CUMBERLAND PHARMACEUTICALS INC
Form 10-Q
May 17, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________.

Commission File Number: 001-33637

Cumberland Pharmaceuticals Inc.

(Exact name of registrant as specified in its charter)

Tennessee (State or other jurisdiction of incorporation or organization)	**62-1765329** (I.R.S. Employer Identification No.)
2525 West End Avenue, Suite 950, Nashville, Tennessee (Address of principal executive offices)	**37203** (Zipcode)

(615) 255-0068

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer þ (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).Yes o No þ

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at May 7, 2010
Common stock, no par value	20,437,176

CUMBERLAND PHARMACEUTICALS INC.
INDEX

Table of Contents

PART I FINANCIAL INFORMATION

Item 1: Financial Statements

CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 73,752,814	$ 78,701,682
Accounts receivable, net of allowances	3,814,947	6,176,585
Inventories	7,406,402	4,822,873
Other current assets	3,369,809	3,472,455
Total current assets	88,343,972	93,173,595
Property and equipment, net	948,580	918,412
Intangible assets, net	7,818,394	7,956,009
Other assets	1,578,723	1,676,304
Total assets	$ 98,689,669	$ 103,724,320
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 6,000,000	$ 9,061,973
Current portion of other long-term obligations	88,739	144,828
Accounts payable	6,813,974	5,632,796
Other accrued liabilities	2,556,585	3,784,777
Total current liabilities	15,459,298	18,624,374
Revolving line of credit	1,825,951	1,825,951
Long-term debt, excluding current portion	7,438,027	8,938,027
Other long-term obligations, excluding current portion	181,455	184,632
Total liabilities	24,904,731	29,572,984
Commitments and contingencies		
Redeemable common stock	100,000	1,930,000
Equity:		
Shareholders equity:		
Common stock no par value; 100,000,000 shares authorized; 20,413,605[1] and 20,180,486[1] shares issued and outstanding as of March 31, 2010 and December 31, 2009, respectively	68,861,850	67,711,746

Retained earnings	4,865,704	4,542,126
Total shareholders equity	73,727,554	72,253,872
Noncontrolling interests	(42,616)	(32,536)
Total equity	73,684,938	72,221,336
Total liabilities and equity	$ 98,689,669	$ 103,724,320

(1) Number of shares issued and outstanding represent total shares of common stock regardless of classification on the consolidated balance sheet. The number of shares of redeemable common stock at March 31, 2010 and December 31, 2009 was 9,497 and 142,016, respectively.

See accompanying notes to unaudited condensed consolidated financial statements.

CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Income
(Unaudited)

	Three Months Ended March 31,	
	2010	**2009**
Net revenues	$ 10,130,652	$ 9,404,599
Costs and expenses:		
Cost of products sold	859,288	733,218
Selling and marketing	5,607,512	4,140,187
Research and development	773,868	770,117
General and administrative	1,881,203	1,444,863
Amortization of product license right	171,726	171,726
Other	26,547	27,463
Total costs and expenses	9,320,144	7,287,574
Operating income	810,508	2,117,025
Interest income	60,679	17,596
Interest expense	(345,952)	(97,711)
Income before income tax expense	525,235	2,036,910
Income tax expense	(211,737)	(831,059)
Net income	313,498	1,205,851
Net loss attributable to noncontrolling interests	10,080	12,239
Net income attributable to common shareholders	$ 323,578	$ 1,218,090
Earnings per share attributable to common shareholders		
- Basic	$ 0.02	$ 0.12
- Diluted	$ 0.02	$ 0.08
Weighted-average shares outstanding		
- Basic	20,233,267	10,321,175
- Diluted	21,395,419	16,127,240

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2010	**2009**
Cash flows from operating activities:		
Net income	$ 313,498	$ 1,205,851
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization expense	231,332	196,059
Nonemployee equity compensation	3,972	37,760
Stock-based compensation employee stock options	130,915	143,902
Excess tax benefit derived from exercise of stock options	(206,418)	(2,842,825)
Noncash interest expense	67,380	14,256
Net changes in assets and liabilities affecting operating activities:		
Accounts receivable	2,361,638	(267,892)
Inventory	(2,583,529)	415,948
Other current assets and other assets	132,847	955,169
Accounts payable and other accrued liabilities	127,104	(1,187,558)
Other long-term obligations	(59,266)	(405,801)
Net cash provided by (used in) operating activities	519,473	(1,735,131)
Cash flows from investing activities:		
Additions to property and equipment	(64,085)	(15,601)
Additions to patents		(16,345)
Net cash used in investment activities	(64,085)	(31,946)
Cash flows from financing activities:		
Costs of initial public offering		(114,428)
Principal payments on note payable	(4,561,973)	
Costs of financing for long-term debt and credit facility	(27,500)	(15,475)
Proceeds from exercise of stock options	807,496	4,296
Excess tax benefit derived from exercise of stock options	206,418	2,842,825
Payments made in connection with repurchase of common shares	(1,828,697)	(2,707,419)
Net cash (used in) provided by financing activities	(5,404,256)	9,799
Net decrease in cash and cash equivalents	(4,948,868)	(1,757,278)
Cash and cash equivalents at beginning of period	78,701,682	11,829,551

Cash and cash equivalents at end of period	$ 73,752,814	$ 10,072,273
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	$ 276,288	$ 33,517
Income taxes	12,376	80,000
Non-cash investing and financing activities:		
Increase in accounts payable and accrued expenses of initial public offering		5,311

See accompanying notes to unaudited condensed consolidated financial statements.

3

Table of Contents

CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Equity and Comprehensive Income
(Unaudited)

	Common stock		Retained	Non-controlling	Total
	Shares	**Amount**	**earnings**	**interests**	**equity**
Balance, December 31, 2009	20,180,486	$ 67,711,746	$ 4,542,126	$ (32,536)	$ 72,221,336
Stock-based compensation - nonemployees		3,972			3,972
Exercise of options and related tax benefit, net of mature shares redeemed for the exercise price	386,662	1,013,914			1,013,914
Stock-based compensation - employees		130,915			130,915
Repurchase of shares	(153,543)	(1,828,697)			(1,828,697)
Reclass of redeemable common stock		1,830,000			1,830,000
Net and comprehensive income			323,578	(10,080)	313,498
Balance, March 31, 2010	20,413,605	$ 68,861,850	$ 4,865,704	$ (42,616)	$ 73,684,938

See accompanying notes to unaudited condensed consolidated financial statements.

CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES
Notes to condensed consolidated financial statements
(unaudited)

(1) BASIS OF PRESENTATION

In the opinion of management, the accompanying unaudited condensed consolidated financial statements (condensed consolidated financial statements) of Cumberland Pharmaceuticals Inc. and its subsidiaries (collectively, the Company or Cumberland) have been prepared on a basis consistent with the December 31, 2009 audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary to fairly present the information set forth herein. All significant intercompany accounts and transactions have been eliminated in consolidation. The condensed consolidated financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission, or SEC, and omit certain information and footnote disclosure necessary to present the statements in accordance with U.S. generally accepted accounting principles. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009. The results of operations for the first three months of 2010 are not necessarily indicative of the results to be expected for the entire fiscal year or any future period.

Total comprehensive income was comprised solely of net income for the three months ended March 31, 2010 and 2009.

Accounting Policies:

In preparing the condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles, management must make decisions that impact the reported amounts and the related disclosures. Such decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. In reaching such decisions, management applies judgments based on its understanding and analysis of the relevant circumstances, historical experience, and other available information. Actual amounts could differ from those estimated at the time the condensed consolidated financial statements are prepared.

The Company has evaluated events occurring subsequent to March 31, 2010 for accounting and disclosure implications.

(2) EARNINGS PER SHARE

The following table reconciles the numerator and denominator used to calculate diluted earnings per share for the three months ended March 31, 2010 and 2009:

	Three Months Ended March 31,	
	2010	**2009**
Numerator:		
Net income attributable to common shareholders	$ 323,578	$ 1,218,090
Denominator:		
Weighted-average shares outstanding basic	20,233,267	10,321,175
Convertible preferred stock shares		1,625,498

Dilutive effect of other securities	1,162,152	4,180,567
Weighted-average shares outstanding diluted	21,395,419	16,127,240

As of March 31, 2010 and 2009, options to purchase 541,522 and 344,587 shares of common stock, respectively, were outstanding but were not included in the computation of diluted EPS because the effect would be antidilutive.

Table of Contents

CUMBERLAND PHARMACEUTICALS INC. AND SUBSIDIARIES
Notes to condensed consolidated financial statements continued
(unaudited)

(3) SEGMENT REPORTING

We operate in one segment, specialty pharmaceutical products. Management has chosen to organize the Company based on the type of products sold. All of the Company s assets are located in the United States. The Company had sales of less than $0.1 million to non-U.S. customers during the three months ended March 31, 2010 and $0.7 million during the three month period ended March 31, 2009.

The Company s net revenues consisted of the following for the three months ended March 31, 2010 and 2009:

	Three Months Ended March 31,	
	2010	**2009**
Products:		
Acetadote	$ 7,723,273	$ 7,133,430
Kristalose	2,309,982	2,228,615
Caldolor	19,305	
Other	78,092	42,554
Total net revenues	$ 10,130,652	$ 9,404,599

(4) SHAREHOLDERS EQUITY

In February 2010, the Company repurchased 153,543 shares of common stock totaling $1.8 million for the settlement of tax liabilities associated with the exercise of certain options in 2009. As of December 31, 2009, this amount was included in redeemable common stock in the condensed consolidated balance sheet. The repurchase amount was based on the fair-market value of common stock on the date of settlement.

During the first quarter of 2010, options to purchase 394,456 shares of common stock were exercised. In connection with an exercise, 7,794 shares of mature stock was tendered as consideration for the exercise price. The exercise of these options created a tax deduction of approximately $3.6 million, of which approximately $0.5 million was used to offset the estimated tax liability resulting from the results of operations for the three months ended March 31, 2010. As of March 31, 2010, the Company has unrecognized tax deductions of approximately $68.6 million that will be recognized when the deduction reduces income taxes payable.

(5) COLLABORATIVE AGREEMENTS

The Company is a party to several collaborative arrangements with certain research institutions to identify and pursue promising pre-clinical pharmaceutical product candidates. The Company has determined these collaborative agreements do not meet the criteria for accounting under Accounting Standards Codification 808, *Collaborative Agreements*. The agreements do not specifically designate each party s rights and obligations to each other under the collaborative arrangements. Except for patent defense costs, expenses incurred by one party are not required to be reimbursed by the other party. The funding for these programs is generally provided through private sector investments or federal Small Business (SBIR/STTR) grant programs. Expenses incurred under these collaborative agreements are included in research and development expenses in the condensed consolidated statements of income. Funding received from private sector investments and grants are recorded as net revenues in the condensed consolidated statements of income.

(6) SUBSEQUENT EVENTS

In May 2010, the Board of Directors authorized the repurchase of up to $10 million of common stock. Repurchases will be made from time to time on the open market over a number of months and will be funded through excess cash flow.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains certain forward-looking statements which reflect management s current views of future events and operations. These statements involve certain risks and uncertainties, and actual results may differ materially from them. Forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We caution you that our actual results may differ significantly from the results we discuss in these forward looking statements. Some important factors which may cause results to differ from expectations include: availability of additional debt and equity capital required to finance the business model; market conditions at the time additional capital is required; significant leverage and debt service requirements of the Company; our ability to continue to acquire branded products; product sales; and management of our growth and integration of our acquisitions. Other important factors that may cause actual results to differ materially from forward-looking statements are discussed in Risk Factors on pages 20 through 32 and Special note regarding forward-looking statements on page 32 of our Annual Report on Form 10-K for the year ended December 31, 2009. The Company does not undertake to publicly update or revise any of its forward-looking statements, even in the event that experience or future changes indicate that the anticipated results will not be realized. The following presentation of management s discussion and analysis of financial condition and results of operations should be read in conjunction with the Company s unaudited condensed consolidated financial statements and related notes thereto included in this Form 10-Q.

OVERVIEW

Our Business

We are a profitable and growing specialty pharmaceutical company focused on the acquisition, development and commercialization of branded prescription products. Our primary target markets are hospital acute care and gastroenterology, which are characterized by relatively concentrated physician bases that we believe can be penetrated effectively by relatively small, targeted sales forces. Cumberland is dedicated to providing innovative products which improve quality of care for patients.

Our product portfolio includes Acetadote® (*acetylcysteine*) Injection for the treatment of acetaminophen poisoning, Caldolor® (*ibuprofen*) Injection, the first injectable treatment for pain and fever available in the United States, and Kristalose® (*lactulose*) for Oral Solution, a prescription laxative. We market and sell our products through our dedicated hospital and gastroenterology sales forces in the United States, and are working with partners to reach international markets.

We have both product development and commercialization capabilities, and believe we can leverage our existing infrastructure to support our expected growth. Our management team consists of pharmaceutical industry veterans experienced in business development, product development, sales and marketing and finance and accounting. Our internal product development and regulatory executives develop proprietary product formulations, design and manage our clinical trials, prepare all regulatory submissions and manage our medical call center. Cumberland s operations and quality affairs professionals play an active role in the manufacture of our products by our manufacturing partners. All aspects of commercialization are handled by our sales and marketing professionals, and we work closely with our distribution partner to make our products available across the United States.

We have been profitable since 2004, and have generated sufficient cash flows to fund our development and marketing programs. In 2009, we completed an initial public offering of our common stock to help facilitate further growth. Our strategy includes maximizing the potential of our existing products and continuing to build a portfolio of new, differentiated products. Our current products are approved for sale in the United States, and we are working to bring them to select international markets. We also look for opportunities to expand into additional patient populations through new product indications, whether through our own resources or by supporting investigator-initiated studies at research institutions. We actively pursue opportunities to acquire additional late-stage development product candidates as well as marketed products in our target medical specialties. Further, we are supplementing the aforementioned growth strategies through the early-stage drug development activities of Cumberland Emerging Technologies (CET), our majority-owned subsidiary. CET partners with university research centers to

Table of Contents

identify and cost-effectively develop promising, early-stage product candidates that Cumberland Pharmaceuticals has the opportunity to commercialize.

We were incorporated in 1999 and have been headquartered in Nashville, Tennessee since inception. Our website address is www.cumberlandpharma.com. We make available through our website our annual reports on Form 10-K, our quarterly reports on Form 10-Q, our current reports on Form 8-K and any amendments, as well as other documents, as soon as reasonably practicable after their filing with the SEC. These filings are also available to the public through the Internet of the SEC, at www.sec.gov.

Recent Developments

Acetadote®

Supplemental New Drug Application

In March 2010, we submitted a supplemental new drug application (sNDA) to the U.S. Food and Drug Administration (FDA) for the use of Acetadote in patients with non-acetaminophen acute liver failure. The sNDA includes data from a clinical trial led by investigators at the University of Texas Southwestern Medical Center indicating that acute liver failure patients treated with Acetadote have a significantly improved chance of survival without a transplant. These patients can also survive a significant number of days longer without transplant, providing patients requiring transplant increased time for a donor organ to become available.

Acute liver failure is associated with a high mortality rate and frequent need for liver transplantation. Approximately half of acute liver failure cases are caused by acetaminophen poisoning while the other half result from a variety of causes including hepatitis and alcohol. Currently, transplantation of the liver is the only treatment for patients with liver failure not caused by acetaminophen overdose.

In May 2010, the FDA officially accepted the sNDA and granted a priority review. In addition to expanded labeling for Acetadote, we have requested additional exclusivity for the product. If approved, we expect to begin marketing Acetadote with the new indication in 2011.

Australian Regulatory Approval

In April 2010, the Therapeutic Goods Administration approved Acetadote for marketing in Australia. We previously granted an exclusive license to Phebra Pty Ltd., an Australian-based specialty pharmaceutical company, to commercialize Acetadote in Australia. Phebra is now preparing for the Australian launch of the product, which it expects to commence this year.

Under our agreement, Phebra is responsible for ongoing regulatory requirements, marketing, distribution and sales of Acetadote in Australia while we maintain responsibility for product formulation, development and manufacturing. In exchange for the product license, Cumberland receives upfront and milestone payments, a transfer price and royalties on future sales.

Caldolor®

License Agreement for Canada

In April 2010, we entered into an exclusive agreement with Alveda Pharmaceuticals Inc., a Toronto-based specialty pharmaceutical company, for the commercialization of Caldolor in Canada. Under the agreement, Alveda will seek Canadian regulatory approval for Caldolor and, upon approval, will handle ongoing regulatory requirements as well as product marketing, distribution and sales throughout Canada. Cumberland will maintain responsibility for product formulation, development and manufacturing. In exchange for the license to the product, Cumberland will receive royalties on future sales of Caldolor in addition to upfront and milestone payments as well as a transfer price.

Compassionate Use in Australia

In December 2009, we entered into an exclusive agreement with Phebra Pty Ltd. for distribution of Caldolor in Australia and New Zealand. As of April 2010, Phebra has made the product available in Australia on a limited, compassionate use basis. The Therapeutics Goods Administration (TGA), which regulates drugs and medical devices in Australia, operates compassionate use programs that allow patients with critical clinical need to access products not yet approved through their medical practitioner. Phebra is also planning to submit an application to the TGA for regulatory approval of Caldolor.

RECENT LEGISLATION

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act, or PPACA. On March 30, 2010, the Health Care and Education Reconciliation Act of 2010, or HCERA, was enacted into law, which modified the revenue provisions of the PPACA. The PPACA as amended by the HCERA constitutes the healthcare reform legislation. The following highlights certain provisions of the legislation that may affect us in the future.

Pharmaceutical Industry Fee

Beginning in calendar-year 2011, an annual fee will be imposed on pharmaceutical manufacturers and importers that sell branded prescription drugs to specified government programs (e.g., Medicare Part D, Medicare Part B, Medicaid, Department of Veterans Affairs programs, Department of Defense programs and TRICARE). The annual fee will be allocated to companies based on their previous calendar-year market share using sales data that the government agencies that purchase the pharmaceuticals will provide to the Treasury Department. We participate in minimal governmental programs that would subject us to this fee. The first $5.0 million of sales to government programs is exempted from the fee. Our current sales volume to government programs is estimated to be less than $5.0 million and, thus, we do not anticipate being impacted by this fee.

Medicaid Rebate Rate

We currently provide rebates for Kristalose sold to Medicaid beneficiaries. Effective January 1, 2010, the rebate increased from 11 percent to 13 percent of the average manufacturer price, or AMP. We do not have a significant volume of Kristalose sales to Medicaid beneficiaries and, thus, the impact on our results of operations for the three months ended March 31, 2010 was not material. We do not expect this aspect of the legislation will have a material impact on our results of operations in the future.

Therapeutic Discovery Project Credit

The legislation established a 50 percent nonrefundable investment tax credit for qualified investments in qualifying therapeutic discovery projects. The provision allocates $1 billion during the two-year period (2009-2010) for the program. The credit is available only to companies with 250 or fewer employees. The qualified investment for any tax year is the aggregate amount of the costs paid or incurred in that year for expenses necessary for and directly related to the conduct of the qualifying therapeutic discovery project. We are currently evaluating our projects to position ourselves to apply for these credits when the United States Treasury issues guidance on how taxpayers may apply for the credits, which is expected to occur by May 21, 2010.

CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES

Please see a discussion of our critical accounting policies and significant judgments and estimates on pages 39 through 42 in Management s discussion and analysis of our Annual Report on Form 10-K for the year ended December 31, 2009.

Accounting Estimates and Judgments

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. We base our estimates on past experience and on other factors we deem reasonable given the circumstances. Past results help form the basis of our judgments about the carrying value of assets and liabilities that are not determined from other sources. Actual results could differ from these estimates. These estimates, judgments and assumptions are most critical with respect to our accounting for revenue recognition, provision for income taxes, stock-based compensation, research and development accounting and intangible assets.

RECENTLY ISSUED ACCOUNTING STANDARDS

In March 2010, the Financial Accounting Standards Board, or FASB, issued guidance providing for the recognition of revenue using the milestone method. Under this new guidance, an entity can recognize revenue associated with milestones if the milestones are substantive and there is substantive uncertainty about whether the milestone will be achieved. To meet the definition of a substantive milestone, the consideration earned by achieving the milestone (1) would have to be commensurate with either the level of effort required to achieve the milestone or the enhancement in the value of the item delivered, (2) would have to relate solely to past performance and (3) should be reasonable relative to all deliverables and payment terms in the arrangement. The new guidance is effective for our third quarter ended September 30, 2010. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on our consolidated financial position or results of operations.

In October 2009, the FASB issued guidance setting forth requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered. The overall arrangement fee will be allocated to each element based on their relative selling prices. If an entity does not have a selling price for an element, then management must estimate the selling price. This guidance is effective for us for all revenue arrangements entered into or materially modified after January 1, 2011. Early adoption is permitted. The future impact of adopting this standard will depend on the nature and extent of transactions covered by this standard.

RESULTS OF OPERATIONS

Three months ended March 31, 2010 compared to the three months ended March 31, 2009

Net revenues. Net revenues for the three months ended March 31, 2010 totaled approximately $10.1 million, representing an increase of approximately $0.7 million, or 8%, over the same period in 2009, of which $0.6 million was attributable to Acetadote, with sales volume for Acetadote and Kristalose remaining consistent for the three months ended March 31, 2010 as compared to the same period in 2009. Also impacting our net revenues was an increase in our gross-to-net revenue adjustments for Acetadote and Kristalose primarily due to additional fee-for-service agreements in 2010.

During the second quarter of 2009, we expanded our hospital sales force in connection with the commercial launch of Caldolor. In addition to the expansion of our hospital sales force, we realigned our field sales force to enable them to also promote Caldolor in the surgery-center market. The sales forces have been working diligently in the continued launch of Caldolor while maintaining a consistent level of focus on our existing products, which is evidenced by consistent sales volume of Acetadote and Kristalose.

Cost of products sold. Cost of products sold as a percentage of net revenues increased slightly from 7.8% for the three months ended March 31, 2009 to 8.5% for the same period in 2010. The increase in cost of products sold as a percentage of net revenues was primarily due to (1) the weakening of the U.S. dollar and (2) an increase in our gross-to-net revenue adjustments discussed above.

Selling and marketing. Selling and marketing expense for the three months ended March 31, 2010 totaled approximately $5.6 million, representing an increase of approximately $1.5 million, or 35%, over the same period in 2009. The increase was primarily due to the expansion of our hospital sales force in the second quarter of 2009, and the resulting increases in payroll and related taxes, travel, meals and promotional activities.

General and administrative. General and administrative expense for the three months ended March 31, 2010 totaled approximately $1.9 million, representing an increase of approximately $0.4 million, or 30%, over the same period in 2009. The increase is primarily due to additional expenses associated with being an SEC registrant, including legal and accounting-related costs and insurance. In addition, we incurred additional foreign currency expense associated with our products bought from overseas suppliers.

Interest expense. Interest expense for the three months ended March 31, 2010 totaled approximately $0.3 million, representing an increase of approximately $0.2 million as compared to the same period in 2009. The increase is directly attributable to the increase in our term debt balance of $8.4 million as of March 31, 2010 as compared to March 31, 2009.

Income tax expense. Income tax expense for the three months ended March 31, 2010 totaled approximately $0.2 million, representing a decrease of approximately $0.6 million, or 75%, over the same period in 2009. As a percentage of income before income taxes, income tax expense decreased slightly from 40.8% for the three months ended March 31, 2009 to 40.3% for the three months ended March 31, 2010. The decrease, in dollars, was primarily due to lower earnings in the first quarter of 2010 as compared to the same period in 2009.

LIQUIDITY AND CAPITAL RESOURCES

Working Capital

Our primary sources of liquidity are cash flows provided by our operations, our borrowings and the cash proceeds from our initial public offering of common stock that was completed in August 2009. We believe that our internally generated cash flows, amounts available under our credit facilities and cash on hand will be adequate to service existing debt, finance internal growth and fund capital expenditures. As of March 31, 2010 and December 31, 2009, cash and cash equivalents was $73.8 million and $78.7 million, respectively, working capital (current assets minus current liabilities) was $72.9 million and $74.5 million, respectively, and our current ratio (current assets to current liabilities) was 5.7x and 5.0x, respectively. As of March 31 2010, we had an additional $2.2 million available to us on our line of credit.

The following table summarizes our net changes in cash and cash equivalents for the three months ended March 31, 2010 and 2009:

	Three Months Ended March 31,	
	2010	**2009**
	(in thousands)	
Net cash provided by (used in):		
Operating activities	$ 519	$ (1,735)
Investing activities	(64)	(32)
Financing activities	(5,404)	10
Net decrease in cash and cash equivalents [(1)]	$ (4,949)	$ (1,757)

(1) The sum of the individual amounts may not agree due to rounding.

The net decrease in cash and cash equivalents of $4.9 million for the three months ended March 31, 2010 was primarily due to cash used in financing activities, which included (1) principal payments on our term debt of approximately $4.6 million, (2) the repurchase of common stock of approximately $1.8 million, (3) proceeds from the exercise of stock options of approximately $0.8 million and (4) the excess tax benefit derived from the exercise of nonqualified options of approximately $0.2 million.

Table of Contents

OFF-BALANCE SHEET ARRANGEMENTS

During the three months ended March 31, 2010, the Company did not engage in any off-balance sheet arrangements.

Item 3: Quantitative and Qualitative Disclosure about Market TIFY">4.1

Net income recognised directly in equity

(0.2)

(1.9)

20.7

18.6

Profit

(484.5)

(484.5)

Total recognised income and expense for the year

(0.2)

(1.9)

(463.8)

(465.9)

Issue of share capital

(78.7)

(78.7)

Share-based payments

(5.9)

(5.9)

Equity dividends

210.0

210.0

At 29 January 2006

(2,162.3)

4.9

(395.3)

0.3

(1.9)

(1,201.3)

(3,755.6)

At 25 July 2004

(1,626.1)

(680.6)

31.5

(395.3)

(1,114.3)

(3,784.8)

Movement in foreign exchange

(0.8)

(0.8)

Net income recognised directly in equity

(0.8)

(0.8)

Profit

(438.5)

(438.5)

Total recognised income and expense for the year

(0.8)

(438.5)

(439.3)

Issue of share capital

(89.8)

(89.8)

Share-based payments

(2.8)

(2.8)

Equity dividends

205.4

205.4

At 23 January 2005

(1,715.9)

(680.6)

28.7

(395.3)

(0.8)

(1,347.4)

(4,111.3)

(i) Equity compensation reserve

The equity compensation reserve includes shares held by the Employee Share Plan Trust and the amortised value of options and performance

rights granted to employees.

(ii) General reserve

Under A-IFRS transitional rules, the foreign currency translation reserve on transition to A-IFRS has been transferred to the general reserve.

In addition, under A-IFRS the asset revaluation reserve will no longer be required, and hence has been transferred to the general reserve.

(iii) Foreign currency reserve

The foreign currency translation reserve includes foreign currency translation differences on translation of foreign operations post transition to A-IFRS.

(iv) Hedge Reserve

The hedge reserve recognises the gains and losses on outstanding cash flow hedges to the extent that they are effective.

Statement of Cash Flows

For the 26 weeks ended 29 January 2006

		January 2006	January 2005

		$m	$m
		Inflows/(outflows)	
Cash flows from operating activities			
Receipts from customers (inclusive of goods and services tax)		20,673.7	19,864.1
Payments to suppliers and employees (inclusive of goods and services tax)		(19,528.7)	(19,102.5)
Distributions received from associated entities		4.5	3.9
Interest received		11.0	14.5
Borrowing costs paid		(56.0)	(33.7)
Income tax paid		(233.2)	(243.5)
Net cash inflow from operating activities		871.3	502.8
Cash flows from investing activities			
Payments for property, plant and equipment		(578.2)	(374.9)
Payments for purchase of businesses and controlled entities		(31.9)	(2.0)
Payment for purchase of associated entity		(0.5)	(0.6)
Proceeds on disposal of property, plant and equipment		10.7	13.3
Proceeds on disposal of businesses		2.2	2.8
Proceeds from capital returns on investments		1.1	
Payment for purchases of investments			(1.5)
Repayment of loan advanced to other entities		1.3	3.6
Net cash (outflow) from investing activities		(595.3)	(359.3)
Cash flows from financing activities			
Proceeds from issue of shares		78.7	89.8
Proceeds from borrowings		3,641.2	623.9
Repayments of borrowings		(3,648.6)	(623.9)
Dividends paid		(210.0)	(205.4)

Net cash (outflow) from financing activities		(138.7)	(115.6)
Net increase in cash held		137.3	27.9
Cash at beginning of the half-year		440.9	841.9
Cash at end of the half-year		578.2	869.8
Reconciliation of net cash inflow from operating activities to net profit is as follows:			
Net cash inflow from operating activities		871.3	502.8
Depreciation and amortisation		(264.1)	(251.6)
Changes in assets and liabilities:			
Increase in current receivables		19.6	54.2
Increase in inventories		152.6	235.1
Increase in deferred tax assets		23.6	16.5
Increase in other assets		28.3	25.3
(Increase) in trade creditors		(275.9)	(43.9)
(Increase) in other liabilities		(44.6)	(101.6)
Decrease in provision for taxation		1.1	26.9
(Increase) in provisions		(10.4)	(34.3)
Decrease in deferred income tax		5.8	21.2
Net loss on disposal of plant and equipment		(24.3)	(26.0)
Net profit on sale of freehold properties		0.2	1.0
Net profit on sale of businesses and controlled entities		1.3	0.6
Write-down of non-current assets to recoverable amounts		(10.1)	(9.1)
Fair value adjustments to property		11.4	24.1
Capital returns on investments		1.1	
Fair value gains on financial instruments		2.2	

Non-cash employee benefits expense - share-based payemnts		(4.6)	(2.7)
Net profit		484.5	438.5

Statement of Cash Flows (continued)

Acquisitions

Details of the aggregate cash flows relating to the acquisition of businesses and controlled entities and the assets and liabilities at the date of acquisition are as follows:

	Acquisitions				
	2006 $m	2005 $m			
Consideration	(31.9)	(2.0)			
Cash		-			
Receivables	0.3				
Inventories	1.1	0.2			
Property, plant and equipment	13.6	0.1			
Intangibles	17.5	1.7			
Payables - current	(0.6)				
Net assets acquired	31.9	2.0			
Reconciliation of cash flows:					
Cash consideration	(31.9)	(2.0)			
Cash acquired	-	-			

Cash outflow	(31.9)	(2.0)			

Significant transactions included in the above table

During the half year to 29 January 2006 the CML Group acquired a hotel business in New South Wales for $17.4 million and 2 hotels in Queensland for $10.8 million.

Reconciliation of cash

For the purposes of the Statement of Cash Flows, cash includes cash on hand, at bank and on short-term deposit, net of bank overdraft. Cash at the end of the half-year as shown in the Statement of Cash Flows is reconciled to the relevant Balance Sheet items as follows:

	January 2006 $m	July 2005 $m	January 2005 $m
Cash assets	578.2	849.0	876.7
Bank overdraft		(7.1)	(6.9)
	578.2	841.9	869.8

Details of major financing facilities

Credit standby facilities

- The CML Group has $430.0 million (2005 $430.0 million) of committed facilities of which $430.0 million (2005 $430.0 million) was undrawn at balance date. The facilities have maturity dates ranging between August 2007 and August 2010 (2005 maturity dates ranged between May 2005 and August 2009).

Commercial paper

- The CML Group has commercial paper programmes based in Australia and Europe. The programmes are guaranteed by CML and are supported by the credit standby facilities referred to above. At balance date $119.8 million of commercial paper was on issue (2005 $NIL).

Medium term notes

- The CML Group has issued medium term notes under a debt issuance programme both domestically and internationally. At balance date $655.6 million (2005 $669.3 million) equivalent of medium term notes were on issue.

Other loans

- $350.0 million (2005 $NIL) of domestic bank loans of various maturities were outstanding at balance date.

Dividends				
			January 2006 $m	January 2005 $m
Ordinary shares				
Final dividend of 17.0 cents (2005 15.0 cents) per fully paid ordinary share paid on 14 November 2005 (2005 8 November 2004). Fully franked at 30% tax rate (2005 30%).			210.0	182.6
Non-redeemable reset convertible preference shares (ReCAPS)				
Dividend of $NIL (2005 $3.2589) per share paid in 2006 (2005 30 November 2004). Fully franked at 30% tax rate (2005 30%).				22.8
Total dividends paid			210.0	205.4
Dividends not recognised at half-year end				
In addition to the above dividends, since the half-year end the directors have proposed an interim dividend of 19.5 cents per fully paid ordinary share, fully franked based on tax paid at 30%. The aggregate amount of the proposed ordinary dividend expected to be paid on 15 May 2006 out of retained profits at 29 January 2006, but not recognized as a liability at year end is $243.4 million. The interim dividend declared after 29 January 2006 will be fully-franked out of existing franking credits or out of franking credits arising from the payment of income tax in the year ending 30 July 2006.				

The franked portions of the interim dividends recommended after 29 January 2006 will be franked out of existing franking credits or out of franking credits arising from the payment of income tax in the year ending 30 July 2006.

Franking credits

Franking credits of $549.3 million (at 30%) are available for the consolidated entity, and will enable the payment of franked dividends for at least the next year.

Dividend reinvestment plan

The dividend reinvestment plan has been suspended. The interim dividend will be paid in cash.

Earnings Per Share		
	January 2006	January 2005
Basic earnings per share	39.0 cents	33.8 cents
Diluted earnings per share	38.7 cents	33.5 cents
Weighted average number of shares ('000s) used as the denominator		
Weighted average number of shares used as the denominator in calculating basic earnings per share	1,241,977	1,230,334
Weighted average number of ordinary shares and potential ordinary shares used as the denominator in calculating diluted earnings per share	1,253,020	1,310,700
Reconciliation of earnings used in calculating earnings per share ($m)		
Basic earnings per share		
Net profit	484.5	438.5
Dividends on ReCAPS		(22.8)

Earnings used in calculating basic earnings per share	484.5	415.7
Diluted earnings per share		
Net profit	484.5	438.5
Earnings used in calculating diluted earnings per share	484.5	438.5

Depreciation and Amortisation				
			January 2006 $m	January 2005 $m
Depreciation				
Freehold buildings			0.5	0.4
Leasehold improvements			25.6	24.7
Plant and equipment			215.8	209.6
			241.9	234.7
Amortisation				
Co-branded operating rights			2.6	2.4
Computer software			18.0	13.1
Stamp duty			1.6	1.4
			22.2	16.9

NTA Backing		
	January 2006 $	January 2005 $

Net tangible asset backing per ordinary security	2.35	2.22

Interests in Associated Entities								
	Investment		Contribution to net profit		Ownership interest			
	January 2006 $m	January 2005 $m	January 2006 $m	January 2005 $m	January 2006 %	January 2005 %	Principal activity	Balance date
Unit Trust CMS General Trust	124.5	111.8	16.1	32.4	50	50	Property ownership	30 June
Partnership Fly Buys Partnership	2.0	2.0			50	50	Loyalty program	31 December
Proprietary company Quids Technology Pty Ltd	-	-			50	50	Software development	30 June

Segment Revenue		
	January 2006 $m	January 2005 $m
Food, Fuel & Liquor	12,888.9	12,108.6
Kmart	2,191.3	2,233.1

Officeworks	595.8	575.3
Myer	1,618.6	1,583.3
Megamart	66.5	135.7
Target	1,737.7	1,665.8
Property & Unallocated	33.4	43.1
Sub-total	19,132.2	18,344.9
Interest income	11.4	14.6
Total Revenue	19,143.6	18,359.5

Segment Result		
	January 2006 $m	January 2005 $m
Food, Fuel & Liquor	396.8	358.3
Kmart	92.9	90.7
Officeworks	29.5	28.9
Myer	67.9	64.0
Megamart	(16.1)	(19.0)
Target	188.8	148.1
Property & Unallocated [1]	(24.2)	(31.8)
Sub-total	735.6	639.2
Net borrowing costs	(49.5)	(24.1)
Profit from ordinary activities before income tax	686.1	615.1
Income tax expense	(201.6)	(176.6)

Net profit	484.5	438.5

1

Includes supply chain strategy costs of $16.5 million in 2005.

Changes in Accounting Policies & Estimates

Changes in accounting estimates in the current period

Change in accounting estimate for computer software

Effective 1 August 2005, the CML Group changed its accounting estimate with respect to the useful life of major investments of computer software. The previous estimate recognised that computer software had a useful life not exceeding five years irrespective of the size of the investment.

The revised accounting estimate recognises that for major investments of computer software the useful life will not exceed seven years. The remaining computer software projects will continue to have a useful life not exceeding five years. The impact of the change was an increase to profit before tax of $5.5 million for the half-year to 29 January 2006.

Changes in accounting estimates in the previous period

Change in accounting policy for concession sales

During 2005, the CML Group changed its accounting policy with respect to concession sales. Under the previous policy the gross value of the transaction was recorded as Sales and the amount paid to the supplier was recorded as Cost of goods sold, resulting in the net amount retained by the CML Group being recorded as Gross profit. Under the revised accounting policy the net amount retained by the CML Group is recorded as Other income. The table below summarizes the impact on sales resulting from this change in accounting policy.

		January 2005 $m			
		Unadjusted for Accounting Policy Change	Impact of Accounting Policy Change	Adjusted for Accounting Policy Change	
	Sales				
	Food, Fuel & Liquor	12,137.8	(71.0)	12,066.8	
	Kmart	2,192.8		2,192.8	
	Officeworks	574.7	(1.5)	573.2	
	Myer	1,667.0	(107.4)	1,559.6	

	Megamart	138.2	(2.9)	135.3	
	Target	1,634.4		1,634.4	
	Total sales	18,344.9	(182.8)	18,162.1	

Contingent Liabilities

Contingent liabilities as at 29 January 2006 were $353.3 million, an increase of $12.0 million since 31 July 2005, mainly associated with bank guarantees.

Events Occurring After Balance Date

Acquisition of Hedley Hotel Group

On 24 February 2006, Coles Myer announced it had acquired the Hedley Hotel Group for $306 million (excluding inventory). At least $79 million of the purchase price will be taken in the form of Coles Myer shares with the balance in cash. The shares will be issued at the market price of Coles Myer shares at the time of completion. It is intended that as part of the Company's capital management program an equivalent number of shares will be bought back on market.

The acquisition is contingent on usual conditions including the regulatory approval.

Myer Sale

On 13 March 2006, Coles Myer announced the sale of the Myer department store business and the freehold property Myer Melbourne is located on, to Newbridge Capital and the Myer Family Company for $1,400 million. The sale is expected to be completed in the next few months subject to certain third party consents. Subject to the finalisation of completion processes, the Company's current best estimate of the result of the disposal of Myer is a net profit of $700 million.

Explanation of Transition to Australian Equivalents to IFRS

(1) Reconciliation of equity reported under previous Australian Generally Accepted Accounting Principles (AGAAP) to equity under Australian equivalents to IFRS (A-IFRS)

(a) At the date of transition to A-IFRS: 26 July 2004	Notes	Previous AGAAP	Effect of transition to A-IFRS	A-IFRS

		$m	$m	$m
Current assets				
Cash		849.0		849.0
Receivables	4(h)	646.7	(127.2)	519.5
Inventories	4(h)	3,032.7	99.0	3,131.7
Other		41.1		41.1
Total current assets		4,569.5	(28.2)	4,541.3
Non-current assets				
Receivables	4(b)	50.4	(29.7)	20.7
Investments		112.9		112.9
Property, plant and equipment	4(c),(e),(j)	3,318.2	(179.0)	3,139.2
Investment properties	4(e)	77.5	(52.0)	25.5
Deferred tax assets	4(f)	302.7	79.8	382.5
Intangibles	4(c)	576.1	74.7	650.8
Other	4(i)	30.0	9.4	39.4
Total non-current assets		4,467.8	(96.8)	4,371.0
Total assets		9,037.3	(125.0)	8,912.3
Current liabilities				
Payables	4(h)	2,808.6	15.9	2,824.5
Interest bearing liabilities		261.5		261.5
Tax liabilities	4(b)	161.6	5.7	167.3
Provisions	4(i)	570.4	(9.4)	561.0
Total current liabilities		3,802.1	12.2	3,814.3
Non-current liabilities				
Interest bearing liabilities		713.4		713.4

Deferred tax liabilities	4(f)	108.4	17.9	126.3
Provisions		281.9		281.9
Other	4(g)	48.3	143.3	191.6
Total non-current liabilities		1,152.0	161.2	1,313.2
Total liabilities		4,954.1	173.4	5,127.5
Net assets		4,083.2	(298.4)	3,784.8
Equity				
Contributed equity		2,306.7		2,306.7
Reserves	4(a),(b),(e)	430.2	(66.4)	363.8
Retained profits	4(m)	1,346.3	(232.0)	1,114.3
Total equity		4,083.2	(298.4)	3,784.8

Explanation of Transition to Australian Equivalents to IFRS (continued)

(b) At the end of the last half-year reporting period under previous AGAAP: 23 January 2005

	Notes	Previous AGAAP $m	Effect of transition to A-IFRS $m	A-IFRS $m
Current assets				
Cash		876.7		876.7
Receivables	4(h)	624.2	(57.1)	567.1
Inventories	4(h)	3,308.7	43.8	3,352.5
Other		60.2		60.2
Total current assets		4,869.8	(13.3)	4,856.5
Non-current assets				
Receivables	4(b)	45.3	(26.3)	19.0
Investments		143.7		143.7

Property, plant and equipment	4(c),(e),(j)	3,386.0	(201.4)	3,184.6
Investment properties	4(e)	72.8	(52.0)	20.8
Deferred tax assets	4(f)	320.2	78.8	399.0
Intangibles	4(c),(d)	569.9	111.5	681.4
Other	4(i)	30.0	12.2	42.2
Total non-current assets		4,567.9	(77.2)	4,490.7
Total assets		9,437.7	(90.5)	9,347.2
Current liabilities				
Payables	4(h)	2,933.0	23.5	2,956.5
Interest bearing liabilities		617.9		617.9
Tax liabilities	4(b)	134.8	5.7	140.5
Provisions	4(i)	588.5	(9.4)	579.1
Total current liabilities		4,274.2	19.8	4,294.0
Non-current liabilities				
Interest bearing liabilities		345.2		345.2
Deferred tax liabilities	4(f)	83.8	21.3	105.1
Provisions		291.1		291.1
Other	4(g)	49.1	151.4	200.5
Total non-current liabilities		769.2	172.7	941.9
Total liabilities		5,043.4	192.5	5,235.9
Net assets		4,394.3	(283.0)	4,111.3
Equity				
Contributed equity		2,396.5		2,396.5
Reserves	4(a),(b),(e)	455.1	(87.7)	367.4
Retained profits	4(m)	1,542.7	(195.3)	1,347.4

Total equity		4,394.3	(283.0)	4,111.3

Explanation of Transition to Australian Equivalents to IFRS (continued)

(c) At the end of the last full year reporting period under previous AGAAP: 31 July 2005

	Notes	Previous AGAAP $m	Effect of transition to A-IFRS $m	A-IFRS $m
Current assets				
Cash		440.9		440.9
Receivables	4(h)	677.5	(141.4)	536.1
Inventories	4(h)	3,155.0	106.6	3,261.6
Other		21.0		21.0
Total current assets		4,294.4	(34.8)	4,259.6
Non-current assets				
Receivables	4(b)	33.6	(16.0)	17.6
Investments		144.9		144.9
Property, plant and equipment	4(c),(e),(j)	3,711.6	(223.8)	3,487.8
Investment properties	4(e)	145.4	(135.8)	9.6
Deferred tax assets	4(f)	371.3	77.7	449.0
Intangibles	4(c),(d)	610.9	192.4	803.3
Other	4(i)	34.3	17.7	52.0
Total non-current assets		5,052.0	(87.8)	4,964.2
Total assets		9,346.4	(122.6)	9,223.8
Current liabilities				
Payables	4(h)	3,001.4	17.4	3,018.8
Interest bearing liabilities		216.0		216.0

Tax liabilities	4(b)	125.2	2.1	127.3
Provisions	4(i)	607.4	(6.6)	600.8
Total current liabilities		3,950.0	12.9	3,962.9
Non-current liabilities				
Interest bearing liabilities		1,213.3		1,213.3
Deferred tax liabilities	4(f)	79.1	23.9	103.0
Provisions		317.9		317.9
Other	4(g)	56.1	155.5	211.6
Total non-current liabilities		1,666.4	179.4	1,845.8
Total liabilities		5,616.4	192.3	5,808.7
Net assets		3,730.0	(314.9)	3,415.1
Equity				
Contributed equity		2,083.6		2,083.6
Reserves	4(a),(b),(e)	485.7	(101.7)	384.0
Retained profits	4(m)	1,160.7	(213.2)	947.5
Total equity		3,730.0	(314.9)	3,415.1

Explanation of Transition to Australian Equivalents to IFRS (continued)

2. Reconciliation of profit under previous AGAAP to profit under Australian equivalents to IFRS (A-IFRS)

(a) Reconciliation of profit for the half-year ended 23 January 2005

	Notes	Previous AGAAP $m	Effect of transition to A-IFRS $m	A-IFRS $m
Sales	4(h)	18,162.1	62.1	18,224.2
Cost of goods sold	4(h)	(13,613.4)	(55.2)	(13,668.6)

Gross profit	4(h)	4,548.7	6.9	4,555.6
Other revenue from the operating activities		48.1		48.1
Other revenue from non-operating activities	4(e),(h)	166.9	(79.7)	87.2
Proceeds from sale of business and property, plant and equipment	4(e)	7.2	(7.2)	
Net book value of businesses and property, plant and equipment	4(e)	(35.4)	35.4	
Borrowing costs	4(l)	(33.0)	(5.7)	(38.7)
Advertising expenses	4(h)	(257.8)	39.6	(218.2)
Selling and occupancy expenses	4(e),(g),(h)	(3,145.5)	(7.0)	(3,152.5)
Administrative expenses	4(b),(d),(e),(h),(i),(l)	(721.5)	55.1	(666.4)
Profit before ordinary activities before income tax expense		577.7	37.4	615.1
Income tax expense		(173.9)	(2.7)	(176.6)
Net profit		403.8	34.7	438.5

(b) Reconciliation of profit for the year ended 31 July 2005

	Notes	Previous AGAAP $m	Effect of transition to A-IFRS $m	A-IFRS $m
Sales	4(h)	36,185.2	(17.4)	36,167.8
Cost of goods sold	4(h)	(27,286.8)	9.4	(27,277.4)
Gross profit	4(h)	8,898.4	(8.0)	8,890.4
Other revenue from the operating activities		97.3		97.3
Other revenue from non-operating activities	4(e),(h)	304.2	(145.1)	159.1

Proceeds from sale of business and property, plant and equipment	4(e)	20.6	(20.6)	
Net book value of businesses and property, plant and equipment	4(e)	(68.1)	68.1	
Borrowing costs	4(l)	(74.0)	(11.3)	(85.3)
Advertising expenses	4(h)	(474.5)	66.8	(407.7)
Selling and occupancy expenses	4(e),(g),(h)	(6,299.7)	(13.5)	(6,313.2)
Administrative expenses	4(b),(d),(e),(h),(i),(l)	(1,513.3)	75.9	(1,437.4)
Profit before ordinary activities before income tax expense		890.9	12.3	903.2
Income tax expense		(266.4)	1.1	(265.3)
Net profit		624.5	13.4	637.9

Explanation of Transition to Australian Equivalents to IFRS (continued)

3. Reconciliation of cash flow statement for the year ended 31 July 2005

The adoption of A-IFRS has not resulted in any material adjustments to the cash flow statement.

Notes to the reconciliations

The following notes to the reconciliations describe the significant changes to the Company's accounting policies on adoption of A-IFRS. These notes should be read in conjunction with the annual report for the year ended 31 July 2005, for a description of other accounting policies not effected by the adoption of A-IFRS.

(a) AASB 1 "First time adoption of Australian Equivalents to International Financial Reporting Standards"

Under the transitional rules of AASB 1, CML has elected to reset the foreign currency translation reserve to $NIL. This election has resulted in the transfer of $47.5 million from the foreign currency translation reserve to general reserves.

CML has taken advantage of a number of other exemptions from A-IFRS standards provided by AASB 1 to which reference is made under the analysis of each standard to which each exemption applies.

(b) AASB 2 "Share-based Payment"

On adoption of AASB 2, equity instruments issued to employees will be recognised as an expense over the relevant vesting periods. Under the current accounting policy an expense is not recognised for equity instruments issued.

The expense will be determined with reference to the fair value of the equity instruments issued. The determination of fair value is prescribed by the new standard. Under an optional exemption provided by AASB 1 adopted by

CML only those equity instruments granted after 7 November 2002 and vesting after 1 January 2005 are accounted for in this manner.

The Coles Myer Employee Share Plan Trust (the Trust) administers the Company's share based payment plans. Under A-IFRS the results, financial position and cash flows of the Trust will be consolidated into the CML Group.

(i) Impact on the transition balance sheet - as at 25 July 2004

A transitional adjustment of $2.4 million has been recorded against opening retained earnings to reflect the amortisation of these instruments up to 26 July 2004. This adjustment has also resulted in an increase to an equity compensation reserve within Equity. Accordingly, this adjustment has no impact on net assets or total equity.

As a result of the consolidation of the Trust, loans receivable of $29.7 million were eliminated. The loans receivable from employees of $23.1 million and the shares held by the Trust of $12.3 million were included in the equity compensation reserve, reducing equity by $35.4 million. The provision for income tax increased by $5.7 million.

(ii) Impact on the half-year ended 23 January 2005

For the half-year ended 23 January 2005 remuneration expense increased by $2.7 million, resulting in a cumulative credit to the equity compensation reserve of $5.1 million.

As a result of the consolidation of the Trust, as at 23 January 2005 loans receivable of $26.3 million were eliminated, the provision for income tax increased by $5.7 million, and equity was reduced by $33.8 million.

(iii) Impact on the year ended 31 July 2005

For the year ended 31 July 2005 remuneration expense increased by $5.4 million, resulting in a cumulative credit to the equity compensation reserve of $7.8 million.

As a result of the consolidation of the Trust, interest income of $3.6 million was eliminated. As at 31 July 2005 loans receivable of $16.0 million were also eliminated, the provision for income tax increased by $2.1 million, and equity was reduced by $18.6 million.

Explanation of Transition to Australian Equivalents to IFRS (continued)

4. Notes to the reconciliations (continued)

(c) AASB 138 "Intangible Assets"

Under the previous policy CML had recognised liquor licences on acquisition. Under A-IFRS whilst liquor licences meet the definition of separable intangible assets, they are not reliably measurable separate from the acquired business or premises. Therefore on transition the balance of $298.8 million has been transferred to goodwill under transitional provisions contained in AASB 1.

Under the previous policy CML had recognised computer software as property, plant & equipment. Under AASB 138 where computer software is not an integral part of the computer hardware it is required to be recognised as an Intangible Asset.

Impact on the transition balance sheet - as at 25 July 2004

On transition at 25 July 2004 there was a reclassification of $74.7 million from property, plant and equipment to intangibles for computer software.

Impact on the half-year ended 23 January 2005

For the half-year ended 23 January 2005 there was a reclassification of $105.7 million from property, plant and equipment to intangibles for computer software.

Impact on the year ended 31 July 2005

For the end year ended 31 July 2005 there was a reclassification of $152.7 million from property, plant and equipment to intangibles for computer software.

(d) AASB 3 "Business Combinations"

CML has adopted the optional exemption provided by AASB 1 to not re-open acquisition accounting which occurred before the date of transition to A-IFRS. As noted at item (c) above, liquor licenses acquired as part of a business combination are not recognised separately as an intangible. Accordingly, liquor licenses acquired post transition to A-IFRS have been recognised as goodwill or incorporated in property values where relevant.

Under the previous accounting policy goodwill was amortised over the period in which the benefits were expected to arise. Under AASB 3, goodwill is no longer amortised, but instead is subject to impairment testing at each reporting date.

(i) Impact on the transition balance sheet - as at 25 July 2004

On transition to A-IFRS, a deferred tax liability of $16.5 million was recognised for gaming licenses and brand names. Opening retained earnings was reduced accordingly.

(ii) Impact on the half-year ended 23 January 2005

For the half-year ended 23 January 2005 amortisation expense decreased by $5.1 million, with a corresponding increase to the goodwill balance.

(iii) Impact on the year ended 31 July 2005

For the year ended 31 July 2005 amortisation expense decreased by $10.0 million, with a corresponding increase to the goodwill balance.

During the year ended 31 July 2005, the CML Group acquired seven hotels and freehold properties. Under the previous policy liquor licenses were recognised as an intangible asset. Under AASB 138, $48.0 million has not met the criteria for separate recognition as an intangible and has been recorded as goodwill.

In addition, gaming licenses valued at $22.2 million have been recognised separately as an intangible asset. A deferred tax liability of $6.7 million has been recorded, resulting in a corresponding increase to goodwill.

The cumulative impact on intangibles at 31 July 2005 is a decrease in liquor licenses of $347.1 million, an increase in gaming licenses of $22.2 million and an increase in goodwill of $365.0 million.

Explanation of Transition to Australian Equivalents to IFRS (continued)

4. Notes to the reconciliations (continued)

(e) AASB 116 "Property, Plant and Equipment" and AASB 140 "Investment Property"

Under CML's previous accounting policy freehold land and buildings and investment properties were measured at their fair value. Under A-IFRS the Company has elected to measure freehold land and buildings at cost and investment properties at fair value.

Under CML's previous accounting policy fair value increments and decrements, to the extent that they offset a previous increment in the same class of assets, were recorded in the asset revaluation reserve. Under A-IFRS, changes in the fair value of investment properties are recognised in the Income Statement on an asset by asset basis. As a result, under A-IFRS the asset revaluation reserve will no longer be utilised, and it has been transferred to general reserves.

Under CML's previous accounting policy proceeds on sale of non-current assets are to be included as revenue. Under A-IFRS the net profit/(loss) on sale will be disclosed in the Income Statement.

Under AASB 140, a property should be classified as an investment property only where an insignificant portion of a property is held for the Company's own use.

Under AASB 5, where it is highly probable that assets will be sold within twelve months, those assets should be classified as current assets.

(i) Impact on the transition balance sheet - as at 25 July 2004

CML has elected to restate certain freehold properties to their depreciated historical cost on transition. As a result freehold property and the asset revaluation reserve have been reduced by $34.9 million. Other freehold properties have been recorded at their existing AGAAP fair values as deemed cost on transition under an optional election provided by AASB 1.

As a result of the change in definition of an investment property, on transition $52.0 million has been reclassified from investment property to freehold property. On transition, the CML Group increased deferred tax liabilities and reduced opening retained earnings by $5.4 million in relation to tax base differences on buildings.

(ii) Impact on the half-year ended 23 January 2005

For the half-year ended 23 January 2005 profit was increased by $28.8 million to reflect the Company's share of the net increment in the value of property held in the CMS General Trust which is accounted for as an investment. Profit was reduced by $4.7 million as a result of decrements in the value of freehold property.

As a result of the reclassification from investment to freehold property, depreciation expense increased by $0.4 million.

(iii) Impact on the year ended 31 July 2005

During 2005, $83.0 million of property acquisitions were recorded as investment property under the previous policy. Under AASB 140, these properties have been reclassified as freehold property.

For the year ended 31 July 2005, profit was increased by $27.6 million as a result of the net movement in the value of investment property and the CMS General Trust. Profit was reduced by $12.7 million as a result of decrements in the value of freehold property. As a result of the election to measure freehold properties at cost, under the current policy increments recorded in 2005 are not recorded. This has resulted in the reduction in the carrying value of freehold property by $41.2 million, with a corresponding reduction in the asset revaluation reserve.

As a result of the reclassification from investment to freehold property, depreciation expense increased by $0.8 million. As a result of the transitional adjustment to the carrying value of freehold property, profit on disposal of property increased by $0.9 million.

The cumulative impact on the carrying value of property at 31 July 2005 is an increase to freehold property of $58.9 million, a decrease in investment property of $135.0 million, and a decrease in the asset revaluation reserve of $91.0 million.

Explanation of Transition to Australian Equivalents to IFRS (continued)

4. Notes to the reconciliations (continued)

(f) AASB 112 "Income Taxes"

Under the previous accounting policy deferred tax balances were determined using the income statement method. Items were only tax-effected if they were included in the determination of pre-tax accounting profit or loss and/or taxable income or loss and current and deferred taxes could not be recognised directly in equity.

Under AASB 112, deferred tax balances are determined using the balance sheet method, which calculates temporary differences based on the carrying amounts of an entity's assets and liabilities in the Balance Sheet and their associated tax bases. In addition, current and deferred taxes attributable to amounts recognised directly in equity are also recognised directly in equity.

The CML Group will be required to record additional deferred income tax liabilities in relation to tax base differences on buildings, gaming licenses and brand names. These were not required under the income statement approach.

On transition, the CML Group increased deferred income tax liabilities and reduced opening retained earnings by $21.9 million in relation to tax base differences on buildings, gaming licenses and brand names. The tax impact on other items is disclosed separately in this note. The net effect on deferred tax assets is summarised below:

	Notes	25 July 2004 $m	23 January 2005 $m	31 July 2005 $m
Leases	(g)	43.0	45.5	46.6
Revenue	(h)	3.2	4.8	3.4
Employee benefits	(i)	(2.8)	(5.0)	(4.5)

Impairment of assets	(j)	36.4	33.5	32.2
Increase in deferred tax assets		79.8	78.8	77.7

	Notes	25 July 2004 $m	23 January 2005 $m	31 July 2005 $m
Business combinations	(d)	16.5	16.5	23.2
Property	(e)	5.4	4.6	5.1
Revenue	(h)	(6.8)	(2.6)	(7.2)
Employee benefits	(i)	2.8	2.8	2.8
Increase in deferred tax liability		17.9	21.3	23.9
Financial instruments*	(k)			

* Additionally on the adoption of AASB 132 and AASB 139 on 1 August 2005 a deferred tax liability is recognised of $2.6 million

(g) AASB 117 "Leases"

Under the previous accounting policy lease payments on operating leases were expensed as they are incurred. Under AASB 117, where leases include fixed rental increases the lease payments must be expensed on a straight-line basis over the lease term. Under the current interpretation factors such as the time value of money, anticipated inflation, or expected future revenues cannot be used to allocate scheduled rent increases. In the early years of the lease, rental expense will be greater than rental payments, which will result in the accumulation of a liability that will be released to income in the later years of the lease when rental expense is required to be less than rental payments

Under the previous accounting policy lease incentives received from landlords at the inception of leases were deferred and amortised over the period of the lease up to the first market rent review. Under AASB 117 lease incentives are amortised over the lease term. This has resulted in incentives being amortised over a longer period.

Explanation of Transition to Australian Equivalents to IFRS (continued)

4. Notes to the reconciliations (continued)

(i) Impact on the transition balance sheet - as at 25 July 2004

As a result of the change in accounting treatment for fixed rental increases, on transition to A-IFRS the CML Group recognised a liability of $112.0 million, a deferred tax asset of $33.6 million, and opening retained earnings decreased by $78.4 million.

As a result of the change in accounting treatment for lease inducements, on transition to A-IFRS deferred income increased by $31.3 million, deferred tax assets increased by $9.4 million, and opening retained earnings decreased by $21.9 million.

(ii) Impact on the half-year ended 23 January 2005

For the half-year ended 23 January 2005 the liability for fixed rental increments was increased to $118.5 million, resulting in an increase to rental expense of $6.5 million. The deferred tax asset increased by $2.0 million.

As a result of the change in accounting treatment for lease inducements, for the half-year ended 23 January 2005 the cumulative increase to deferred income was $32.9 million, resulting in an increase to rental expense of $1.6 million. Deferred tax assets increased by $0.5 million.

(iii) Impact on the year ended 31 July 2005

For the year ended 31 July 2005 the liability for fixed rental increments was increased to $121.1 million, resulting in an increase to rental expense of $9.0 million. The deferred tax asset increased by $2.7 million.

As a result of the change in accounting treatment for lease inducements, for the year ended 31 July 2005 the cumulative increase to deferred income was $34.4 million, resulting in an increase to rental expense of $3.1 million. Deferred tax assets increased by $0.9 million.

(h) AASB 118 "Revenue"

Under the previous accounting policy, non-merchandise allowances and rebates are recorded as revenue. Under A-IFRS these items have been offset against the related expense.

Under the previous accounting policy "lay by" transactions were recognised at the point of sale. Under AASB 118, lay by transactions are recognised at a later date when the customer satisfies all payment obligations and takes possession of the merchandise.

Under the previous accounting policy, sales were recognised net of sales returns, however, at the reporting date a provision for sales returns was not recorded. Under AASB 118, a provision for sales returns must be recognised.

(i) Impact on the transition balance sheet - as at 25 July 2004

On transition to A-IFRS, all outstanding lay by transactions have been derecognised. Receivables decreased by $127.2 million, inventory increased by $99.0 million, accrued liabilities increased by $5.1 million, and deferred tax liabilities decreased by $6.8 million. The net impact of this was to reduce opening retained earnings by $26.5 million.

On transition to A-IFRS, the CML Group recognised a provision for sales returns of $10.8 million, a deferred tax asset of $3.2 million, and a reduction to opening retained earnings of $7.6 million.

Explanation of Transition to Australian Equivalents to IFRS (continued)

4. Notes to the reconciliations (continued)

(ii) Impact on the half-year ended 23 January 2005

As a result of the derecognition of lay by transactions, as at 23 January 2005 receivables decreased by $57.1 million, inventory increased by $43.8 million, accrued liabilities increased by $7.1 million, and deferred tax liabilities decreased by $2.6 million. For the half-year ended 23 January 2005, sales increased by $74.5 million, and Cost of goods sold increased by $62.1 million.

As a result of the recognition of a sales provision, as at 23 January 2005 accrued liabilities increased by $16.4 million, and deferred tax assets increased by $4.8 million. For the half-year ended 23 January 2005, sales decreased by $12.4 million, and Cost of goods sold decreased by $7.1 million.

(iii) Impact on the year ended 31 July 2005

As a result of the derecognition of lay by transactions, as at 31 July 2005 receivables were decreased by $141.4 million, inventory was increased by $106.6 million, accrued liabilities were increased by $5.9 million, and deferred tax liabilities were reduced by $7.2 million. For the year ended 31 July 2005, sales decreased by $15.9 million, and Cost of goods sold decreased by $8.6 million.

As a result of the recognition of a sales provision, as at 31 July 2005 accrued liabilities increased by $11.5 million, and deferred tax assets increased by $3.4 million. For the year ended 31 July 2005, sales decreased by $1.5 million, and Cost of goods sold decreased by $0.8 million.

(i) AASB 119 "Employee Benefits"

Under the previous accounting policy an asset or liability was not recognised for the actuarially determined surplus or deficit of the defined benefit superannuation plan.

Under AASB 119 net surpluses or deficits that arise within the defined benefit superannuation plan must be recognised as an asset or liability in the Balance Sheet.

Under AASB 119, CML has elected to recognise actuarial gains and losses directly in retained earnings. Other components of superannuation costs have been recognised in the Income Statement.

Under the previous accounting policy, liabilities for annual leave entitlements were accrued at nominal amounts and were not discounted. Under AASB 119, leave entitlements are discounted.

(i) Impact on the transition balance sheet - as at 25 July 2004

An actuarial valuation of the defined benefit superannuation plan has been performed in accordance with AASB 119. On transition to A-IFRS, the CML Group recognised a defined benefit superannuation asset of $9.4 million, a deferred tax liability of $2.8 million, and opening retained earnings increased by $6.6 million.

As a result of the change in accounting treatment for annual leave entitlements, the provision for employee entitlements decreased by $9.4 million, deferred tax assets decreased by $2.8 million, and opening retained earnings increased by $6.6 million.

(ii) Impact on the half-year ended 23 January 2005

For the half-year ended 23 January 2005 the defined benefit superannuation asset increased to $12.2 million, resulting in a reduction in superannuation expense of $2.9 million.

Explanation of Transition to Australian Equivalents to IFRS (continued)

4. Notes to the reconciliations (continued)

(iii) Impact on the year ended 31 July 2005

For the year ended 31 July 2005 the defined benefit superannuation asset increased to $17.7 million, resulting in a reduction in superannuation expense of $5.7 million and an increase to retained earnings of $5.8 million.

As a result of the change in accounting treatment for annual leave entitlements, the cumulative decrease in the provision for employee entitlements was $6.6 million, resulting in an increase in annual leave expense of $2.9 million.

(j) AASB 136 "Impairment of Assets"

Under the previous accounting policy, the cash generating unit (CGU), which determines the level at which asset impairment is assessed, was the brand. In addition an assessment is made of the carrying value of clearly redundant assets using discounted cash-flows. The CML Group's interpretation of AASB 136 is that the CGU, and the level at which impairment is assessed on store assets, is an individual store. Therefore impairment is assessed by comparing the carrying value of store assets to their recoverable amount. Intangible assets, including goodwill, which are not subject to amortisation are tested for impairment annually based on a grouping of CGUs.

(i) Impact on the transition balance sheet - as at 25 July 2004

On transition to A-IFRS the carrying value of plant and equipment decreased by $121.4 million, deferred tax assets increased by $36.4 million, and opening retained earnings decreased by $85.0 million.

(ii) Impact on the half-year ended 23 January 2005

As a result of the change in accounting treatment, at 23 January 2005 the carrying value of plant and equipment decreased by $112.5 million, resulting in a net reduction in expenses of $8.9 million. Deferred tax assets increased by $33.5 million.

(iii) Impact on the year ended 31 July 2005

As a result of the change in accounting treatment, at 31 July 2005 the carrying value of plant and equipment decreased by $109.1 million, resulting in a net reduction in expenses of $12.3 million. Deferred tax assets increased by $32.3 million.

(k) AASB 132 "Financial Instruments: Disclosure and Presentation" and AASB 139 "Financial Instruments: Recognition and Measurement"

CML has adopted the exemption available under AASB 1 to apply AASB 132 and AASB 139 from 1 August 2005. This allows CML to apply previous AGAAP principles to comparative information of financial instruments within the scope of these standards.

From 1 August 2005 CML will comply with AASB 132 and AASB 139. Under AASB 139 derivative financial instruments will be recorded on the balance sheet and measured at fair value. In the case of cash flow hedges, where hedge effectiveness tests are met, changes in fair value will be recognised directly in equity and recycled through the Income Statement when the underlying hedged item is recorded in the Income Statement. Ineffectiveness outside the prescribed range precludes the use of hedge accounting, in which case the fair value changes are recognised directly in the Income Statement. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the Income Statement.

CML had on issue 7,000,000 ReCAPS that were treated as equity. On 12 July 2005 the ReCAPS were converted to ordinary shares. Under AASB 132 the ReCAPS would have been reclassified as debt, and dividends paid would have been recorded as interest expense. AASB 132 and AASB 139 are not applicable until 1 August 2005, accordingly, there is no impact on the treatment of the ReCAPS.

Explanation of Transition to Australian Equivalents to IFRS (continued)

4. Notes to the reconciliations (continued)

(i) Impact on the transition balance sheet - as at 1 August 2005

On transition to A-IFRS the CML Group recognised a derivative financial asset of $8.6 million, a deferred income tax liability of $2.6 million, and a cash flow hedge reserve of $6.0 million. In addition, the CML Group recognised a derivative financial liability of $2.1 million, a deferred tax asset of $0.7 million, and retained earnings was reduced by $1.4 million.

Under the current accounting policy the investment in Agentrics (formerly GNX) was valued at historical cost, with its value being assessed based on the cost savings to the business. Under A-IFRS the investment is carried at fair value, which is determined based on expected future cash flows from dividends and the final sale of the shares. No such cash flows are anticipated. Accordingly, the investment of $19.3 million has been written off against retained earnings at 1 August 2005.

(l) AASB 137 "Provisions, Contingent Liabilities and Contingent Assets"

Under the current accounting policy long term provisions are calculated annually and the movement is taken to the respective related expense. Under AASB 137, where discounting is used, the carrying amount of a provision increases each period to reflect the passage of time. This increase is recognised as a borrowing cost.

Impact on the half-year ended 23 January 2005

For the half-year ended 23 January 2005 an expense of $5.7million was reclassified as a borrowing cost rather than as an administrative expense.

Impact on the year ended 31 July 2005

For the year ended 31 July 2005 an expense of $11.3 million was classified as a borrowing cost rather than as an administrative expense.

(m) Retained Earnings

The effect on retained earnings of the changes set out above are as follows:

	Notes	25 July 2004 $m	23 January 2005 $m	31 July 2005 $m
Share based payments	(b)	2.4	5.1	7.8
Business combinations	(d)		(5.1)	(10.0)
Property	(e)		(23.7)	(15.0)
Income taxes	(f)	21.9	21.0	20.4
Leases	(g)	100.3	105.9	108.7
Revenue	(h)	34.1	29.7	41.4
Employee benefits	(i)	(13.2)	(15.2)	(17.0)
Impairment of assets	(j)	85.0	79.0	76.9
Other		1.5	(1.4)	
Impact on retained earnings		232.0	195.3	213.2
Financial instruments *	(k)			(20.7)

* Additionally, on the adoption of AASB 132 and AASB 139 on 1 August 2005 there was a reduction in retained earnings of $20.7 million.

Directors' Report

The directors present their report for the 26 weeks ended 29 January 2006.

Directors

The names of the directors in office at the date of this report are:

Richard Allert, AM Chairman

John Fletcher Managing Director and Chief Executive Officer

Patricia Akopiantz Non-executive Director

Keith Barton Non-executive Director

William Gurry, AO Non-executive Director

Anthony Hodgson Non-executive Director

Belinda Hutchinson Non-executive Director

Sandra McPhee Non-executive Director

Martyn Myer Non-executive Director

Michael Wemms Non-executive Director

The above directors each held office during and since the end of the period, with the exception of Belinda Hutchinson who was appointed on 23 September 2005.

Review of operations

The results of the operations of the CML Group during the period are reviewed on pages 1 to 14.

Auditor's independence declaration

A copy of the auditors' independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 40.

Rounding of amounts

CML is a company of the kind referred to in the Australian Securities & Investments Commission Class Order 98/0100 dated 10 July 1998. As a result, amounts in the accompanying financial report have, where appropriate, been rounded to the nearest one hundred thousand dollars except where otherwise indicated.

Directors' Declaration

The directors declare that the financial statements and the notes set out on pages 15 to 38 are in accordance with the Corporations Act 2001, including:

complying with the Accounting Standards and the Corporations Regulations 2001; and

giving a true and fair view of the CML Group's financial position at 29 January 2006 and its performance for the 26 weeks ended on that date.

The directors further declare that in their opinion there are reasonable grounds to believe that CML will be able to pay its debts as and when they become due and payable.

The directors have elected to adopt AASB 119: "Employee Benefits" early for the half-year ended 29 January 2006 in accordance with the subsection 334(5) of the Corporations Act 2001.

This directors' report and declaration are made in accordance with a resolution of the directors.

John Fletcher

Managing Director and Chief Executive Officer

Melbourne, 20 March 2006

Auditor's Independence Declaration

As lead auditor for the review of Coles Myer Ltd. for the half ended 29 January 2006, I declare that to the best of my knowledge and belief, there have been:

no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the review; and

no contraventions of any applicable code of professional conduct in relation to the review.

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

Dale McKee Melbourne

PartnerJ0 March 2006

PricewaterhouseCoopers

Independent review report to the members of Coles Myer Ltd.

Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half year report of Coles Myer Ltd.:

does not give a true and fair view, as required by the Corporations Act 2001 in Australia, of the financial position of the Coles Myer Ltd. (defined below) as at 29 January 2006 and of its performance for the 26 weeks ended on that date, and

is not presented in accordance with the Corporations Act 2001, Accounting Standard AASB 134: Interim Financial Reporting and other mandatory financial reporting requirements in Australia, and the Corporations Regulations 2001.

This statement must be read in conjunction with the rest of our review report.

Scope

The half year report and directors' responsibility

The half year report comprises the balance sheet, income statement, statement of changes in equity, cash flow statement, accompanying notes to the financial statements, and the directors' declaration for Coles Myer Ltd. (the consolidated entity), for the 26 weeks ended 29 January 2006. The consolidated entity comprises both Coles Myer Ltd. (the Company) and the entities it controlled during the 26 weeks ended 29 January 2006.

The directors of the Company are responsible for the preparation and true and fair presentation of the half year report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the half year report.

Review approach

We conducted an independent review in order for the Company to lodge the half year report with the Australian Securities and Investments Commission. Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements.

We performed procedures in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the half year report does not present fairly, in accordance with the Corporations Act 2001, Accounting Standard AASB 134: Interim Financial Reporting and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the consolidated entity's financial position, and its performance as represented by the results of its operations and cash flows.

We formed our statement on the basis of the review procedures performed, which included:

inquiries of company personnel and

analytical procedures applied to financial data.

Our procedures include reading the other information included with the half year report to determine whether it contains any material inconsistencies with the half year report.

These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than that given in an audit. We have not performed an audit, and accordingly, we do not express an audit opinion.

While we considered the effectiveness of management's internal controls over half year reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

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

Independence

In conducting our review, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

PricewaterhouseCoopers

Dale McKee Melbourne

PartnerJ0 March 2006

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorised.

COLES MYER LTD.

(Registrant)

By /s/ R F BENNETT

(Signature)

ROBERT F BENNETT

COMPANY SECRETARIAT MANAGER

Date March 21, 2006