# TISSUE THERAPIES

# Financial Report
# Year Ended 30th June 2012

Tissue Therapies Limited ABN 45 101 955 088

## DIRECTORS' REPORT

Your Directors present their report on Tissue Therapies Limited ("the Company") and Controlled Entity, ("the Group") for the year ended 30 June 2012.

**Directors**

The names of Directors at any time during or since the end of the year, and their qualifications are detailed below:

**Roger Clarke** – Chairman (appointed 6 November 2003)

| | | |
|---|---|---|
| Qualifications | — | Bachelor of Commerce<br>Chartered Accountant |
| Experience | — | Chairman of Board of Advice, RBS Morgans Limited<br>Chairman of NextDC Limited, Coalbank Limited (formerly Lodestone Energy Limited) and MTQ Insurance Ltd, Director of Trojan Equity Limited, and Maverick Drilling and Exploration Limited |
| Former ASX entity Directorships | — | PIPE Networks Limited (February 2005 to March 2010) |
| Special Responsibilities | — | Member of the Audit and Risk Management Committee, Member of Remuneration Committee and Nomination Committee |
| Interest in Shares and Options | — | 5,200,000 Ordinary Shares |

**Melvyn Bridges** – Director (appointed 12 March 2009)

| | | |
|---|---|---|
| Qualifications | — | Bachelor of Science (Chemistry)<br>Honorary Doctorate from Queensland University of Technology<br>Fellow of the Australian Institute of Company Directors |
| Experience | — | Extensive experience as a CEO and Company Director in Healthcare, Agricultural Technology, Drug Development, Pathology, Diagnostics and Medical Devices. Related experience in Retail. Has successfully raised in excess of $300M investment capital in the healthcare/biotech sector and been directly involved in over $1B in M&A and related transactions<br>Chairman of Alchemia Limited, Genetic Technologies Limited and Leaf Energy Limited (formerly AquaCarotene Limited), Director of Benitec Limited, Campbell Brothers Limited and ImpediMed Limited. |
| Former ASX entity Directorships | — | Incitive Limited (November 2007 to June 2010), Peptech Limited (December 2002 to October 2007) and Genera Biosystems Limited (December 2008 to November 2010) |
| Special Responsibilities | — | Chairman of the Audit and Risk Management Committee, Member of Remuneration Committee and Nomination Committee |
| Interest in Shares and Options | — | 245,287 Ordinary Shares and options to acquire a further 250,000 Ordinary Shares |

**Iain Ross** – Director (appointed 25 May 2012)

| | | |
|---|---|---|
| Qualifications | — | Bachelor of Science (Hons) Biochemistry<br>Chartered Director |
| Experience | — | Chairman of Ark Therapeutics Plc (LSE), Biomer Technology Limited, and Pharminox Limited, Director of Benitec BioPharma Limited |
| Former ASX entity Directorships | — | None |
| Special Responsibilities | — | Member of the Audit and Risk Management Committee, Member of Remuneration Committee and Nomination Committee |
| Interest in Shares and Options | — | None |

## DIRECTORS' REPORT (Continued)

**Cherrell Hirst** – Director (appointed 30 June 2009)

| | | |
|---|---|---|
| Qualifications | — | Bachelor of Medicine, Bachelor of Surgery<br>Bachelor of Education Studies<br>Honorary Doctorates from Queensland University of Technology, Griffith University and Southern Cross University<br>Fellow of the Australian Institute of Company Directors<br>Deputy Chair and CEO (part time) of QIC and a Director of Medibank Private Limited, Avant Mutual Group, Avant Insurance Limited, ImpediMed Limited and Xenome Limited |
| Experience | — | Distinguished clinical career in the screening and diagnosis of breast cancer and extensive and respected achievements as Director and Chair of multiple commercial, government and not-for-profit organisations |
| Former ASX entity Directorships | — | Peplin Inc. (August 2000 to November 2009) and Suncorp-Metway Limited (February 2002 to April 2010) |
| Special Responsibilities | — | Member of the Remuneration Committee and Nomination Committee |
| Interest in Shares and Options | — | 281,250 Ordinary Shares |

**Gregory Baynton** – Director (appointed 6 September 2002, resigned 12 June 2012)

| | | |
|---|---|---|
| Qualifications | — | Master of Business Administration<br>Master of Economic Studies<br>Post Graduate Diploma in Applied Finance and Investment<br>Bachelor of Business<br>Fellow of the Australian Institute of Company Directors<br>Fellow of the Financial Services Institute of Australia |
| Experience | — | Director of Coalbank Limited (formerly Lodestone Energy Limited), NextDC Limited and Diversa Limited |
| Former ASX entity Directorships | — | PIPE Networks Limited (December 2004 to March 2010) |
| Special Responsibilities | — | Member of the Audit and Risk Management Committee, Member of Remuneration Committee and Nomination Committee |
| Interest in Shares and Options | — | 764,780 Ordinary Shares are held by Orbit Capital, which is a related entity of Gregory Baynton |

**Steven Mercer** – Chief Executive Officer and Executive Director (appointed 10 May 2006)

| | | |
|---|---|---|
| Qualifications | — | Bachelor of Medical Science<br>Bachelor of Medicine, Bachelor of Surgery<br>Fellow of the Australian Institute of Management<br>Fellow of the Australian Institute of Company Directors<br>Registered Medical Practitioner |
| Experience | — | Significant medical and commercial experience, most recently as Managing Director of Mercy Tissue Engineering, a successful tissue engineering company. Significant international expertise prior to Tissue Therapies following a successful career with multinational companies, including six years with Smith & Nephew as General Manager, Smith & Nephew Surgical and seven years with IBM Health Industry Centre in Australia and New York |
| Former ASX entity Directorships | — | Nil |
| Special Responsibilities | — | Chief Executive Officer, and appointed Executive Director on 10 May 2006 |
| Interest in Shares and Options | — | 1,125,750 Ordinary Shares and options to acquire a further 480,000 Ordinary Shares |

## Company Secretary

The following person held the position of company secretary at the end of the financial year:

**Drummond McKenzie** – Company Secretary

| | | |
|---|---|---|
| Qualifications | — | Bachelor of Science (Economics) (Hons.)<br>Fellow of the Institute of Chartered Accountants<br>Fellow of the Institute of Chartered Secretaries |
| Experience | — | Over 15 years experience in the financial management and administration of public companies |

## Principal activities

During the year the principal activities of the Group consisted of the research, development and commercialisation of the Group's exclusive international intellectual property in wound healing and tissue regeneration.

There were no significant changes in the nature of the Group's principal activities during the year.

## Operating results

The loss of the Group after tax amounted to $6,769,382 (2011: loss $5,340,548).

## Dividends

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

## DIRECTORS' REPORT (Continued)

**Review of operations**

During the 2011-12 financial year:

Tissue Therapies recorded an after-tax loss of $6,769,382 in line with budget expectations. This loss includes non-cash expenses of $694,651 relating to the write off of protein component inventory developed during the Group's research programme.

Net assets decreased by $6,566,545 to $10,466,891 and at 30 June 2012 the Group had cash resources of $5,158,393.

VitroGro® has been developed from a profound set of discoveries by the Chief Scientific Officer, Professor Zee Upton and her research group from the Institute of Health and Biomedical Innovation at the Queensland University of Technology.

VitroGro® ECM is a topically applied, biomimetic scaffold, comprising a synthetic extracellular matrix (ECM) protein.

**How it works:** VitroGro® ECM replaces the degraded matrix of a hard to heal wound. VitroGro® ECM binds to a prepared wound bed and provides a physical structure (a scaffold) for cell attachment, which is a primary requirement for subsequent cell functions critical for healing, such as cell proliferation and migration [1].

**An optimal scaffold:** One of the characteristics of hard to heal wounds is prolonged inflammation, which damages the native ECM that would normally guide the wound healing process [1,2,3,4]. Replacement of this damaged ECM is a beneficial strategy for treating hard to heal wounds [1]. VitroGro® ECM is ideal as an ECM replacement since its structural and functional elements mimic those present in the ECM at the early stages of normal wound healing.

Expert health economics modelling indicates that VitroGro® ECM offers the opportunity for substantially more cost effective treatment of wounds than the current standard of care.


[1] Widgerow AD. Deconstructing the stalled wound. Wounds 2012

[2] Schultz GS. Extracellular Matrix: review of its roles in acute and chronic wounds. World Wide Wounds. 2005

[3] Moor AN. et al. Proteolytic activity in wound fluids and tissues derived from chronic venous leg ulcers. Wound Rep Reg. 2009

[4] International consensus, Acellular matrices for treatment of wounds. Wounds Int. 2010


VitroGro® is protected by a family of international patent applications with patents already granted in the EU, US, China, Japan, South Korea, South Africa, Australia and New Zealand.

*Highlights*

During the 2011 - 2012 financial year the final phases of commercialisation of VitroGro® ECM necessary for approval for sale within the European Union (including the UK) were successfully completed and preparation for approval for sale in the United States and global rollout were started.

1. Larger scale commercial manufacturing was successfully developed and tested. EU compliant final packaging was also completed and the first full scale commercial manufacturing batches of VitroGro® ECM were successfully completed, compliant with all required health product standards.

2. US Food & Drug Administration (FDA) gave a formal classification of the final VitroGro® ECM product as a combination biologic / device. This was a significant milestone for the Group since it confirmed that in the United State, VitroGro® ECM is not considered to be a pharmaceutical and this decision also gave certaintly about that the US reimbursement approval process.

3. The EU Notified Body, British Standards Institute (BSI) completed a formal audit of the Tissue Therapies quality management system and found zero non-conformities. This represented the successful completion of another important milestone for global commercialisation of VitroGro® ECM.

## DIRECTORS' REPORT (Continued)

4. Strong clinical results were reported from the EU multicentre trial from 44 difficult-to-treat venous ulcer patients treated with VitroGro® ECM for only 12 weeks:
   - 34% (15 patients) were completely healed.
   - 1 of the patients who was completely healed within 12 weeks was 100 years of age.
   - 43% (19 patients) were more than 90% healed.
   - 82% (36 patients) were improved ie. were partially or completely healed
   - Average reduction in venous ulcer area was 56%
   - Average ulcer size at the start of the trial was 7.2 cm2
   - Average time the treated ulcers had not responded to expert care prior to VitroGro® ECM treatment was 36 months
   - Average age of the patients in this study was 74 years

5. Final commercial partnerships were agreed for multilingual customer service, logistics and dedicated, full time sales staff for the launch of sales in the EU, starting with the UK, Germany, Austria, Switzerland and the Netherlands. These sales arrangements provide Tissue Therapies with the advantages of minimising operational risk, limiting costs and optimising revenue while maximising flexibilty and control.

6. A comprehensive Design Dossier was completed and submitted to BSI for approval for sale of VitroGro® ECM throughout the EU for the indicated use of "treatment of hard to heal wounds, particularly venous ulcers." Following this submission, additional information was provided by Tissue Therapies Ltd to BSI in response to BSI examiner questions. These queries were as expected and are routine during a Design Dossier review.

### Significant Changes in State of Affairs

There were no siginificant changes in the state of affairs of the Group during the financial year.

### Matters Subsequent to the End of the Financial Year

During July 2012 the Group was advised by BSI that VitroGro® ECM conforms to the essential requirements of the EU Medical Devices Directive. This meant that the examination of the Design Dossier was complete, that all examiner questions had been answered to the satisfaction of BSI and BSI advised that CE Mark would be granted shortly.

During August 2012, despite the earlier notification, BSI advised that it had referred the VitroGro® ECM application to the UK Government Health Regulatory Body, the Medicines and Healthcare products Regulatory Agency (MHRA) for a final decision as to which Medical Device Rule was appropriate for the classification of VitroGro® ECM: Device Rule 8 or Device Rule 13.

BSI further advised the Group that the review by MHRA would take up to 30 calendar days, plus any additional days necessary for questions to the Group and for Tissue Therapies' staff to reply to MHRA, but that there would be no additional charges for the MHRA review.

Once CE Mark is received, the Device Rule under which it is granted is of no practical or commercial importance to Tissue Therapies.

It is possible that the MHRA review may result in a further referral to the European Medicines Agency (EMA) for a review of the VitroGro® ECM manufacturing process. EMA is the European Union health regulatory agency.

Except for the above, no other matters or circumstances have arisen since the end of the financial year which significantly affected or may significantly affect the operations of the Group, the results of those operations, or the state of affairs of the Group in future financial years.

### Future Developments, Prospects and Business Strategies

The planned developments in the operations of the Group in future financial years are as follows:

| Key Achievement / Indicative Milestone | Target |
|---|---|
| FDA application for venous ulcer trial. | Q1 2013 |
| FDA application for diabetic ulcer trial. | Q2 2013 |
| Canada & Australia: application for accelerated approval for sale of VitroGro® ECM under the Mutual Recognition agreements with the EU. | 6 months after CE Mark |
| Define requirements; regulatory approval, taz, local content, other requirements: India, Japan, China, rest of East Asia, Brazil, Argentina. | Q1 2013 |
| Prioritise and lodge applications for approval for sale: global rollout | Q3 2013 |

### Workforce Diversity

The Board recognises that workforce diversity is fundamental to the sustainability of our business. Our Group Diversity Policy ensures a strong culture of diversity is established where each employee is respected for who they are and valued for their skills and experience.

| | % of Women | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| The Group | | |
| Board[1] | 25% | 25% |
| Scientific Advisors | 33% | 33% |
| Executive and management | 38% | - |
| Total | 33% | 20% |

[1] Non-executive Directors only

### Options

At the date of this report, options over the un-issued shares of the Group are as follows:

| Grant date | Date of Expiry | Exercise price | Number under option | |
|---|---|---|---|---|
| 29/11/2007 | 2 years from each milestone achieved* | $0.64 | 180,000 | * |
| 27/11/2008 | 2 years from each milestone achieved* | $0.15 | 50,000 | ** |
| 9/3/2010 | 31 October 2012 | $0.26 | 500,000 | *** |
| 19/6/2012 | 4 July 2014 | $0.59 | 950,000 | *v |
| | | | 1,680,000 | |

* Options issued to the CEO under the Company's Equity Option Plan in lieu of cash bonus. 400,000 options were originally issued which vest on the achievement of certain Key Events. As at 30 June 2012, 220,000 of the options issued had expired.

** Options issued to the CEO under the Company's Equity Option Plan in lieu of cash bonus. 500,000 options were originally issued which vest on the achievement of certain Key Events. As at 30 June 2012, 350,000 of the options issued had expired and 100,000 had been exercised by 30 June 2012.

*** Options issued to Directors. 750,000 options were issued of which 250,000 had been exercised by 30 June 2012.

*v Options issued to Key Personnel.

360,000 ordinary shares were issued on the exercise of options during the year ended 30 June 2012.

During the year 1,115,000 options expired.

Option holders do not have any rights to participate in any issues of ordinary shares or other interests in the Company or any other entity.

**Remuneration Report (Audited)**

This report outlines the remuneration arrangements in place for the Directors and executives of Tissue Therapies Limited.

The Company's Board of Directors is responsible for determining and reviewing compensation arrangements for the Directors, the Chief Executive Officer (CEO) and others involved in the operation of the Group.

The Board assesses the appropriateness of the nature and amount of remuneration of the Directors and senior managers on a periodic basis by reference to relevant market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality Board and executive team.

**Non-executive Director Remuneration**

Objective: The Board seeks to set aggregate remuneration at a level which provides the Group with the ability to attract and retain Directors of the highest calibre at a cost that is acceptable to shareholders.

Structure: The Constitution and the ASX Listing Rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. An amount not exceeding the amount determined is then divided between the Directors as agreed. The latest determination was at the Annual General Meeting held on 28 November 2011 when shareholders approved an aggregate remuneration of $400,000 per year.

The amount of aggregate remuneration sought to be approved by shareholders and the manner in which it is apportioned among Directors is reviewed annually. Each Director receives an annual fee for being a Director of the Company. No incentive payments are included.

**Executive Director Remuneration**

Objective: The Company aims to reward the Executive Directors with remuneration commensurate with their position and responsibilities. The CEO, Dr Steven Mercer, does not receive additional remuneration above his CEO salary to act as an Executive Director.

Structure: The Executive Directors receive a fixed annual amount in remuneration plus incentive payments for achievment of specific objectives.

**Executive Remuneration**

*Chief Executive Officer*

Objective: The Company aims to reward the CEO with remuneration commensurate with his position and responsibilities.

Structure: The CEO, Dr Steven Mercer is employed under contract. The current contract commenced on 27 September 2004. Dr Mercer's employment contract with the Company encompasses a curent total remuneration package of $299,750 per annum.

Dr Mercer was awarded 400,000 performance based options in 2007 in lieu of a cash bonus. These options vested on the achievement of a series of specific performance milestones and have an exercise price of 64c within two years of each tranche of options vesting, however 220,000 of these options had expired by the end of the financial year.

In 2008, in lieu of a cash bonus, Dr Mercer was awarded a further 500,000 performance based options. These options will also vest on the achievement of specific performance milestones and have an exercise price of 15c within two years of each tranche of options vesting, however 350,000 of these options had expired and 100,000 had been exercised by the end of the financial year.

During 2010 a futher 250,000 options were awared to Dr Mercer as part of the options issued at that time to key management personnel. These options are exercisable at $0.26 and are included in the following section, "Key Management Personnel Remuneration".

During June 2011 Dr Mercer was awarded a performance based cash bonus of $25,000. Achievement of this bonus is dependent on successful completion of the international multicentre venous ulcer trial, successful completion of larger scale manufacturing and successful classification by the FDA of VitroGro®.

## DIRECTORS' REPORT (Continued)

*Company Secretary*

Objective: The Company aims to reward the Company Secretary with remuneration commensurate with his position and responsibilities.

Structure: The Company Secretary is employed under contract. The current contract commenced on 5 September 2011. Mr McKenzie's employment contract with the Company encompasses a current total remuneration package of $218,000 per annum.

During 2010, 250,000 options at $0.26 were awarded to the Company Secretary as part of the options issued at that time to key management personnel. These options had been exercised by the end of the financial year.

### Key Management Personnel Remuneration

Details of the nature and amount of each element of the emoluments to Key Management Personnel of Tissue Therapies Limited for the year ended 30 June 2012 are set out as follows:

| | | Primary | | Post Employment | Share-based payment | | | |
|---|---|---|---|---|---|---|---|---|
| Key Management Personnel | | Cash Salary and fees $ | Bonus / Non-monetary benefits $ | Super-annuation $ | Equity $ | Options (a) $ | Total $ | Performance related % |
| **Non-Executive Directors** | | | | | | | | |
| **R. Clarke (Chairman)** | **2012** | **60,000** | **-** | **5,400** | **-** | **-** | **65,400** | **-** |
| | 2011 | 45,000 | - | 4,050 | - | - | 49,050 | - |
| **M. Bridges** | **2012** | **59,952** | **-** | **-** | **-** | **-** | **59,952** | **-** |
| | 2011 | 40,000 | - | - | - | 47,750 | 87,750 | 54.4% |
| **I. Ross** | **2012** | **4,979** | - | - | - | - | **4,979** | - |
| | 2011 | - | - | - | - | - | - | - |
| **C. Hirst** | **2012** | **55,000** | **-** | **4,950** | **-** | **-** | **59,950** | **-** |
| | 2011 | 40,000 | - | 3,600 | - | 47,750 | 91,350 | 52.3% |
| **G. Baynton** | **2012** | **57,454** | **-** | **-** | **-** | **-** | **57,454** | **-** |
| | 2011 | 40,000 | - | - | - | - | 40,000 | - |
| **Executive Directors** | | | | | | | | |
| **Dr S. Mercer (CEO)** | **2012** | **275,000** | **22,936** | **26,814** | **-** | **-** | **324,750** | **-** |
| | 2011 | 205,620 | - | 18,505 | - | 47,750 | 271,875 | 17.6% |
| **Other Key Management Personnel** | | | | | | | | |
| **D. McKenzie** | **2012** | **184,943** | **-** | **10,668** | **-** | **-** | **195,611** | **-** |
| | 2011 | 84,065 | - | - | - | 8,061 | 92,126 | 8.7% |
| | | | | | | | | |
| **Total** | **2012** | **728,831** | **-** | **48,603** | **-** | **-** | **777,434** | |
| | 2011 | 454,685 | - | 26,155 | - | 151,311 | 632,151 | |

#### (a) Options issued to Key Management Personnel

During the year 950,000 (2011: 750,000) options were issued under the Company's Equity Option Plan to Key Personnel. 360,000 options were exercised during the year.

The value of options issued to Key Personnel have been partly amortised during the year with $6,333 (2011: $183,393) being included in Administration expense in the statement of comprehensive income.

### Options Granted as Remuneration

| Key Management Personnel | Vested no. | Granted no. | Grant date | Terms and conditions for each grant: Value per option at grant date $ | Exercise price $ | First exercise date | Last exercise date |
|---|---|---|---|---|---|---|---|
| 2011 | | | | | | | |
| M Bridges | 250,000 | 250,000 | 9/3/2010 | 0.191 | 0.26 | 31/03/2011 | 31/10/2012 |
| Dr C Hirst | 250,000 | 250,000 | 9/3/2010 | 0.191 | 0.26 | 31/03/2011 | 31/10/2012 |
| Dr S Mercer | 250,000 | 250,000 | 9/3/2010 | 0.191 | 0.26 | 31/03/2011 | 31/10/2012 |

360,000 shares were issued on the exercise of options during the financial year.

### Directors' and Officers' Indemnification

The Company has indemnified Directors and officers to the maximum extent permitted by law, against any liability incurred by them as, or by virtue of their holding office as and acting in the capacity of, an officer of the Company.

Insurance premiums have been paid during the year in respect of a contract insuring Directors and officers against legal costs incurred in defending proceedings against them. Details of the nature of liabilities covered or the amount of premiums paid are not disclosed as such disclosure is prohibited in terms of the contract.

### Directors' Meetings

The number of meetings of Directors (including meetings of committees of Directors) held during the year and the number of meetings attended by each Director was as follows:

| | Directors' Meetings | | Audit and Risk Management Committee | | Remuneration Committee | | Nomination Committee | |
|---|---|---|---|---|---|---|---|---|
| | Eligible to Attend | Attended | Eligible to Attend | Attended | Eligible to Attend | Attended | Eligible to Attend | Attended |
| R Clarke | 9 | 9 | 3 | 3 | 1 | 1 | 1 | 1 |
| M Bridges | 9 | 9 | 3 | 3 | 1 | 1 | 1 | 1 |
| I Ross | 1 | 1 | 1 | 1 | - | - | - | - |
| C Hirst | 9 | 9 | n/a | n/a | 1 | 1 | 1 | 1 |
| G Baynton | 9 | 8 | 3 | 3 | 1 | 1 | 1 | 1 |
| Dr S Mercer | 9 | 9 | n/a | n/a | n/a | n/a | n/a | n/a |

### Environmental Regulation

The Group's operations are not regulated by any significant environmental regulation under a law of the Commonwealth or of a State or Territory.

### Proceedings on Behalf of the Company

No proceedings have been brought, or intervened in, on behalf of the company with leave of the Court under S237 of the *Corporations Act 2001*

## DIRECTORS' REPORT (Continued)

### Auditor

Lawler Hacketts Audit has been appointed as the Company's auditor.

There is no former partner or director of Lawler Hacketts Audit who is or was at any time during the year an officer of the Company.

### Non-audit Services

The Board of Directors, in accordance with advice from the Audit and Risk Management Committee, is satisfied that the provision of the non-audit services during the year is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The Directors are satisfied that the services disclosed below did not compromise the external auditor's independence for the following reasons:

- all non-audit services are reviewed and approved by the Audit and Risk Management Committee prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and
- the nature of the services provided do not compromise the general principles relating to auditor independence in accordance with APES 110: Code of Ethics for Professional Accountants set by the Accounting Professional and Ethical Standards Board.

The following fees for non-audit services were paid / payable to the external auditors or related entities of the external auditors during the year ended 30 June 2012:

| *Non-audit services* | **30 June 2012**<br>**$** | **30 June 2011**<br>**$** |
|---|---|---|
| Audit or review of regulatory returns and due diligence services | 1,500 | 12,500 |

### Auditor's Declaration

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is attached to this Directors' Report.

Signed in accordance with a resolution of the Board of Directors.

**Roger Clarke**
**Chairman**
Brisbane, 21 August 2012

**Steven Mercer**
**CEO & Director**

lawler hacketts chartered accountants

Brisbane
Rockhampton
Sydney
Melbourne
Newcastle

**Auditor's Independence Declaration under Section 307C of the Corporations Act 2001 to the Directors of Tissue Therapies Limited and Controlled Entity**

I declare that, to the best of my knowledge and belief, during the year ended 30 June 2012 there have been:

(a) no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and
(b) no contraventions of any applicable code of professional conduct in relation to the audit.

**Lawler Hacketts Audit**

**L J Murphy**
**Partner**

Brisbane, 21 August 2012

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# FINANCIAL STATEMENTS

## TISSUE THERAPIES LIMITED AND CONTROLLED ENTITY
## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
## FOR THE YEAR ENDED 30 JUNE 2012

| | Note | CONSOLIDATED 30 June 2012 $ | 30 June 2011 $ |
|---|---|---|---|
| **Continuing operations** | | | |
| Revenue | 2(a) | 336,637 | 232,024 |
| Other income | 2(b) | 532,815 | 220,586 |
| | | 869,452 | 452,610 |
| Research and development expenses | | (1,288,256) | (1,255,700) |
| Clinical trials expenses | | (668,550) | (2,168,238) |
| Occupancy expenses | | (102,903) | (21,847) |
| Marketing and business development | | (294,759) | (9,470) |
| Regulatory approvals | | (754,827) | - |
| Intellectual property | | (324,908) | (349,148) |
| Sales and distribution | | (182,266) | - |
| Transport and logistics | | (58,433) | - |
| Inventory write down to net realisable value | | (728,601) | (364,995) |
| Manufacturing expenses | | (25,646) | - |
| Employment expenses | | (1,443,517) | (574,030) |
| Consultants | | (977,807) | (471,239) |
| Administration expenses | | (878,843) | (723,592) |
| Depreciation and amortisation | | (37,404) | (13,836) |
| Finance costs | | (8,204) | (3,780) |
| Loss on foreign exchange | | (165,864) | (48,883) |
| Other expenses | | (135,890) | (93,439) |
| Loss before income tax benefit | 3 | (7,207,226) | (5,645,587) |
| Income tax benefit | 4(a) | 437,844 | 305,039 |
| Loss from continuing operations after income tax benefit | | (6,769,382) | (5,340,548) |
| **Other comprehensive income items** | | | |
| Other comprehensive income: | | | |
| - Foreign exchange translation reseve | | (2,012) | - |
| Income tax relating to components of other comprehensive income items | | - | - |
| Other comprehensive income after income tax benefit | | (2,012) | - |
| Total comprehensive income for the year | | (6,771,394) | (5,340,548) |
| Loss attributable to members of the Company | | (6,769,382) | (5,340,548) |
| Total comprehensive income attributable to members of the Company | | (6,771,394) | (5,340,548) |
| | | **Cents** | **Cents** |
| **Overall Operations** | | | |
| Basic earnings per share | 26 | (4.01) | (3.79) |
| Diluted earnings per share | 26 | (4.01) | (3.79) |

*The accompanying notes form part of these statements*

**TISSUE THERAPIES LIMITED AND CONTROLLED ENTITY**
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION**
**AS AT 30 JUNE 2012**

| | Note | CONSOLIDATED | |
|---|---|---|---|
| | | **30 June 2012** | **30 June 2011** |
| **CURRENT ASSETS** | | | |
| Cash and cash equivalents | 5 | 5,158,393 | 15,416,321 |
| Trade and other receivables | 6(a) | 122,391 | 125,689 |
| Current tax assets | 4(c) | 393,730 | 217,845 |
| Inventories | 7(a) | 5,983,541 | 574,651 |
| Other assets | 8(a) | 254,372 | 545,695 |
| **TOTAL CURRENT ASSETS** | | 11,912,427 | 16,880,201 |
| **NON-CURRENT ASSETS** | | | |
| Inventories | 7(b) | 305,552 | 694,796 |
| Property, plant and equipment | 9 | 370,499 | 86,119 |
| Intangible assets | 10 | 342,250 | 342,250 |
| Other assets | 8(b) | 1,525 | - |
| **TOTAL NON-CURRENT ASSETS** | | 1,019,826 | 1,123,165 |
| **TOTAL ASSETS** | | 12,932,253 | 18,003,366 |
| **CURRENT LIABILITIES** | | | |
| Trade and other payables | 11 | 2,071,919 | 858,718 |
| Current tax liabilities | 4(e) | 5,649 | - |
| Provisions | 12 | 168,934 | 111,212 |
| Financial liabilities | 27 | 23,972 | - |
| Other liabilities | 13 | 29,964 | - |
| **TOTAL CURRENT LIABILITIES** | | 2,300,438 | 969,930 |
| **NON-CURRENT LIABILITIES** | | | |
| Other liabilities | 13 | 164,924 | - |
| **TOTAL NON-CURRENT LIABILITIES** | | 164,924 | - |
| **TOTAL LIABILITIES** | | 2,465,362 | 969,930 |
| **NET ASSETS** | | 10,466,891 | 17,033,436 |
| **EQUITY** | | | |
| Contributed equity | 14(a) | 39,740,331 | 39,525,004 |
| Reserves | 15 | 121,986 | 356,799 |
| Accumulated losses | | (29,395,426) | (22,848,367) |
| **TOTAL EQUITY** | | 10,466,891 | 17,033,436 |

*The accompanying notes form part of these statements.*

**TISSUE THERAPIES LIMITED AND CONTROLLED ENTITY**
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**
**FOR THE YEAR ENDED 30 JUNE 2012**

| | | Reserves | | | |
|---|---|---|---|---|---|
| | Share Capital<br>$ | Option Reserve<br>$ | Foreign Exchange Translation Reserve<br>$ | Accumulated Losses<br>$ | Total<br>$ |
| **Total equity at 1 July 2010** | 25,276,808 | 173,406 | - | (17,507,819) | 7,942,395 |
| Total comprehensive income | - | - | - | (5,340,548) | (5,340,548) |
| Transactions with owners in their capacity as owners: | | | | | |
| - Contributions of equity | 15,177,873 | - | - | - | 15,177,873 |
| - Transaction costs | (929,677) | - | - | - | (929,677) |
| - Employee share options | - | 183,393 | - | - | 183,393 |
| Total transactions with owners | 14,248,196 | 183,393 | - | - | 14,431,589 |
| **Total equity at 30 June 2011** | 39,525,004 | 356,799 | - | (22,848,367) | 17,033,436 |
| Total comprehensive income | - | - | (2,012) | (6,769,382) | (6,771,394) |
| Transactions with owners in their capacity as owners: | | | | | |
| - Contributions of equity | 229,481 | (16,811) | - | - | 212,670 |
| - Transaction costs | (14,154) | - | - | - | (14,154) |
| - Employee share options | - | 6,333 | - | - | 6,333 |
| - Option reserve transferred | - | (222,323) | - | 222,323 | - |
| Total transactions with owners | 215,327 | (232,802) | - | 222,323 | 204,849 |
| **Total equity at 30 June 2012** | 39,740,331 | 123,998 | (2,012) | (29,395,426) | 10,466,891 |

*The accompanying notes form part of these statements.*

**TISSUE THERAPIES LIMITED AND CONTROLLED ENTITY**
**CONSOLIDATED STATEMENT OF CASH FLOWS**
**FOR THE YEAR ENDED 30 JUNE 2012**

| | Note | CONSOLIDATED 30 June 2012 | 30 June 2011 |
|---|---|---|---|
| **CASH FLOW FROM OPERATING ACTIVITIES** | | | |
| Receipts from customers (inclusive of goods and services tax) | | 346,152 | 508,790 |
| Payments for research, clinical trials and regulatory | | (3,024,421) | (1,204,324) |
| Payments to suppliers and employees (inclusive of goods and services tax) | | (8,356,405) | (4,056,285) |
| Interest received | | 551,219 | 187,709 |
| Finance costs paid | | (8,204) | (3,780) |
| Income tax rebate received | | 267,607 | 277,001 |
| Net cash provided by (used in) operating activities | 25(b) | (10,224,052) | (4,290,889) |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | | |
| Payments for property, plant and equipment | | (112,037) | - |
| Net cash provided by (used in) investing activities | | (112,037) | - |
| **CASH FLOW FROM FINANCING ACTIVITIES** | | | |
| Proceeds from share issues | | 93,600 | 15,177,873 |
| Costs of share issue | | (14,154) | (929,677) |
| Net cash provided by (used in) financing activities | | 79,446 | 14,248,196 |
| Net increase / (decrease) in cash held | | (10,256,643) | 9,957,307 |
| Cash at beginning of year | | 15,416,321 | 5,500,285 |
| Effects of exchange rate fluctuations on cash held | | (1,285) | (41,271) |
| Cash at end of year | 25(a) | 5,158,393 | 15,416,321 |

*The accompanying notes form part of these statements.*

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements and notes represent those of Tissue Therapies Limited (the "Company") and Controlled Entity (the "Consolidated Group" or "Group"). The company was incorporated and domiciled in Australia.

The separate financial statements of the parent entity, Tissue Therapies Limited, have not been presented within this financial report as permitted by the *Corporations Act 2001*.

The financial report was authorised for issue on 21 August 2012 by the Board of Directors.

### Basis of preparation

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, including Australian Accounting Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board and the *Corporations Act 2001*.

The Group is a for-profit entity for financial reporting purposes under Australian Accounting Standards.

Australian Accounting Standards set out accounting policies that the AASB has concluded would result in a financial report containing relevant and reliable information about transactions, events and conditions to which they apply. Compliance with Australian Accounting Standards ensures that the financial statements and notes also comply with International Financial Reporting Standards. Significant accounting policies adopted in the preparation of this financial report are presented below. They have been consistently applied unless otherwise stated.

Except for cashflow information, the financial report has been prepared on an accrual basis, based on historical costs, modified, where applicable, by the measurement at fair value of selected non-current assets, financial assets and financial liabilities.

### Accounting Policies

### a. Principles of Consolidation

The consolidated financial statements incorporate the assets, liabilities and results of entities controlled by Tissue Therapies Limited, a Listed Public Limited at the end of the reporting period. A controlled entity is any entity over which Tissue Therapies Limited has the ability and right to govern the financial and operating policies so as to obtain benefits from the entity's activities.

Where controlled entities have entered or left the Group during the year, the financial performance of those entities is included only for the period of the year that they were controlled. A list of controlled entities is contained in Note 30 to the financial statements.

In preparing the consolidated financial statements, all intragroup balances and transactions between entities in the consolidated group have been eliminated in full on consolidation.

Non-controlling interests, being the equity in a subsidiary not attributable, directly or indirectly, to a parent, are reported separately within the equity section of the consolidated statement of financial position and statement of comprehensive income. The non-controlling interests in the net assets comprise their interests at the date of the original business combination and their share of changes in equity since that date.

### b. Income Tax

The income tax expense (revenue) for the year comprises current income tax expense (income) and deferred tax expense (income). Current income tax expense charged to the profit or loss is the tax payable on taxable income calculated using applicable income tax rates enacted, or substantially enacted, as at reporting date. Current tax liabilities (assets) are therefore measured at the amounts expected to be paid to (recovered from) the relevant taxation authority.

Deferred income tax expense reflects movements in deferred tax asset and deferred tax liability balances during the year as well unused tax losses.

Current and deferred income tax expense (income) is charged or credited directly to equity instead of the profit or loss when the tax relates to items that are credited or charged directly to equity.

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### b. Income Tax (Continued)

Deferred tax assets and liabilities are ascertained based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets also result where amounts have been fully expensed but future tax deductions are available. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax assets and liabilities are calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates enacted or substantively enacted at reporting date. Their measurement also reflects the manner in which management expects to recover or settle the carrying amount of the related asset or liability.

Deferred tax assets relating to temporary differences and unused tax losses are recognised only to the extent that it is probable that future taxable profit will be available against which the benefits of the deferred tax asset can be utilised.

### c. Research and Development expenditure

Expenditure during the research phase of a project is recognised as an expense when incurred. Development costs are capitalised only when technical feasibility studies identify that the project will deliver future economic benefits and these benefits can be measured reliably.

### d. Intangibles

*Licenses and Patents*

Licenses and patents are recognised at cost of acquisition. Licenses, patents and trademarks have a finite life and are carried at cost less any accumulated amortisation and any impairment losses. Licenses and patents are amortised over their useful life, which has been assessed as ten years from the date the intangible asset is in its intended use.

### e. Employee benefits

Provision is made for the Company's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits that are expected to be settled within one year have been measured at the amounts expected to be paid when the liability is settled, plus related on-costs. Employee benefits payable later than one year have been measured at the present value of the estimated future cash outflows to be made for those benefits with consideration given to employees wages increases and the probability that the employees may satisfy vesting requirements.

*Equity –settled Compensation*

The Company operates equity-settled share-based payment employee share and option schemes. The fair value of the equity to which employees become entitled is measured at grant date and recognised as an expense over the vesting period, with a corresponding increase to an equity account. The fair value of shares is ascertained as the market bid price. The fair value of options is ascertained using a Black–Scholes pricing model which incorporates all market vesting conditions. The number of shares and options expected to vest is reviewed and adjusted at each reporting date such that the amount recognised for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest.

### f. Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within short-term borrowings in current liabilities on the statement of financial position.

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### g. Revenue recognition

Revenues are recognised at fair value of the consideration received net of any applicable taxes.

Interest revenue is recognised as it accrues taking into account the interest rates applicable to the financial assets.

Government grants are recognised at fair value where there is reasonable assurance that the grant will be received and all grant conditions will be met. Grants relating to expense items are recognised as income over the periods necessary to match the grant to the costs they are compensating. Grants relating to assets are credited to deferred income at fair value and are credited to income over the expected useful life of the asset on a straight-line basis.

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

### h. Goods and Services Tax (GST)

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

Cash flows are presented in the statement of cash flows on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

### i. Property, plant and equipment

Each class of property, plant and equipment is carried at cost or fair value less, where applicable, any accumulated depreciation and impairment losses.

*Plant and equipment*

Plant and equipment are initially measured on the cost basis.

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

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

*Depreciation*

The depreciable amount of all fixed assets including building and capitalised lease assets, but excluding freehold land, is depreciated on a straight-line basis over their useful lives to the Group commencing from the time the asset is held ready for use. The expected useful life for plant and equipment is 3 to 10 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

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

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### j. Inventory

Inventories are measured at the lower of cost and net realisable value. The cost of manufactured products includes direct materials, direct labour and an appropriate portion of variable and fixed overheads.

### k. Trade and other creditors

These amounts represent liabilities for goods and services provided to the Group prior to the end of the financial year and which are unpaid. The amounts are unsecured and usually paid within 30 days of recognition.

### l. Leases

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

Lease incentives under operating leases are recognised as a liability and amortised on a straight-line basis over the lease term.

### m. Impairment of assets

At each reporting date, the Group reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the asset, being the higher of the asset's fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying value over its recoverable amount is expensed to the statement of comprehensive income. Impairment testing is performed annually for intangible assets with indefinite lives.

Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

### n. Comparative figures

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

### o. Financial Instruments

*Recognition and Initial Measurement*

Financial assets and financial liabilities are recognised when the entity becomes a party to the contractual provisions to the instrument. For financial assets, this is equivalent to the date that the company commits itself to either the purchase or sale of the asset (ie trade date accounting is adopted).

Financial instruments are initially measured at fair value plus transaction costs, except where the instrument is classified "at fair value through profit or loss", in which case transaction costs are expensed to profit or loss immediately.

*Classification and Subsequent Measurement*

Financial instruments are subsequently measured at fair value, amortised cost using the effective interest method, or cost.

*Amortised cost* is calculated as the amount at which the financial asset or financial liability is measured at initial recognition less principal repayments and any reduction for impairment, and adjusted for any cumulative amortisation of the difference between that initial amount and the maturity amount calculated using the *effective interest method.*

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

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### o. Financial Instruments (Continued)

The *effective interest method* is used to allocate interest income or interest expense over the relevant period and is equivalent to the rate that discounts estimated future cash payments or receipts (including fees, transaction costs and other premiums or discounts) over the expected life (or when this cannot be reliably predicted, the contractual term) of the financial instrument to the net carrying amount of the financial asset or financial liability. Revisions to expected future net cash flows will necessitate an adjustment to the carrying amount with a consequential recognition of an income or expense item in profit or loss.

The Group does not designate any interests in subsidiaries, associates or joint venture entities as being subject to the requirements of Accounting Standards specifically applicable to financial instruments.

(i) *Financial assets at fair value through profit or loss*

Financial assets are classified at "fair value through profit or loss" when they are held for trading for the purpose of short-term profit taking, derivatives not held for hedging purposes, or when they are designated as such to avoid an accounting mismatch or to enable performance evaluation where a Group of financial assets is managed by key management personnel on a fair value basis in accordance with a documented risk management or investment strategy. Such assets are subsequently measured at fair value with changes in carrying amount being included in profit or loss.

(ii) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are subsequently measured at amortised cost. Gains or losses are recognised in profit or loss through the amortisation process and when the financial asset is derecognised.

(iii) *Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets that have fixed maturities and fixed or determinable payments, and it is the Group's intention to hold these investments to maturity. They are subsequently measured at amortised cost. Gains or losses are recognised in profit or loss through the amortisation process and when the financial asset is derecognised.

(iv) *Available-for-sale investments*

Available-for-sale investments are non-derivative financial assets that are either not capable of being classified into other categories of financial assets due to their nature or they are designated as such by management. They comprise investments in the equity of other entities where there is neither a fixed maturity nor fixed or determinable payments.

They are subsequently measured at fair value with any remeasurements other than impairment losses and foreign exchange gains and losses recognised in other comprehensive income. When the financial asset is derecognised, the cumulative gain or loss pertaining to that asset previously recognised in other comprehensive income is reclassified into profit or loss.

Available-for-sale financial assets are classified as non-current assets when they are expected to be sold after 12 months from the end of the reporting period. All other available-for-sale financial assets are classified as current assets.

(v) *Financial liabilities*

Non-derivative financial liabilities other than financial guarantees are subsequently measured at amortised cost. Gains or losses are recognised in profit or loss through the amortisation process and when the financial liability is derecognised.

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### o. Financial Instruments (Continued)

*Impairment*

At the end of each reporting period, the Group assesses whether there is objective evidence that a financial asset has been impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events (a "loss event") having occurred, which has an impact on the estimated future cash flows of the financial asset(s).

In the case of available-for-sale financial assets, a significant or prolonged decline in the market value of the instrument is considered to constitute a loss event. Impairment losses are recognised in profit or loss immediately. Also, any cumulative decline in fair value previously recognised in other comprehensive income is reclassified to profit or loss at this point.

In the case of financial assets carried at amortised cost, loss events may include: indications that the debtors or a group of debtors are experiencing significant financial difficulty, default or delinquency in interest or principal payments; indications that they will enter bankruptcy or other financial reorganisation; and changes in arrears or economic conditions that correlate with defaults.

For financial assets carried at amortised cost (including loans and receivables), a separate allowance account is used to reduce the carrying amount of financial assets impaired by credit losses. After having taken all possible measures of recovery, if management establishes that the carrying amount cannot be recovered by any means, at that point the written-off amounts are charged to the allowance account or the carrying amount of impaired financial assets is reduced directly if no impairment amount was previously recognised in the allowance account.

When the terms of financial assets that would otherwise have been past due or impaired have been renegotiated, the Group recognises the impairment for such financial assets by taking into account the original terms as if the terms have not been renegotiated so that the loss events that have occurred are duly considered.

*Financial Guarantees*

Where material, financial guarantees issued that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due are recognised as a financial liability at fair value on initial recognition.

The fair value of financial guarantee contracts has been assessed using a probability-weighted discounted cash flow approach. The probability has been based on:

- the likelihood of the guaranteed party defaulting during the next reporting period;
- the proportion of the exposure that is not expected to be recovered due to the guaranteed party defaulting; and
- the maximum loss exposure if the guaranteed party were to default.

Financial guarantees are subsequently measured at the higher of the best estimate of the obligation in accordance with AASB 137: Provisions, Contingent Liabilities and Contingent Assets and the amount initially recognised less, when appropriate, cumulative amortisation in accordance with AASB 118: Revenue. Where the entity gives guarantees in exchange for a fee, revenue is recognised under AASB 118.

*Derecognition*

Financial assets are derecognised when the contractual rights to receipt of cash flows expire or the asset is transferred to another party whereby the entity no longer has any significant continuing involvement in the risks and benefits associated with the asset. Financial liabilities are derecognised when the related obligations are discharged, cancelled or have expired. The difference between the carrying amount of the financial liability extinguished or transferred to another party and the fair value of consideration paid, including the transfer of non-cash assets or liabilities assumed, is recognised in profit or loss.

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### p. Foreign Currency Transactions and Balances

*Functional and Presentation Currency*

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

*Transactions and Balances*

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary items are translated at the year-end exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are reported at the exchange rate at the date when fair values were determined.

Exchange differences arising on the translation of monetary items are recognised in profit or loss, except where deferred in equity as a qualifying cash flow or net investment hedge.

Exchange differences arising on the translation of non-monetary items are recognised directly in other comprehensive income to the extent that the underlying gain or loss is recognised in other comprehensive income; otherwise the exchange difference is recognised in profit or loss.

*Group Companies*

The financial results and position of foreign operations, whose functional currency is different from the Group's presentation currency, are translated as follows:

- assets and liabilities are translated at exchange rates prevailing at the end of the reporting period;
- income and expenses are translated at average exchange rates for the period; and
- retained earnings are translated at the exchange rates prevailing at the date of the transaction.

Exchange differences arising on translation of foreign operations with functional currencies other than Australian dollars are recognised in other comprehensive income and included in the foreign currency translation reserve in the statement of financial position. These differences are recognised in profit or loss in the period in which the operation is disposed of.

### q. Critical Accounting Estimates and Judgments

The Directors evaluate estimates and judgments incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the Group.

*Key Estimates — Impairment*

The Group assesses impairment at each reporting date by evaluating conditions specific to the Group that may lead to impairment of assets. Where an impairment trigger exists, the recoverable amount of the asset is determined.

No impairment has been recognised in respect of licenses and trademarks for the year ended 30 June 2012.

*Key Judgements - Inventory*

The Group assessed the valuation of protein inventory on hand at 30 June 2012. Based on the outcome of research and development activities to date and anticipated future events and use of protein on hand, the Group has written down the value of protein components on hand by $728,601 (2011 : $364,995). This is shown in the statement of comprehensive income for the current year.

## NOTE 1: STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### r. Uncertainty regarding the Recoverability of VitroGro® ECM Inventory

Subsequent to 30 June 2012, the group was advised by the Notified Body, the British Standards Institute (BSI) that the product could be regulated as a Medical Device under an alternative Rule to that which was previously agreed. The United Kingdom regulator, the Medicines and Healthcare products Regulatory Agency (MHRA) is currently arbitrating the matter. Depending upon the outcome, there is potential for a delay in commencement of sales while an additional regulatory review is undertaken as a result of the alternative Device Rule being applied. At 30 June 2012, the current shelf life of the inventory of VitroGro® ECM is 14 months which will expire in August 2013.Therefore, as a result of a potential delay in the sales of VitroGro® ECM and its shelf life there is uncertainty as to the recoverable value of the finished goods of VitroGro® ECM, unless a concession note to extend shelf life is obtained and the cost of relabeling of the finished goods can be absorbed by the available margin in the sales price.

In assessing the recoverable value of the inventory of VitroGro® ECM, Management recognises that a routine concession note process exists under the regulatory procedures allowing an extension to the shelf life for a period of time that can be supported by stability data available at the time. In this regard, at 30 June 2012, and based on stability analysis already undertaken which indicates a stable profile for the commercial lifetime of the product, Management has assessed that the inventory of VitroGro® ECM is not impaired and no impairment provisions has been raised.

Management is therefore confident that the carrying value of finished goods of VitroGro® ECM at 30 June 2012 is recoverable provided the following circumstances can be achieved:

- Successful resolution of the mediation to allow sales of product in line with forecast sales for 2013, or
- The routine concession note process under the relevant regulatory procedures allows an extension to the shelf life of the March 2012 batch at the time it is requested, and;
- The additional cost of relabeling the finished goods of VitroGro® ECM is absorbed by the available margin in the sales price.

The directors are confident of achieving the above and therefore believe that the carrying value of finished goods of VitroGro® ECM is recoverable.

No adjustments have therefore been made relating to the recoverability of recorded cost of finished goods of VitroGro® ECM.

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 2: REVENUE / OTHER INCOME** | | |
| **a) Revenue** | | |
| Research grants | 336,637 | 220,461 |
| Product sales | - | 11,563 |
| Total revenue | 336,637 | 232,024 |

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 2: REVENUE / OTHER INCOME (Continued)** | | |
| **b) Other income** | | |
| Interest received | 532,815 | 220,586 |
| Total other income | 532,815 | 220,586 |
| **NOTE 3: LOSS FOR THE YEAR** | | |
| **Expenses** | | |
| Research and development expenses | 1,288,256 | 1,255,700 |
| Clinical trials expenses | 668,550 | 2,168,238 |
| Inventory write down to net realisable value | 728,601 | 364,995 |
| Loss on foreign exchange | 165,864 | 48,883 |
| Finance costs – external | 8,204 | 3,780 |
| Rental expense on operating leases – minimum lease payments | 75,022 | 7,240 |
| Depreciation expenses | 37,404 | 13,836 |
| **NOTE 4: INCOME TAX** | | |
| **a) The components of income tax benefit comprises** | | |
| Current tax | 388,100 | 217,843 |
| Under provision in respect of prior years | 49,744 | 87,196 |
| Total tax benefit | 437,844 | 305,039 |
| **b) The prima facie tax benefit on loss from ordinary activities before income tax is reconciled to the income tax benefit as follows** | | |
| Tax benefit on loss from ordinary activities at 30% (2011 : 30%) | 2,162,168 | 1,693,676 |
| Tax effect of: | | |
| R&D expenditure taken as a cash offset | (313,353) | (231,364) |
| Other | (61,248) | (88,682) |
| Tax losses available | 1,787,567 | 1,373,630 |
| Tax losses utilised by: | | |
| Income tax benefit attributable to R&D tax offset receivable | 393,730 | 217,843 |
| Income tax benefit attributable to R&D tax offset understated in prior year | 49,744 | 87,196 |
| Income tax expense | (5,630) | - |
| Income tax benefit relating to entity | 437,844 | 305,039 |
| The applicable weighted average effective tax rates are as follows: | (6.1%) | (5.4%) |

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 4: INCOME TAX (Continued)** | | |
| **c) Current Tax Asset** | | |
| Opening balance of R&D tax offset concession claimed | 217,845 | 189,807 |
| Add- R&D tax offset understated in prior year | 49,744 | 87,196 |
| Less- Income tax benefit attributable to R&D tax offset received | (267,589) | (277,001) |
| Add - Income tax benefit attributable to R&D tax offset receivable | 393,730 | 217,843 |
| Closing balance of research and development tax offset concession claimed | 393,730 | 217,845 |
| | | |
| **d) Deferred Tax Asset** | | |
| Deferred tax assets not brought to account, the benefits of which will only be realised if the conditions for deductibility set out in Note 1a occur: | | |
| Temporary differences | 692,589 | 644,542 |
| Tax losses – operating losses | 7,468,278 | 5,675,726 |
| | 8,160,867 | 6,320,268 |
| | | |
| **e) Current Tax Liabilities** | | |
| Opening balance | - | - |
| Income tax payable | 5,649 | - |
| Closing balance of current tax liabilities | 5,649 | - |
| | | |
| **NOTE 5: CASH AND CASH EQUIVALENTS** | | |
| Cash at bank | 56,166 | 581,539 |
| Short term bank deposits - at call * | 5,102,227 | 14,834,782 |
| | 5,158,393 | 15,416,321 |

* The deposits were in interest bearing floating rate accounts. Interest rates varied between 0.0% and 6.00% (2011 : 0.0% to 6.00%).

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |

## NOTE 6: TRADE AND OTHER RECEIVABLES

### a) Current assets

| | | |
|---|---|---|
| GST/VAT receivable | 103,523 | 92,804 |
| Other receivables | 18,868 | 32,885 |
| | 122,391 | 125,689 |

Current trade and term receivables are non-interest bearing loans and generally on 30 day terms. A provision for impairment is recognised when there is objective evidence that an individual trade or term receivable is impaired. There are no balances within trade debtors which are 'past due'.

## NOTE 7: INVENTORIES

### a) Current assets

| | | |
|---|---|---|
| VitroGro® ECM – at cost | 5,718,740 | - |
| VitroGro® ECM – Work-in-progress – at cost | 264,801 | - |
| VitroGro® protein – at cost | - | 574,651 |
| | 5,983,541 | 574,651 |

The inventory of finished goods of VitroGro® ECM is represented by a batch of VitroGro® ECM produced in March 2012 with a common shelf life of 18 months. At 30 June 2012, the current shelf life of the inventory of VitroGro® ECM is 14 months which will expire in August 2013. In assessing the recoverable value of the inventory of VitroGro® ECM, Management recognises that a routine concession note process exists under the relevant health regulatory procedures allowing an extension to the shelf life for a period of time that can be supported by stability data available at the time. In this regard, at 30 June 2012, and based on stability analysis already undertaken which indicates a stable profile for the commercial lifetime of the product, Management has assessed that the inventory of VitroGro® ECM is not impaired and no impairment provision has been raised.

### b) Non-current assets

| | | |
|---|---|---|
| VitroGro® production cells and reference protein – at net realisable value | 305,552 | - |
| VitroGro® Protein Components – at net realisable value | - | 694,796 |
| | 305,552 | 694,796 |

Although the VitroGro® Protein Components were expensed during the year, it is expected that this material will be consumed during normal research and development activities.

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 8: OTHER ASSETS** | | |
| **a) Other current assets** | | |
| Prepayments | | |
| - Clinical trials expenses | 147,523 | - |
| - Inventory | - | 491,912 |
| - Other | 106,849 | 53,783 |
| | 254,372 | 545,695 |
| **b) Other non-current assets** | | |
| Other assets | 1,525 | - |
| **NOTE 9: PROPERTY, PLANT AND EQUIPMENT** | | |
| Plant and equipment – at cost | 93,117 | 93,117 |
| Less: Accumulated depreciation | (20,930) | (15,745) |
| | 72,187 | 77,372 |
| Furniture and fixtures – at cost | 80,033 | 29,453 |
| Less: Accumulated depreciation | (35,316) | (20,706) |
| | 44,717 | 8,747 |
| Computer hardware and software – at cost | 61,457 | - |
| Less: Accumulated depreciation | (2,750) | - |
| | 58,707 | - |
| Fit out – at cost | 209,747 | - |
| Less: Accumulated depreciation | (14,859) | - |
| | 194,888 | - |
| Total property, plant and equipment | 370,499 | 86,119 |

## NOTE 9: PROPERTY, PLANT AND EQUIPMENT (Continued)

| Reconciliations of the carrying amounts of each class of property, plant and equipment at the beginning and end of the current financial year are set out below. | Plant and equipment | Furniture and fixtures | Computer hardware and software | Fit out | Total |
|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ |
| Carrying amount at 1July 2010 | 87,507 | 17,635 | - | - | 105,142 |
| Additions | - | - | - | - | - |
| Disposals (written down value) | (5,187) | - | - | - | (5,187) |
| Depreciation expense | (4,948) | (8,888) | - | - | (13,836) |
| Carrying amount at 30 June 2011 | 77,372 | 8,747 | - | - | 86,119 |
| Additions | - | 50,580 | 61,457 | 209,747 | 112,037 |
| Disposals (written down value) | - | - | - | - | - |
| Depreciation expense | (5,185) | (14,610) | (2,750) | (14,859) | (37,404) |
| Carrying amount at 30 June 2012 | 72,187 | 44,717 | 58,707 | 194,888 | 370,499 |

Based on the methodology applied in Note 1 to the financial statements, there were no impairment gains or losses recorded during the current financial year.

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 10: INTANGIBLE ASSETS** | | |
| Licenses and patents - at cost | 342,250 | 342,250 |

Licences and patents are assessed to have finite useful lives. Amortisation will begin during the financial year ended 30 June 2013 when the Company commences commercial operations. There are no amortisation charges for licenses and patents for the current or prior financial periods.

## NOTE 11: TRADE AND OTHER PAYABLES

| | | |
|---|---|---|
| **Current liabilities** | | |
| Trade creditors | 1,222,789 | 594,770 |
| Other creditors and accruals | 849,130 | 263,948 |
| | 2,071,919 | 858,718 |

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |

**NOTE 12: PROVISIONS**

**Current provisions**

| | | |
|---|---|---|
| Provision for annual leave | 168,934 | 111,212 |

**NOTE 13: OTHER LIABILITIES**

**a) Current liabilities**

| | | |
|---|---|---|
| Deferred lease incentives | 29,964 | - |

**b) Non-current liabilities**

| | | |
|---|---|---|
| Deferred lease incentives | 164,924 | - |

**NOTE 14: ISSUED CAPITAL**

**a) Share capital**

| | | |
|---|---|---|
| 169,357,192 (2011: 168,739,422) fully paid ordinary shares | 39,740,331 | 39,525,004 |

**b) Fully paid ordinary shares**

Ordinary shares participate in dividends and the proceeds on winding up of the Company in proportion to the number of shares held.

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

## NOTE 14: ISSUED CAPITAL (Continued)

### c) Movements in ordinary share capital

| Date | Details | No. Shares | Issue price | $ |
|---|---|---|---|---|
| | Balance at 1 July 2010 | 138,201,447 | | 25,276,808 |
| 09/11/10 | Ordinary shares issued on exercise of Options | 100,000 | 15c | 15,000 |
| 18/04/11 | Ordinary shares issued on exercise of Options | 250,000 | 26c | 65,000 |
| 26/05/11 | Ordinary shares issued by Placement | 11,500,000 | 50c | 5,750,000 |
| 26/05/11 | Ordinary shares issued by Rights Issue | 18,632,464 | 50c | 9,316,232 |
| 21/06/11 | Ordinary shares issued to consultant for consultancy services | 55,511 | 57c | 31,641 |
| | Transaction costs arising from share issues | | | (929,677) |
| | Balance at 30 June 2011 | 168,739,422 | | 39,525,004 |
| 02/12/11 | Ordinary shares issued to consultant for consultancy services | 115,712 | 52c | 59,893 |
| 28/03/12 | Ordinary shares issued on exercise of Options | 320,000 | 31c | 98,144 |
| 30/03/12 | Ordinary shares issued on exercise of Options | 40,000 | 31c | 12,268 |
| 20/04/12 | Ordinary shares issued to consultant for consultancy services | 127,160 | 41c | 51,840 |
| 20/06/12 | Ordinary shares issued to consultant for consultancy services | 14,898 | 49c | 7,336 |
| | Transaction costs arising from share issues | | | (14,154) |
| | Balance at 30 June 2012 | 169,357,192 | | 39,740,331 |

### d) Options

For information relating to options issued, exercised and lapsed during the financial year and the options outstanding at year-end refer to Note 19: Share-based Payments.

### e) Capital Management

Management controls the capital of the Group in order to maintain an appropriate debt to equity ratio, and ensure that the Group can fund its operations and continue as a going concern. The Group's debt and capital includes ordinary share capital and financial liabilities, supported by financial assets. There are no externally imposed capital requirements.

Management effectively manages the Group's capital by assessing the Group's financial risks and adjusting its capital structure in response to changes in these risks and in the market. These responses include the management of debt levels, distributions to shareholders and share issues.

There have been no changes in the strategy adopted by management to control the capital of the Group since the prior year.

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 15: RESERVES** | | |
| Option reserve | 123,998 | 356,799 |
| Foreign exchange translation reserve | (2,012) | - |
| | 121,986 | 356,799 |

**a) Option Reserve**

The option reserve records items recognised as expenses on valuation of employee share options.

| **Movement** | | |
|---|---|---|
| Balance at beginning of year | 356,799 | 173,406 |
| Amortisation of options granted during the year | 6,333 | 183,393 |
| Options exercised during the year | (16,811) | - |
| Transfer of amortisation relating to expired options to retained earnings | (222,323) | - |
| Balance at end of year | 123,998 | 356,799 |

**b) Foreign Exchange Translation Reserve**

| **Movement** | | |
|---|---|---|
| Balance at beginning of year | - | - |
| Movement during the year | (2,012) | - |
| Balance at end of year | (2,012) | - |

**NOTE 16: REMUNERATION OF AUDITORS**

| | | |
|---|---|---|
| Audit services – Lawler Hacketts Audit | | |
| Audit and review of financial reports and other audit work under the Corporations Act 2001 | 39,000 | 35,463 |
| Non-audit services | | |
| Audit / review of regulatory returns and due diligence services – Hacketts Corporate Advisory | 1,500 | 12,500 |
| | 40,500 | 47,963 |

## NOTE 17: FINANCIAL RISK MANAGEMENT

**Financial Risk Management Policies**

The Group's financial instruments consist mainly of deposits with banks, short-term investments, and accounts receivable and payable.

**a) Treasury Risk Management**

The Board, at each of its meetings, analyses financial risk exposure and evaluates treasury management strategies in the context of the most recent economic conditions and forecasts. The Board's overall risk management strategy seeks to assist the Group in meeting its financial targets, whilst minimising potential adverse effects on financial performance. Risk management policies are approved and reviewed on a regular basis.

**b) Financial Risk Exposures and Management**

The main risks the Group is exposed to through its financial instruments are credit risk, interest rate risk, liquidity risk and foreign currency risk.

*Credit risk exposures*

Exposure to credit risk relating to financial assets arises from the potential non-performance by counterparties of contract obligations that could lead to a financial loss to the Group. The credit risk on financial assets of the Group which have been recognised on the statement of financial position is generally the carrying amount, net of any provisions for doubtful debts.

*Interest rate risk exposures*

Exposure to interest rate risk arises on financial assets and financial liabilities recognised at the end of the reporting period whereby a future change in interest rates will affect future cash flows or the fair value of fixed rate financial instruments. The Group is also exposed to earnings volatility on floating rate instruments. The Group's exposure to interest rate risk and the effective weighted average interest rate is set out in the relevant note.

*Liquidity risk*

Liquidity risk arises from the possibility that the Group might encounter difficulty in settling its debts or otherwise meeting its obligations related to financial liabilities. The Group manages liquidity risk by monitoring forecast cash flows and ensuring that adequate facilities or financing options are maintained.

*Foreign currency risk*

Exposure to foreign currency risk may result in the fair value or future cash flows of a financial instrument fluctuating due to movement in foreign exchange rates of currencies in which the Group holds financial instruments which are other than the functional currency of the Group. The Group manages foreign currency risk by monitoring forecast foreign currency commitments and foreign exchange rates. The Group's exposure to foreign currency risk arises from the holding of cash balances €3,662 (2011 : €4,071), £3,402 (2011: £30,658) and CHF82.00 at exchange rates of 0.8080, 0.6507 and 0.9709 respectively.

**c) Net fair value of financial assets and liabilities**

The net fair value of cash and cash equivalents and non-interest bearing monetary financial assets and the financial liabilities of the Group approximates their carrying amounts.

The net fair value of other monetary financial assets and financial liabilities is based upon market prices where a market exists or by discounting the expected future cash flows by the current interest rates for assets and liabilities with similar risk profiles.

**d) Sensitivity Analysis**

The Group has performed a sensitivity analysis relating to its exposure to interest rate and foreign currency exchange rate risks, to assess the effect on reported results and equity which could result from a change in these risks.

Management have determined that, at 30 June 2012, the effect on profit and equity as a result of changes in the interest rate by +100 basis points or -100 basis points would be $51,022 (2011 : $147,829) additional, or less, interest revenue.

Management have determined that, at 30 June 2012, the effect on profit and equity as a result of changes in foreign currency exchange rates by +100 basis points or -100 basis points would be $135 (2011 : $764) exposure to foreign currency exposure.

## NOTE 18: KEY MANAGEMENT PERSONNEL COMPENSATION

### a) Key Management Personnel

Names and positions held of the Company's key management personnel in office at any time during the financial year are:

| Key Management Person | Position |
|---|---|
| Mr R Clarke | Chairman – Non-executive |
| Mr I Ross | Director – Non-executive (appointed 25 May 2012) |
| Mr G Baynton | Director – Non-executive (resigned 12 June 2012) |
| Mr M Bridges | Director – Non-executive |
| Dr C Hirst | Director – Non-executive |
| Dr S Mercer | Chief Executive Officer and Executive Director |
| Mr D McKenzie | Company Secretary |

Key management personnel remuneration has been included in the Remuneration Report section of the Directors' Report.

### b) Option Holdings

Number of options held by Key Management Personnel:

| Key Management Personnel | Balance 30.06.2011 | Granted as compensation | Options exercised | Options expired | Balance 30.06.2012 | Total Vested 30.06.2012 | Total Exercisable 30.06.2012 |
|---|---|---|---|---|---|---|---|
| Mr R Clarke | - | - | - | - | - | - | - |
| Mr G Baynton | - | - | - | - | - | - | - |
| Mr M Bridges | 250,000 | - | - | - | 250,000 | 250,000 | 250,000 |
| Dr C Hirst | - | - | - | - | - | - | - |
| Dr S Mercer | 705,000 | - | - | 225,000 | 480,000 | 480,000 | 480,000 |
| Mr D McKenzie | 250,000 | - | 250,000 | - | - | - | - |
| **Total** | **1,205,000** | **-** | **250,000** | **225,000** | **730,000** | **730,000** | **730,000** |

### c) Share Holdings

Number of Shares held by Key Management Personnel:

| Key Management Personnel | Balance 1.7.2011 | Acquired in Rights Issue, Options Exercised and other purchases | Balance 30.06.2012 |
|---|---|---|---|
| Mr R Clarke | 5,200,000 | - | 5,200,000 |
| Mr I Ross | - | - | - |
| Mr M Bridges | 147,299 | 97,988 | 245,287 |
| Dr C Hirst | 281,250 | - | 281,250 |
| Dr S Mercer | 1,125,750 | - | 1,125,750 |
| Mr D McKenzie | 225,000 | 250,000 | 475,000 |
| **Total** | **6,979,299** | **347,988** | **7,327,287** |

## NOTE 19: SHARE-BASED PAYMENTS

The following share-based payment arrangements existed at 30 June 2012:

- On 29 November 2007, 400,000 share options were granted to the CEO to take up ordinary shares at an exercise price of $0.64 each. These options which remain exercisable will vest on the achievement of a series of specific performance milestones and are exercisable within two years of each tranche of options vesting. At 30 June 2012, 220,000 of these options had expired.
- On 27 November 2008, 500,000 share options were granted to the CEO to take up ordinary shares at an exercise price of $0.15 each. These options which remain exercisable will vest on the achievement of a series of specific performance milestones and are exercisable within two years of each tranche of options vesting. At 30 June 2012, 350,000 of these options had expired and 100,000 had been exercised.
- On 9 March 2010, 1,250,000 share options were granted to Key Management Personnel, and research staff employed by the Queensland University of Technology, to take up ordinary shares at an exercise price of $0.26 each. The options cannot be exercised unless the exercise price is less than the share price on the exercise date. At 30 June 2012, 890,000 of these options had expired and 360,000 had been exercised.
- On 13 October 2010, 750,000 options were granted to Directors on approval by shareholders at the Annual General Meeting, to take up ordinary shares at an exercise price of $0.26 each. The options cannot be exercised unless the exercise price is less than the share price on the exercise date. The options expire on 31 October 2012. At 30 June 2011 250,000 of these options had been exercised.
- On 19 June 2012, 950,000 share options were granted to Key Personnel, to take up ordinary shares at an exercise price of $0.59 each. These options cannot be exercised unless the exercise price is less than the share price on the exercise date. The options will vest on 15 June 2013 and expire on 4 July 2014. Total value of these options granted was $152,000 which will be amortised during vesting period. Current year amortisation of $6,333 have been included under Administration expense in the Statement of Comprehensive Income.

The options hold no voting or dividend rights and are not transferable.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | **Number of options** | **Weighted average exercise price $** | **Number of options** | **Weighted average exercise price $** |
| Outstanding at the beginning of the year | 2,205,000 | 0.29 | 1,925,000 | 0.31 |
| Granted | 950,000 | 0.59 | 750,000 | 0.26 |
| Forfeited | - | - | - | - |
| Exercised | (360,000) | 0.26 | (350,000) | 0.23 |
| Expired | (1,115,000) | 0.26 | (120,000) | 0.64 |
| Outstanding at year-end | 1,680,000 | 0.33 | 2,205,000 | 0.29 |
| Exercisable at year-end | 730,000 | 0.35 | 1,890,000 | 0.29 |

There were 360,000 options exercised during the year ended 30 June 2012.

The options outstanding at 30 June 2012 had a weighted average exercise price of $0.33 and a weighted average remaining contractual life of 1.3 (2011 : 0.8) years. Exercise prices range from $0.15 to $0.64 in respect of options outstanding at 30 June 2012.

Included under Administration expense in the Statement of Comprehensive Income is $6,333 (2011 : $183,393) which relates, in full, to equity-settled share-based payment transactions.

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 20: COMMITMENTS FOR EXPENDITURES** | | |
| Commitments for rental lease and consultancy services contracted for at the reporting date but not recognised as liabilities payable: | | |
| Within one year | 1,153,537 | 531,415 |
| Later than one year but not later than 5 years | 820,341 | 184,140 |
| Later than 5 years | 328,731 | - |
| | 2,302,609 | 715,555 |

## NOTE 21: CONTINGENT LIABILITIES AND CONTINGENT ASSETS

The Company has entered into a Deed of Assignment of Intellectual Property Rights with Queensland University of Technology ("QUT"), under which QUT will assign the Intellectual Property to the Company on the payment of $100,000 by the Company and the satisfaction of certain preconditions regarding, among other things, its level of cash reserves, the Company's share price and a minimum level of expenditure under the R&D Agreement. The Directors are not able to reasonably determine at this point in time when the above pre-conditions are likely to be satisfied.

Directors are not aware of any other contingent liabilities or assets that are likely to have a material effect on the results of the Group as disclosed in these financial statements.

## NOTE 22: RELATED PARTY TRANSACTIONS

*Transactions with related parties*

Transactions between related parties are on normal commercial terms and conditions no more favourable than those available to other parties unless otherwise stated.

The following transactions occurred with related parties:

*Key management personnel*

The Company has incurred share issue transaction costs of $9,091 (2011 : $791,378) to RBS Morgans Corporate Limited primarily for its part in the rights issue and share placement for previous financial year. Roger Clarke is associated with RBS Morgans Corporate Limited.

## NOTE 23: SEGMENT INFORMATION

Operating segments are identified, and segment information disclosed, on the basis of internal reports that are regularly provided to, or reviewed by, the Company's chief operating decision maker which, for the Company, is the Board of Directors. In this regard, the Board of Directors confirms that the Company continues to operate in one operating segment, being biotechnology.

## NOTE 24: EVENTS SUBSEQUENT TO REPORTING DATE

During July 2012 the Group was advised by BSI that VitroGro® ECM conforms to the essential requirements of the EU Medical Devices Directive. This meant that the examination of the Design Dossier was complete, that all examiner questions had been answered to the satisfaction of BSI and BSI advised that CE Mark would be granted shortly.

During August 2012, despite the earlier notification, BSI advised that it had referred the VitroGro® ECM application to the UK Government Health Regulatory Body, the Medicines and Healthcare products Regulatory Agency (MHRA) for a final decision as to which Medical Device Rule was appropriate for the classification of VitroGro® ECM: Device Rule 8 or Device Rule 13.

BSI further advised the Group that the review by MHRA would take up to 30 calendar days, plus any additional days necessary for questions to the Group and for Tissue Therapies' staff to reply to MHRA, but that there would be no additional charges for the MHRA review.

Once CE Mark is received, the Device Rule under which it is granted is of no practical or commercial importance to Tissue Therapies.

It is possible that the MHRA review may result in a further referral to the European Medicines Agency (EMA) for a review of the VitroGro® ECM manufacturing process. EMA is the European Union health regulatory agency.

Except for the above, no other matters or circumstances have arisen since the end of the financial year which significantly affected or may significantly affect the operations of the Group, the results of those operations, or the state of affairs of the Group in future financial years

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 25: CASH FLOW INFORMATION** | | |
| **a) Reconciliation of Cash** | | |
| Cash at end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows: | | |
| Cash and cash equivalents | 5,158,393 | 15,416,321 |

**NOTE 25: CASH FLOW INFORMATION (Continued)**

**b) Reconciliation of Cash Flow from Operations with Loss after Income Tax**

| | CONSOLIDATED 30 June 2012 $ | CONSOLIDATED 30 June 2011 $ |
|---|---|---|
| Loss after income tax benefit | (6,769,382) | (5,340,548) |
| Non-cash flows in profit from ordinary activities | | |
| Depreciation | 37,270 | 13,836 |
| Amortisation of deferred lease incentives | (14,859) | - |
| Unrealised exchange loss | 23,972 | 41,271 |
| Inventory write down to net realisable value | 728,601 | 364,995 |
| Loss on disposal of property, plant and equipment | - | 5,187 |
| Non-cash consultant fees | 119,070 | - |
| Amortisation of option expenses | 6,333 | 183,393 |
| Changes in assets and liabilities | | |
| (Increase)/ decrease in receivables | 2,705 | 343,755 |
| (Increase) / decrease in inventory | (5,483,446) | (255,909) |
| (Increase) / decrease in current tax assets | (175,885) | (28,038) |
| (Increase) / decrease in other assets | 24,997 | - |
| Increase / (decrease) in payables and provisions | 1,270,923 | 381,169 |
| Increase / (decrease) in current tax liabilities | 5,649 | - |
| Cash outflows from operations | (10,224,052) | (4,290,889) |

| | CONSOLIDATED | |
|---|---|---|
| | 30 June 2012 | 30 June 2011 |
| | $ | $ |
| **NOTE 26: EARNINGS PER SHARE** | | |
| Loss after income tax benefit attributable to the Company | (6,769,382) | (5,340,548) |
| **Weighted average number of shares used as the denominator** | **No.** | **No.** |
| Weighted average number of ordinary shares outstanding during the year used in calculation of Basic EPS | 168,925,642 | 140,884,769 |
| Weighed average number of options outstanding which are considered potentially dilutive | - | - |
| Weighted average number of potential ordinary shares outstanding during the year used in calculation of Dilutive EPS | 168,925,642 | 140,884,769 |

The diluted EPS calculation includes that portion of these options considered to be potentially dilutive, weighted with reference to the date of conversion.

| | Cents | Cents |
|---|---|---|
| Basic earnings per share | (4.01) | (3.79) |
| Diluted earnings per share | (4.01) | (3.79) |

## NOTE 27: FINANCIAL ASSETS AND LIABILITIES

The Group's planned developments include the USA approval of VitroGro® for the treatment of venous ulcers. The expenditure associated with these developments will be incurred by the Group in USD currencies over the period to 30 June 2013. In accordance with the Group's Risk Management policy the Group has executed forward exchange contracts to mitigate the Group's exposure to foreign currency movements in these foreign currencies.

Forward Exchange Contracts

The Group has open forward exchange contracts at the end of the reporting period relating to highly probable forecast transactions and recognised financial assets and liabilities. These forward exchange contracts commit the Group to buy and sell specified amounts of foreign currencies in the future as specified exchange rates.

The following table summarises the notional amounts of the Group's commitments in relation to forward exchange contracts. The notional amounts do not represent amounts exchanged by the transaction counterparties and are therefore not a measure of the exposure of the Group through the use of these contracts.

## NOTE 27: FINANCIAL ASSETS AND LIABILITIES (Continued)

| | Notional Amount | | Average exchange rate | |
|---|---|---|---|---|
| | 2012 $ | 2011 $ | 2012 | 2011 |
| Buy USD / sell AUD | | | | |
| Settlement – expire on 28 June 2013 (2011: 28 June 2012) | | | | |
| - Buy USD with a variable asset value of AUD as at 30 June of | 1,447,347 | 2,502,002 | 0.978 | 1.0445 |
| - Sell AUD for a fixed liability amount of | (1,471,319) | 2,502,002 | 1.008 | 1.0445 |
| Net exposure | (23,972) | - | | |
| Buy Euro / sell AUD | | | | |
| Settlement – expire on (2011: 28 June 2012) | | | | |
| - Buy EUR with a variable asset value of AUD as at 30 June of | - | 2,302,566 | - | 0.7320 |
| - Sell AUD for a fixed liability amount of | - | (2,302,566) | - | 0.7320 |
| Net exposure | - | - | | |
| Net unrealised exposure at 30 June | (23,972) | - | | |

Prior period comparative figures for financial assets of $4,804,568 and financial liabilities of $4,804,568 relating to a Foreign Exchange Facility have been offset and presented on a net basis. This amendment to disclosure recognises management's intention to settle the foreign exchange facility on a net basis in accordance with the terms of the facility agreement.

## NOTE 28: CHANGE IN ACCOUNTING POLICY

*New Accounting Standards for Application in Future Periods*

The AASB has issued a number of new and amended Accounting Standards and Interpretations that have mandatory application dates for future reporting periods, some of which are relevant to the Group. The Group has decided not to early adopt any of the new and amended pronouncements. The Group's assessment of the new and amended pronouncements that are relevant to the Group but applicable in future reporting periods is set out below:

– AASB 9: Financial Instruments (December 2010) and AASB 2010–7: Amendments to Australian Accounting Standards arising from AASB 9 (December 2010) [AASB 1, 3, 4, 5, 7, 101, 102, 108, 112, 118, 120, 121, 127, 128, 131, 132, 136, 137, 139, 1023 & 1038 and Interpretations 2, 5, 10, 12, 19 & 127] (applicable for annual reporting periods commencing on or after 1 January 2013).

  These Standards are applicable retrospectively and include revised requirements for the classification and measurement of financial instruments, as well as recognition and derecognition requirements for financial instruments.

  The key changes made to accounting requirements include:

  - simplifying the classifications of financial assets into those carried at amortised cost and those carried at fair value;
  - simplifying the requirements for embedded derivatives;

## NOTE 28: CHANGE IN ACCOUNTING POLICY (Continued)

- removing the tainting rules associated with held-to-maturity assets;
- removing the requirements to separate and fair value embedded derivatives for financial assets carried at amortised cost;
- allowing an irrevocable election on initial recognition to present gains and losses on investments in equity instruments that are not held for trading in other comprehensive income. Dividends in respect of these investments that are a return on investment can be recognised in profit or loss and there is no impairment or recycling on disposal of the instrument;
- requiring financial assets to be reclassified where there is a change in an entity's business model as they are initially classified based on: (a) the objective of the entity's business model for managing the financial assets; and (b) the characteristics of the contractual cash flows; and
- requiring an entity that chooses to measure a financial liability at fair value to present the portion of the change in its fair value due to changes in the entity's own credit risk in other comprehensive income, except when that would create an accounting mismatch. If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in profit or loss.

The Group has not yet been able to reasonably estimate the impact of these pronouncements on its financial statements.

– AASB 2010–8: Amendments to Australian Accounting Standards – Deferred Tax: Recovery of Underlying Assets [AASB 112] (applies to periods beginning on or after 1 January 2012).

This Standard makes amendments to AASB 112: Income Taxes and incorporates Interpretation 121: Income Taxes – Recovery of Revalued Non-Depreciable Assets into AASB 112.

Under the current AASB 112, the measurement of deferred tax liabilities and deferred tax assets depends on whether an entity expects to recover an asset by using it or by selling it. The amendments introduce a presumption that an investment property is recovered entirely through sale. This presumption is rebutted if the investment property is held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time, rather than through sale.

The amendments are not expected to significantly impact the Group.

– AASB 10: Consolidated Financial Statements, AASB 11: Joint Arrangements, AASB 12: Disclosure of Interests in Other Entities, AASB 127: Separate Financial Statements (August 2011), AASB 128: Investments in Associates and Joint Ventures (August 2011) and AASB 2011–7: Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards [AASB 1, 2, 3, 5, 7, 9, 2009–11, 101, 107,.112, 118, 121, 124, 132, 133, 136, 138, 139, 1023 & 1038 and Interpretations 5, 9, 16 & 17] (applicable for annual reporting periods commencing on or after 1 January 2013).

AASB 10 replaces parts of AASB 127: Consolidated and Separate Financial Statements (March 2008, as amended) and Interpretation 112: Consolidation – Special Purpose Entities. AASB 10 provides a revised definition of control and additional application guidance so that a single control model will apply to all investees. The Group has not yet been able to reasonably estimate the impact of this Standard on its financial statements.

AASB 11 replaces AASB 131: Interests in Joint Ventures (July 2004, as amended). AASB 11 requires joint arrangements to be classified as either "joint operations" (where the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities) or "joint ventures" (where the parties that have joint control of the arrangement have rights to the net assets of the arrangement). Joint ventures are required to adopt the equity method of accounting (proportionate consolidation is no longer allowed).

AASB 12 contains the disclosure requirements applicable to entities that hold an interest in a subsidiary, joint venture, joint operation or associate. AASB 12 also introduces the concept of a "structured entity", replacing the "special purpose entity" concept currently used in Interpretation 112, and requires specific disclosures in respect of any investments in unconsolidated structured entities. This Standard will affect disclosures only and is not expected to significantly impact the Group.

To facilitate the application of AASBs 10, 11 and 12, revised versions of AASB 127 and AASB 128 have also been issued. These Standards are not expected to significantly impact the Group.

## NOTE 28: CHANGE IN ACCOUNTING POLICY (Continued)

– AASB 13: Fair Value Measurement and AASB 2011–8: Amendments to Australian Accounting Standards arising from AASB 13 [AASB 1, 2, 3, 4, 5, 7, 9, 2009–11, 2010–7, 101, 102, 108, 110, 116, 17, 118, 119, 120, 121, 128, 131, 132, 133, 134, 136, 138, 139, 140, 141, 1004, 1023 & 1038 and Interpretations 2, 4, 12, 13, 14, 17, 19, 131 & 132] (applicable for annual reporting periods commencing on or after 1 January 2013).

  AASB 13 defines fair value, sets out in a single Standard a framework for measuring fair value, and requires disclosures about fair value measurement.

  AASB 13 requires:

  - inputs to all fair value measurements to be categorised in accordance with a fair value hierarchy; and
  - enhanced disclosures regarding all assets and liabilities (including, but not limited to, financial assets and financial liabilities) to be measured at fair value.

  These Standards are not expected to significantly impact the Group.

– AASB 2011–9: Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income [AASB 1, 5, 7, 101, 112, 120, 121, 132, 133, 134, 1039 & 1049] (applicable for annual reporting periods commencing on or after 1 July 2012).

  The main change arising from this Standard is the requirement for entities to group items presented in other comprehensive income (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently.

  This Standard affects presentation only and is therefore not expected to significantly impact the Group.

– AASB 119: Employee Benefits (September 2011) and AASB 2011–10: Amendments to Australian Accounting Standards arising from AASB 119 (September 2011) [AASB 1, AASB 8, AASB101, AASB124, AASB134, AASB1049 & AASB 2011–8 and Interpretation 14] (applicable for annual reporting periods commencing on or after 1 January 2013).

  These Standards introduce a number of changes to accounting and presentation of defined benefit plans. The Group does not have any defined benefit plans and so is not impacted by the amendment.

  AASB 119 (September 2011) also includes changes to the accounting for termination benefits that require an entity to recognise an obligation for such benefits at the earlier of:

  (i) for an offer that may be withdrawn – when the employee accepts;

  (ii) for an offer that cannot be withdrawn – when the offer is communicated to affected employees; and

  (iii) where the termination is associated with a restructuring of activities under AASB 137: Provisions, Contingent Liabilities and Contingent Assets, and if earlier than the first two conditions – when the related restructuring costs are recognised.

  The Group has not yet been able to reasonably estimate the impact of these changes to AASB 119.

## NOTE 29: PARENT INFORMATION

The following information has been extracted from the books and records of the parent and has been prepared in accordance with Australian Accounting Standards.

| | 30 June 2012<br>$ | 30 June 2011<br>$ |
|---|---|---|
| **STATEMENT OF FINANCIAL POSITION** | | |
| **ASSETS** | | |
| Current assets | 11,889,001 | 16,880,201 |
| Non-current assets | 1,029,701 | 1,123,165 |
| **TOTAL ASSETS** | 12,918,702 | 18,003,366 |
| **LIABILITIES** | | |
| Current liabilities | 2,310,008 | 969,930 |
| Non-current liabilities | 164,924 | - |
| **TOTAL LIABILITIES** | 2,474,932 | 969,930 |
| **NET ASSETS** | 10,443,770 | 17,033,436 |
| **EQUITY** | | |
| Contributed equity | 39,740,331 | 39,525,004 |
| Reserves | 123,998 | 356,799 |
| Accumulated losses | (29,420,559) | (22,848,367) |
| **TOTAL EQUITY** | 10,443,770 | 17,033,436 |
| **STATEMENT OF COMPREHENSIVE INCOME** | | |
| Total losses after income tax benefit | (6,794,515) | (5,340,548) |
| Total comprehensive income | (6,794,515) | (5,340,548) |

*Guarantees*

Tissue Therapies Limited has not entered into any guarantees, in the current or previous financial year, in relation to the debts of its subsidiary.

*Contingent Liabilities*

For information relating to contingent liabilities, refer to Note 21: Contingent Liabilities and Contingent Assets.

*Contractual Commitments*

For information relating to contractual commitments, refer to Note 20: Commitments for Expenditures.

## NOTE 30: CONTROLLED ENTITY

Tissue Therapies Europe Limited ("the Subsidiary"), a wholly owned subsidiary was formed on 23rd January 2012, based in United Kingdom, to provide administration support to Tissue Therapies Limited ("the Parent Entity).

## NOTE 31: COMPANY DETAILS

The registered office and the principal place of business of the Company is:

Tissue Therapies Limited
Level 19
179 Turbot Street
BRISBANE QLD 4000
Australia

## DIRECTORS' DECLARATION

In accordance with a resolution of the directors of Tissue Therapies Limited declare that:

1. the financial statements and notes, as set out on pages 12 to 43, are in accordance with the *Corporations Act 2001* and:
   a. comply with Australian Accounting Standards, which, as stated in accounting policy Note 1 to the financial statements, constitutes compliance with International Financial Reporting Standards (IFRS); and
   b. give a true and fair view of the financial position as at 30 June 2012 and of the performance for the year ended on that date of the consolidated group;
2. in the directors' opinion there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable; and
3. the directors have been given the declarations required by s 295A of the *Corporations Act 2001* from the Chief Executive Officer and Chief Financial Officer.

**Roger Clarke**
**Chairman**
Brisbane, 21 August 2012

**Steven Mercer**
**CEO & Director**

lawler hacketts chartered accountants

# INDEPENDENT AUDITOR'S REPORT
# TO THE MEMBERS OF TISSUE THERAPIES LIMITED

Brisbane
Rockhampton
Sydney
Melbourne
Newcastle

## Report on the Financial Report

We have audited the accompanying financial report of Tissue Therapies Limited which comprises the consolidated statement of financial position as at 30 June 2012, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the Directors' declaration of the consolidated entity comprising the company and the entity it controlled at the year's end or from time to time during the financial year.

### *Directors' Responsibility for the Financial Report*

The Directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the Directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the Directors also state, in accordance with Accounting Standard AASB 101: *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

### *Auditor's Responsibility*

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Independence*

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

### *Opinion*

In our opinion:

a) the financial report of Tissue Therapies Limited is in accordance with the *Corporations Act 2001*, including:
   i. giving a true and fair view of the consolidated entity's financial position as at 30 June 2012 and of their performance for the year ended on that date; and
   ii. complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and

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

### *Emphasis of Matter*

Without qualification to the opinion expressed above, attention is drawn to the following matter. As a result of the matters described in Note 1(r) to the financial statements, there is uncertainty as to whether the carrying value of finished goods of VitroGro® ECM as at 30 June 2012 is recoverable.

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## INDEPENDENT AUDITOR'S REPORT
## TO THE MEMBERS OF TISSUE THERAPIES LIMITED
## (continued)

**Report on the Remuneration Report**

We have audited the Remuneration Report included in pages 7 to 9 of the Directors' Report for the year ended 30 June 2012. The Directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with Section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

*Opinion*

In our opinion the Remuneration Report of Tissue Therapies Limited for the year ended 30 June 2012, complies with section 300A of the *Corporations Act 2001*.

Lawler Hacketts

**Lawler Hacketts Audit**

Brisbane, 21 August 2012

**L J Murphy**
**Partner**