		
Diluted earnings per share (cents)		10.85	4.66		

The Income Statement is to be read in conjunction with the attached notes

Balance Sheet As at 30 June 2007

	Note	Economic Entity 2007 $	Economic Entity 2006 $	Parent Entity 2007 $	Parent Entity 2006 $
CURRENT ASSETS					
Cash and cash equivalents	10	2,028,209	632,478	681,606	316,032
Trade receivables	11	7,541,236	7,230,334	23,121,689	18,218,481
Inventories	12	15,118,665	8,819,549	–	–
Other current assets	13	479,675	1,224,769	114,427	418,595
Total Current Assets		25,167,785	17,907,130	23,917,722	18,953,108
NON-CURRENT ASSETS					
Investments accounted using equity method	14	2,522,756	2,031,444	–	–
Property, plant and equipment	15	34,391,709	31,390,962	20,725,054	16,467,961
Investments	16	–	–	8,933,890	7,925,626
Deferred tax assets	18	4,116,911	4,999,084	1,998,989	1,638,649
Intangible assets	17	11,714,960	5,592,623	250,000	250,000
Total Non-Current Assets		52,746,336	44,014,113	31,907,933	26,282,236
Total Assets		77,914,121	61,921,243	55,825,655	45,235,344
CURRENT LIABILITIES					
Trade & other payables	19	9,009,827	8,220,053	538,874	1,176,551
Short-term borrowings	20	6,447,376	14,769,849	4,879,362	12,864,348
Current tax liabilities	5	23,668	–	–	–
Short-term provisions	21	508,225	434,846	67,409	169,713
Total Current Liabilities		15,989,096	23,424,748	5,485,645	14,210,612
NON-CURRENT LIABILITIES					
Long-term borrowings	20	19,432,822	8,436,708	18,782,822	7,686,708
Deferred tax liabilities	22	4,417,778	3,463,283	4,369,016	2,687,593
Long-term provisions	21	52,025	51,393	985	17,531
Total Non-Current Liabilities		23,902,625	11,951,384	23,152,823	10,391,832
Total Liabilities		39,891,721	35,376,132	28,638,468	24,602,444
Net Assets		38,022,400	26,545,111	27,187,187	20,632,900
EQUITY					
Issued capital	24	20,229,511	15,541,970	20,229,510	15,541,970
Shares held by equity compensation plan	25	(955,000)	(955,000)	(955,000)	(955,000)
Reserves	26	4,523,583	2,711,359	4,409,606	2,556,238
Retained earnings		14,224,306	9,246,782	3,503,071	3,489,692
Total Equity		38,022,400	26,545,111	27,187,187	20,632,900

The Balance Sheet is to be read in conjunction with the attached notes

Statement of Changes in Equity For the year ended 30 June 2007

Economic Entity	Ordinary Share Capital $	Shares held by Equity Compensation Plan $	Asset Revaluation Reserve $	Retained Earnings $	Total $
Balance as at 1 July 2005	11,163,171	–	2,711,358	7,441,230	21,315,759
Shares issued during the year	4,378,800	(955,000)	–	–	3,423,800
Profit attributable to members of parent entity	–	–	–	1,805,552	1,805,552
Revaluation increment	–	–	–	–	–
Balance as at 1 July 2006	15,541,971	(955,000)	2,711,358	9,246,782	26,545,111
Shares issued during the year (Note 25)	5,812,231	–	–	–	5,812,231
Equity Raising Expenses	(1,124,691)	–	–	–	(1,124,691)
Revaluation increment	–	–	1,812,225	–	1,812,225
Profit attributable to members of parent entity		–	–	4,977,524	4,977,524
Balance as at 30 June 2007	20,229,511	(955,000)	4,523,583	14,224,306	38,022,400

Parent Entity	Ordinary Share Capital $	Shares held by Equity Compensation Plan $	Asset Revaluation Reserve $	Retained Earnings $	Total $
Balance as at 1 July 2005	11,163,170	–	2,556,237	3,559,441	17,278,848
Shares issued during the year	4,378,800	(955,000)	–	–	3,423,800
Loss attributable to members of parent entity	–	–	–	(69,749)	(69,749)
Revaluation increment	–	–	–	–	–
Balance at 1 July 2006	15,541,970	(955,000)	2,556,237	3,489,692	20,632,899
Shares issued during the year (a)	5,812,231	–	–	–	5,812,231
Equity Raising Expenses	(1,124,691)	–	–	–	(1,124,691)
Revaluation increment	–	–	1,853,369	–	1,853,369
Profit attributable to members of parent entity	–	–	–	13,379	13,379
Balance as at 30 June 2007	20,229,510	(955,000)	4,409,606	3,503,071	27,187,187

(a) Includes share based payment reserve amounting to $59,288 (refer footnote 1k)

The Statement of changes in equity is to be read in conjunction with the attached notes

Cash Flow Statement For the year ended 30 June 2007

	Note	Economic Entity 2007 $	Economic Entity 2006 $	Parent Entity 2007 $	Parent Entity 2006 $
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from customers		53,681,029	39,768,773	200,953	3,316,662
Payments to suppliers and employees		(47,665,389)	(38,362,484)	(1,825,760)	(4,719,581)
Interest received		45,110	10,177	45,110	10,177
Interest and other costs of finance paid		(1,601,512)	(1,530,460)	(1,601,512)	(1,491,117)
Income tax paid		–	–	–	–
Net cash provided by operating activities	33 (b)	4,459,238	(113,994)	(3,181,209)	(2,883,859)
CASH FLOWS FROM INVESTING ACTIVITIES					
Payment for property, plant and equipment – net		(3,294,089)	(1,756,335)	(3,243,621)	(3,790,484)
Payments relating to investments		(1,008,264)	(769,707)	(1,008,264)	(769,707)
Purchase of other non-current asset		(6,122,337)	(1,603,873)	–	–
Net cash used in investing activities		(10,424,690)	(4,129,915)	(4,251,885)	(4,560,191)
CASH FLOWS FROM FINANCING ACTIVITIES					
Proceeds from issues of shares		4,687,541	3,423,799	4,687,540	4,378,799
Proceeds from borrowings		4,435,178	1,204,764	4,535,179	4,272,152
Repayment of borrowings		(1,424,051)	(625,000)	(1,424,051)	(625,000)
Net cash used in financing activities		7,698,668	4,003,563	7,798,668	8,025,951
Net Increase/(Decrease) In Cash Held		1,733,217	(240,346)	365,574	581,901
Cash at beginning of financial year		(1,173,022)	(932,676)	316,032	(265,869)
Cash at end of financial year		560,196	(1,173,022)	681,606	316,032

RECONCILIATION OF CASH AND CASH EQUIVALENT

For the purposes of the statement of cash flows, cash includes cash on hand and in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:

Cash	2,028,209	632,478	681,606	316,032
Bank Overdraft	(1,468,014)	(1,805,500)	–	–
	560,195	(1,173,022)	681,606	316,032

The Cash Flow Statement is to be read in conjunction with the attached notes

Notes to the financial statements

For the year ended 30 June 2007

1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted by Probiotec Limited and its subsidiaries are stated in order to assist in a general understanding of the financial report.

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASBs), adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The financial report of the economic entity complies with IFRS and interpretations adopted by the International Accounting Standards Board. The parent company's financial report does not comply with IFRSs as the Company has elected to apply the relief provided to parent entities by AASB 132 Financial Instruments: Presentation and Disclosure in respect of certain disclosure requirements.

Basis of Preparation

Probiotec Limited and controlled entities, and Probiotec Limited as an individual parent entity have prepared financial statements in accordance with the Australian equivalents to International Financial Reporting Standards (AIFRS) from 1 July 2004. These consolidated accounts are the second financial statements of Probiotec Limited to be prepared in accordance with the Australian equivalents of IFRS. The accounting policies set out below have been consistently applied to all years presented.

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

Reporting Basis and Convention

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

Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements are prepared by combining the financial statements of all the entities that comprise the consolidated entity, being Probiotec Limited (the parent entity) and its controlled entities as defined in accounting standard AASB 127 "Consolidated Accounts". A list of controlled entities appears in Note 29 to the financial statements. Where a subsidiary either began or ceased to be controlled during the year, the results of its operations are included only from the date control commenced or ceased.

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

(b) Income Tax

i) General

The charge for current income tax expense is based on the profit for the year adjusted for any non-assessable or disallowed items. It is calculated using the tax rates that have been enacted or are substantially enacted by the balance sheet date.

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

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

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

ii) Capital Gains Tax

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

iii) Goods and Services Tax

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

(c) Foreign Currency Translation

i) Functional and presentation currency

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

ii) Foreign Currency Transactions

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of the transaction. Foreign currency monetary items are translated at the year end exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction.

(d) Impairment of assets

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

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

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

In calculating the value in use, the cash flow includes projections of cash inflows and outflows from continuing use of the asset and cash flows

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

(e) Inventories

Inventories are valued at the lower of cost and net realisable value. Costs comprise all cost of purchase and conversion, including material, labour an appropriate portion of fixed and variable overhead expenses. Costs have been assigned to inventory on hand at balance sheet date using either the first-in-first-out (F.I.F.O.) basis or the weighted average cost basis, depending on the nature of product being manufactured.

(f) Property, Plant and Equipment

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

i) Property

Freehold land and buildings are stated at fair value (being the amount for which an asset could be exchanged between knowledgeable willing parties in an arm's length transaction), based on periodic, valuations by external valuers, less subsequent depreciation for building. Any accumulated depreciation at the date of valuation is eliminated against the gross carrying amount of the asset and the net amount is reinstated to the revalued amount of the asset.

ii) Plant and Equipment

Plant and equipment are measured on the cost basis.

The carrying amount of plant and equipment is reviewed annually by directors to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows that will be received from the asset's employment and subsequent disposal. The expected net cash flows have been discounted to their present value in determining recoverable values.

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

Increases in the carrying amount arising on revaluation of land and buildings are credited to a revaluation reserve in equity. Decreases that offset previous increases of the same asset are charged against fair value reserves directly in equity; all other decreases are charged to the income statement. Each year the difference between depreciation based on the revalued carrying amount of the asset charged to the income statement and depreciation based on the asset's original cost is transferred from the revaluation reserve to retained earnings.

Depreciation

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

Notes to the financial statements

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

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

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

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These gains and losses are included in the income statement. When revalued assets are sold, amounts included in the revaluation reserve relating to the asset are transferred to retained earnings.

(g) Leases

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

Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses in the periods in which they are incurred.

(h) Investments in Associates

Associates comprise entities over which the parent entity or the consolidated entity have significant influence and hold an ownership interest. Investments in associated companies are recognised in the financial statements by applying the equity method of accounting. The parent entity's investments in associates are brought to account using the cost method.

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

(i) Interests in Joint Venture Entities

The economic entity's interest in joint venture entities are brought to account using the equity method of accounting in the consolidated financial statements. The parent entity's interest in joint venture entities are brought to account using the cost method.

(j) Intangibles

i) Goodwill

Goodwill and goodwill on consolidation are initially recorded at the amount by which the purchase price for a business or for an ownership interest in a controlled entity exceeds the fair value attributed to its net assets at date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

ii) Trademarks, Licenses and Product Dossiers

Trademarks, licenses and product dossiers ("Brands") are recognised at cost. Brands having an infinite life are tested at each balance date for impairment and carried at cost less accumulated impairment losses. Those with a finite life are carried at cost and amortised over their useful life.

iii) Research and Development

Expenditure on research associated with product research is charged against net income in the year of expenditure.

Development activities associated with brand development innovation is capitalised if the product is technically and commercially feasible and adequate resources are available to complete development.

(k) Employee Benefits

i) Wages, Salaries & Annual Leave

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

ii) Long Service Leave

Liabilities relating to Long Service Leave are measured as the present value of the estimated future cash outflows to be made in respect to services provided by employees, up to the reporting date. Consideration is given to expected future wage levels, experience of employee departures and period of service.

iii) Superannuation

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

iv) Employee share based Payment

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

(l) Financial Instruments

Recognition

Financial instruments are initially measured at cost on trade date, which includes transaction costs, when the related contractual rights or obligations exist. Subsequent to initial recognition these instruments are measured as set out below.

Financial assets at fair value through profit and loss

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

Notes to the financial statements

Loan and Receivables

Loan and Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised costs using the effective interest rate method.

Held to maturity Investments

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

Available for sale financial assets

Available for sale financial assets include any financial assets not included in the above categories. Available for sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity.

Financial liabilities

Non-derivative financial liabilities are recognised at amortised costs, comprising original debt less principal payments and amortisation.

Fair Value

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

Impairment

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

(m) Government Grants

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

(n) Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns, allowances and discounts. Sales revenue comprises revenue earned from the provision of products and services to entities outside the consolidated entity. Sales revenue is recognised when the risks and rewards of ownership have transferred to the customer. No revenue is recognised if there are significant uncertainties regarding the recovery of the consideration due, the costs incurred or to be incurred cannot be measured reliably, there is risk of return of goods or there is continuing management involvement with the goods.

Interest income is recognised as it accrues, taking into account the effective yield of the financial asset. Interest income is included as financial income in the income statement.

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

(o) Financing costs

Financing costs include interest income and expense, amortisation of discounts or premiums relating to borrowings, amortisation of ancillary costs incurred in connection with the arrangement of borrowings and lease finance charges. Borrowing costs are expensed as incurred.

(p) Provisions

A provision is recognised when there is a legal or constructive obligation as a result of a past event and it is probable that a future sacrifice of economic benefits will be required to settle the obligation, and the amount can be reliably estimated. Provisions are not recognised for future operating losses.

(q) Cash

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

(r) Comparative Figures

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

(s) Use of Accounting Estimates

The preparation of the financial report requires management to make estimates and assumptions that affect the recognised amounts of assets, liabilities, revenues and expenses and the disclosure of contingent liabilities. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

(t) New Accounting Standards

The following Standards and Amendments were available for early adoption but have not been applied by the consolidated entity in its financial statements:

New or revised requirement	Effective Date	
AASB 101 Presentation of Financial Statements (Revised) Removes Australian specific requirements for AASB 101, but incorporates amendments made on the introduction of AASB 7 surrounding the disclosure of the entity's objectives, policies and processes for managing capital. No impact is anticipated on the financial result, however, impacts on disclosures.	Beginning 1 January 2007	Mandatory for half-year ending 30 June 2007 Optional for early adoption for year ending 30 June 2007, no specific disclosure required in interim period
AASB 7 Financial Instruments: Disclosure, AASB 2005-10 Amendments to Australian Accounting Standards No impact is anticipated on the financial result, however, impacts on disclosures.	Beginning 1 January 2007	Optional for early adoption for year ending 30 June 2007, no specific disclosure required in interim period.
AASB 123 Borrowing Costs (Revised), AASB 2007-6 Amendments to Australian Accounting Standards Eliminates the option of expensing borrowing costs relating to qualifying assets, instead requiring capitalisation. Transitional provisions require prospective application to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after application date. The Company expenses borrowing costs as incurred. Depending upon future capital programs, there may be an impact on future financial results.	Beginning 1 January 2009	Optional for half-year ending 30 June 2007 Optional for early adoption for year ending 30 June 2007

Notes to the financial statements

New or revised requirement	Effective Date	
AASB 8 Operating Segments, AASB 2007-3 Amendments to Australian Accounting Standards arising from AASB 8 No impact is anticipated on the financial result, however, impacts on disclosures.	Beginning 1 January 2009	Optional for half-year ending 30 June 2007 Optional for early adoption for year ending 30 June 2007
AASB 2007-4 Amendments to Australian Accounting Standards New accounting policy choices are introduced and many Australian-specific disclosures deleted. No impact is anticipated on the financial result, however, may impacts on presentation of financial results and disclosures.	Beginning 1 July 2007	Optional for half-year ending 30 June 2007 Optional for early adoption for year ending 30 June 2007

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
2: REVENUE				
Operating activities				
Sale of goods	53,991,931	41,480,394	–	–
Management fees & other charges	–	–	5,299,174	3,326,834
Government subsidies received	115,191	276,393	–	176,667)
Other revenue	213,421	441,421	200,953	191,279
Interest received	45,110	10,177	45,110	8,644
Total other income	373,722	727,991	5,545,237	3,703,424
Total Revenue	54,365,653	42,208,385	5,545,237	3,703,424

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $

3: PROFIT/(LOSS) FOR THE YEAR

Net profit/(loss) has been arrived at after including:

Finance cost – non related parties	1,601,512	1,520,283	1,601,512	1,480,940
Foreign currency translation losses	126,433	10,638	55,089	–
Bad and doubtful debts expense-trade receivables	103,352	171,531	–	–
Rental on operating lease expenses – minimum lease payments	134,640	84,333	–	–
Inventory write-offs	313,318	112,846	–	–
Professional and consulting expenses	920,790	965,983	673,302	788,131
Employee benefits expenses	9,886,955	8,602,192	1,343,185	646,110
Repairs and maintenance expenses	604,443	603,300	–	–
Research and development cost	2,242,230	1,120,000	–	–
Depreciation and Amortisation expense	2,105,566	1,783,173	839,896	641,108
Impairment Costs – in relation to investment	–	–	–	–

4: ADMINISTRATION & OTHER EXPENSES

Administration & other expenses comprises:

Employee Benefits	2,499,174	2,976,868	1,343,185	565,661
Other Expenses	3,531,547	4,038,552	1,777,193	1,948,480
	6,030,721	7,015,420	3,120,378	2,514,141

Notes to the financial statements

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $

5: INCOME TAX EXPENSE

Deferred income tax revenue (expense) included in the income tax expense comprises:

	2007 $	2006 $	2007 $	2006 $
Current tax	23,668	–	–	–
Deferred tax	1,060,285	806,326	526,783	(221,908)
	1,083,953	806,326	526,783	(221,908)
Prima facie tax on profit/(loss) from ordinary activities before income tax at 30%	1,818,443	783,698	162,049	(87,497)
Add Tax effect of:				
Non allowable expenses, recoupment of prior losses not yet booked and other differences	(734,490)	22,628	364,734	(134,411)
Income tax expense	1,083,953	806,326	526,783	(221,908)
The weighted average effective tax rates are as follows:	17.9%	30.9%	97.5%	76.1%

The primary reason for the variance between the Prima Facie tax rate and the effective tax rate was due to the recoupment of taxation losses of prior years not previously brought to account.

6: DISCONTINUED OPERATIONS

No operations were discontinued during the year.

7: KEY MANAGEMENT PERSONNEL AND THEIR RELATED PARTIES DISCLOSURES

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

8: REMUNERATION OF AUDITORS

(a) Remuneration of auditor of the parent entity:

	2007 $	2006 $	2007 $	2006 $
Auditing or reviewing the financial report	134,851	160,000	134,851	160,000
AIFRS consultation	19,800	17,000	19,800	17,000
	154,651	177,000	154,651	177,000

(b) Related practice of the auditor for non audit services:

	2007 $	2006 $	2007 $	2006 $
Investigating Accountants Report	78,431	113,245	78,431	113,245

The auditor of Probiotec Limited is PKF Gold Coast.

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $

9: DIVIDENDS

No Dividends were paid or declared during the year.

10: CASH AND CASH EQUIVALENTS

Cash on hand and at bank	2,028,209	632,478	681,606	316,032

See Cash Flow Statement for reconciliation of cash.

11: TRADE RECEIVABLES

CURRENT				
Trade accounts receivable – third parties	7,711,141	7,598,714	117,123	53,582
Trade accounts receivable – subsidiaries	–	–	23,004,566	18,177,497
Less: Allowance for impairment of receivables – third parties	(169,905)	(368,380)	–	(12,598)
Total current trade receivables	7,541,236	7,230,334	23,121,689	18,218,481

12: INVENTORIES

Raw material – at cost	8,488,212	6,318,673	–	–
Work in progress – at cost	1,471,120	516,822	–	–
Finished goods – at cost	5,159,333	1,984,054	–	–
	15,118,665	8,819,549	–	–

13: OTHER CURRENT ASSETS

Prepayments	122,978	461,045	31,613	400,000
GST receivable	332,150	630,455	–	–
Other receivables	24,547	133,269	82,814	18,595
	479,675	1,224,769	114,427	418,595

Notes to the financial statements

14: INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

(a) Interests are held in the following associated company and joint venture company:

	Name 2007	Domicile 2006	Ownership Interest 2007	Carrying Amount Of Investment 2006
Australian Dairy Proteins Pty Ltd Australia	50%	50%	50%	50%
Phoscal Holdings Ltd (unlisted) Australia	26%	26%	–	–

Australian Dairy Proteins Pty Ltd ("ADP") is a joint venture entity and is involved in the manufacture of a range of specialty protein fractions extracted from cheese whey for sale into the nutraceutical, pharmaceutical, specialty food and cosmetic markets. The reporting date is 30 June 2007. The voting power of Probiotec Ltd is 50.001%. The entity is accounted for as a jointly controlled entity as the shareholders agreement specifies that all significant financial and operating decisions require unanimous approval.

The principal activity of Phoscal Holdings Ltd is dairy product derivatives. The company has been dormant and has not been trading for the 12 months ending 30 June 2007.

(b) Interest in investments accounted for using the equity method are comprised as follows:

	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
Interest in joint venture entity – ADP:				
Shares in joint venture entity – at cost	50,000	50,000	–	–
Investment Loan	3,574,643	2,566,379	–	–
Share of Retained profits (accumulated losses)	(1,101,887)	(584,935)	–	–
Dividends	–	–	–	–
	2,522,756	2,031,444	–	–
Interests in Associates				
Share in associates – at cost	280,047	280,047	–	–
Loan to associates	712,234	712,234	–	–
	992,281	992,281	–	–
Less: Impairment provision	(992,281)	(992,281)	–	–
	–	–	–	–
Total investments accounted for using the equity method	2,522,756	2,031,444	–	–

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
(c) Movements in the carrying amount of equity accounted investments in associated company:				
Beginning of financial year	2,031,444	1,634,411	–	–
Additional investments	1,008,264	769,707	–	–
Share of results	(516,952)	(372,674)	–	–
Dividends	–	–	–	–
End of Financial Year	2,522,756	2,031,444	–	–
Share of ADP's financial position and financial results:				
Financial Position				
Current Assets	329,648	896,997	–	–
Non-Current Assets	5,606,212	5,048,317	–	–
Total Assets	5,935,859	5,945,314	–	–
Current Liabilities	661,340	118,098	–	–
Non-Current Liabilities	6,403,937	6,362,150	–	–
Total Liabilities	7,065,276	6,480,248	–	–
Net Assets	(1,129,417)	(534,934)	–	–
Financial Results				
Revenues	330,139	288,000	–	–
Expenses	(847,090)	(660,674)	–	–
Loss from Ordinary Activities before Income Tax	(516,952)	(372,674)	–	–
Income tax expense	–	–	–	–
Loss from ordinary activities after income tax	(516,952)	(372,674)	–	–
Aggregate contingent liabilities arising from interest in Joint Venture	–	–	–	–
Aggregate capital commitments arising from interest in Joint Venture	–	–	–	–
Retained Earnings/(accumulated loss) attributable to interest in Joint Venture:				
Balance at beginning of year	(584,934)	(212,260)		
Share of Joint Venture's (loss) after income tax	(516,952)	(372,674)		
Balance at the end of the financial year	(1,101,886)	(584,934)		

Notes to the financial statements

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
15: PROPERTY, PLANT AND EQUIPMENT				
Freehold land – at valuation	4,337,775	3,476,601	3,993,375	2,955,000
Building – at independent valuation	12,207,475	8,747,393	11,651,875	8,200,967
Less: Accumulated depreciation	–	(479,993)	–	(371,015)
	12,207,475	8,267,400	11,651,875	7,829,952
Plant & Equipment – at cost	19,153,998	19,596,071	1,282,545	1,272,560
Less: Accumulated depreciation	(6,068,691)	(5,170,919)	(963,893)	(811,360)
	13,085,307	14,425,152	318,652	461,200
Leased Plant & Equipment	5,453,104	5,570,990	5,453,104	5,570,990
Less: Accumulated depreciation	(691,952)	(349,181)	(691,952)	(349,181)
	4,761,152	5,221,809	4,761,152	5,221,809
TOTAL PROPERTY, PLANT AND EQUIPMENT	34,391,709	31,390,962	20,725,054	16,467,961

All of the economic entity's freehold land & buildings were revalued by an independent valuer in June 2007 and resulted in a net revaluation increase of 2,588,608. Valuations were made on the basis of weighted depreciated values and open market values. The revaluation surplus net of applicable deferred income taxes was credited to an asset revaluation reserve in shareholders' equity. As at 30 June 2007 the historical cost of the Group's freehold land and buildings were $3,290,199 and $6,010,374 respectively.

Movements during the year Economic Entity	Freehold land $	Buildings $	Plant, Equipment & Other $	Leased Plant, Equipment & Other $	Total $
Carrying Amount at 1 July 2005	3,476,601	8,160,624	14,322,382	1,901,613	27,861,220
Additions	–	440,025	1,524,006	3,556,680	5,520,711
Disposals	–	–	(123,772)	(83,924)	(207,696)
Revaluation/Impairment	–	–	–	–	–
Depreciation and amortisation	–	(333,249)	(1,297,464)	(152,560)	(1,783,273)
Carrying Amount at 30 June 2006	3,476,601	8,267,400	14,425,152	5,221,809	31,390,962
Carrying Amount at 1 July 2006	3,476,601	8,267,400	14,425,152	5,221,809	31,390,962
Additions	–	708,140	1,505,434	294,568	2,508,142
Reclassification	1,981,596	(1,585,138)	(396,458)	–	
Disposals	–	–	(2,329)	–	(2,329)
Revaluation/Impairment	861,174	1,727,434	–	–	2,588,608
Depreciation and amortisation	–	(477,095)	(1,257,812)	(358,767)	(2,093,674)
Carrying Amount at 30 June 2007	4,337,775	12,207,475	13,085,307	4,761,152	34,391,709

For the year ended 30 June 2007 Movements during the year **Parent Entity**	Freehold land $	Buildings $	Plant, Equipment & Other $	Leased Plant, Equipment & Other $	Total $
Carrying Amount at 1 July 2005	2,955,000	7,937,234	608,663	1,817,688	13,318,585
Additions	–	211,532	17,695	3,585,029	3,814,256
Disposals	–	–	(23,772)	–	(23,772)
Revaluation/Impairment	–	–	–	–	–
Depreciation and amortisation	–	(318,814)	(141,386)	(180,908)	(641,108)
Carrying Amount at 30 June 2006	2,955,000	7,829,952	461,200	5,221,809	16,467,961
Carrying Amount at 1 July 2006	2,955,000	7,829,952	461,200	5,221,809	16,467,961
Additions	–	644,032	1,513,049	294,568	2,451,649
Reclassification	–	1,897,193	(1,500,735)	(396,458)	–
Disposals	–	–	(2,329)	–	(2,329)
Revaluation/Impairment	1,038,375	1,609,293	–	–	2,647,668
Depreciation and amortisation	–	(328,595)	(152,533)	(358,767)	(839,895)
Carrying Amount at 30 June 2007	3,993,375	11,651,875	318,652	4,761,152	20,725,054

	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $

16: INVESTMENT

Investments in:				
Shares in Subsidiaries – at cost	–	–	5,309,247	5,309,247
Associated Entities – at cost (Note 14)	–	–	3,624,643	2,616,379
	–	–	8,933,890	7,925,626

17: INTANGIBLE ASSETS

Acquired Intangible Assets – Infinite Life:				
Goodwill – at cost	250,000	250,000	250,000	250,000
Brands – at cost	8,267,647	3,545,087	–	
	8,517,647	3,795,087	250,000	250,000
Internally Generated Intangible Assets – Infinite Life:				
Brands – at cost	2,278,449	1,669,781	–	–
Products under Development – at cost	598,214	127,755	–	–
	2,876,663	1,797,536	–	–

Notes to the financial statements

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007	2006	2007	2006
	$	$	$	$
Internally Generated Intangible Assets – Finite Life:				
Brands – at cost	332,965	–	–	–
Accumulated Amortisation	(12,315)	–		
	320,650	–	–	–
Total intangible assets	11,714,960	5,592,623	250,000	250,000

Probiotec Ltd has both acquired and internally generated trademarks, licenses and product dossiers (“Brands”). Product dossiers incorporate formulations, registrations, Therapeutic Goods Administration (TGA) listings, stability and validation data, and manufacturing and testing procedures.

Reconciliation of Intangible Assets:

	Goodwill	Brands	Products under Development
Year ended 30 June 2006			
Balance at beginning	250,000	3,545,087	–
Additions	–	1,669,781	127,755
Disposals	–	–	–
transfer of commercialised product	–	–	–
Amortisation	–	–	–
Closing balance as at 30 June 2006	250,000	5,214,868	127,755
Balance as at 30 June 2007			
Balance at beginning	250,000	5,214,868	127,755
Additions	–	4,722,560	1,412,092
Disposals	–	–	–
transfer of commercialised product	–	941,633	– 941,633
Amortisation	(12,315)	–	
Closing balance as at 30 June 2007	250,000	10,866,746	598,214

Estimated useful life of Intangible Assets

Intangible assets, comprising brands and goodwill, have infinite useful lives apart from brands which are subject to a license with a specified term. Brands with indefinite lives comprise trademarks and product dossiers. Brands with finite useful lives are amortized on a straight line basis over their effective life. The current amortisation charges for intangible assets are included under depreciation and amortisation expense in the income statement.

Impairment Disclosures

Goodwill of $250,000 is allocated to the Golden Life cash-generating unit. The balance of intangible assets amounting to $11,464,960 are allocated to the Milton Biotech cash-generating unit.

The recoverable amount of each cash-generating unit above is determined based on value-in-use calculations. Value-in-use is calculated based on the present value of cash flow projections over a 5-year period. The assumed growth rate and discount rate used in the determination of value in use were 5% and 15%.

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
18: DEFERRED TAX ASSETS				
Deferred tax assets is comprised as follows:				
Temporary differences – provisions	682,477	600,506	137,444	–
Temporary differences – Property, plant & Equipment	209,291	146,998	209,291	–
Temporary differences – leases	1,308,944	1,478,043	1,308,944	1,478,043
Temporary differences – other	34,624	47,935	–	–
Tax losses	1,881,575	2,725,602	343,310	160,606
	4,116,911	4,999,084	1,998,989	1,638,649
19: TRADE PAYABLES AND OTHER PAYABLES				
CURRENT				
Trade accounts payable	7,066,041	5,497,699	48,962	333,063
Sundry creditors & accruals	1,566,764	1,764,672	178,197	383,040
GST payable	377,022	957,684	311,715	460,448
	9,009,827	8,220,055	538,874	1,176,551
Tax payable	23,668	–	–	–

Net fair values

The carrying amounts of borrowings approximate net fair values.

Amounts payable in foreign currencies

CURRENT				
US Dollars	63,100	315,058	–	–
Euro	51,955	10,520		
	115,055	325,578	–	–

Notes to the financial statements

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
20: BORROWINGS				
CURRENT				
Secured borrowings				
Bank overdrafts	1,468,014	1,805,501	–	–
Bank loans	4,200,000	11,717,039	4,100,000	11,617,039
Lease liabilities	779,362	690,101	779,362	690,101
	6,447,376	14,212,641	4,879,362	12,307,140
Unsecured borrowings				
Related parties:				
Director related entity	–	557,208	–	557,208
Total current interest-bearing liabilities	6,447,376	14,769,849	4,879,362	12,864,348
NON-CURRENT				
Secured borrowings				
Bank loans	15,849,039	4,200,000	15,199,039	3,450,000
Lease liabilities	3,583,783	4,236,708	3,583,783	4,236,708
	19,432,822	8,436,708	18,782,822	7,686,708
(a) Total current and non-current secured liabilities				
Bank overdrafts	1,468,014	1,805,501	–	–
Bank loans	20,049,039	15,917,039	19,299,039	15,067,039
Lease liabilities	4,363,145	4,926,809	4,363,145	4,926,809
	25,880,198	22,649,349	23,662,184	19,993,848
(b) The carrying amount of the non-current assets pledged as security are:				
First mortgage				
Freehold land and building (Note 15)	16,545,250	11,744,001	15,645,250	10,784,952
Floating charge over assets	–	–	–	–
	16,545,250	11,744,001	15,645,250	10,784,952

(c) The bank overdrafts of the parent entity and subsidiaries are provided by the Commonwealth Bank.

The Commonwealth bank covenants within the bank borrowings require interest coverage not less than 4 times, current ratio of not less than 1.5 times and net worth of 40% of total tangible assets.

(d) The bank loans are provided by Rabo Australia Limited and is secured by a registered first mortgage over certain freehold property of the parent entity and the subsidiaries.

The Rabo Australia Limited covenants within the bank borrowings require tangible net worth to exceed $20 million, an equity ratio of greater than 35%, debt service to EBITDA to exceed 2 and the ratio of financial indebtedness to EBITDA of less than 4.

Term loan facilities will mature 7 years after the initial date draw down.

(e) All wholly owned companies within the group have executed Deeds of Cross Guarantee in favour of both Rabo Australia Limited and the Commonwealth Bank of Australia.

(f) Finance lease liabilities:

Weighed average interest 7.66%
Secured by leased plant/assets

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $

21: PROVISIONS

	2007 $	2006 $	2007 $	2006 $
CURRENT				
Sundry provisions	81,061	154,748	–	154,748
Employees benefits	427,164	280,098	67,409	14,965
Total current provisions	508,225	434,846	67,409	169,713
NON-CURRENT				
Employees benefits	52,025	51,393	985	17,531
Total non-current provisions	52,025	51,393	985	17,531
Total provisions	560,250	486,239	68,394	187,244

Reconciliation

Economic Entity	Leave entitlements $	Other $	Total $
Opening balance as at 1 July 2006	331,491	154,748	486,239
Additional provisions	465,980	81,061	547,041
Amount Used	(318,282)	(154,748)	(473,030)
Balance as at 30 June 2007	479,189	81,061	560,250

Notes to the financial statements

Parent Entity	Leave entitlements $	Other $	Total $
Opening balance as at 1 July 2006	32,496	154,748	187,244
Additional provisions	60,006	–	60,006
Amount Used	(24,108)	(154,748)	(178,856)
Balance as at 30 June 2007	68,394	–	68,394

	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $

22: DEFERRED TAXES

	2007 $	2006 $	2007 $	2006 $
Deferred taxes is comprised as follows:				
Deferred tax assets (note 18)	4,116,911	4,999,084	1,998,989	1,638,649
Deferred tax liabilities – temporary differences	4,417,778	3,463,283	4,369,016	2,687,593
Net deferred tax assets (liabilities)	(300,866)	1,535,801	(2,370,026)	(1,048,944)
Deferred tax expense charge (credit) to income	(1,060,285)	806,326	(526,783)	(221,908)
Deferred tax expense charged to equity	(776,382)	–	(794,300)	–

Reconciliation of net deferred tax assets (liabilities):

	Economic Entity $	Parent Entity $
Opening as at 1 July 2005	2,342,127	1,270,852
Less: deferred tax expense charge (credit) to income	(806,326)	(221,908)
Less: deferred tax expense charged to equity	–	–
Closing as at 30 June 2006	1,535,801	(1,048,944)
Less: deferred tax expense charge (credit) to income	(1,060,285)	(526,783)
Less: deferred tax expense charged to equity	(776,382)	(794,300)
Closing as at 30 June 2007	(300,866)	(2,370,027)

23: RETIREMENT BENEFIT OBLIGATIONS

The consolidated entity does not participate in plans that provide retirement benefits for its employees and their dependants. The company contributes its minimum legal superannuation obligations to the employees nominated superannuation funds on a monthly basis.

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007	2006	2007	2006
	$	$	$	$

24: ISSUED CAPITAL

46,525,000 (2006: 41,882,506) fully paid ordinary shares	20,229,511	15,541,970	20,229,510	15,541,970

Reconciliation of fully paid ordinary shares

Balance at beginning of the financial year	15,541,970	11,163,171	15,541,970	11,163,171
Issue of shares	4,687,541	4,378,799	4,687,540	4,378,799
Balance at end of financial year	20,229,511	15,541,970	20,229,510	15,541,970

	Economic Entity		Parent Entity	
	2007	2006	2007	2006
	No.	No.	No.	No.
Reconciliation of ordinary shares				
Balance at the beginning of reporting period	41,882,506	36,408,907	41,882,506	36,408,907
Shares issued during the year	4,642,494	5,473,599	4,642,494	5,473,599
Shares bought back during the year	–	–	–	
Balance at end of the report date	46,525,000	41,882,506	46,525,000	41,882,506

Immediately prior to the company's listing on the Australian Stock Exchange on 14 November 2006, a share split of 1:250 occurred. To enhance comparability, 2006 figures have been converted to post-split equivalents.

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

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

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
25: SHARE HELD BY EQUITY COMPENSATION PLAN				
Balance at beginning of report period	(955,000)	–	(955,000)	–
Employee share plan issue	–	(955,000)	–	(955,000)
Movement in unvested Probiotec ordinary shares held by the Employee Share Plan	–	–	–	–
Balance at the end of the reporting period	(955,000)	(955,000)	(955,000)	(955,000)

The shares held in the “Equity Compensation “ account is used to record the balance of Probiotec Limited ordinary shares which as at the end of the financial period have not vested to Group employees, and therefore controlled by the Group. 1,193,772 shares were issued on 30 June 2006 and are held by Probiotec Employee Share Plan (ESP).

26: RESERVES

(a) Reserves comprise:

	2007 $	2006 $	2007 $	2006 $
Asset revaluation	4,523,583	2,711,359	4,409,606	2,556,238

(b) Movements in reserves

	2007 $	2006 $	2007 $	2006 $
Reconciliation				
Balance at beginning of financial year	2,711,359	2,711,359	2,556,238	2,556,238
Movements	1,812,224	–	1,853,368	–
Balance at end of financial year	4,523,583	2,711,359	4,409,606	2,556,238

The asset revaluation reserve arises on the revaluation of non-current assets.

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

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $

27: COMMITMENTS

Capital commitments

Commitments for the acquisition of plant and equipment contracted for at the reporting date but not recognised as liabilities, payable:

Within one year	220,397	–	–	–
Later than one year but not later than 5 years	–	–	–	–
	–	–	–	–

Lease commitments

Operating leases

Non-cancellable operating leases contracted for but not capitalised in the financial statement.

Payable – minimum lease payments:				
Within one year	138,680	132,000	–	–
Later than one year but not later than 5 years	340,167	528,000	–	–
More than 5 years	–	–	–	–
Commitments not recognised in the financial Statements	478,847	660,000	–	–
Finance leases commitments				
Payable – minimum lease payments:				
Within one year	1,108,634	1,017,572	1,108,634	1,017,572
Later than one year but not later than 5 years	3,919,569	4,808,380	3,919,569	4,808,380
More than 5 years	–	–	–	–
Minimum lease payments	5,028,203	5,825,952	5,028,203	5,825,952
Less: Future finance charges	(665,058)	(899,143)	(665,058)	(899,143)
	4,363,145	4,926,809	4,363,145	4,926,809
Representing lease liabilities:				
Current	779,362	690,101	779,362	690,101
Non-current	3,583,783	4,236,708	3,583,783	4,236,708
	4,363,145	4,926,809	4,363,145	4,926,809

The weighted average interest rate implicit in the leases is 7.66%.

Notes to the financial statements

28: CONTINGENT LIABILITIES AND CONTINGENT ASSETS

(a) Unquantifiable litigation

Background

In April 2007, in the case of NSI Dental Pty Ltd v University of Melbourne [2007] FTA 523 ("the Claim"), Probiotec Limited and several of its subsidiaries ("the Company") along with other respondents, have been ordered jointly and severally to pay the claimant's costs ("the Cost Orders"). At this time, the other respondents are in liquidation and the Company believes they do not have the funds to meet their obligations under this order.

Probiotec had previously raised a provision of $100,000 based on legal advice, to cover any legal fees and damages that may be incurred as a result of this action. The Company has settled the damages portion of the claim in full. As at balance date, the Company has incurred expenses in excess of the provision previously raised in the amount of $149,708, being the settlement of the damages claim along with legal fees incurred in relation to the Company's defence.

Current Proceedings

The Company has appealed the judgment relating to the costs orders with the hearing expected to be held towards the end of this calendar year.

The Company has also commenced legal proceeding against its former legal advisors as it believes that it was not properly advised in relation to its potential costs exposure. The Company will be seeking to recover any damages that it may suffer as a result of the advice that it received.

Due to the fact that both the proceeding mentioned above are in their initial stages, it has not been possible to determine or quantify an expected outcome or probability of success.

Quantum of Liability

At this point in time, the Company is unable to determine the quantum of the liability under the costs order described above. The Company has consulted with its specialist litigation legal counsel in an attempt to determine a best estimate or an estimated range, but as at the date of this report has been unable to do so. The Directors consider the reasons why such determinations cannot be made include, but are not limited to, the following:

- No formal claim has been made against the Company in relation to this action;
- The costs order is the subject of an appeal;
- Any costs claim made against the Company will be subject to a taxing process which is expected to materially reduce the amount;
- The number of uncertainties and the fact that a start point cannot be ascertained, make it not possible to determine a range of possible outcomes or make a best estimate of the obligation. The Company's specialist litigation legal counsel advise that they are unable to provide Probiotec with an estimate of what they would advise the Company to settle the obligation without further contest and to avoid further uncertainties with regard to litigation and defence.

The Company believes that any amount payable as a result of the Claim can be funded through internal cash flows and existing debt facilities.

Further details in regard to this matter have not been disclosed as the Directors consider that it may seriously prejudice its position.

29: CONTROLLED ENTITIES

Controlled entities

Name of entity	Country of Incorporation	Ownership Interest 2007 %	Ownership Interest 2006 %
Parent Entity			
Probiotec Limited	Australia	100	100
Controlled Entities			
Probiotec (QLD) Pty Limited	Australia	100	100
Probiotec (NSW) Pty Limited	Australia	100	100
Probiotec (Pharma) Pty Limited	Australia	100	100
Biotech Pharmaceutical Pty Ltd	Australia	100	100
Milton Pharmaceuticals Pty Ltd	Australia	100	100
Golden Life Pty Ltd	Australia	100	100

Controlled entities acquired

No entity became controlled by the group during the 2007 financial year.

30: ECONOMIC DEPENDENCY

There is no economic dependency on any one customer for revenue or sales.

31: SUBSEQUENT EVENTS

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

32: RELATED PARTY TRANSACTIONS

Transactions between related parties are on normal commercial terms and conditions no favourable than those available to other parties unless otherwise stated. Save for the matter disclosed in note 7 and 14, no balances have been written off and no provision for doubtful debts has been made against any balances with related parties.

Ultimate parent company
There were no payments to the ultimate parent company.

Notes to the financial statements

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
Associated companies				
Sales of lactoferrin to Probiotec Limited and its subsidiaries	410,809	404,299	–	–
Key Management personnel				
Payments were made to Inston Pty Ltd, an entity associated with Wayne Stringer (CEO)	207,053	607,550	207,053	595,050
Repayment of loan provided by Inston	470,731	–	470,731	–
Repayment of loan provided by Rudi Ganter	107,338	–	107,338	–

Identification of Related parties Ultimate Parent Entity
The ultimate parent company is Probiotec Limited which is incorporated in Australia.

33: NOTES TO THE CASH FLOW STATEMENT

Financing Facilities with Banks

	Economic Entity 2007 $	Economic Entity 2006 $	Parent Entity 2007 $	Parent Entity 2006 $
Secured bank overdraft facility, reviewed annually and payable at call:				
Facility balance	19,799,039	15,067,039	19,799,039	15,067,039
Amount used	(19,299,039)	(15,067,039)	(19,299,039)	(15,067,039)
Amount unused	500,000	–	500,000	–
Bank bill acceptance facility, reviewed annually:				
Facility balance	750,000	850,000	750,000	850,000
Amount used	(750,000)	(850,000)	(750,000)	(850,000)
Amount unused	–	–	–	–

Reconciliation of Profit from Ordinary Activities After Related Income Tax to Net Cash Flows From Operating Activities:

For the year ended 30 June 2007	Economic Entity		Parent Entity	
	2007 $	2006 $	2007 $	2006 $
Profit/(loss) from ordinary activities after related income tax	4,977,524	1,805,552	13,379	(69,749)
Depreciation and amortisation	2,105,566	1,783,273	839,896	641,108
Share in (profit) loss of associate	516,952	372,675	–	–
Loss (profit) on sale of plant & equipment	–	(50,532)	–	–
(Decrease)/increase in net deferred taxes	1,836,667	806,327	1,321,083	(221,908)
(Increase)/decrease in inventories	(6,299,116)	(374,121)	–	–
(Increase)/decrease in trade receivables	(310,902)	(2,439,612)	(4,903,208)	(3,894,309)
(Increase)/decrease in other receivables & prepayments	745,094	(1,041,095)	304,168	(265,858)
Increase/(decrease) in trade creditors	789,774	(1,793,103)	(637,677)	947,647
Increase/(decrease) in other creditors and provisions	97,679	816,642	(118,851)	(20,790)
Net cash from operating activities	4,459,238	(113,994)	(3,181,210)	(2,883,859)

Non-cash Financing and Investing Activities

During the year the economic entity acquired plant and equipment with an aggregate value of $294,568 (2006: $3,556,680) by means of finance leases. These acquisitions are not reflected in the statement of cash flows.

Notes to the financial statements

	Economic Entity	
	2007 $	2006 $
34: EARNINGS PER SHARE		
Profit	4,977,524	1,805,552
Profit attributable to minority equity interest	–	–
Redeemable and converting preference share dividends	–	–
Earnings used in the calculation of basic EPS	4,977,524	1,805,552
Dividends on converting preference shares	–	–
Earnings used in the calculation of dilutive EPS	4,977,524	1,805,552
Weighted average number of ordinary shares outstanding during the year used in calculation of basic EPS	44,643,985	38,742,449
Weighted average number of options outstanding	1,216,065	–
Weighted average number of ordinary shares outstanding during the year used in calculation of dilutive EPS	45,860,050	38,742,449
Earnings per share:		
Basic Earnings per Share (cents)	11.15	4.66
Diluted Earnings per Share (cents)	10.85	4.66

35: BUSINESS COMBINATIONS

No acquisition of any going concern was undertaken by Probiotec Limited in the year ended 30 June 2007.

36: COMPANY DETAILS

The registered office of the company is:

Probiotec Limited
83 Cherry Lane
Laverton VIC 3026

The principal places of businesses are:
83 Cherry Lane, Laverton VIC
36 Bolong Road, Bomaderry NSW
36 Norfolk Avenue, South Nowra NSW
47 Production Street, Bundaberg QLD

37: FINANCIAL INSTRUMENTS

(a) Financial risk management

The Group's financial instruments consist mainly of deposit with banks, short term investments, accounts receivable & payable, loans to and from subsidiaries and leases. The consolidated entity manages its exposure to interest rate and foreign currency fluctuations through a formal set of policies and procedures approved by the Board of Directors.

The consolidated entity does not engage in any significant transactions which are speculative in nature.

(b) Derivative Financial instruments

i) Foreign Currency and Derivatives

The economic entity evaluates each transaction involving foreign currency according to its policies and procedures to determine whether to enter into forward exchange contracts to buy or sell specified amount of foreign currencies in the future at stipulated exchange rates. The factors considered in this evaluation are the timespan of the transaction, the amount of funds in question and the volatility of the currency. The economic entity also does not enter into any interest swap transactions.

ii) Interest Rate Risk

The economic entity's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates and the effective weighted average interest rates on classes of financial liabilities, is as follows:

	Fixed interest rate maturing					
2007	Weighted average interest rate %	1 year or less $	Over 1 to 5 years $	More than 5 years $	Floating interest rate $	Total $
Financial assets:						
Cash	6.00	2,028,209	–	–	–	2,028,209
Receivable	–	7,541,236	–	–	–	7,541,236
Investments	–	–	–	–	–	–
Total financial assets		9,569,445	–	–	–	9,569,445
Financial Liabilities:						
Accounts payable	–	9,009,827	–	–	–	9,009,827
Loans and overdraft	7.66	5,668,014	15,849,039	–	–	21,517,053
Lease liability	7.66	779,362	3,583,783	–	–	4,363,145
Total financial liabilities		15,457,203	19,432,822	–	–	34,890,025

Notes to the financial statements

2006	Weighted average interest rate %	Fixed interest rate maturing: 1 year or less $	Over 1 to 5 years $	More than 5 years $	Floating interest rate $	Total $
Financial assets:						
Cash	4.50	632,478	–	–	–	632,478
Receivable	–	7,230,334	–	–	–	7,230,334
Investments	–	–	–	–	–	–
Total financial assets		7,862,812	–	–	–	7,862,812
Financial Liabilities:						
Accounts payable	–	8,220,053	–	–	–	8,220,053
Loans and overdraft	7.98	14,079,748	4,200,000	–	–	18,279,748
Lease liability	7.76	690,101	4,236,708	–	–	4,926,809
Total financial liabilities		22,989,902	8,436,708	–	–	31,426,610

(c) Credit Risk Exposure

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance sheet date to recognised financial assets, is the carrying amount, net of provisions for impairment of those assets, as disclosed in the balance sheet and notes to the financial statements. The economic entity does not have any material credit risk exposure to any single receivable or group of receivables under financial instruments entered into by the economic entity.

(d) Price Risk Exposure

The group is not exposed to any commodity price risk. Most of the raw materials are sourced through importing agents and major suppliers in the local milk powder industry.

(e) Net Fair Values

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

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

	2007		2006	
	Carrying Amount $	Net Fair Value $	Carrying Amount $	Net Fair Value $
Financial Assets				
Trade & Other current Receivables	7,541,236	7,541,236	7,230,334	7,230,334
Cash	2,028,209	2,028,209	632,478	632,478
	9,569,445	9,569,445	7,862,812	7,862,812
Financial Liabilities				
Trade & others Payables	9,009,827	9,009,827	8,220,053	8,220,053
Short term borrowings	5,668,014	5,668,014	14,079,748	14,079,748
Long term borrowings	15,849,039	15,849,039	4,200,000	4,200,000
Lease Liability	4,363,145	4,363,145	4,926,809	4,926,809
	34,890,025	34,890,025	31,426,610	31,426,610

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

38: SEGMENT INFORMATION

Business Segments	Types of products and services
Business Segment 1	Pharmaceuticals
Business Segment 2	Nutritional/Nutraceutical Foods

All inter-segment transactions are at arms length.

(a) Business Segments

	Business Segment 1		Business Segment 2		Unallocated		Consolidated	
	2007 ($'000)	2006 ($'000)	2007 ($'000)	2006 ($'000)	2007 ($'000)	2006 ($'000)	2007 ($'000)	2006 ($'000)
Revenue								
External sales	34,079	26,235	19,913	15,245	–	–	53,992	41,480
Inter-segment sales	–	–	–	–	–	–	–	–
Other revenue	82	–	32	–	260	–	374	–
Total sales revenue	34,161	26,235	19,945	15,245	260	–	54,366	41,480
Share of net profit of associates	–	–	–	–			–	–
Total segment revenue	34,161	26,235	19,945	15,245	260	–	54,106	41,480
Result								
Segment result	6,557	5,649	4,009	2,408	4,505	5,446	6,061	2,611
Profit from ordinary activities before income tax							6,061	2,611
Income tax expenses							1,084	806
Profit from ordinary activities after income tax							4,978	1,806
Extraordinary items							–	–
Net profit							4,978	1,806

	Business Segment 1		Business Segment 2		Unallocated		Consolidated	
	2007 ($'000)	2006 ($'000)	2007 ($'000)	2006 ($'000)	2007 ($'000)	2006 ($'000)	2007 ($'000)	2006 ($'000)
Assets								
Segment assets	36,174	24,503	16,884	15,925	24,856	21,494	77,914	61,921
Consolidated total assets							77,914	61,921
Acquisition of property, plant, equipment and intangible assets	8,585	4,738	355	575	355	575	8,940	5,313
Liabilities								
Segment liabilities	6,663	4,425	2,126	4,353	31,058	26,598	39,847	35,376
Consolidated total liabilities							39,892	35,376
Other information								
Depreciation and amortisation	1,133	858	866	925	107	–	2,106	1,783
Non-cash expenses other than depreciation and amortisation	–	–	–	270	–	270	–	270

(b) Geographic Segments

The economic entity's business segments are located in Australia. Only minor exports are made to other countries.

Directors' declaration

In the directors' opinion:

1. the financial statements and notes, as set out on the attached pages are in accordance with the Corporations Act 2001:
   (i) comply with Accounting Standards and the Corporations Regulations 2001; and
   (ii) give a true and fair view of the financial position as at 30 June 2007 of the performance for the year ended on that date of the company and consolidated entity;
2. in the directors' opinion there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

The company and its wholly-owned subsidiaries have entered into a deed of cross guarantee under which the company and its subsidiaries guarantee the debts of each other.

At the date of this declaration, there are reasonable grounds to believe that the companies which are party to this deed of cross guarantee will be able to meet any obligations or liabilities to which they are, or may become subject to, by virtue of the deed.

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

Charles Wayne Stringer
Director

Richard David Kuo
Director

Signed at Sydney this 28th day of August 2007

Audit report

PKF

Chartered Accountants
& Business Advisers

INDEPENDENT AUDITOR'S REPORT

To the members of Probiotec Limited

We have audited the accompanying financial report of Probiotec Limited, which comprises the balance sheet as at 30 June 2007, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies and other explanatory notes and the directors' declaration of Probiotec Limited ("the Company") and of Probiotec Limited the consolidated entity ("the consolidated entity"). The consolidated entity comprises the Company and the entities it controlled at the year's end or from time to time during the financial year.

We have also audited the remuneration disclosures contained in the directors' report. As permitted by the Corporations Regulations 2001, the company has disclosed information about remuneration of directors and executives ('remuneration disclosures') required by accounting standard AASB 124 *Related Party Disclosures*, under the heading "remuneration report" in pages 7 to 11 of the directors' report and not in the financial report.

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial report of the Group, comprising the financial statement and the notes, complies with International Financial Reporting Standards, but that the financial report of the company does not comply.

The directors' of the company are also responsible for the remuneration disclosures contained in the directors' report.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report and the remuneration disclosures contained in the directors report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report and the remuneration disclosures contained in the directors report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

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PO Box 588 I Surfers Paradise 4217 I Queensland I Australia

Audit report

PKF

Independence

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

Auditor's Opinion

In our opinion:

(a) the financial report of Probiotec Limited is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the Company's and consolidated entity's financial position as at 30 June 2007 and of its performance for the year ended on that date; and

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

(b) the financial report of the consolidated entity also complies with International Financial Reporting Standards as disclosed in Note 1.

Significant Uncertainty Regarding Litigation

Without qualification to the opinion expressed above, we draw attention to Note 28 to the financial statements. Probiotec Ltd is party to a lawsuit regarding infringement of certain patent rights on which judgement has been delivered. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial report.

In our opinion the remuneration disclosures that are contained in pages 7 to 11 of the directors' report comply with Accounting Standard AASB 124.

PKF Gold Coast.

PKF Gold Coast

Michael J. Sheehy
Partner

28 August 2007

Level 5, RSL Centre
9 Beach Road
Surfers Paradise

Other information required by ASX listing rules

The information in this section is current as at the 3rd September 2007.

SUBSTANTIAL HOLDERS IN THE ENTITY

Wayne Stringer	7,945,662 fully paid ordinary shares
Rudi Ganter	2,481,800 fully paid ordinary shares
Vintage Capital Pty Ltd (ACN 116 337 592)	2,398,199 fully paid ordinary shares

HOLDERS OF EACH CLASS OF EQUITY SECURITIES

Security Classes	Holders	Total Units
Fully Paid Ordinary	631	48,043,413

VOTING RIGHTS ATTACHED TO EACH CLASS OF EQUITY SECURITIES

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

DISTRIBUTION SCHEDULE OF NUMBER OF HOLDERS OF EACH CLASS OF EQUITY SECURITIES

Security Classes	Holdings Ranges	Holders	Total Units	%
Fully Paid Ordinary	1 – 1,000	123	95,884	0.200
	1,001 – 5,000	118	410,259	0.854
	5,001 – 10,000	145	1,295,732	2.698
	10,001 – 100,000	200	7,409,110	15.425
	100,001 and over	45	38,814,428	80.824
Totals		631	48,043,413	100.000

HOLDERS WITH LESS THAN A MARKETABLE PARCEL OF THE MAIN CLASS OF SECURITIES

At the date of this report, a marketable parcel of fully paid ordinary shares was 401 or more shares.

Security Classes	Holdings Ranges	Holders	Total Units	%
Fully Paid Ordinary	1 – 400	0	0	0.000
	401 and over	631	48,043,413	100.000
Totals		631	48,043,413	100.000

COMPANY SECRETARIES

The secretaries of Probiotec Limited are:

Mr Christopher Brian Blake
Mr Jared Stringer

Full details and qualifications for secretaries can be found on pages 5 and 6 of the Directors' Report.

Other information required by ASX listing rules

20 LARGEST HOLDERS OF EACH CLASS OF QUOTED EQUITY SECURITIES

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

Holder Name	Balance	%
Inston Pty Ltd	5,733,272	12.323
ANZ Nominees Limited <Cash Income A/C>	2,866,760	6.162
Vintage Capital Pty Ltd	2,510,284	5.396
Ganter Corporation Pty Ltd <Ganter Family Account>	2,481,800	5.334
Charles Wayne Stringer	2,212,390	4.755
Cogent Nominees Pty Limited	2,200,000	4.729
Ubs Nominees Pty Ltd	2,110,000	4.535
J P Morgan Nominees Australia Limited	2,060,273	4.428
CVC Limited	1,875,151	4.030
Trifern Pty Ltd <Super Fund Account>	1,385,775	2.979
Holtex Pty Limited <Buckeridge Super Fund A/C>	1,224,924	2.633
Ubs Wealth Management Australia Nominees Pty Ltd	1,185,000	2.547
Mr Scott Johnston <Johnston Family S/F A/C>	975,018	2.096
Healthnet Investments Pty Ltd	753,789	1.620
Taylor Co Pty Ltd <Peter Taylor Super Fund A/C>	725,018	1.558
Crownace Pty Ltd	700,000	1.505
T H C Pty Ltd	600,011	1.290
Holtex Pty Limited <Buckeridge S/F A/C>	593,761	1.276
Charanda Nominee Company Pty Ltd <The Amchar A/C>	550,024	1.182
Mr Henry Atholl Robertson	506,277	1.088

REGISTERED OFFICE AND PRINCIPAL ADMINISTRATIVE OFFICE

The registered office and principal administrative office for Probiotec is:

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

REGISTER OF SECURITIES, REGISTER OF DEPOSITARY RECEIPTS AND OTHER FACILITIES FOR REGISTRATION OR TRANSFER

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

Registries Limited
Level 2, 28 Margaret Street
Sydney NSW 2000
Ph: (02) 9290 9600
Fax: (02) 9279 0664

OTHER STOCK EXCHANGES ON WHICH ENTITY'S SECURITIES ARE QUOTED

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

RESTRICTED AND ESCROWED SECURITIES

At the date of this report the following securities were subject to voluntary escrow:

Holder	Number of securities	Escrow Expiry date
Inston Pty Ltd (ACN 069 982 538)	5,733,272	13 September 2007
CVC Limited (ACN 002 700 631)	1,875,151	13 September 2007
Charles Wayne Stringer	2,212,390	13 September 2007

UNQUOTED EQUITY SECURITIES

Security Classes	Holders	Total Units
Fully Paid Ordinary – issued under Employee incentive schemes	122	1,518,413

ON MARKET BUY-BACK

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

USE OF CASH AND ASSETS IN A FORM READILY CONVERTIBLE TO CASH

Probiotec Limited has used the cash and assets in a form readily convertible to cash that it had at the time of admission to the Australian Stock Exchange (ASX) in a way that is consistent with its business objectives. This statement is applicable to the period from admission until the end of the reporting period.

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DESIGN: COLLIER & ASSOCIATES THE STRATEGIC DESIGN COMPANY #12276