

# Directors' report

The directors of Watty Limited present their report on the consolidated entity consisting of Watty Limited (the company) and the entities it controlled at the end of, or during, the year ended 30 June 2007.

## Directors

The following persons were directors of the company during the whole of the financial year and up to the date of this report:

J.W. Ingram  
J.D. Nolan  
U.B. Meyerhans  
M.R. Brown  
P.E. Akopiantz

M.B. Luby was appointed as a non-executive director on 7 March 2007

D.J. Grady resigned as a director on 27 October 2006.

Information on directors is set out on page 17 of this Annual Report.

## Directors' shareholdings

	Shares	Options	Performance Rights
J.W. Ingram	71,246	n/a	n/a
J.D. Nolan	32,000	n/a	n/a
U.B. Meyerhans	202,000	200,000	118,970
M.R. Brown	5,000	n/a	n/a
P.E. Akopiantz	2,000	n/a	n/a
M.B. Luby	2,000	n/a	n/a

## Principal activities

During the year the principal activities of the consolidated entity were the manufacture and marketing of paints and other surface coatings. There was no significant change in the nature of these activities during the year.

## Dividends – Watty Limited

	2007 \$'000	2006 \$'000
Dividends paid to members during the financial year were as follows:		
Final ordinary dividend for the year ended 30 June 2006 of 6 cents (2006 – 2 cents) per fully paid share paid on 22 September 2006	4,834	1,600
Final special dividend for the year ended 30 June 2006 of 40 cents (2006 – 5 cents) per fully paid share paid on 15 September 2006	32,801	4,001
Interim ordinary dividend for the year ended 30 June 2007 of 8 cents (2006 – 8 cents) per fully paid share paid on 30 March 2007	5,929	6,432
	43,564	12,033

In addition to the above dividends, since the end of the financial year the directors have recommended the payment of a final ordinary dividend of \$5,935,000 (7 cents per fully paid share) to be paid on 21 September 2007.

## Review of operations

The consolidated net profit for the year after income tax was \$16,588,000, including a charge for non-recurring items of \$174,000, this compares with a reported net profit after income tax of \$4,084,000 in the prior corresponding period, which included a charge for non-recurring items of \$8,980,000.

### Australia

Improved price management and a focus on higher value product mix more than offset a slight decline in volume, which in turn resulted from a decline in the housing market.

The continued focus on costs and delivery performance to customers had a major impact on earnings, improving EBIT (excluding non-recurring items) by some 80%.

### New Zealand

The New Zealand market continued to be impacted by a lower level of housing starts. While sales volume was slightly ahead of the previous year, the challenging market conditions made it difficult to recover increased costs with higher sales prices.

The performance was further impacted by investment in the company owned distribution network and a strengthening of our presence in the south island, with an upgraded dedicated warehouse to better serve that market. A decision to convert to low VOC tinters across our network, while more environmentally friendly, added additional costs to cost of doing business.

The consolidated net profit included the following non-recurring items:

	2007 \$'000	2006 \$'000
Exit/restructure costs in US operations	923	–
Restructure of Australian operations	(1,450)	(2,965)
Inventory write down	–	(3,670)
Strategic business review	–	(772)
Takeover advice and compliance costs	(127)	(5,153)
Non-recurring items before tax	(654)	(12,560)
Tax benefit relating to one-off items	480	3,580
Non-recurring items after tax	(174)	(8,980)

A detailed review of the operations of the consolidated entity during the financial year and the results of those operations is set out in the Chairman's and Managing Director's Report on pages 4 to 7 of the Annual Report.

## Significant changes in the state of affairs

The directors are not aware of any other significant change in the state of affairs of the consolidated entity that occurred during the financial year, other than as disclosed in the accompanying financial statements and reports.

## Subsequent events

The directors are not aware of any matter or circumstance that has arisen since the end of the financial year that has significantly or may significantly affect the operations of the consolidated entity, the results of those operations or the state of affairs of the consolidated entity in subsequent financial years, other than as disclosed in the accompanying financial statements and reports.

## Likely developments

Likely developments in the operations of the consolidated entity and the expected results of those operations are contained in the Chairman's and Managing Director's Report. In the opinion of the directors, it would be unreasonably prejudicial to the consolidated entity's interests if any further information on likely developments and expected results of operations were included in the report.

## Directors' report (continued)

### Environmental policy and performance

The aims of the policy are to:

1. Promote and maintain environmentally responsible practices, for the benefit of consumers, community and our employees;
2. Develop specific programmes to ensure that such practices are carried out; and
3. Ensure that such programmes consist of environmental assessment, development and execution of action plans to address issues identified in the assessment and review programmes regularly to maintain effectiveness.

All operating sites within the consolidated entity are subject to environmental regulations. These regulations include controls over discharge to air and water, the removal of solid wastes to licensed disposal facilities, the storage of dangerous goods and requirements for each site to hold appropriate operating licenses.

During the year there were no major breaches of the environmental regulations that gave rise to an infringement notice being issued by any relevant authority.

### Meetings of directors

The number of meetings of the company's Board of Directors and of each Board Committee held during the year ended 30 June 2007 and the numbers of meetings attended by each director were:

	Board		Audit		Organisation & Remuneration	
	A	B	A	B	A	B
John Ingram	10	10	4	4	5	5
John Nolan	10	10	-	4 <sup>#</sup>	5	5
Urs Meyerhans	10	10	-	4 <sup>#</sup>	-	-
Patricia Akopiantz <sup>(3)</sup>	10	10	3	3	5	5
Diane Grady <sup>(1)</sup>	5	5	-	-	2	2
Michael Brown	10	10	4	4	-	1 <sup>#</sup>
Mark Luby <sup>(2)</sup>	3	3	1	1	-	1 <sup>#</sup>

A = maximum number of meetings the director could have attended

B = number of meetings attended

(1) Diane Grady retired as a director on 27 October, 2006

(2) Mark Luby was appointed as a non-executive director on 7 March, 2007

(3) Patricia Akopiantz was a member of the Audit Committee until 20 March, 2007

# Director attending meeting not a member of the relevant committee.

### Directors' and officers' insurance

During the financial year the company has paid for a directors' and officers' insurance policy to insure certain officers of the company and related entities. The officers of the company covered by the insurance policy include the directors referred to above and officers of the parent entity. Other officers covered by the contract of insurance include executive officers of controlled entities. In accordance with normal commercial practice, the insurance policy prohibits disclosure of the nature of the liability insured against and the amount of the premium.

### Indemnification of directors and officers

The company's Constitution provides an indemnity for existing and former directors, secretaries and other officers where liability is incurred in the performance of their duties in those roles unless the liability arises from their negligence, default, breach of duty or breach of trust.

# Remuneration report

This report outlines the remuneration arrangements for Directors and Executives of the Watty Group.

The information provided in this report includes disclosures that are required under Accounting Standard AASB124 Related Party Disclosures. These disclosures have been transferred from the financial report and have been audited. Additional disclosures required by the Corporations Regulations which have not been audited are marked unaudited in the following report.

## Organisation and remuneration committee

The Company's Board of Directors has an established Organisation and Remuneration (O&R) Committee. The Committee's main role is to assist the Board in fulfilling its corporate governance responsibilities and to review and make recommendations on the following matters:

- Managing Director performance assessment and succession planning;
- A remuneration framework and compensation and benefits practices that enable Watty Limited (Watty) to attract and retain high quality executives and directors who are dedicated to the interests of Watty's shareholders;
- The reward for the Managing Director, and those who report to the Managing Director (together, "Senior Executives"), taking into account shareholders' interests, Watty's business performance, the performance of the relevant executive and to employment market conditions within the industry;
- Reviewing the Remuneration Report;
- Non Executive performance review process and fees.

In addition, the O&R Committee reviews Human Resources strategy and policies for consistency with the business strategy.

The Committee comprises two non-executive directors (one of whom is the Chair) and the Managing Director. The members are Patty Akopiantz (Chair of the Committee), John Ingram (Chairman of the Board) and the Managing Director of Watty, John Nolan. Diane Grady the previous Chairman of the Committee, was a member until October 27, 2006. Attendance at Committee meetings by its members are set out on page 26 of the Annual Report.

## Remuneration philosophy

The objective of the company's executive remuneration framework is to be able to attract, retain and motivate highly skilled executives, and ensure reward for performance is competitive and appropriate given the results delivered. In particular, the framework aligns executive reward with achievement of strategic objectives, the creation of value for shareholders and competitive market practice for delivery of reward.

The Board and the O&R Committee ensure that the remuneration framework embodies the following principles:

- Provide competitive remuneration arrangements relative to market, to attract, retain and motivate high calibre executives
- Link executive rewards to shareholder value
- Ensure a significant portion of executive remuneration is 'at risk' (via short-term and long-term incentives), measured through achievement of strategic goals and growth in shareholder value
- Establish appropriate, challenging performance hurdles for variable executive remuneration
- Reward behaviour which is consistent with Watty's values and behaviours
- Encourage ownership of Watty shares
- Ensure full legal compliance and transparent disclosure of executive remuneration

The Board and the O&R Committee recognise that while remuneration has an important role in recruiting, retaining and motivating talented executives, other factors also play a major role e.g. Watty's corporate reputation, ethical culture and business values, executive leadership and broader human resources policies.

## Directors' report (continued)

### Remuneration report (continued)

#### Remuneration of senior executives

##### Objective

The company aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities within the company so as to:

- Reward executives for company, business unit and individual performance against targets
- Align the interests of executives with those of shareholders
- Link rewards with the strategic goals and performance of the company
- Ensure total remuneration is competitive by market standards

##### Remuneration structure

The remuneration of senior executives is governed by policies and programs approved by the Board of Directors upon recommendation by the O&R Committee.

During the course of the year, advice was received from various remuneration consultants on non-executive Director remuneration, executive remuneration, market remuneration practices and long term incentive plan design and administration. All advisors are independent and were retained on the basis on their competency in the field.

There are two components to senior executive remuneration:

- The fixed remuneration component is defined as Total Employment Cost (TEC), comprised of base salary and benefits which may include superannuation, vehicle benefits and any associated Fringe Benefit Tax.
- The variable remuneration or "at risk" component, comprised of an annual short-term incentive plan and a long-term incentive plan. Both plans provide for remuneration subject to performance. Variable remuneration is the at-risk component and aligns individual executive performance to Watty's performance.

The remuneration structure is designed to provide an appropriate balance between fixed and variable remuneration. Watty's executive remuneration policy is designed so that the fixed component of the remuneration package should be between the 50th and the 60th percentile in the relevant market sector. The addition of the maximum short-term and long-term incentives can bring remuneration into the top quartile of the relevant market for exceptional performers.

##### Remuneration mix

The relative weighting between fixed and variable remuneration is as follows:

Name	% of total Remuneration at risk	
	06/07	05/06
John Nolan – <i>Managing Director</i>	60%	60%
Urs Meyerhans – <i>Finance Director</i>	55%	41%
John Foyle – <i>Group Sales &amp; Marketing Manager</i>	55%	41%
James Fuller – <i>General Manager, Watty's New Zealand</i>	50%	n/a
Martin Robb – <i>Group Operations Manager</i>	50%	33%
Rebecca Roberts – <i>Group Human Resources Manager</i>	50%	33%
Paul Breeze – <i>National Technical Manager</i>	45%	n/a

The % of total remuneration at risk seen above falls between the guidelines agreed by the O&R Committee, being between 45% and 55% for senior executives and 60–65% for the Managing Director. These guidelines were based on competitive practice and independent advice.

##### Remuneration review process

Senior executive remuneration is reviewed annually. Remuneration data is derived for key positions via market benchmarking surveys that compare roles with similar responsibilities. The O&R Committee approves Senior Executives' increases based on recommendations from the Managing Director with reference to market data.

The O&R Committee recommends and the Board approves all elements of the Managing Director's remuneration, including base salary and benefits, short-term incentive payment and long-term incentive participation. The Managing Director does not participate in either the O&R Committee's or the Board's deliberations on his remuneration.

The Managing Director reviews his direct reports' remuneration (including short-term incentive payments and participation in the long-term incentive plan), and makes recommendations to the O&R Committee for submission to the Board for approval.

## Remuneration components

Details of each remuneration component are shown below.

### Fixed remuneration

Fixed remuneration is structured as a Total Employment Cost (TEC) package, which may be taken as a mix of cash (e.g. base pay) and benefits. TEC is determined by reference to appropriate external benchmark information taking into account the individual executive's responsibilities, performance, size of role, competencies displayed, qualifications and experience. External remuneration consultants are asked to provide analysis and advice on a regular basis to ensure that the TEC reflects the market for comparable roles. TEC is reviewed annually to ensure the executive's pay is competitive with the market. An executive's TEC is also reviewed on promotion.

There are no guaranteed TEC increases in any senior executives' contracts.

### Variable remuneration

The Board believes that well-designed and managed short-term and long-term incentive plans are important elements of remuneration, providing tangible incentives for executives to strive to improve Watty's short and long-term performance to benefit shareholders. Participation in these plans encourages Watty's executives to commit to and share in the future growth, viability and profitability of the company.

Senior executives' variable remuneration opportunities are in line with market and industry practices and proportionate to the executive's responsibilities, performance and contribution.

- *Short-term Incentive Plan (STI)*

The STI is designed to directly link variable remuneration to key indicators of financial and non-financial performance that supports the implementation and achievement of Watty's business strategy. The STI is integral to a high performance culture and is linked to driving continuous performance improvement in each of Watty's key functions and across the business. It rewards senior executives for successful achievement of individual, business unit and total group performance over the financial year.

Each executive has a target STI opportunity depending on the accountabilities of their role and its impact on business performance based on financial measures and individual key performance indicators (KPIs). For direct reports to the Managing Director the maximum STI opportunity is between 50% to 70% of total TEC.

The O&R Committee annually reviews STI proposals and recommends for Board approval, financial targets relating to key performance measures for the financial year, both for the Managing Director and his direct reports. This year STI financial measures were based on earnings before interest and tax (EBIT). The Managing Director & Finance Director's financial targets also included reduction in working capital, and the General Manager, Watty NZ had EBIT targets for both New Zealand and the group.

Individual strategic KPIs for senior executives are recommended by the Managing Director and approved by the O&R Committee. The strategic KPIs for the Managing Director are approved by the Board.

Incentive payments are linked to performance against these targets and are payable in cash during September each year after Board approval. The Board has the discretion to adjust individual STI awards.

- *Long-term Incentive Plan (LTI)*

Prior to the financial year ending June 30, 2004, Watty granted share options to senior executives and other key employees. This practice ended in 2003, in anticipation of the development, design and implementation of the Watty Executive Stock Ownership Plan (WESOP) in January 2004.

Long-term incentives may be provided to senior executives through the WESOP, which was approved by shareholders at Watty's 2003 Annual General Meeting.

The WESOP was established to reward senior executives based on the company's longer term performance and allows for Performance Rights (Rights) to be awarded to senior executives. LTIs are provided in addition to STIs in order to motivate senior executives to adopt strategies and make decisions which have a positive and enduring impact on the drivers of shareholder value over the longer term. They are also provided as a motivation and retention tool for key senior executives.

The Board considers the allocation of the Rights annually. Participation in the Plan is by invitation from the Board, based on the impact of the executive's role on the performance and profitability of Watty and its business units.

Rights cannot be sold or used as security for a loan and do not entitle the holder to receive any dividends or to vote. Rights can only be exercised on the exercise date (which falls on the third anniversary of the grant date) if the employee to whom they are allocated has been employed for three successive years by Watty.

The percentage of Rights which vest and may be exercised is currently based on Watty's Total Shareholder Return (TSR) over the year performance period relative to the companies in the S&P/ASX 200 Industrials Accumulation Index (the "comparator group").

The percentage of Rights vesting to plan participants is calculated in accordance with a 'sliding scale' (see below):

### Watty's TSR ranking in S&P/ASX 200 industrials accumulation index

### Percentage of rights vesting and exercisable

Below 51st percentile	Nil
51st percentile	50%
Greater than 51st percentile and less than 75th percentile	Calculated on a pro-rata basis between 51% and 100% depending on Watty's percentile performance ranking (rounded down to the nearest whole number)
75th percentile and above	100%

## Directors' report (continued)

### Remuneration report (continued)

In determining the extent to which Rights will vest at the end of the performance period, the company receives data from an external firm which provides Watty's TSR relative to the ranking of the companies in the peer group. Participants may choose to exercise their vested Rights and convert these into shares in the company. Any Rights not vesting at the end of the period will lapse. Shares resulting from the exercise of the Rights must be retained for a further two years until at least the fifth anniversary of the grant date of the performance rights. Information on the current Watty Executive Option Scheme and the Watty Executive Stock Ownership Plan is set out in Note 29.

When the WESOP was established in 2003, TSR was chosen as the key indicator of shareholder value creation. Vesting of Rights is based on Watty's TSR over the three-year performance period relative to the companies in the S&P/ASX 200 Industrials Accumulation Index (the comparator group).

During the year, the O&R Committee conducted a review of the current Long Term Incentive plan (WESOP) with the objective of ensuring the plan meets the requirements of the shareholders and continues to motivate and reward senior executives. The O&R Committee is concerned to ensure a direct line of sight for senior executives between performance and reward and are aware that a number of companies over the last two years have adopted a second performance hurdle in addition to TSR.

Following a market review by independent remuneration consultants, we believe the overall interests of shareholders is best served using two performance hurdles, that is, by retaining TSR for relative Total Shareholder Return and introducing a new measure – underlying earnings per share (EPS) growth.

#### *TSR*

TSR measures changes in the market value of the Company's shares over a three-year test period. TSR was originally chosen as a performance measure because it:

- ensures alignment between the return to shareholders and executive remuneration;
- provides a comparative, externally focused performance benchmark with which to measure Watty's relative performance; and
- is a performance measure widely used in long-term incentive plans adopted by Australian companies.

TSR performance is currently compared with the TSR performance of the S&P/ASX 200 index, over discrete three-year periods. Watty is no longer in this index, so we are proposing to adopt the S&P/ASX 300 index, of which Watty is now a member, as the comparator group for any FY2008 grant.

#### *EPS*

EPS is a measure of earnings of profits that accrued to each shareholder and is calculated by dividing Watty's underlying net profit after tax by the weighted average number of shares on issue during the year. An underlying profit figure is used and reflects reported profit after tax excluding certain non-recurring items of income and expenditure.

EPS has been chosen as a conditional performance measure because it:

- like TSR, remains a fundamental indicator of financial performance, both internally and externally;
- links directly to Watty's long-term objective of growing earnings; and
- provides a clear line of sight between performance and reward to motivate participants

EPS performance would be assessed at the end of each discrete three-year period. Performance Rights would vest if the EPS over the three-year period exceeded target EPS. The O&R Committee would set the target EPS growth for each grant which would range from a minimum threshold target where 50% of Performance Rights vest to a full target where 100% of the Performance Rights vest. If the Company's EPS is between the minimum required EPS and the maximum required EPS, the number of rights which may be exercised will be calculated on a straight line basis.

We believe that the use of these two performance hurdles applied equally facilitates the achievement of our two key objectives for the plan, that is, ensuring growth in shareholder value for the longer term, and the motivation and retention of key senior executives which is also an imperative to the ongoing success of the Company.

Our intention is to introduce EPS as an additional performance measure with the new comparator group for the next Performance Rights grant in FY2008.

## Relationship of variable remuneration to Wattyl's financial performance

### *Relationship to Company earnings (unaudited)*

In FY2007, the Company's underlying EBIT increased by 47% to \$30.6 million. Key Management Personnel's remuneration reflects actual performance against this financial measure as well as performance against individual KPIs.

Wattyl's Shareholder Return in recent periods has also improved with the Total Shareholder Return (TSR) increasing from the 26th percentile to the 52nd percentile during the Performance Period September 29, 2006 to June 30, 2007.

## Remuneration of non-executive directors

### *Non-executive director's remuneration policy and fees*

Non-executive directors' fees are determined within an aggregate directors' fee pool limit, which is periodically recommended for approval by shareholders. Shareholders at the 2004 Annual General Meeting of the company approved the maximum amount of remuneration to be shared in the aggregate by the non-executive directors to be \$800,000 per annum. Total emoluments disclosed as primary benefits are subject to this limit.

Fees and payments made to non-executive directors reflect the nature and demands of the role and the responsibilities of the directors. No directors' fees are paid to executive directors. Non-executive directors' fees are reviewed annually by the Board. The Board seeks the advice of independent remuneration consultants to ensure that non-executive directors' fees and payments are appropriate and aligned with the market. The Chairman's fees are determined independently to the fees of non-executive directors based on comparative roles in the external market. The Chairman does not receive any additional fees for committee membership. The Chairman is not present at discussions relating to determination of his own remuneration.

A market review of non-executive directors' fees was conducted by independent remuneration consultants in January 2007. It was agreed that the current annual fee structure (fixed remuneration, inclusive of any superannuation contributions) be retained with no increases to non-executive directors' fees this year.

Non-executive directors' fees will continue to be reviewed in January each year. Any adjustments recommended and agreed to, will be effective from the subsequent July 1st.

The current fees are reflected in the table below.

Chairman	\$235,000
Non Executive Director	\$ 94,000
Chair – Audit Committee	\$ 17,000
Chair – O&R Committee	\$ 14,000
Member – Audit Committee	\$ 8,500
Member – O&R Committee	\$ 7,000

No element of the remuneration of any non-executive director is dependent on the satisfaction of a performance condition. However the performance of the Board is assessed on an annual basis.

Non-executive directors do not receive any benefits. However, at the Board Meeting held on June 24, 2003, the Board resolved to "grandfather" the then existing retirement benefits scheme which had been approved and adopted at the 1990 Annual General Meeting, to existing Board members and not offer the scheme to new directors. As of October 31, 2005, the Board agreed to fix the retirement benefits of Mr John Ingram with the fixed benefit invested on his behalf until his retirement from the Board.

## Details of remuneration

Details of the remuneration of the directors and the key management personnel (as defined in AASB 124 Related Party Disclosures) of Wattyl Limited and the Wattyl Limited Group are set out in the following tables.

The key management personnel of Wattyl Limited, the parent entity, includes the directors as per page 24 and the following executive officers, which are also the highest paid executives of the entity:

Rebecca Roberts – *Group Human Resources Manager*

Jennifer Waldegrave – *Company Secretary and Group Financial Controller*

The above executives, along with Dr J.D. Nolan (Managing Director) and U.B. Meyerhans (Finance Director), are the only executive officers of Wattyl Limited.

The key management personnel of the Group, comprising Wattyl Limited and its subsidiaries, are the directors of Wattyl Limited (see page 24) and those executives that report directly to the Managing Director. This includes the 5 continuing group executives who received the highest remuneration for the year ended 30 June 2007. The executives are:

John Foyle – *Group Sales and Marketing Manager*

Martin Robb – *Group Operations Manager*

James Fuller – *General Manager, Wattyl New Zealand*

Rebecca Roberts – *Group Human Resources Manager*

Paul Breeze – *National Technical Manager*

## Directors' report (continued)

### Remuneration report (continued)

#### Key Management personnel of Watty Limited (parent entity)

2007 Name	Short-term benefits		Post-employment	Share-based payments			Total \$
	Cash salary and fees \$	Cash bonus \$	Super-annuation \$	Retirement benefit plan \$	Deferred incentive Scheme \$	Performance rights \$	
<i>Non-executive directors</i>							
J.W. Ingram Chairman	235,000		–				235,000
M.R. Brown	101,835		9,165				111,000
P.E. Akopiantz	102,551		9,230				111,781
D.J. Grady <sup>(1)</sup>	36,000		–				36,000
M.B. Luby <sup>(2)</sup>	29,720		2,675				32,395
<b>Sub-total</b>	505,106		21,070				526,176
<i>Executive directors</i>							
Dr J.D. Nolan	742,500	300,000	–	–	657,167 <sup>(3)</sup>	–	1,699,667
U.B. Meyerhans	462,480	170,000	12,686	–	–	40,746	685,912
<i>Other key management personnel</i>							
R. Roberts	188,300	72,000	12,686	–	–	10,203	283,189
J. Waldegrave	214,050	81,224	12,686	–	–	15,891	323,851
<b>Total key management personnel</b>	2,112,436	623,224	59,128	–	657,167	66,840	3,518,795

(1) D.J. Grady retired as a director on 27 October 2006

(2) M.B. Luby was appointed a non-executive director on 7 March 2007.

(3) Dr Nolan's deferred incentive comprises:

- a. Deferred incentive of \$407,250 being the FY2007 service period charge.
- b. Dividends relating to FY2006 deferred incentive of \$123,709 (including special dividend of \$91,636).
- c. Fair value adjustment to FY2006 deferred incentive of \$126,208 reflecting the increase in share price.

Owing to the short term nature of Dr Nolan's contract, Long Term Incentives under the WESOP plan cannot be included. However, under the deferred annual incentive award, Dr Nolan can be rewarded for improvement in the Company's performance and shareholder value as reflected in the share price over the three year period of the contract. The deferred incentive award is in the form of notional shares which will accumulate during Dr Nolan's employment and will be converted to a cash payment upon termination of employment.

Dr Nolan is not entitled to any payment if he elects to resign or if his employment is terminated without notice.

## Key Management personnel of WattyI Group

Name	Short-term benefits			Post-employment		Share-based payments		Total \$
	Cash salary and fees \$	Cash bonus \$	Non monetary benefits \$	Super-annuation \$	Retirement benefit plan \$	Deferred incentive Scheme \$	Performance rights \$	
<i>Non-executive directors</i>								
J.W. Ingram Chairman	235,000			–				235,000
M.R. Brown	101,835			9,165				111,000
P.E. Akopiantz	102,551			9,230				111,781
D.J. Grady <sup>(1)</sup>	36,000			–				36,000
M.B. Luby <sup>(2)</sup>	29,720			2,675				32,395
<b>Sub-total</b>	505,106			21,070				526,176
<i>Executive directors</i>								
Dr J.D. Nolan	742,500	300,000	–	–	–	657,167 <sup>(6)</sup>	–	1,699,667
U.B. Meyerhans	462,480	170,000	–	12,686	–	–	40,746	685,912
<i>Other key management personnel</i>								
J. Fuller <sup>(3)</sup>	107,059	32,979	25,341	16,630	–	–	672	182,681
J. Foyle	227,209	70,000	28,192	43,784	–	–	17,231	386,416
M. Robb	217,558	80,000	–	12,686	–	–	15,297	325,541
R. Roberts	188,300	72,000	–	12,686	–	–	10,203	283,189
P. Breeze	199,290	25,000	–	38,526	–	–	2,583	265,399
<b>Total key management personnel</b>	2,649,502	749,979	53,533	158,068	–	657,167	86,732	4,354,981
<i>Other executives</i>								
J. Waldegrave	214,050	81,224	–	12,686	–	–	15,891	323,851
J. Neumann <sup>(4)</sup>	115,069	–	16,726	87,510	166,200	–	6,461	391,966
M. Affleck <sup>(5)</sup>	28,890	–	–	7,515	250,826	–	–	287,231

(1) D.J. Grady retired as a director on 27 October 2006

(2) M.B. Luby was appointed a non-executive director on 7 March 2007

(3) The *New Zealand Privacy Act 1993* operates to prevent disclosure of emoluments of New Zealand officers of the economic entity without their consent. Mr Fuller has consented to this disclosure

(4) J. Neumann terminated employment on 30 November 2006 after 21 years service

(5) M. Affleck terminated employment on 31 August 2006 after 27 years service

(6) Dr Nolan's deferred incentive comprises:

a. Deferred incentive of \$407,250 being the FY2007 service period charge.

b. Dividends relating to FY2006 deferred incentive of \$123,709 (including special dividend of \$91,636).

c. Fair value adjustment to FY2006 deferred incentive of \$126,208 reflecting the increase in share price.

Owing to the short term nature of Dr Nolan's contract, Long Term Incentives under the WESOP plan cannot be included. However, under the deferred annual incentive award, Dr Nolan can be rewarded for improvement in the Company's performance and shareholder value as reflected in the share price over the three year period of the contract. The deferred incentive award is in the form of notional shares which will accumulate during Dr Nolan's employment and will be converted to a cash payment upon termination of employment.

Dr Nolan is not entitled to any payment if he elects to resign or if his employment is terminated without notice.

## Directors' report (continued)

### Remuneration report (continued)

#### Key Management personnel of WattyI Group

Name	Short-term benefits			Post-employment		Share-based payments		Total \$
	Cash salary and fees \$	Cash bonus \$	Non monetary benefits \$	Super-annuation \$	Retirement benefit plan <sup>(9)</sup> \$	Deferred incentive Scheme \$	Performance rights \$	
<i>Non-executive directors</i>								
J.W. Ingram Chairman	235,000			–	55,869			290,869
P.C. Cadwallader <sup>(2)</sup>	32,333			–	5,662			37,995
P.E. Akopiantz <sup>(1)</sup>	76,837			6,915	–			83,752
D.J. Grady <sup>(7)</sup>	112,583			–	44,425			157,008
M.R. Brown <sup>(7)</sup>	110,641			9,958	–			120,599
<b>Sub-total</b>	<b>567,394</b>			<b>16,873</b>	<b>105,956</b>			<b>690,223</b>
<i>Executive directors</i>								
Dr J.D. Nolan <sup>(7)</sup>	723,604	572,000	–	–	–	504,000 <sup>(8)</sup>	–	1,799,604
U.B. Meyerhans	444,905	322,835	–	12,866	–	–	22,235	802,841
<i>Other key management personnel</i>								
J. Neumann	261,000	253,000	40,000	71,000	–	–	14,600	639,600
J. Foyle <sup>(3)</sup>	160,177	52,212	40,708	15,929	–	–	6,218	275,244
M. Robb	199,645	109,000	–	11,855	–	–	5,217	325,717
R. Roberts	173,940	97,500	–	11,855	–	–	–	283,295
J. Croker	179,726	77,860	–	11,855	–	–	731	270,172
<b>Total key management personnel</b>	<b>2,710,391</b>	<b>1,484,407</b>	<b>80,708</b>	<b>152,233</b>	<b>105,956</b>	<b>504,000</b>	<b>49,001</b>	<b>5,086,696</b>
<i>Other executives</i>								
D. Marginson <sup>(4)</sup>	54,264	–	–	4,070	217,486	–	2,102	277,922
C. Muir <sup>(5)</sup>	150,723	56,056	–	7,753	196,315	–	4,049	414,896
R. Sharp <sup>(6)</sup>	98,372	11,667	–	6,797	159,542	–	2,422	278,800

(1) P.E. Akopiantz was appointed a director on 15 September 2005

(2) P.C. Cadwallader retired as a director on 28 October 2005

(3) The *New Zealand Privacy Act 1993* operates to prevent disclosure of emoluments of New Zealand officers of the economic entity without their consent. Mr Fuller has consented to this disclosure

(4) D. Marginson (General Manager – WattyI Australia Pty Ltd) terminated employment on 31 August 2005

(5) C. Muir (Group Operations Manager) terminated employment on 31 January 2006

(6) R. Sharp (National Distribution Manager) terminated employment on 31 January 2006

(7) Includes backpay of non-executive director committee fee adjustment for FY2005

(8) Dr Nolan's deferred incentive for FY2006

(9) In 2003, the Board resolved to "grandfather" the then existing retirement benefits scheme which had been approved and adopted at the 1990 Annual General Meeting, to existing Board members and not offer the scheme to new directors. As of October 31, 2005, the Board agreed to fix the retirement benefits of Mr John Ingram and Ms Diane Grady with the fixed benefit invested on their behalf until retirement from the Board

Prior to the financial year ended 30 June, 2004 options were issued to senior executives and other key employees under the Watty Executive Option Scheme. Performance rights are now granted to executive directors and other executives under the Watty Executive Stock Option Plan implemented in January 2004. Details of both plans are set out in note 29 to the financial statements.

The amounts disclosed as emoluments relating to options and performance rights are the assessed fair values at grant date of options and performance rights granted to executive directors and other executives, allocated equally over the period from grant date to vesting date. Fair values at grant date are independently determined using a binomial option pricing model that takes into account the exercise price, the term of the option or right, the vesting and performance criteria, the impact of dilution, the non-tradeable nature of the option or right, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the option or right.

*Cash bonuses, options and performance rights (unaudited)*

For each bonus and grant of options and performance rights included in the above tables, the percentage of the available bonus or grant that was paid, or that vested, in the financial year, and the percentage forfeited because the person did not meet the service and performance criteria is set out below.

Name	Cash bonus		Performance Rights And Options					
	Paid %	Forfeited %	Year Granted	Vested %	Forfeited %	Minimum total value of grant yet to vest \$	Maximum total value of grant yet to vest \$	Financial years in which grant may vest
J. Nolan	53%	47%	–	–	–	–	–	–
U.B. Meyerhans	51%	49%	2004	–	100%	–	–	–
			2005	–	–	nil	12,963	2008
			2007	–	–	nil	114,705	2010
J. Fuller <sup>(1)</sup>	59%	41%	2005	–	–	nil	1,853	2008
J. Foyle	40%	60%	2004	–	100%	–	–	–
			2005	–	–	nil	5,742	2008
			2007	–	–	nil	58,653	2010
P. Breeze	37%	63%	2004	–	100%	–	–	–
			2005	–	–	nil	2,164	2008
R. Roberts	71%	29%	2007	–	–	nil	48,499	2010
M. Robb	71%	29%	2004	–	100%	–	–	–
			2005	–	–	nil	2,982	2008
			2007	–	–	nil	54,219	2010
J. Waldegrave	71%	29%	2004	–	100%	–	–	–
			2005	–	–	nil	4,330	2008
			2007	–	–	nil	54,716	2010
J. Neumann	0%	100%	2004	–	100%	–	–	–
			2005	–	44%	nil	4,633	2008
M. Affleck	0%	100%	–	–	–	–	–	–

(1) The *New Zealand Privacy Act 1993* operates to prevent disclosure of emoluments of New Zealand officers of the economic entity without their consent. Mr Fuller has consented to this disclosure.

The percentage of bonus paid in this financial year reflects actual performance against the financial and non-financial KPIs

## Directors' report (continued)

### Remuneration report (continued)

#### Service agreements

##### *Managing Director's contract*

In September 2005, WattyI agreed with Dr John Nolan that it would extend the term of his employment and vary his remuneration upon receiving advice from an external remuneration consultant and the Board determining financial and non financial targets for Dr Nolan's variable remuneration arrangements for FY2006.

The terms of Dr Nolan's employment were formally confirmed in January 2006. The term of Dr Nolan's employment as Managing Director has now been increased from 12 months to three years ending in May 2008. However, the Board retains the right to terminate Dr Nolan's employment at any time by giving one month's notice in writing, and there is no entitlement to severance or redundancy payments on termination.

Dr Nolan's fixed remuneration for the FY2007 was increased by 4% effective October 1, 2007, following a market review of competitiveness and as part of the annual review process. While Dr Nolan's employment with WattyI continues, his fixed remuneration is subject to annual review in accordance with WattyI's annual review process.

Dr Nolan is eligible for an incentive scheme of up to 150% of his fixed remuneration for each financial year in which he is employed by WattyI. The incentive scheme has two components: a short term incentive opportunity of up to 75% of his fixed remuneration which is payable on the completion of each financial year; and a deferred incentive award valued up to a further 75% of his fixed remuneration.

Owing to the short term nature of Dr Nolan's contract, Long Term Incentives under the WESOP plan cannot be included. However, under the deferred annual incentive award, Dr Nolan can be rewarded for improvement in the Company's performance and shareholder value as reflected in the share price over the three year period of the contract. The deferred incentive award is in the form of notional shares which will accumulate during Dr Nolan's employment and will be converted to a cash payment upon termination of employment.

Dr Nolan is not entitled to any payment if he elects to resign or if his employment is terminated without notice.

During Dr Nolan's employment, the amount of any cash payment or the award of notional shares made under the incentive arrangement is linked to performance against financial and non financial targets determined by the Board.

For the FY2007, the financial targets were based on EBIT performance and a reduction in working capital and the non financial targets were based on cost reduction, delivery in full on time (DIFOT) performance, safety, development of a brand, marketing and manufacturing strategy and core business values.

##### *Key Management Personnel*

The service contracts outline the components of remuneration paid to the Key Management Personnel.

Each Key Management Personnel has an open ended contract with remuneration and other terms of employment formalised in a service agreement. The agreements include a notice period of 12 months for the Finance Director, and three months for the other key management personnel.

The terms of the Service Agreements allow for payment of termination benefits on early termination by the employer, other than for gross misconduct, equating to base salary inclusive of superannuation for the remainder of the notice period. In addition, the Finance Director is entitled to a pro-rata share of the annual bonus, subject to the objectives having been met.

For LTIs, participants may be entitled to exercise their Rights when their employment ceases before the Exercise Date only in the following circumstances:

- From the date on which employment ceases due to death or incapacity;
- From the exercise date when employment ceases due to redundancy or retirement;
- In other circumstances, only if and to the extent permitted by the Board and subject to such conditions as the Board may determine.

In all cases, the required performance hurdle will be applied and the number of Rights which a participant will be able to exercise under the hurdle in these circumstances will be reduced pro-rata to reflect the proportion of the performance period actually served.

#### Share-based compensation

Non-executive directors are paid a fee for their services as per the table on page 31 and receive no other benefits including performance rights or options.

Options over unissued ordinary shares of the company and performance rights granted to any of the executive directors or the key management personnel of the Group as remuneration were as follows:

Name	Number of performance rights granted during the year		Number of options or performance rights vested during the year	
	2007	2006	2007	2006
<i>Directors of WattyI Limited</i>				
U.B. Meyerhans	81,932	–	–	–
<i>Other key management personnel of the Group</i>				
J. Foyle	41,895	–	–	–
M. Robb	38,728	–	–	–
R. Roberts	34,642	–	–	–
P. Breeze	–	–	–	–
<i>Other executives</i>				
J. Waldegrave	39,083	–	–	–
J. Neumann	–	–	–	–

The performance rights were granted under the WattyI Executive Stock Ownership Plan on 23 November 2006.

#### Fair value of rights granted

The assessed fair value at grant date of performance rights granted during the year ended 30 June 2007 was \$1.40 per right. The fair value at grant date is independently determined using a Monte Carlo simulation model that takes into account the exercise price, the term of the right, the impact of dilution, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk free interest rate for the term of the right.

The model inputs for rights granted during the year ended 30 June 2007 included:

- grant date 23 Nov 2006
- exercise price Nil
- expected life three years
- share price at grant date \$3.02
- expected price volatility of shares 31%
- expected dividend yield 6.7%
- risk-free interest rate 5.82%
- impact of dilution Immaterial

#### Shares issued on exercise of remuneration options

Details of ordinary shares in the company provided as a result of the exercise of remuneration options to any of the executive directors or the key management personnel of the Group are as follows:

Name	Number of ordinary shares issued on exercise of options during the year		Amount paid per share	Date options Granted	Value at exercise date \$
	2007	2006			
<i>Other key management personnel of the Group</i>					
J. Neumann	–	200,000	\$2.66	23 Aug 2002	\$168,000

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

#### Share options and performance rights lapsed

Options over unissued ordinary shares of the company and performance rights which have lapsed during the financial year relating to any of the executive directors or the key management personnel of the Group are as follows:

Name	Number of options and performance rights lapsed	Value at lapse date \$
<i>Directors of Wattyl Limited</i>		
U.B. Meyerhans	25,238	85,809
<i>Other key management personnel of the Group</i>		
J. Foyle	5,952	20,237
M. Robb	5,952	20,237
P. Breeze	3,810	12,954
<i>Other executives</i>		
J. Neumann	27,231	87,068
J. Waldegrave	5,952	20,237

All performance rights granted in FY2004 lapsed during FY2007.

#### Shares under option

##### Wattyl Executive Option Scheme

Unissued ordinary shares of Wattyl Limited under option at the date of this report are as follows:

Grant date	Date exercisable	Expiry date	Exercise price	Number
30 Sep 2002	19 Nov 2004	19 Nov 2007	\$2.54	200,000

##### Wattyl Executive Stock Ownership Plan

Performance rights (zero exercise price options) issued under this plan are as follows:

Grant date	Date exercisable	Expiry date	Value per right at grant date	Number
30 Jun 2005	1 Apr 2008	1 Apr 2010	\$0.35	157,865
23 Nov 2006	29 Sep 2009	29 Sep 2011	\$1.40	296,440

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

## Directors' report (continued)

### Non – audit services

The Board of the company is cognisant of the requirement to preserve the independence of the company's external auditors. Accordingly, the Board has adopted policies concerning the services provided by external auditors. These policies are designed to minimise the risk of auditor independence being compromised through financial dependence and familiarity.

The Board has established authority levels for the engagement of firms providing external audit services to provide non-audit services as they apply to the Audit Committee and the Finance Director. Approval is required prior to a commitment being made.

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

Details of the amounts paid or payable to PricewaterhouseCoopers for audit and non-audit services provided during the year are set out below.

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

- all non-audit services have been reviewed by the audit committee to ensure that they do not impact the impartiality and objectivity of the auditor;
- none of the services undermine the general principles relating to auditor independence as set out in APES 110 Code of Ethics for Professional Accountants.

A copy of the auditor's independence declaration is set out on page 40.

	<b>Consolidated</b>	
	<b>2007</b>	<b>2006</b>
	<b>\$</b>	<b>\$</b>
During the year the following fees were paid or payable for services provided by the auditor of the parent entity, its related practices and non-related audit firms:		
<b>(a) Audit services</b>		
PricewaterhouseCoopers Australian Firm:		
Audit and review of financial reports and other audit work under the <i>Corporations Act 2001</i>	497,068	510,186
Related practices of PricewaterhouseCoopers Australian firm	57,304	56,069
<b>Total remuneration for audit services</b>	<b>554,372</b>	<b>566,255</b>
<b>(b) Non-audit services</b>		
<b>Audit-related services</b>		
PricewaterhouseCoopers Australian Firm:		
Takeover compliance	—	294,500
Legal restructure	—	13,240
Other	7,500	—
<b>Total remuneration for audit-related services</b>	<b>7,500</b>	<b>307,740</b>
<b>Taxation services</b>		
PricewaterhouseCoopers Australian Firm:		
Tax compliance services, including review of company income tax returns	120,625	206,614
Takeover compliance	—	18,474
Tax advice on legal structure	12,500	167,430
Related practices of PricewaterhouseCoopers Australian firm	26,063	18,253
<b>Total remuneration for taxation services</b>	<b>159,188</b>	<b>410,771</b>
<b>Total remuneration for non-audit services</b>	<b>166,688</b>	<b>718,511</b>

## Rounding of amounts

The amounts shown in the report and in the financial statements have been rounded off, except where otherwise stated, to the nearest thousand dollars, in accordance with Class Order 98/0100 issued by the Australian Securities and Investments Commission, the consolidated entity being in a class specified in that class order.

## Auditor

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

This report is made in accordance with a resolution of the directors and is signed on behalf of the Board.



**J.W. Ingram**  
Chairman



**Dr J.D. Nolan**  
Managing Director

Sydney  
22 August 2007