

# **Pharmacybrands Limited**

## **Independent Adviser's Report and Appraisal Report**

### **In Respect of the Proposed Allotment of Shares to Cape Healthcare Limited and LPL Trustee Limited**

*June 2011*

## Index

Section	Page
1. Introduction .....	1
2. Evaluation of the Merits of the Allotment of Shares Under the Cape Healthcare Allotment and the LPL Trustee Allotment .....	6
3. Evaluation of the Fairness of the Cape Healthcare Allotment and the LPL Trustee Allotment.....	16
4. Profile of Pharmacybrands .....	18
5. Sources of Information, Reliance on Information, Disclaimer and Indemnity .....	23
6. Qualifications and Expertise, Independence, Declarations and Consents .....	25

## 1. Introduction

### 1.1 Background

Pharmacybrands Limited (**Pharmacybrands** or the **Company**) is listed on the main equities security market (**NZSX**) operated by NZX Limited (**NZX**) with a market capitalisation of \$50 million as at 3 June 2011 and audited total equity of \$43 million as at 31 March 2011.

Pharmacybrands operates the *Life Pharmacy*, *Unichem*, *Amcal*, *Care Chemist* and *Radius Pharmacy* franchise brands comprising 303 stores within New Zealand.

The Company was previously named Life Pharmacy Limited (**LPL**) up until 31 March 2010. LPL merged with Pharmacy Transition Limited (which at the time was called Pharmacybrands Limited (**PBL**)) on 30 September 2009, effected by way of a full takeover offer.

A profile of the Company is set out in section 4.

### 1.2 Acquisition of Radius Companies

Pharmacybrands acquired 100% of the shares in Radius Pharmacy Limited (**Radius Pharmacy**) on 1 April 2011, following shareholder approval of the acquisition on 24 March 2011. The acquisition price was \$17.1 million paid in cash and the assumption of \$18.0 million of debt.

The acquisition of Radius Pharmacy has provided Pharmacybrands with an interest in an additional 34 pharmacy businesses which operate under the *Radius Pharmacy* brand throughout New Zealand.

Pharmacybrands entered into an agreement on 11 May 2011 to acquire 100% of the shares in Radius Medical Limited (**Radius Medical**) and Radius Medical Solutions Limited (**Radius Solutions**). The acquisition price is \$3.2 million, subject to net asset and other adjustments. Settlement of the acquisition is expected to be in the first week of June 2011.

Radius Medical has an interest in 6 medical centres in the North Island. Radius Solutions provides comprehensive back office support services to the medical centre practices operating under the *Radius* brand as well as other medical centre practices.

The acquisitions were partly funded by new borrowings of approximately \$26 million from ANZ National Bank Limited (**ANZ National**). A condition of the borrowing was the requirement for Pharmacybrands to undertake a capital raising.

### 1.3 Cape Healthcare Allotment and LPL Trustee Allotment

Pharmacybrands has 2 cornerstone shareholders who each hold 26.90% of the shares in the Company:

- Cape Healthcare Limited (**Cape Healthcare**)
- LPL Trustee Limited (**LPL Trustee**).

Cape Healthcare acquired its shares on 7 September 2009 by accepting the takeover offer made by LPL for PBL.

LPL Trustee first invested in LPL in July 2007 via a share placement.

Pharmacybrands intends to raise \$8.0 million of additional equity by allotting a total of 17,777,778 new ordinary shares to Cape Healthcare and LPL Trustee at an issue price of \$0.45 per share (the **Allotments**):

- 8,888,889 new ordinary shares to Cape Healthcare to raise \$4.0 million (the **Cape Healthcare Allotment**)
- 8,888,889 new ordinary shares to LPL Trustee to raise \$4.0 million (the **LPL Trustee Allotment**).

The Allotments will result in Cape Healthcare and LPL Trustee each becoming the holder of 30.39% of the ordinary shares (and therefore the voting rights) in the Company.

Changes in Shareholding Following the Allotments					
	Current		Allotments	Post the Allotments	
	No. of Shares	%		No. of Shares	%
Cape Healthcare	26,904,646	26.90%	8,888,889	35,793,535	30.39%
LPL Trustee	26,904,355	26.90%	8,888,889	35,793,244	30.39%
Non-associated Shareholders	46,192,022	46.20%	-	46,192,022	39.22%
Total	100,001,023	100.00%	17,777,778	117,778,801	100.00%

Pharmacybrands is also planning to raise up to \$3.5 million of additional equity under a share purchase plan (the **Share Purchase Plan**). The Share Purchase Plan will offer shareholders the opportunity to subscribe for new ordinary shares in the Company at a price no higher than the price at which shares will be issued under the Allotments.

The Share Purchase Plan will not proceed if the Allotments are not approved by the Company's shareholders. If the Allotments are approved, the Share Purchase Plan will take place shortly after the annual meeting.

Neither Cape Healthcare nor LPL Trustee will participate in the Share Purchase Plan.

Proceeds from the Allotments and the Share Purchase Plan will be applied towards reducing the Company's loans from ANZ National.

## 1.4 Annual Meeting

The Company's shareholders other than Cape Healthcare and LPL Trustee and their respective associates / associated persons (the **Non-associated Shareholders**) will vote on an ordinary resolution in respect of the Allotments (the **Allotments Resolution**) at the Company's annual meeting on 18 July 2011 (resolution 5).

Cape Healthcare and LPL Trustee and their respective associates / associated persons are not permitted to vote on the Allotments Resolution.

As part of the ordinary business of the annual meeting, shareholders will also vote on ordinary resolutions in respect of:

- the re-election of Bill Meaney as a director of the Company (resolution 1)
- the re-election of John Bolland as a director of the Company (resolution 2)
- the re-election of Andrew Davidson as a director of the Company (resolution 3)
- the reappointment of the Company's auditors and the authorisation of the directors to fix the auditors' fees for the ensuing year (resolution 4).

## **1.5 Regulatory Requirements**

### ***Takeovers Code***

Rule 6 of the Code prohibits:

- a person who holds or controls less than 20% of the voting rights in a code company from increasing its holding or control of voting rights beyond 20%
- a person holding or controlling 20% or more of the voting rights in a code company from increasing its holding or control of voting rights

unless the person and that person's associates comply with exceptions to this fundamental rule.

One of the exceptions, set out in Rule 7(d) of the Code, enables a person and its associates to increase their holding or control of voting rights by an allotment of shares if the allotment is approved by an ordinary resolution of the code company.

The Cape Healthcare Allotment and the LPL Trustee Allotment will result in:

- Cape Healthcare increasing its control of the voting rights in Pharmacybrands from 26.90% to 30.39%
- LPL Trustee increasing its control of the voting rights in Pharmacybrands from 26.90% to 30.39%.

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on an ordinary resolution in respect of the Cape Healthcare Allotment and the LPL Trustee Allotment in accordance with the Code.

Rule 18 of the Code requires the directors of a code company to obtain an Independent Adviser's Report on the merits of an allotment under Rule 7(d).

This Independent Adviser's Report is to be included in, or accompany, the notice of meeting pursuant to Rule 16(h).

### **NZSX Listing Rules**

Listing Rule 7.3.1 of the NZSX Listing Rules (the **Listing Rules**) states that no Issuer shall issue any Equity Securities unless the precise terms and conditions of the specific proposal to issue those Equity Securities have been approved by separate resolutions (passed by a simple majority of votes) of holders of each Class of Quoted Equity Securities of the Issuer whose rights or entitlements could be affected by that issue.

Listing Rule 7.5 states that no issue of Securities shall be made by an Issuer if:

- there is a significant likelihood that the issue will result in any person or group of Associated Persons materially increasing their ability to exercise, or direct the exercise of effective control of that Issuer and
- that person or group of Associated Persons is entitled before the issue to exercise not less than 1% of the total votes attaching to the Securities of the Issuer

unless the precise terms and conditions of the issue have been approved by an ordinary resolution of the Issuer.

Cape Healthcare and LPL Trustee both currently hold 26.90% of the Company's shares and the Allotments involve the issue of equity securities which may materially increase Cape Healthcare's and the LPL Trustee's ability to exercise, or direct the exercise of effective control of the Company.

Listing Rule 9.2.1 stipulates that an Issuer shall not enter into a Material Transaction if a Related Party is (or is likely to become) a party to the Material Transaction or to one of a related series of transactions of which the Material Transaction forms part without first obtaining approval of the transaction by way of an ordinary resolution from shareholders who are not associated persons of the Related Party.

The Cape Healthcare Allotment and the LPL Trustee Allotment are Material Transactions because the Allotments have a value greater than 10% of Pharmacybrands' Average Market Capitalisation (as calculated in accordance with the Listing Rules). Cape Healthcare and LPL Trustee are Related Parties of the Company as their respective current shareholdings in Pharmacybrands exceed 10% of the total shares on issue.

Accordingly, the Non-associated Shareholders will vote at the Company's annual meeting on an ordinary resolution in respect of the Cape Healthcare Allotment and the LPL Trustee Allotment in accordance with the Listing Rules.

Listing Rule 6.2.2 (a) requires an Appraisal Report to be prepared where a meeting will consider a resolution required by Listing Rule 7.5. Furthermore, Listing Rule 6.2.2 (b) requires an Appraisal Report to be prepared where more than 50% of the Securities to be issued are acquired by Directors or Associated Persons of Directors of the Issuer.

Listing Rule 9.2.5 (b) requires an Appraisal Report to be prepared where a meeting will consider a resolution required by Listing Rule 9.2.1.

## 1.6 Purpose of the Report

The directors of Pharmacybrands not associated with Cape Healthcare or LPL Trustee, being Andrew Davidson, Keith Rushbrook, Ian Sharp and Mark Vuksich (the **Independent Directors**) have engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Independent Adviser's Report on the merits of the allotment of shares under the Cape Healthcare Allotment and the LPL Trustee Allotment in accordance with Rule 18 of the Code.

Simmons Corporate Finance was approved by the Takeovers Panel on 16 December 2010 to prepare the Independent Adviser's Report.

The Independent Directors have engaged Simmons Corporate Finance to prepare an Appraisal Report on the fairness of the Cape Healthcare Allotment and the LPL Trustee Allotment in accordance with Listing Rules 6.2.2 (a), 6.2.2 (b) and 9.2.5 (b).

Simmons Corporate Finance was approved by NZX on 13 April 2011 to prepare the Appraisal Report.

Simmons Corporate Finance issues this Independent Adviser's Report and Appraisal Report to the Independent Directors of Pharmacybrands for the benefit of the Non-associated Shareholders to assist them in forming their own opinion on whether to vote for or against the Allotments Resolution.

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the merits and fairness of the allotment of shares under the Allotments in relation to each shareholder. This report on the merits and fairness of the allotment of shares under the Allotments is therefore necessarily general in nature.

This Independent Adviser's Report and Appraisal Report is not to be used for any other purpose without our prior written consent.

## 2. Evaluation of the Merits of the Allotment of Shares Under the Cape Healthcare Allotment and the LPL Trustee Allotment

### 2.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the allotment of shares to Cape Healthcare under the Cape Healthcare Allotment and the allotment of shares to LPL Trustee under the LPL Trustee Allotment, having regard to the interests of the Non-associated Shareholders.

There is no legal definition of the term *merits* in New Zealand in either the Code or in any statute dealing with securities or commercial law.

In the absence of an explicit definition of *merits*, guidance can be taken from:

- the Takeovers Panel guidance note on the role of independent advisers dated August 2007
- definitions designed to address similar issues within New Zealand regulations which are relevant to the proposed transaction
- overseas precedents
- the ordinary meaning of the term *merits*.

We are of the view that an assessment of the merits of the allotment of shares to Cape Healthcare and LPL Trustee under the Cape Healthcare Allotment and the LPL Trustee Allotment should focus on:

- the rationale for the Allotments
- the alternatives to the Allotments
- the terms and conditions of the Allotments
- the impact of the Allotments on Pharmacybrands' financial position
- the impact of the Allotments on the control of the Company
- the impact of the Allotments on Pharmacybrands' share price
- the benefits and disadvantages to Cape Healthcare and LPL Trustee of the Allotments
- the benefits and disadvantages to the Non-associated Shareholders of the Allotments
- the implications if the Allotments Resolution is not approved.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.



## 2.2 Summary of the Evaluation of the Merits of the Allotments

In our opinion, after having regard to all relevant factors, the positive aspects of the allotment of shares under the Cape Healthcare Allotment and the LPL Trustee Allotment outweigh the negative aspects from the perspective of the Non-associated Shareholders.

Our evaluation of the merits of the allotment of shares to Cape Healthcare and LPL Trustee under the Allotments is set out in detail in sections 2.4 to 2.14. In summary, the key factors leading to our opinion are:

- the rationale for the Allotments is sound. Following the acquisition of the 3 Radius companies, the Company requires an injection of capital to reduce its level of borrowings
- alternative capital raising options to the Allotments are limited and are unlikely to provide the same level of capital within a similar timeframe
- the terms of the Allotments are reasonable. The issue price of \$0.45 per new ordinary share is at a discount of 10% to the one month volume weighted average share price (**VWAP**) immediately before the date on which the Company's directors resolved to proceed with the Allotments
- the Allotments will have a positive impact on the Company's financial position, increasing equity by between \$8.0 million and \$11.5 million and reducing the Company's level of financial leverage
- the Allotments will increase Cape Healthcare's and LPL Trustee's ability to influence the outcome of shareholding voting but only to a moderate degree
- the Allotments are not expected to increase either Cape Healthcare's or LPL Trustee's influence over the Company's board of directors (the **Board**) or the Company's operations
- the dilutionary impact of the Allotments on Non-associated Shareholders will be in the vicinity of 15%. This level of dilution will reduce to approximately 7% if all the Non-associated Shareholders take up their entitlements under the Share Purchase Plan
- the Allotments are unlikely to have any material impact on the Company's share price or the liquidity of its shares in the near term
- the Allotments may reduce the attraction of Pharmacybrands as a takeover target to Cape Healthcare or the LPL Trustee to a minor degree but not necessarily to other bidders
- the implications of the Allotments not being approved by the Non-associated Shareholders are that alternative capital raising initiatives will need to be undertaken but there is no guarantee that such initiatives will deliver the level of capital sought or provide capital within the desired timeframes.

## 2.3 Rationale for the Allotments

The Allotments will raise \$8.0 million of additional equity for Pharmacybrands to be applied to the repayment of debt.

Following the acquisition of Radius Pharmacy, Radius Medical and Radius Solutions, Pharmacybrands has loans of approximately \$27.4 million owing to ANZ National. The loans consist of a short term facility and a 5 year term loan. A term of ANZ National lending the funds to the Company to finance the acquisitions was that the Company undertake a capital raising after the acquisitions to repay the short term facility and the current instalments of the term loan.

In addition to the Allotments, Pharmacybrands plans to raise up to \$3.5 million of additional equity under the Share Purchase Plan. The Share Purchase Plan will offer shareholders the opportunity to subscribe for new ordinary shares in the Company at a price no higher than the price at which shares will be issued under the Allotments.

The Share Purchase Plan will not proceed if the Allotments are not approved by the Company's shareholders. If the Allotments are approved, the Share Purchase Plan will take place shortly after the annual meeting.

Neither Cape Healthcare nor LPL Trustee will participate in the Share Purchase Plan.

## 2.4 Alternatives to the Allotments

Pharmacybrands could potentially pursue alternative forms of raising capital including:

- seeking alternate debt funding
- undertaking a rights issue
- seeking another strategic investor.

Pharmacybrands' alternative forms of raising capital at this point in time appear limited:

- given that the purpose of the Allotments is to raise capital to pay down a portion of the ANZ National borrowings, the Company is unlikely to be able to source additional debt funding from lenders at this point in time
- undertaking a rights issue would require the issue of a prospectus and the rights issue would need to be underwritten in order to provide the Company with certainty as to the level of capital that would be raised. This would take longer to implement than share placements and would be a more expensive form of raising capital
- seeking another strategic investor may not be desirable for some shareholders (especially Cape Healthcare and LPL Trustee) and in any event, given the current economic environment, may be difficult to achieve within a relatively short timeframe.

We are advised by the Independent Directors that they explored the options of raising capital via a rights issue and share placements and reached the conclusion that the Allotments coupled with the Share Purchase Plan was the most cost efficient and effective means of raising the required level of capital whilst also ensuring that all shareholders had the ability to participate in the capital raising exercise.

We are of the view that other potential funding sources are not realistic alternatives at this point in time as the current economic environment is still relatively challenging for capital raising and the likelihood of Pharmacybrands raising capital from external parties in the near term appears limited. The Allotments provide certainty to Pharmacybrands as to the level of capital that will be raised and the Share Purchase Plan enables the Non-associated Shareholders to participate in the capital raising program at a price that is no higher than the Allotments issue price.

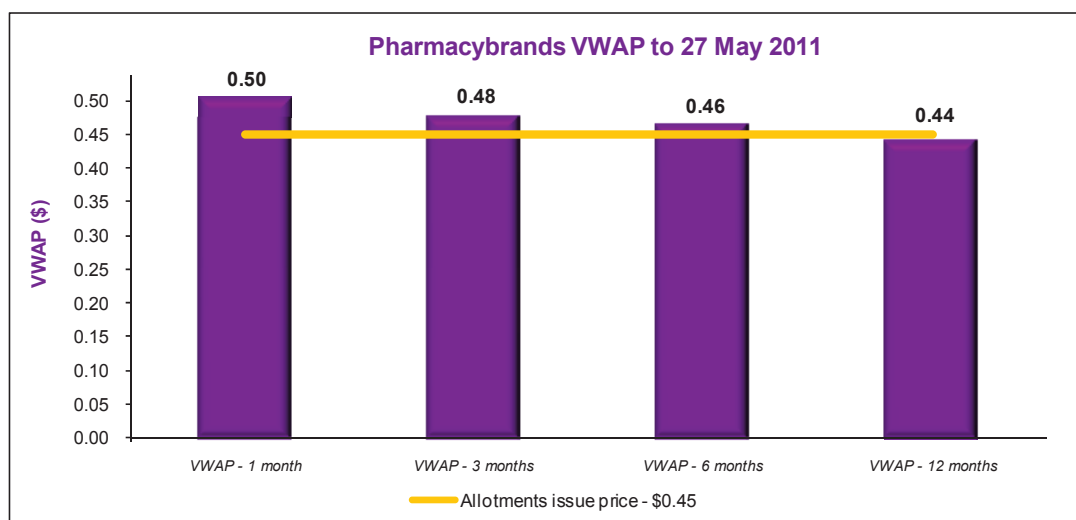
## 2.5 Terms of the Allotments

The terms of the Cape Healthcare Allotment and the LPL Trustee Allotment are set out in Subscription Agreements between Pharmacybrands and Cape Healthcare and LPL Trustee respectively. The key terms of the Allotments are:

- Pharmacybrands will issue 8,888,889 new ordinary shares to Cape Healthcare and 8,888,889 new ordinary shares to LPL Trustee
- Cape Healthcare and LPL Trustee will subscribe for the shares at a price of \$0.45 per share, payable in cash
- the new shares will rank equally with all of Pharmacybrands' existing shares and will carry full voting rights
- the Allotments are conditional on:
  - shareholder approval of the Allotments Resolution
  - the Board resolving to approve the issue of the Allotments shares to Cape Healthcare and LPL Trustee
- if the conditions are not satisfied by 30 September 2011, each Subscription Agreement will be avoided
- the two Subscription Agreements must complete simultaneously
- the total subscription price of \$4.0 million per shareholder is payable on the 5th business day following the date on which the Subscription Agreement becomes unconditional.

The issue price is \$0.45 per share. We understand that this was based on a 10% discount to the Company's VWAP for the month up to 27 May 2011 (being the day before the Independent Directors and Cape Healthcare and LPL Trustee agreed the terms of the Allotments).

Set out in section 4.8 is an analysis of Pharmacybrands' share price history from 5 January 2009. The issue price of \$0.45 is a 10% discount to the Company's one month VWAP, a 5% discount to the 3 months VWAP, a 2% discount to the 6 months VWAP and a 3% premium to the one year VWAP up to 27 May 2011.



In instances where a company is issuing shares to a shareholder and that shareholder will subsequently hold a significant percentage of the company's voting rights – but less than 50% - we consider the market value of the company's shares to be the most appropriate basis upon which to evaluate the reasonableness of the issue price.

Placements of shares in companies listed on the NZSX have generally (but not always) been undertaken at a discount to their market value (determined on a VWAP basis). A placement of new shares at a discount to their market value results in a value transfer from existing shareholders to the recipients of the new shares. The quantum of the value transfer is dependent on the size of the discount and the size of the share placement.

We are of the view that the issue price of \$0.45 for the Allotments is fair to the Non-associated Shareholders. The proposed price is at a reasonable discount to the recent trading prices and Non-associated Shareholders will be able to participate in the Share Purchase Plan at a price no higher than the \$0.45 Allotments issue price. Accordingly, any value transfer between the Non-associated Shareholders and Cape Healthcare and LPL Trustee will be negligible.

We consider the other terms of Allotments to be in line with normal commercial terms for a transaction of this nature.

## 2.6 Impact on Financial Position

Pharmacybrands' audited total equity as at 31 March 2011 was \$43.3 million. This equated to \$0.43 per share.

The Allotments will raise \$8.0 million (before costs). For illustrative purposes, if the proceeds were to have been received on 31 March 2011, Pharmacybrands' total equity would increase by 18% to \$51.3 million (\$0.44 per share).

Illustrative Effect of the Allotments			
	Equity (\$000)	No. of Shares (000)	Equity \$/ Share
31 March 2011	43,326	100,001.0	\$0.43
Allotments proceeds	8,000	17,777.8	\$0.45
Post the Allotments	<u>51,326</u>	<u>117,778.8</u>	<u>\$0.44</u>

In addition to the \$8.0 million of equity raised from the Allotments, the Company is seeking to raise further equity of up to \$3.5 million from the Share Purchase Plan.

## **2.7 Impact on Control**

### ***Share Capital and Shareholders***

Pharmacybrands currently has 100,001,023 ordinary shares on issue. The names, number of shares and percentage holding of the Company's 10 largest shareholders as at 27 May 2011 are set out in section 4.4.

Pharmacybrands currently has 2 substantial security holders (Cape Healthcare and LPL Trustee) each holding 26.90% of the Company's shares.

The 2 shareholders collectively control 53.80% of the voting rights in the Company at present.

### ***Cape Healthcare's and LPL Trustee's Shareholding Levels***

The allotment of shares under the Cape Healthcare Allotment and the LPL Trustee Allotment will enable Cape Healthcare and LPL Trustee to increase their shareholdings in Pharmacybrands from 26.90% each to 30.39% without having to make a formal offer to all shareholders in accordance with Rules 7(a) or 7(b) of the Code. This is the reason why the Non-associated Shareholders have the opportunity to vote for or against the Allotments Resolution.

### ***Shareholding Voting***

Cape Healthcare's and LPL Trustee's current shareholding levels of 26.90% each enable either of them to block special resolutions (which require the approval of 75% of the votes cast by shareholders), but are not sufficient to singlehandedly pass or block ordinary resolutions (which require the approval of more than 50% of the votes cast by shareholders).

Following the Allotments, Cape Healthcare's and LPL Trustee's ability to influence the outcome of shareholder voting will not change materially. Their respective 30.39% shareholdings will still not be able to singlehandedly pass or block ordinary resolutions.

We are advised that Cape Healthcare and LPL Trustee are not deemed to be associates and that they do not have any agreement whereby they vote together on resolutions. However, they may, independently of each other, decide to vote the same way on any particular resolution. In such circumstances, their combined votes can determine the outcome of ordinary resolutions. However, this potential outcome exists irrespective of whether they each hold 26.90% or 30.39% of the Company's shares.

The ability for any shareholder to influence the outcome of voting on the Company's ordinary resolutions or special resolutions may be reduced by external factors such as the Company's constitution, the Code, the Listing Rules and the Companies Act 1993.

Given the above, we are of the view that the allotment of shares to Cape Healthcare and LPL Trustee under the Allotments will not significantly increase their respective ability to exert shareholder control over Pharmacybrands.

We also note that after the Share Purchase Plan, Cape Healthcare's and LPL Trustee's shareholdings will reduce from 30.39% each. The extent of the reduction will depend on the issue price of the shares under the Share Purchase Plan and the number of shares taken up by the Non-associated Shareholders. By way of example, if the issue price was \$0.45 and the Non-associated Shareholders took up all of their entitlements, Cape Healthcare's and LPL Trustee's shareholdings would each reduce to 28.51%.

### **Board Control**

We are advised by the Independent Directors that at this point in time, no agreements have been made with Cape Healthcare or LPL Trustee as to future additional Board representation following the Allotments.

### **Operations**

We are advised by the Independent Directors that Cape Healthcare and LPL Trustee currently do not have any influence over the operations of the Company other than through their representation on the Board.

## **2.8 Dilutionary Impact**

A total of 17,777,778 new ordinary shares will be issued under the Allotments. This will result in the Non-associated Shareholders' proportionate shareholdings in the Company being diluted by approximately 15%. However, Non-associated Shareholders will be able to subscribe for new ordinary shares in the Company under the Share Purchase Plan at a price no higher than the price at which shares will be issued under the Allotments.

If all Non-associated Shareholders took up their full entitlements under the Share Purchase Plan, the combined dilutionary effect of the Allotments and the Share Purchase Plan on the Non-associated Shareholders would be reduced to approximately 7%.

## **2.9 Impact on Share Price and Liquidity**

### **Share Price**

A summary of Pharmacybrands' daily closing share price and daily volume of shares traded from 5 January 2009 is set out in section 4.8.

Given that the number of shares issued under the Allotments represents 18% of the shares currently on issue and the issue price of \$0.45 is at a discount to the current market price of \$0.50, the Company's share price (in theory) may drop marginally immediately after the Allotments. The theoretical post Allotments share price would be in the vicinity of \$0.49. However, given that a range of factors influence the Company's share price (including the levels of supply and demand for the shares, macro economic factors and general movements in the equity markets), it is not certain that the Allotments will place downwards pressure on the Company's share price.

### ***Liquidity***

Trading in the Company's shares is relatively thin, reflecting that Cape Healthcare and LPL Trustee hold 53.80% of the shares. Only 3.3% of the Company's shares have traded in the past year.

The size of the pool of shares held by the Non-associated Shareholders will not change under the Allotments.

In our view, the Allotments on their own are unlikely to have a positive or negative effect on the liquidity of Pharmacybrands' shares.

## **2.10 Benefits to Cape Healthcare and LPL Trustee**

The key benefit of the Allotments to Cape Healthcare and LPL Trustee is that it provides them with the opportunity to increase their shareholdings (and level of control) in Pharmacybrands at an issue price of \$0.45 per share.

## **2.11 Disadvantages to Cape Healthcare and LPL Trustee**

### ***Increased Exposure to the Risks of Pharmacybrands***

As Cape Healthcare's and LPL Trustee's ownership in Pharmacybrands increases, so does their exposure to the key issues and risks that are likely to impact upon the Company's business operations.

### ***Significant Financial Commitment***

The Allotments require Cape Healthcare and LPL Trustee to each subscribe for \$4.0 million of new ordinary shares.

## **2.12 Benefits to the Non-associated Shareholders**

### ***Certainty of Equity Raising***

The key benefit to the Non-associated Shareholders of the Allotments is that the Company is certain to obtain an additional \$8.0 million of equity capital in order to pay down a portion of the ANZ National debt.

### ***Cornerstone Shareholders***

The Allotments will enhance Cape Healthcare's and LPL Trustee's position as important cornerstone shareholders in the Company.

The Allotments also further signal Cape Healthcare's and LPL Trustee's confidence in the future prospects of Pharmacybrands.

### ***Non-associated Shareholder Approval is Required***

Pursuant to Rule 7(d) of the Code, the Non-associated Shareholders must approve by ordinary resolution the Allotments.

The Allotments will not proceed unless the Non-associated Shareholders approve the Allotments Resolution.



## 2.13 Disadvantages to the Non-associated Shareholders

### *Dilutionary Impact*

The main disadvantage is that the Allotments will increase Cape Healthcare's and LPL Trustee's shareholding in Pharmacybrands from 26.90% to 30.39%, which will result in the Non-associated Shareholders' shareholdings being diluted by approximately 15%.

However, the combined dilutionary effect of the Allotments and the Share Purchase Plan on the Non-associated Shareholders will be reduced to approximately 7% if all the Non-associated Shareholders take up their full entitlements under the Share Purchase Plan.

### *Likelihood of a Takeover Offer from Cape Healthcare or LPL Trustee does not Change Significantly*

As long as Cape Healthcare and LPL Trustee each hold more than 20% and not more than 50% of the voting rights in the Company, neither shareholder can increase the level of its shareholding unless it complies with the provisions of the Code. Either shareholder will only be able to acquire more shares in the Company if:

- it makes a full or partial takeover offer or
- the acquisition is approved by way of an ordinary resolution of the Non-associated Shareholders or
- the Company makes an allotment of shares which is approved by way of an ordinary resolution of the Non-associated Shareholders.

Cape Healthcare or LPL Trustee could also increase their level of shareholding in the Company if Pharmacybrands undertook a share buyback that was approved by the Company's shareholders and Cape Healthcare or LPL Trustee did not fully participate in the buyback.

Neither Cape Healthcare nor LPL Trustee will be able to increase their shareholding under the creep provisions of Rule 7(e) of the Code as these provisions are only available to persons that hold between 50% and 90% of the voting securities in a code company.

We do not consider that an increase in Cape Healthcare's and LPL Trustee's shareholdings from 26.90% to 30.39% under the Allotments will change the likelihood of a takeover offer for the Company from either shareholder to any significant degree.

### *Likelihood of Other Takeover Offers does not Change Significantly*

With Cape Healthcare and LPL Trustee both currently holding 26.90% of the shares in the Company, any bidder looking to fully take over the Company would need to ensure that both Cape Healthcare and LPL Trustee would accept its offer.

Following the Allotments, and before the Share Purchase Plan, Cape Healthcare and LPL Trustee will each hold 30.39% of the shares in the Company. Accordingly, the position for any bidder would be the same – it would still need to ensure that both cornerstone shareholders would accept its offer.



Similarly, in the event that a bidder made a partial takeover offer for (say) 50.1% of the Company, it would currently want to ensure that Cape Healthcare and LPL Trustee would accept its offer to ensure the success of its offer. Following the Allotments, it would still want to ensure that both Cape Healthcare and LPL Trustee would accept its offer.

In our view, the increase in Cape Healthcare's and LPL Trustee's respective shareholdings from 26.90% to 30.39% under the Allotments will not have a material impact on the attraction of Pharmacybrands as a takeover target to other parties.

#### **2.14 Implications of the Resolution not Being Approved**

In the event that the Allotments Resolution is not approved, then the Allotments cannot proceed. As a consequence, the Share Purchase Plan will also not proceed. Accordingly, Pharmacybrands will not receive the \$8.0 million of additional equity from the Allotments nor the additional equity of up to \$3.5 million from the Share Purchase Plan. The Company will need to undertake an alternative form of capital raising in order to meet ANZ National's requirements for a portion of the borrowings to be repaid.

#### **2.15 Voting For or Against the Allotments Resolution**

Voting for or against the Allotments Resolution is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

### **3. Evaluation of the Fairness of the Cape Healthcare Allotment and the LPL Trustee Allotment**

#### **3.1 Basis of Evaluation**

Listing Rule 1.7.2 requires an Appraisal Report to consider whether the consideration and the terms and conditions of the proposed issue are *fair* to the Non-associated Shareholders.

There is no legal definition of the term *fair* in New Zealand in either the Listing Rules or in any statute dealing with securities or commercial law.

We are of the view that an assessment of the merits of a transaction is a broader test than the fairness of the transaction and encompasses a wider range of issues associated with the transaction. The assessment of the merits of the allotment of shares under the Cape Healthcare Allotment and the LPL Trustee Allotment must consider the fairness of the likely increase in effective control by Cape Healthcare and LPL Trustee in Pharmacybrands as well as the fairness of the terms and conditions of the Cape Healthcare Allotment and the LPL Trustee Allotment.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.

#### **3.2 Evaluation of the Fairness of the Cape Healthcare Allotment and the LPL Trustee Allotment for the Purposes of Listing Rule 1.7.2**

In our opinion, after having regard to all relevant factors, the consideration and the terms and conditions of the Cape Healthcare Allotment and the LPL Trustee Allotment are fair to the Non-associated Shareholders.

The basis for our opinion is set out in detail in sections 2.4 to 2.14. In summary, the key factors leading to our opinion are:

- the rationale for the Allotments is sound
- alternative capital raising options to the Allotments are limited and are unlikely to provide the same level of capital within a similar timeframe
- the terms of the Allotments are reasonable
- the Allotments will have a positive impact on the Company's financial position
- the Allotments will increase Cape Healthcare's and LPL Trustee's ability to influence the outcome of shareholding voting but only to a moderate degree
- the Allotments are not expected to increase either Cape Healthcare's or LPL Trustee's influence over the Board or the Company's operations
- the dilutionary impact of the Allotments on Non-associated Shareholders will be in the vicinity of 15%. This level of dilution will reduce to approximately 7% if all the Non-associated Shareholders take up their entitlements under the Share Purchase Plan
- the Allotments are unlikely to have any material impact on the Company's share price or the liquidity of its shares in the near term

- the Allotments may reduce the attraction of Pharmacybrands as a takeover target to Cape Healthcare or the LPL Trustee to a minor degree but not necessarily to other bidders
- the implications of the Allotments not being approved by the Non-associated Shareholders are that alternative capital raising initiatives will need to be undertaken but there is no guarantee that such initiatives will deliver the level of capital sought or provide capital within the desired timeframes.

### **3.3 Voting For or Against the Allotments Resolution**

Voting for or against the Allotments Resolution is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

## 4. Profile of Pharmacybrands

### 4.1 Background

The *Life Pharmacy* franchise was established in 1995, starting with 10 pharmacies. The pharmacies previously operated under the *Unichem* brand and joined together and rebranded themselves as *Unichem-Life*.

As the brand grew and strengthened, the association with the *Unichem* banner group became less of a pre-requisite. The *Life Pharmacy* brand was launched in 1999.

The Pharmacybrands corporate entity was originally incorporated under the name Beauty Direct and Online Limited on 11 January 1999.

It changed its name to Life Pharmacy Limited on 11 March 2005 following the completion of a reverse listing on the NZSX.

In July 2007, the Company placed 7,000,000 fully paid ordinary shares at \$0.75 per share with LPL Trustee. The Company also granted LPL Trustee an option to subscribe for sufficient shares to increase its shareholding in the Company to up to 50.01%. LPL Trustee exercised its option in August 2008.

In May 2008, the Company (under its previous name Life Pharmacy Limited) acquired the *Care Chemist* franchise pharmacy business which had 8 *Care Chemist* pharmacy members operating in the greater Auckland region.

The Company announced on 3 August 2009 that it had entered into a merger agreement with PBL, under which it would make an offer for 100% of the ordinary shares in PBL, merging the operations of the 2 companies. The Company reached the 90% acceptance threshold on 22 September 2009 and merged with PBL on 30 September 2009. Cape Healthcare acquired its 26,904,646 shares in the Company by accepting the takeover offer.

The Company changed its name to Pharmacybrands Limited on 31 March 2010.

Pharmacybrands acquired 100% of the shares in Radius Pharmacy in April 2011 and announced the acquisition of 100% of the shares in Radius Medical and Radius Solutions in May 2011.

### 4.2 Nature of Operations

Pharmacybrands is the franchisor to *Amcal*, *Care Chemist*, *Life Pharmacy*, *Unichem* and *Radius Pharmacy* brands that operate through New Zealand. The Company currently has 303 franchisees:

- *Amcal* – 79
- *Care Chemist* – 27
- *Life Pharmacy* – 28
- *Unichem* – 135
- *Radius Pharmacy* – 34.

The Company has an ownership interest in 68 pharmacies (including 34 recently acquired *Radius Pharmacy* stores), 2 joint ventures (retail outlets) and 12 100% owned subsidiary companies (pharmacy investment, franchise and management operations and 9 non-trading companies).

### 4.3 Directors

The directors of Pharmacybrands are:

- Peter Merton, chair, associated with Cape Healthcare
- Andrew Bagnall, associated with LPL Trustee
- John Bolland, associated with LPL Trustee
- Andrew Davidson, independent director
- Bill Meaney, associated with Cape Healthcare
- Keith Rushbrook, independent director
- Ian Sharp, independent director
- Mark Vuksich, associated with PIMS 2005 Limited.

### 4.4 Capital Structure and Shareholders

#### Ordinary Shares

Pharmacybrands currently has 100,001,023 ordinary shares on issue held by 670 shareholders.

The names, number of shares and percentage holding of the 10 largest shareholders as at 27 May 2011 are set out below.

Pharmacybrands' 10 Largest Shareholders		
Shareholder	No. of Shares Held	%
Cape Healthcare	26,904,646	26.90%
LPL Trustee	26,904,355	26.90%
Massey Pharmacy Limited	3,030,000	3.03%
Matthew Fleet and MRI Christchurch Trustees Limited	2,421,048	2.42%
Murray Dunn and Fortune Manning Trustee Company Limited	1,967,145	1.97%
Gordon Ritson	1,957,643	1.96%
Ganet Investments Limited	1,598,887	1.60%
New Zealand Permanent Trustees Limited	1,250,000	1.25%
Brett Fordyce, Francis Dragicevich and Christine Hutton	1,182,263	1.18%
Arthur McAulay	1,037,770	1.04%
Subtotal	68,253,757	68.25%
Others (660 shareholders)	31,747,266	31.75%
Total	100,001,023	100.00%

Source: NZX Data

#### Redeemable Ordinary Shares

Pharmacybrands currently has 500,000 redeemable ordinary shares on issue. The shares were issued at \$0.40 per share and initially paid up to \$0.01 each. They are held on trust by Life Pharmacy Trustee Company Limited on behalf of senior executive employees.

## 4.5 Financial Performance

LPL acquired PBL on 30 September 2009. From a legal perspective, the business acquisition was an acquisition by LPL of 100% of the issued share capital of PBL. However, the business combination has been treated as a reverse acquisition for financial reporting purposes and accounted for as if PBL acquired 100% of LPL.

A summary of Pharmacybrands' recent financial performance is set out below.

Summary of Pharmacybrands Financial Performance			
	Year to 31 Mar 09 (Audited) \$000	Year to 31 Mar 10 (Audited) \$000	Year to 31 Mar 11 (Audited) \$000
Operating revenue	11,264	16,197	21,667
EBITDA	1,902	3,839	5,781
EBIT	1,776	3,581	5,499
NPBT	2,237	4,046	6,171
NPAT	1,709	3,523	5,161
<i>EBITDA: Earnings before interest, tax, depreciation and amortisation</i> <i>EBIT: Earnings before interest and tax</i> <i>NPBT: Net profit before tax</i> <i>NPAT: Net profit after tax</i> Source: Pharmacybrands audited financial statements			

The improvement in financial performance in the 2010 financial year reflected the much larger size of the business following the merger of the LPL and PBL businesses.

The further improvement in financial performance in the 2011 financial year was driven by increased revenue from members and associates as the Company continued to grow the number of pharmacies operating under its brands.

## 4.6 Financial Position

A summary of Pharmacybrands' recent financial position is set out below.

Summary of Pharmacybrands Financial Position			
	As at 31 Mar 09 (Audited) \$000	As at 31 Mar 10 (Audited) \$000	As at 31 Mar 11 (Audited) \$000
Current assets	5,812	19,402	21,944
Non-current assets	4,585	26,604	27,378
Total assets	10,397	46,006	49,322
Current liabilities	(3,698)	(7,770)	(5,903)
Non-current liabilities	-	(103)	(93)
Total liabilities	(3,698)	(7,873)	(5,996)
Total equity	<u>6,699</u>	<u>38,133</u>	<u>43,326</u>
Source: Pharmacybrands audited financial statements			

Pharmacybrands' main current assets are cash and bank balances and trade and other receivables. Pharmacybrands had \$15.7 million of cash and bank balances as at 31 March 2011. \$12.0 million of cash was subsequently used to fund the Radius Pharmacy acquisition in April 2011.

Its main non-current assets are investments in associates which amounted to \$25.1 million as at 31 March 2011.

Liabilities consist mainly of payables, accruals and borrowings ANZ National. Borrowings amounted to \$1.1 million as at 31 March 2011. Borrowings have increased to approximately \$27.4 million following the acquisitions of Radius Pharmacy, Radius Medical and Radius Solutions in April and May 2011.

#### 4.7 Cash Flows

A summary of Pharmacybrands' recent cash flows is set out below.

Summary of Pharmacybrands Cash Flows			
	Year to 31 Mar 09 (Audited) \$000	Year to 31 Mar 10 (Audited) \$000	Year to 31 Mar 11 (Audited) \$000
Net cash flow from operating activities	1,984	1,348	4,024
Net cash used in investing activities	(287)	6,539	2,865
Net cash from financing activities	41	(2,006)	(1,535)
Net increase / (decrease) in cash held	1,738	5,881	5,354
Opening cash balance	2,681	4,419	10,300
Closing cash balance	4,419	10,300	15,654

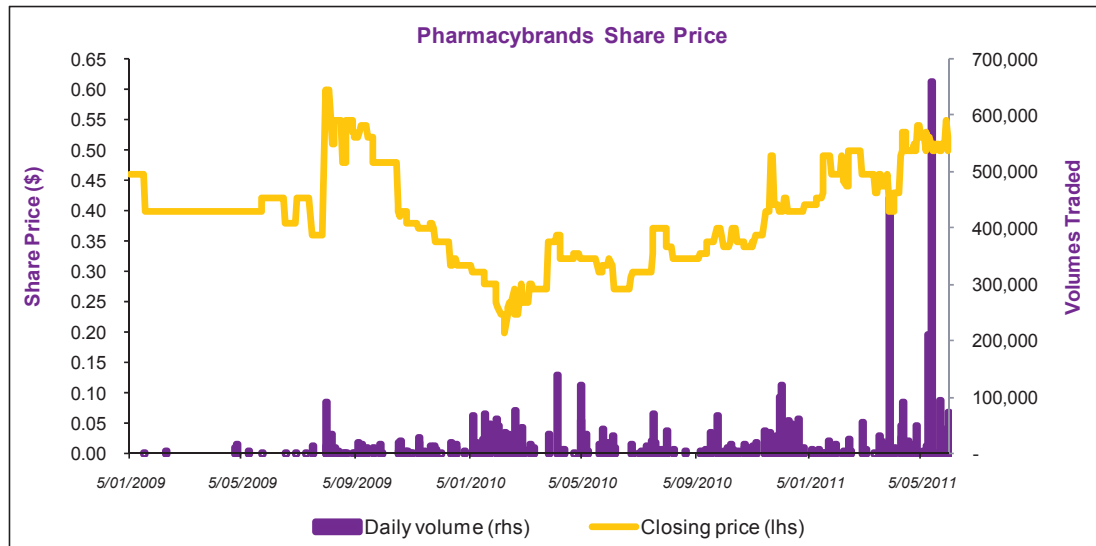
*Source: Pharmacybrands audited financial statements*

The increase in cash in the 2010 financial year was largely attributable to the level of LPL cash that was included in the Company's financial statements following the LPL / PBL merger.

The increase in cash in the 2011 financial year was driven by improved operating cash flows and the sale of certain associates.

## 4.8 Share Price History

Set out below is a summary of Pharmacybrands' daily closing share price and daily volumes of shares traded from 5 January 2009 to 3 June 2011.



During the period, Pharmacybrands' shares have traded between \$0.20 and \$0.60 at a VWAP of \$0.41.

Trading in the Company's shares is extremely thin, reflecting that 53.80% of the shares are currently held by cornerstone shareholders Cape Healthcare and LPL Trustee and the top 10 shareholders hold 68.25% of the shares.

An analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of shares outstanding) is set out below.

Share Trading					
Period	Low <sup>1</sup> (\$)	High <sup>1</sup> (\$)	VWAP <sup>1</sup> (\$)	Volume Traded <sup>1</sup> (000)	Liquidity
1 month	0.50	0.55	0.50	1,153	1.2%
3 months	0.40	0.55	0.48	2,018	2.0%
6 months	0.40	0.55	0.47	2,557	2.6%
12 months	0.27	0.55	0.44	3,325	3.3%
<sup>1</sup> To 3 June 2011					



## **5. Sources of Information, Reliance on Information, Disclaimer and Indemnity**

### **5.1 Sources of Information**

The statements and opinions expressed in this report are based on the following main sources of information:

- the draft notice of annual meeting
- the Pharmacybrands annual reports for the years ended 31 March, 2009 to 2011
- the Cape Healthcare Subscription Agreement
- the LPL Trustee Subscription Agreement
- data in respect of Pharmacybrands from NZX Data and Capital IQ.

During the course of preparing this report, we have had discussions with and/or received information from the directors and executive management of Pharmacybrands and Pharmacybrands' legal advisers.

The Independent Directors have confirmed that we have been provided for the purpose of this Independent Adviser's Report and Appraisal Report with all information relevant to the Cape Healthcare Allotment and the LPL Trustee Allotment that is known to them and that all the information is true and accurate in all material aspects and is not misleading by reason of omission or otherwise.

Including this confirmation, we have obtained all the information that we believe is desirable for the purpose of preparing this Independent Adviser's Report and Appraisal Report.

In our opinion, the information to be provided by Pharmacybrands to the Non-associated Shareholders is sufficient to enable the Independent Directors and the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the Cape Healthcare Allotment and the LPL Trustee Allotment.

### **5.2 Reliance on Information**

In preparing this report we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was available from public sources and all information that was furnished to us by Pharmacybrands and its advisers.

We have evaluated that information through analysis, enquiry and examination for the purposes of preparing this report but we have not verified the accuracy or completeness of any such information or conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of Pharmacybrands. We do not warrant that our enquiries would reveal any matter which an audit, due diligence review or extensive examination might disclose.

### 5.3 Disclaimer

We have prepared this report with care and diligence and the statements in the report are given in good faith and in the belief, on reasonable grounds, that such statements are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial position of Pharmacybrands will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of Pharmacybrands and its directors and management. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.

We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of the report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the report or assumptions reasonably taken as implicit.

Our evaluation has been arrived at based on economic, exchange rate, market and other conditions prevailing at the date of this report. Such conditions may change significantly over relatively short periods of time. We have no obligation or undertaking to advise any person of any change in circumstances which comes to our attention after the date of this report or to review, revise or update our report.

We have had no involvement in the preparation of the notice of annual meeting issued by Pharmacybrands and have not verified or approved the contents of the notice of annual meeting. We do not accept any responsibility for the contents of the notice of annual meeting except for this report.

### 5.4 Indemnity

Pharmacybrands has agreed that, to the extent permitted by law, it will indemnify Simmons Corporate Finance and its directors and employees in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity does not apply in respect of any negligence, wilful misconduct or breach of law. Pharmacybrands has also agreed to indemnify Simmons Corporate Finance and its directors and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where Simmons Corporate Finance or its directors and employees are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, Simmons Corporate Finance shall reimburse such costs.

## **6. Qualifications and Expertise, Independence, Declarations and Consents**

### **6.1 Qualifications and Expertise**

Simmons Corporate Finance is a New Zealand owned specialist corporate finance advisory practice. It advises on mergers and acquisitions, prepares independent expert's reports and provides valuation advice.

The person in the company responsible for issuing this report is Peter Simmons, B.Com, DipBus (Finance), CFIP.

Simmons Corporate Finance and Mr Simmons have significant experience in the independent investigation of transactions and issuing opinions on the merits and fairness of the terms and financial conditions of the transactions.

### **6.2 Independence**

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with Pharmacybrands, Cape Healthcare or LPL Trustee or any conflicts of interest that could affect our ability to provide an unbiased opinion in relation to these transactions.

Simmons Corporate Finance has not had any part in the formulation of the Allotments or any aspects thereof. Our sole involvement has been the preparation of this report.

Simmons Corporate Finance will receive a fixed fee for the preparation of this report. This fee is not contingent on the conclusions of this report or the outcome of the voting in respect of the Allotments. We will receive no other benefit from the preparation of this report.

### **6.3 Declarations**

An advance draft of this report was provided to the Independent Directors for their comments as to the factual accuracy of the contents of the report. Changes made to the report as a result of the circulation of the draft have not changed the methodology or our conclusions.

Our terms of reference for this engagement did not contain any term which materially restricted the scope of the report.

### **6.4 Consents**

We consent to the issuing of this report in the form and context in which it is to be included in the notice of annual meeting to be sent to Pharmacybrands' shareholders. Neither the whole nor any part of this report, nor any reference thereto may be included in any other document without our prior written consent as to the form and context in which it appears.



Peter Simmons  
Director

**Simmons Corporate Finance Limited**  
3 June 2011

