

Phylogica Limited

ACN 098 391 961

Financial Report

30 June 2011

Corporate Information

Directors

Dr Doug Wilson
Executive Chairman

Mr Bruce McHarrie
Non-Executive Director

Mr Nick Woolf
Executive Director

Dr Paul Watt
Executive Director

Company Secretary

Mr Graeme Boden
Telephone: 08 9380 6261
Facsimile: 08 9382 1766
Email: gboden@bigpond.net.au

Share Registry

Security Transfer Registrars Pty Ltd
PO Box 535
Applecross
Western Australia 6953
770 Canning Highway
Applecross
Western Australia 6153
Telephone: 08 9315 2333
Facsimile: 08 9315 2233
Email: registrar@securitytransfer.com.au

Bankers

Australia and New Zealand Banking Group
Subiaco Branch
464 Hay Street
Subiaco
Western Australia 6008

Auditors

HLB Mann Judd
Level 4
130 Stirling Street
Perth
Western Australia 6000

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Postal Address

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Western Australia 6008

Principal Place of Business

Telethon Institute for Child Health Research
100 Roberts Road
Subiaco
Western Australia 6008
Telephone: 08 9489 7777
Facsimile: 08 9489 7700

Website

www.phylogica.com

Incorporated in Western Australia, October 2001
Listed on:

Australian Securities Exchange (ASX)
Home Exchange: Perth
Code: PYC ordinary shares

Frankfurt Exchange
Code: PH7 ordinary shares

Phylogica Limited Directors' Report For the year ended 30 June 2011

The directors present their report on the consolidated group, comprising Phylogica Limited (referred to in these financial statements as "the Group" or "Phylogica") and its wholly owned subsidiary, together with the financial report for the year ended 30 June 2011 and the audit report thereon.

1. Directors

The Directors of the Company at any time during or since the end of the year are:

Non-Executive

	Age	
Mr Bruce McHarrie BCom FCA Non-Executive Director	53	Appointed 9 August 2002. Current term ends November 2013. Mr McHarrie has been in the biotechnology industry for over 15 years. Currently he is the Director of Finance and Business Development at the Telethon Institute for Child Health Research (the Institute), responsible for the executive management of the Institute with a particular focus on commercialisation activities. Mr McHarrie joined the Institute in 1999 after returning to Perth from the United Kingdom where he was Assistant Director in the Bioscience Unit at Rothschild Asset Management. The Bioscience Unit focused on investing in biotechnology and healthcare companies from the early start-up stage through to the publicly listed stage. In this capacity Mr McHarrie was invited to join the board of a number of United Kingdom based biotechnology companies. Prior to joining Rothschild Asset Management, Mr McHarrie was with Coopers and Lybrand in London servicing a client base primarily in the financial services industry. He holds a Bachelor of Commerce Degree from the University of Western Australia and qualified as a Chartered Accountant with Deloitte.
Mr Anthony Barton B.Bus (Accountancy) Non-Executive Director	54	Appointed 22 May 2009. Resigned 13 July 2010. Mr Barton has been involved in founding and growing a number of successful listed public companies. Mr Barton has extensive experience in capital markets, corporate finance, funds management and venture capital. Mr Barton has had advisory roles in the incorporation and listing of many Australian based companies, including Mineral Securities Limited, Panormanic Resources Ltd and CopperCo Limited.
Mr Harry Karelis BSc(Hons) MBA F.Fin CFA FAICD Non-Executive Deputy Chairman	42	Appointed 25 January 2005. Resigned 6 December 2010. Mr Karelis is the founder and Managing Director of Titan BioVentures Management Pty Ltd. Titan is the investment manager of BioTech Capital Ltd. Mr Karelis has led investments in drug discovery, regenerative medicine, medical devices and several other technology platform areas.

Executive

Dr Paul Watt BSc(Hons) D Phil Executive Director Chief Executive Officer	46	Appointed 9 August 2002. Current term ends November 2011. Dr Watt is a leading graduate from The University of Western Australia. He completed his doctorate in Molecular Biology at Oxford University before taking up postdoctoral appointments in yeast genetics at Harvard and Oxford Universities. Working in
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Directors' Report (Cont.)
For the year ended 30 June 2011

		<p>genomic instability and cancer research, Dr Watt discovered three novel genes, including the yeast homologue of the human Bloom's and Werner's syndrome genes involved in cancer susceptibility</p> <p>As an Honorary Research fellow at the Telethon Institute for Child Health Research, Dr Watt was appointed Adjunct Professor at the school of Paediatrics and Child Health of the University for Western Australia. Dr Watt has published more than 45 peer reviewed scientific papers..</p> <p>Dr Watt has more than 12 years experience in commercialising intellectual property and is the primary inventor on 20 patents, Dr Watt founded InfaMed Ltd., now owned by Avita Medical Ltd, which is commercialising a drug delivery device, which he developed for asthmatic children. This device has received US regulatory clearance from the FDA, is CE marked and is currently marketed in Australia and overseas.</p>
<p>Mr Nick Woolf MA (Oxon) FCCA Executive Director Vice President Corporate Development Chief Financial Officer</p>	<p>43</p>	<p>Appointed as a Non-Executive Director on 22 April 2010 and transitioned to Executive Director on 8 October 2010. Current term ends November 2013.</p> <p>Mr Woolf is an accomplished biotechnology professional with 18 years' experience in the industry, equity research and investment banking. He was formerly Chief Business Officer and Executive Director of Oxford BioMedica, a London-listed biotechnology company. Previously, he was Head of European Biotechnology Research at ABN Amro and he has held similar roles at Robertson Stephens, Nomura and SBC Warburg. Mr Woolf is a qualified accountant and has an MA in Chemistry from the University of Oxford.</p>
<p>Dr Doug Wilson MB, ChB, FRACP, FRCPA Executive Chairman</p>	<p>74</p>	<p>Appointed 10 December 2007. Current term ends November 2012.</p> <p>A New Zealand medical graduate with post graduate experience in London at St Thomas Hospital Medical School, and at Walter and Eliza Hall Institute Melbourne.</p> <p>Joined the international pharmaceutical industry and became Senior Vice president for Boehringer Ingeleim for Medicine and regulatory affairs in the USA responsible for all dealings with FDA.</p> <p>Moved to Ingelheim and had the same responsibilities world wide. Headed the company's International Labelling Committee, deputy head of the International Medical Committee which oversaw all drugs in clinical development globally. During his tenure he saw ten drugs approved in the USA.</p> <p>Is now a consultant and is on the board of Neuren Pharmaceuticals and other companies and consults widely on biotech and pharmaceutical issues.</p>

Unless otherwise indicated, all Directors held their position as a Director throughout the entire year and up to the date of this report.

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Directors' Report (Cont.)
For the year ended 30 June 2011

2. Company Secretary

	Age	
Mr Graeme Boden Company Secretary	62	Mr. Boden is an experienced business executive with more than 30 years in senior corporate or financial roles, particularly in the planning and evaluation function of the resources industry and in the finance and administration function of a range of industries, including biotechnology, medical devices and pharmaceuticals. He has more than 25 years experience as a Director or Secretary of ASX listed companies.

3. Directors' Meetings

The number of directors' meetings (including meeting of committees of directors) and the number of meetings attended by each of the directors of the company during the financial year are:

	Directors' Meetings		Audit Committee		Nomination Committee		Remuneration Committee	
	A	B	A	B	A	B	A	B
H Karelis	5	4	1	1	-	-	-	-
B McHarrie	9	9	2	2	-	-	1	1
A Barton	1	1	-	-	-	-	-	-
N Woolf	9	9	-	-	-	-	1	1
P Watt	9	9	-	-	-	-	-	-
D Wilson	9	8	1	1	-	-	1	1

A = Number of Meetings held while in office

B = Meetings attended

4. Principal Activities

The principal activity of the Company during the financial year was the provision of drug discovery services to the international pharmaceutical industry utilising the Company's Phylomer® peptide libraries and proprietary screening capabilities.

5. Operating Results

The consolidated operating loss after tax for the financial year ended on 30 June 2011 was \$3,605,169 (2010 loss: \$4,572,825).

The accounting standards do not permit the capitalisation of research and development expenditure in circumstances where the company cannot demonstrate sustainable revenue generation derived from the results of the expenditure. The expenditure incurred in relation to obtaining and maintaining patent protection is allowed to be capitalised under the standards but the Company has adopted a policy of expensing such expenditure as it is incurred.

Since incorporation, Phylogica has raised \$32.4 million in capital, reduced to \$30.4 million after netting capital raising fees. From this amount the following expenditures have been undertaken (all amounts \$ million):

	<u>Prior to 2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
Research & Development:				
Contract Research	6.71	1.89	2.25	10.85
Personnel (allocation)	3.27	0.67	0.75	4.69
Laboratory Consumables	1.51	0.81	0.50	2.82
	11.49	3.37	3.50	18.36
IP Maintenance	1.62	0.31	0.29	2.22
	13.11	3.68	3.79	20.58

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Directors' Report (Cont.)
For the year ended 30 June 2011

Hence, if the company had been able to capitalise research and development expenditure, in a manner similar to that in which mining companies capitalise exploration expenditure, the net assets of the company would be as set out below.

	2010		2011	
	\$ million	Cents/ Share	\$ million	Cents/ Share
Reported Net Assets	(0.44)	(0.2)	4.35	1.5
Research & Development	14.86	6.6	18.36	6.3
	14.42	6.4	22.71	7.8

The situation with IP maintenance is not as clear as only expenditures on currently held patents could be capitalised and the expenditures would need to be amortised over the patent life.

6. Review of Operations, likely Developments and Expected Results

In the year ended 30 June 2011, Phylogica Limited made significant progress in the implementation of its discovery alliance strategy to drive revenue growth. This is reflected by the substantial growth in the Company's commercial income and narrowing of its net loss versus the previous year. Phylogica's business is such that future performance will depend upon signing new drug discovery alliances with the pharmaceutical industry and also the progress of the Company's existing partnerships. Expenditure continues to be in line with budget.

Highlights of the period include:

- Commercial income for the year ended 30 June 2011 increased by more than 400% to \$2,188,190 versus \$433,120 in the previous year.
- Net loss for the year ended 30 June 2011 narrowed to \$3,605,169 versus \$4,572,825 in the previous year.
- Entered a collaboration and licensing agreement with MedImmune, the worldwide biologics unit of AstraZeneca, to discover novel antibiotics targeting one of the most common causes of hospital-acquired infections utilising the Phylomer® platform.
- Signed a collaboration and licensing agreement with Pfizer to discover novel peptide-based vaccines utilising the Phylomer® drug discovery platform to identify peptides suitable for further evaluation.
- Successfully met the objectives in the first stage of the research collaboration with Roche to identify novel cell-penetrating peptides for targeting intracellular disease pathways from Phylogica's Phylomer® libraries.
- Entered an extended agreement with Roche, following the initial success, granting Roche an option to license a specific Phylomer peptide with demonstrated cell penetration activity for application to delivery across the blood-brain barrier.
- Established new spin-off company called Phenomica with the University of Cambridge to pursue a novel application of Phylogica's Phylomer® peptides for discovery of disease-associated targets. Phenomica offers the potential to secure new revenue streams that would otherwise not be accessible to Phylogica.
- Entered collaborations with Pepscan Therapeutics and XL-Protein to access complementary technologies for optimising and enhancing Phylomer® drug candidates.
- Advanced discussions with other large pharmaceutical regarding new alliances utilising Phylogica's Phylomer® drug discovery platform.
- Successfully completed a Rights Issue and a Share Placement raising total gross proceeds of \$7.6 million. The Share Placement was corner-stoned by US biotech fund, Ascent BioMedical Holdings.
- Strengthened the Board with the appointment of Mr Nick Woolf, an experienced international biotech professional, as Chief Financial Officer and Vice President of Corporate Development.

Phylogica Limited

Directors' Report (Cont.)

For the year ended 30 June 2011

The Directors have not provided specific guidance on the Company's future performance due to the uncertainty and commercial sensitivity of its existing and prospective partnerships with pharmaceutical companies. However, the Directors have indicated their objective that the Company achieve cash sustainability in the next one to two years from continued growth of the Company's discovery alliance business.

7. Significant Changes in the State of Affairs

In October 2010 Phylogica completed a fully underwritten renounceable rights issue to raise \$2,357,517 by the issue of 47,150,353 shares at an issue price of \$0.05 per share and one free attaching option per share exercisable at \$0.15 on or before 31 August 2011.

At the annual general meeting of shareholders held 30 November 2010, shareholders approved the conversion of a loan from Mr N Woolf into shares at the market price resulting in the issue of 524,500 shares at an issue price of \$0.08 per share. In addition, shareholders approved the issue of 1,500,000 options to Dr P Watt and 500,000 options to Dr D Wilson, all vesting on issue with an exercise price of \$0.075 and expiring on or before 31 March 2013. Shareholders also approved the issue of 1,400,000 options to Mr N Woolf, with 50% vesting on 22 April 2010 and 50% vesting on 22 April 2011, with an exercise price of \$0.075 and expiring on or before 31 March 2013.

In May 2011 the Company completed a two-tranche placement of 88,135,594 shares at \$0.059 per share and one free attaching option for every two shares, exercisable at \$0.09 on or before 30 June 2016 to international institutional and sophisticated investors to raise \$5,200,000.

On 31 April 2011, \$1,340,000 convertible notes issued during 2009 and 2010 matured and on that date were converted to shares at \$0.04 per share resulting in the issue of 33,500,000 shares (see note 14).

8. Dividends

No dividends have been paid or declared by the Company since the end of the previous financial year.

9. Events Subsequent to Reporting Date

On 31 July 2011, 400,000 unlisted options, exercisable at \$0.25 expired unexercised.

During August 2011, 160,065 ordinary shares were issued after the exercise of options by payment of \$24,010 to the Company. The remaining 46,990,288 options exercisable at \$0.15 lapsed unexercised on the expiry date 31 August 2011.

10. Directors' Interests

The relevant interest of each director in the shares and options over shares issued by Phylogica as notified by the directors to the Australian Securities Exchange in accordance with S205G(1) of the Corporations Act 2001, at the date of this report is as follows:

	Ordinary Shares	Options
D Wilson	250,000	1,118,337
B McHarrie	2,304,576	752,797
N Woolf	1,971,956	1,823,728
P Watt	6,793,730	5,487,767

11. Indemnification and Insurance of Directors and Officers

11.1 Directors' and officers' indemnity

The Group has agreed to indemnify each Director and the Company Secretary (Officers) against all liabilities or loss (other than the Group or a related body corporate) that may arise from their position as Officers of the Group and its controlled entities, except where the liability arises out of conduct involving a lack of good faith, or

Phylogica Limited

Directors' Report (Cont.)

For the year ended 30 June 2011

indemnification is otherwise not permitted under the Corporations Act. The indemnity stipulates that the Group will meet the full amount of any such liabilities, including costs and expenses, and covers a period of seven years after ceasing to be an Officer of the Group.

The Group has also indemnified the current directors and certain members of its senior management for all liabilities and loss (other than the Group or a related body corporate) that may arise from their position, except where the liability arises out of conduct involving lack of good faith or indemnification is otherwise not permitted under the Corporations Act.

The Group has executed deeds of indemnity, access and insurance in favour of each Officer of the Group.

11.2 Directors' and officers' insurance

The Group has paid insurance premiums for one year cover in respect of directors' and officers' liability insurance contracts, for Officers of the Group. The insurance cover is on standard industry terms and provides cover for loss and liability for wrongful acts in relation to the relevant person's role as an Officer, except that cover is not provided for loss in relation to Officers gaining any profit or advantage to which they were not legally entitled, or Officers committing any criminal, dishonest, fraudulent or malicious act or omission, or any knowing or wilful violation of any statute or regulation. Cover is also only provided for fines and penalties in limited circumstances and up to a small financial limit.

The insurance does not provide cover for the independent auditors of the Group or of a related body corporate of the Group.

In accordance with usual commercial practice, the insurance contract prohibits disclosure of details of the nature of the liabilities covered by the insurance, the limit of indemnity and the amount of the premium paid under the contract.

12. Non-Audit Services

During the year, HLB Mann Judd, the Group's auditor, has performed certain other services in addition to their statutory duties.

The board has considered these non-audit services and is satisfied that their provision by the auditor is compatible with and did not compromise the auditor independence requirements of the Corporations Act 2001 because the services provided do not undermine the general principles relating to auditor independence, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company, or jointly sharing in risks and rewards.

Details of the amounts paid or payable to HLB Mann Judd and its related practices for audit and non-audit services provided during the year are set out below.

	\$
Audit and review of financial reports	31,550
Government grant audit services	1,000

13. Interests in Contracts or Proposed Contracts with the Company

There are no contracts or proposed contracts with the Company in which any director has an interest, other than the following.

- A contract of executive employment for Mr N Woolf.
- A contract of executive employment for Dr P Watt.
- A service contract with Mainz Consulting in relation to the executive services of Dr D Wilson.

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Directors' Report (Cont.)
For the year ended 30 June 2011

14. Unissued Shares under Option

At the date of this report, ordinary shares of the Company under option totalled 66,161,466 exercisable at various dates on or before 31 March 2016 (2010: 15,256,164 options exercisable at various dates on or before 31 March 2016).

Number of options	Exercisable at \$0.075	Exercisable at \$0.09	Exercisable at \$0.10	Total
Issued	19,593,664	44,067,802	2,500,000	66,161,466
Vested	18,893,664	44,067,802	2,500,000	65,461,466

These options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

15. Environmental Regulation and Performance

The Company does not hold any permits in relation to environmental discharge and does not handle or store hazardous materials.

16. Nomination Committee

The full Board carries out the function of the nomination committee. During the reporting period, the Board did not make any decisions regarding its composition.

17. Audit Committee

The audit committee during the year was comprised of:

Mr B McHarrie (Chairman)
Dr D Wilson (appointed 6/12/2010)
H Karelis (resigned 6/12/2010)

The audit committee met twice during the reporting period and both committee members were present.

The members of the audit committee possess financial expertise by virtue of their academic qualifications or career history in executive roles. Details of their qualifications and experience are set out earlier in the Directors' report.

18. Remuneration Committee

The remuneration committee reviews and makes recommendations to the board on remuneration arrangements and policies applicable to the executive officers of the company and directors themselves. Its responsibility includes employee share option plan administration and entitlements and incentive performance arrangements.

Details of remuneration, including the Company's policy on remuneration, are contained in the "Remuneration Report" which forms part of the Directors' report.

The members of the remuneration committee during the year were:

Mr B McHarrie - Non-Executive
Dr D Wilson - Executive
Mr N Woolf - Executive

The remuneration committee met once during the year. The committee members' attendance record is disclosed in the table of directors' meetings on page 3.

The remuneration committee charter is available on the company's website.

Phylogica Limited
Directors' Report (Cont.)
For the year ended 30 June 2011

19. Other

19.1 Skills, experience, expertise and term of office of each director

A profile of each director containing the skills, experience, expertise and term of office of each director is set out earlier in the Directors' report.

19.2 Identification of independent directors

In considering independence of directors, the Board refers to the criteria for independence as recommended by ASX. To the extent that it is necessary for the Board to consider issues of materiality, the Board refers to the thresholds for qualitative and quantitative materiality as adopted by the Board and contained in the Statement of Board and Management Functions, which is disclosed in full on the Company's website.

Applying the independence criteria, none of the present directors are classified as independent.

19.3 Statement concerning availability of independent professional advice

If a director considers it necessary to obtain independent professional advice to properly discharge the responsibility of his office as a director, then, provided the director first obtains approval for incurring such expense from the chairperson, the Company will pay the reasonable expenses associated with obtaining such advice.

19.4 Confirmation whether performance evaluation of the Board and its members have taken place and how conducted

No evaluation of the performance of the board and its members was carried out during the reporting period. Subsequent to the end of the reporting period an evaluation has been conducted. The evaluation process was an internal self- assessment based on questions and analysis of answers with round table discussions. All members of the Board participated in the assessment.

19.5 Existence and terms of any schemes for retirement benefits for non-executive directors

There are no terminations or retirement benefits for non-executive directors, other than the statutory superannuation contribution paid in relation to directors' fees.

20. Remuneration Report - Audited

Remuneration is referred to as compensation throughout this report.

20.1 Principles of compensation

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Company, including directors of the Company and other executives. Key management personnel includes all S300A directors and one of the most highly remunerated executives for the Company.

Compensation levels for key management personnel of the Company are set competitively to attract and retain appropriately qualified and experienced directors and senior executives. The remuneration committee has researched information from companies of similar size or stage of development in the technology sector to assess the level of compensation which would be competitive, receiving this information by way of a report from independent remuneration consultants.

The compensation structures for executives are designed to attract suitably qualified candidates, reward the achievement of strategic objectives and achieve the broader outcome of the creation of value for shareholders. The compensation structures take into account the executives' capability and experience, level of responsibility and ability to contribute to the Company's performance, including, in particular, the establishment of revenue streams and growth in the Company's share price.

Phylogica Limited
Directors' Report (Cont.)
For the year ended 30 June 2011

Compensation packages include a mix of fixed and variable compensation and short-and long-term performance based incentives.

20.2 Fixed remuneration

Fixed compensation consists of a base salary (calculated on a total cost basis, including any fringe benefits tax related to employee benefits) as well as employer contributions to superannuation funds.

Compensation levels are reviewed annually by the remuneration committee through a process that considers individual and company achievement.

20.3 Performance linked remuneration

Performance linked compensation includes short term incentives (STI), in the form of cash bonuses paid upon the achievement of predetermined Key Performance Indicators (KPI), and long term incentives (LTI) provided as options over ordinary shares in the Company under the rules of the Employee Share Option Plan or as shares under a Loan Funded Share Plan. In the case of Executive Directors, the number and conditions of the options or loan funded shares are approved by the shareholders in general meeting.

20.4 Short term incentive bonus (STI)

The remuneration committee has set KPIs in conjunction with each of the Executive Directors and senior management.

Each of the Company's employees is set KPIs and a bonus is payable on achievement of these KPIs. This is either an amount equal to between 5% and 25% of the base salary or a fixed sum per KPI determined at the beginning of the financial year. The objectives include such targets as successful negotiation of commercial deals; delivering on the research objectives specified by a pharmaceutical customer; achieving project milestones for internal programmes; publications of significance in scientific journals; and successful fund raising.

At the end of the year, the remuneration committee assesses the extent to which KPIs have been achieved and the aggregate achievement of all set KPIs for the individual to determine the bonus to be paid.

For the 2011 financial year, the payment of bonuses was made during August 2011.

20.5 Long term incentives (LTI)

The Employee Share Option Plan (ESOP) was established during the 2006 financial year and is open to all employees. The ESOP was renewed at the annual general meeting held 30 November 2010. Options are granted for no consideration and have a three year term. One half of those options allocated will vest immediately and, unless agreed by the Directors, one half will vest on the subsequent anniversary of issue.

During June 2011 the Board resolved to implement a Loan Funded Share Plan ("Plan") for Key Management Personnel. Participants will acquire ordinary shares at market value and the purchase price of the shares will be 100% funded by a loan provided by the Company. Repayment of the loan will be made from sale of the shares and the recourse for repayment will be limited to the shares. The shares will be subject to vesting conditions which will, in turn, be subject to continuing employment with the Company. If the vesting conditions are not met, the Plan shares will be reacquired by the Company and the loan offset against the share value so the participants receive no benefit from the Plan for unvested shares. The Company will seek approval of the Loan Funded Share Plan at the annual general meeting of shareholders to be held in November 2011.

20.6 Short-term and long-term incentive structure

The Company has not established a causal relationship between compensation structure and shareholder returns. The remuneration committee and the directors consider that the Company's progress to date and external remuneration levels provide support for the premise that the compensation structure is appropriate, given the objectives set out earlier in this report.

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Directors' Report (Cont.)
For the year ended 30 June 2011

20.7 Consequences of performance on shareholders' wealth

The Board has regard to a broad range of factors in considering the Company's performance and how best to generate shareholder value. These include financial factors, securing new drug discovery partnerships and others that relate to meeting the objectives of existing discovery alliances, scientific progress of the Company's in-house projects, grants awarded, staff development etc. The Board has some but not absolute regard to the Company's result and cash consumption during the year. It does not utilise earnings per share as a performance measure nor does it contemplate consideration of any dividends in the short to medium term, given that efforts are being expended to build the business and generate self-sustaining revenue streams. The Company is of the view that any adverse movement in the Company's share price should not be taken into account in assessing the performance of employees, unless such a measure is agreed with the executive as a KPI.

20.8 Service agreements

At 30 June 2011, the three senior executives of the Company who are full time employees, had conditions of employment as set out below. Subsequent to year end, these three employees have had contracts renewed until 30 June 2014. Either party may terminate their agreement without cause by giving written notice of three months. There is no termination fee payable other than during the term of notice.

Name	Dr Paul Watt	Mr Nicholas Woolf	Dr Richard Hopkins
Position	Chief Executive Officer	Chief Financial Officer	Chief Operations Officer
Term Expiring	30 June 2012	8 October 2011	30 June 2012
Package	\$300,000 pa	\$210,000 pa	\$210,000 pa
Bonus	\$75,000	\$52,500	\$52,500
Shares¹	9,000,000	6,000,000	6,000,000
Options²	1,500,000	1,400,000	1,000,000

- 1 Proposed Loan Funded Shares to be issued after approval at the annual general meeting to be held in November 2011. Please refer to note 18.
- 2 The options were issued subsequent to shareholder approval obtained on 30 November 2010. The options were issued with an exercise price of \$0.075 and an expiry date of 31 March 2013.

Dr Doug Wilson, the Executive Chairman is a contractor and was paid a fixed fee of \$A8,333 per month during 2011, increased to \$A10,000 per month from 1 July 2011.

The Company Secretary is a contractor with no financial commitment by the Company other than payment of a monthly fee for services rendered.

20.9 Non-executive directors

The aggregate remuneration of all non-executive directors was set at \$200,000 per annum at the annual general meeting held on 26 November 2004. The base fee for a non-executive director had been \$25,000 per annum from that time, and was increased to \$40,000 per annum with effect from 1 July 2011. The Company makes contributions at the statutory minimum rate to superannuation funds nominated by directors, in addition to the base fee.

Directors' fees cover all main board activities and committee memberships.

20.10 Equity Instruments

20.10.1 Options

All options refer to options over ordinary shares of Phylogica Limited which are exercisable on a one for one basis.

(a) Options and rights over equity instruments granted as compensation

During the reporting period 4,400,000 options over ordinary shares in the Company were granted as compensation to key management personnel.

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Directors' Report (Cont.)
For the year ended 30 June 2011

Details of options that vested during the reporting period are as follows:

Directors	Number of options outstanding at 30 June 2011	Grant date	Fair value per option at grant date (\$)	Exercise price per option (\$)	Expiry date	Number of options vested during 2011
Mr B McHarrie	368,700 (1)	30 September 2009	0.047	0.075	31 March 2012	-
Dr D Wilson	500,000 (1)	30 November 2010	0.024	0.075	31 March 2013	500,000
Dr D Wilson	300,000 (2)	26 November 2008	0.016	0.250	31 July 2011	-
Dr D Wilson	618,337 (1)	30 September 2009	0.047	0.075	31 March 2012	-
Dr P Watt	1,500,000 (1)	30 November 2010	0.024	0.075	31 March 2013	1,500,000
Dr P Watt	3,000,000 (1)	30 September 2009	0.059	0.075	31 March 2012	-
Mr N Woolf	1,400,000 (3)	30 November 2010	0.024	0.075	31 March 2013	700,000
Executives						
Dr R Hopkins	1,000,000 (1)	17 December 2010	0.015	0.075	31 March 2013	1,000,000
Dr R Hopkins	750,000 (1)	31 March 2009	0.023	0.075	31 March 2012	-

Directors	Number of options outstanding at 30 June 2010	Grant date	Fair value per option at grant date (\$)	Exercise price per option (\$)	Expiry date	Number of options vested during 2010
Mr B McHarrie	368,700 (1)	30 September 2009	0.047	0.075	31 March 2012	368,700
M H Karelis	368,700 (1)	30 September 2009	0.047	0.075	31 March 2012	368,700
Dr D Wilson	300,000 (2)	26 November 2008	0.016	0.250	31 July 2011	100,000
Dr D Wilson	618,337 (1)	30 September 2009	0.047	0.075	31 March 2012	618,337
Dr P Watt	3,000,000 (1)	30 September 2009	0.059	0.075	31 March 2012	3,000,000
Mr N Woolf	-	-	-	-	-	-
Executives						
Dr R Hopkins	750,000 (1)	31 March 2009	0.023	0.075	31 March 2012	375,000

(1) These options have been issued under the Company's Employee Share Option Plan (ESOP). They expire on the earlier of their expiry date or termination of the individual's employment. The options are exercisable at the discretion of the individual until they expire.

(2) These options expired unexercised on their expiry date of 31 July 2011. One third vested on grant in November 2008 and one third on each of the 31 July 2009 and 31 July 2010. Once vested, options are exercisable at the discretion of the individual until expiry.

(3) These options expire on 31 March 2013. One half vested on 22 April 2011 and the remaining half will vest 22 April 2012. Once vested, options are exercisable at the discretion of the individual until expiry.

Further details, including grant dates and exercise dates regarding options granted to executives under the ESOP are in note 19 to the financial statements. No options have been granted since the end of the year.

(b) Modification of terms of equity-settled share-based payment transactions

No terms of equity-settled share based payment transactions (including options granted as compensation to a key management person) have been altered or modified by the Company during the reporting period or the prior period.

(c) Exercise of options granted as compensation

During the reporting period, no options previously granted as compensation were exercised (2010: Nil).

(d) Analysis of options and rights over equity instruments granted as compensation

Details of vesting profiles of the options granted as remuneration to three executive directors of the Company and the named Company executive are detailed below:

Phylogica Limited
Directors' Report (Cont.)
For the year ended 30 June 2011

	Options Granted		Vested in year (%)	Forfeited in year (%)	Financial years in which grant vests	Value yet to vest	
	Number	Date				Minimum (\$)	Maximum (\$)
Directors							
Dr D Wilson	100,000	26 November 2008	-	-	1 July 2008	-	-
	100,000	26 November 2008	-	-	1 July 2009	-	-
	100,000	26 November 2008	-	-	1 July 2010	-	-
	309,168	30 September 2009	-	-	1 July 2009	-	-
	309,168	30 September 2009	-	-	1 July 2009	-	-
	500,000	30 November 2010	100	-	1 July 2010	-	-
Dr P Watt	1,500,000	30 September 2009	-	-	1 July 2009	-	-
	1,500,000	30 September 2009	-	-	1 July 2009	-	-
	1,500,000	30 November 2010	100	-	1 July 2010	-	-
Mr N Woolf	700,000	30 November 2010	100	-	1 July 2010	-	-
	700,000	30 November 2010	-	-	1 July 2011	13,317	13,317
Executives							
Dr R Hopkins	375,000	31 March 2009	-	-	1 July 2008	-	-
	375,000	31 March 2009	-	-	1 July 2009	-	-
	1,000,000	17 December 2010	100	-	1 July 2010	-	-

(e) Analysis of Movements in options

There were no movements during the reporting period of options over ordinary shares in the Company held by each Company director and other key management personnel, other than the grant of 4,400,000 options on 30 November 2010 to Dr P Watt (1,500,000), Dr D Wilson (500,000), Mr N Woolf (1,400,000) and Dr R Hopkins (1,000,000).

20.10.2 Loan Funded Share Plan

During June 2011 the Board resolved to implement a Share Funded Loan Plan ("Plan") for Key Management Personnel. Offers of allocations under the plan were made to three employees on 3 June 2011 and acceptances have been received from all three employees. It is proposed to seek approval for the Plan at the next general meeting and also for allocations to directors, P Watt and N Woolf.

Offers have been made as follows:

- a) Term of the loan: 7 years (3 June 2018) or cessation of employments, whichever is earlier.
- b) Purchase price of shares funded by loan is 6.4 cents.
- c) 33% of the shares will vest on 3 June 2014, 33% on 3 June 2015 and 34% on 3 June 2016.
- d) Allocations have been made to:

Dr P Watt: 9,000,000 shares, \$576,000 loan
Mr N Woolf: 6,000,000 shares, \$384,000 loan
Dr R Hopkins 6,000,000 shares, \$384,000 loan

Valuations of these shares at 3 June 2011, using the Black & Scholes option pricing algorithm gives a total of \$910,000, which would be amortised over the vesting period as a share based payment. This means that the first charge as remuneration of these executives will occur during the 2011-12 financial year, assuming that the Plan and the director allocations are approved by shareholders at the 2011 annual general meeting.

20.11 Payments to persons before taking office

During the reporting period no payment was made to a person before the person took office as part of the consideration for the person agreeing to hold office.

20.12 Directors' and executive officers' remuneration

Details of the nature and amount of each major element of remuneration of each director and each of the three (in 2011) or three (in 2010) executives of the Company who receive the highest remuneration (Key Management Personnel) are as set out on the following two pages.

Phylogica Limited
Directors' Report (Cont.)
For the year ended 30 June 2011

(f) Directors' and executive officers' remuneration

Directors: <i>Non-Executive</i>	Year	Short Term Benefits		Total	Long Term Benefits	Post Employment Benefits	Share-Based Payments	Total	Proportion of remuneration performance related	Value of options as proportion of Remuneration
		Salary & Fees	Cash Bonus		Long Service Leave	Superannuation	Value of Options			
		\$	\$		\$	\$	\$			
Mr H Karelis (resigned 06/12/10)	2011	21,237	-	21,237	-	1,911	-	23,148	-	-
	2010	25,000	-	25,000	-	2,250	17,292	44,542	-	38.8
Mr B McHarrie	2011	25,000	-	25,000	-	2,250	-	27,250	-	-
	2010	25,000	-	25,000	-	2,250	17,292	44,542	-	38.8
Mr A Barton (resigned 13/07/10)	2011	2,271	-	2,271	-	-	-	2,271	-	-
	2010	27,250	-	27,250	-	-	-	27,250	-	-
Mr N Woolf	2011	-	-	-	-	-	-	-	-	-
(appointed 22/4/10 - executive from 08/10/10)	2010	5,147	-	5,147	-	-	-	5,147	-	-
Executive										
Dr P Watt - Chief Scientific Officer	2011	359,335	75,000	434,335	32,423	15,200	28,536	510,494	14.7	5.6
	2010	220,000	-	220,000	21,511	19,800	177,936	439,247	-	40.5
Mr N Woolf - Chief Financial Officer	2011	168,915	52,500	221,415	-	11,399	19,531	252,345	20.8	7.7
(appointed 22/4/10 - executive from 08/10/10)	2010	-	-	-	-	-	-	-	-	-
Dr D Wilson - Executive Chairman	2011	113,330	-	113,330	-	-	9,835	123,165	-	8.0
	2010	178,000	-	178,000	-	-	29,000	207,000	-	14.0
Management:										
Dr R Hopkins Chief Operating Officer	2011	222,500	52,500	275,000	13,818	15,200	11,808	315,826	16.6	3.7
	2010	160,000	-	160,000	10,775	14,400	6,399	191,574	-	3.3
Total Key Management Personnel	2011	912,588	180,000	1,092,588	46,241	45,960	69,710	1,254,499	14.3	5.5
	2010	640,397	-	640,397	32,286	38,700	247,919	959,302	-	25.8
Secretary:										
Mr G Boden (appointed 04/04/11) (3)	2011	27,656	-	27,656	-	-	-	27,656	-	-
	2010	-	-	-	-	-	-	-	-	-
Mr G MacMillan (resigned 04/04/11) (4)	2011	46,000	-	46,000	-	-	-	46,000	-	-
	2010	36,000	-	36,000	-	-	-	36,000	-	-

Phylogica Limited
Directors' Report
For the year ended 30 June 2011 (Cont.)

Notes in relation to the table of directors' and executive officers' remuneration

- 1) The fair value of the options is calculated at the date of grant using a Black-Scholes pricing model and allocated to each reporting period in accordance with the vesting profile of the options. The value recognised is the portion of the fair value of the options allocated to the reporting period. In valuing the options, market conditions have been taken into account.
- 2) The Company pays an insurance premium for company reimbursement and directors' and officers' liability insurance as a combined amount. The portion of the premium which relates to directors and officers has not been included as part of remuneration.
- 3) Payments made to Boden Corporate Services Pty Ltd (BCS) include time spent on Company activities, including accounting and administration by G Boden and other employees of BCS.
- 4) Payments made to GDM Services Pty Ltd (GDM) are for time spent on Company activities by G MacMillan.

20.13 Analysis of bonuses included in remuneration

Details of the vesting profile of the short-term incentive cash bonuses awarded as remuneration to each director of the Company and each of the named Company executives is detailed below.

Director	Included in remuneration \$ (A)	% vested in year	% forfeited in year (B)
Dr P Watt	75,000	100	-
Mr N Woolf	52,500	100	-
Executive			
Dr R Hopkins	52,500	100	-

- (A) Amounts included in remuneration for the financial year represent the amounts that vested during the financial year based on achievement of personal goals and satisfaction of specified performance criteria. No amounts vest in future years in respect of the bonus schemes for the 2011 and earlier financial years.
- (B) The amounts forfeited are due to the performance or service criteria not being met in relation to the current financial year.

21. Lead Auditor's Independence Declaration

The lead auditor's independence declaration is set out on page 15 and forms part of the Directors' report for the year ended 30 June 2011.

Signed in accordance with a resolution of the directors:



Nicholas Woolf
Director
Perth
27 September 2011

AUDITOR'S INDEPENDENCE DECLARATION

As lead auditor for the audit of the financial report of Phylogica Limited for the year ended 30 June 2011, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- a) the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- b) any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Phylogica Limited.



Perth, Western Australia
27 September 2011

N G NEILL
Partner

Phylogica Limited
Statement of Comprehensive Income
For the year ended 30 June 2011

	<i>Note</i>	Consolidated	
		2011	2010
		\$	\$
Continuing Operations			
Commercial income	<i>5(ii)</i>	2,188,190	433,120
Government grant income	<i>5(i)</i>	170,342	163,136
Net interest income		112,520	91,658
Contract research costs		(2,249,925)	(1,891,831)
Personnel expenses	<i>7</i>	(1,491,967)	(1,339,211)
Depreciation	<i>8</i>	(154,536)	(66,941)
Professional services		(687,930)	(415,768)
Travel and accommodation		(411,956)	(228,940)
Licenses		(10,000)	(17,449)
Intellectual property maintenance		(282,344)	(293,539)
Laboratory consumables		(496,381)	(808,188)
Occupancy costs		(35,877)	(24,110)
Other operating expenses		(255,305)	(174,762)
Loss before income tax expense		(3,605,169)	(4,572,825)
Income tax expense	<i>9</i>	-	-
Net loss for the period		(3,605,169)	(4,572,825)
Other comprehensive income for the period, net of tax		-	-
Total comprehensive loss for the period		(3,605,169)	(4,572,825)
Total comprehensive loss for the period attributable to the members of Phylogica Limited	<i>20(iii)</i>	(3,605,169)	(4,572,825)
		Cents	Cents
Basic earnings per share	<i>21</i>	(1.25)	(2.02)
Diluted earnings per share	<i>21</i>	(1.25)	(2.02)

This statement of comprehensive income is to be read in conjunction with the notes to the financial statements set out on pages 20 to 37.

Phylogica Limited
Statement of Financial Position
As at 30 June 2011

	<i>Note</i>	Consolidated	
		2011	2010
		\$	\$
Current assets			
Cash and cash equivalents		5,199,473	1,281,044
Trade and other receivables	10	112,844	124,417
Prepayments	11	62,216	-
Total current assets		5,374,533	1,405,461
Non-current assets			
Plant and equipment	12	286,544	164,579
Total non-current assets		286,544	164,579
Total assets		5,661,077	1,570,040
Current liabilities			
Trade and other payables	13	712,095	603,991
Interest-bearing liabilities	14	-	1,237,691
Employee benefits	19	546,598	95,303
Deferred government grants		-	44,727
Total current liabilities		1,258,693	1,981,712
Non-current liabilities			
Employee benefits	19	49,661	25,408
Total non-current liabilities		49,661	25,408
Total liabilities		1,308,354	2,007,120
Net assets/ (liabilities)	2(d)	4,352,723	(437,080)
Equity			
Issued capital	20(i)	30,367,388	21,973,323
Reserves	20(ii)	1,016,029	1,015,122
Accumulated losses	20(iii)	(27,030,694)	(23,425,525)
Total equity/ (deficiency)		4,352,723	(437,080)

This statement of financial position is to be read in conjunction with the notes to the financial statements set out on pages 20 to 37.

Phylogica Limited
Statement of Cash Flows
For the year ended 30 June 2011

	<i>Note</i>	Consolidated	
		2011	2010
		\$	\$
Cash flows from operating activities			
Commercial income received		2,188,190	433,120
Government grants received		158,668	204,947
Cash paid to suppliers and employees		<u>(5,398,786)</u>	<u>(4,480,722)</u>
Cash generated from operations		(3,051,928)	(3,842,655)
Interest received		109,331	90,893
Income taxes refunded		-	123,078
Net cash used in operating activities	22	<u>(2,942,597)</u>	<u>(3,628,684)</u>
Cash flows from investing activities			
Acquisition of property, plant and equipment	12	(193,039)	(158,780)
Proceeds from sale of property, plant and equipment		-	15,603
Net cash used in investing activities		<u>(193,039)</u>	<u>(143,177)</u>
Cash flows from financing activities			
Proceeds from the issue of convertible notes		-	100,000
Proceeds from the issue of share capital	20	7,609,478	2,000,000
Payment of transaction costs	20	(555,413)	(120,000)
Net cash from financing activities		<u>7,054,065</u>	<u>1,980,000</u>
Net increase/(decrease) in cash and cash equivalents		3,918,429	(1,791,861)
Cash and cash equivalents at 1 July		<u>1,281,044</u>	<u>3,072,905</u>
Cash and cash equivalents at 30 June		<u>5,199,473</u>	<u>1,281,044</u>

This statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 20 to 37.

Phylogica Limited
Statement of Changes in Equity
For the year ended 30 June 2011

		Consolidated			
<i>Note</i>	Issued Capital	Accumulated Losses	Reserves	Total	
	\$	\$	\$	\$	
Balance at 1 July 2009	20,093,323	(18,852,700)	670,621	1,911,244	
Loss attributable to members of the consolidated entity	-	(4,572,825)	-	(4,572,825)	
Other comprehensive income	-	-	-	-	
Total comprehensive income/(loss)	-	(4,572,825)	-	(4,572,825)	
Shares issued during the year	<i>20(i)</i> 2,000,000	-	-	2,000,000	
Share capital transaction costs	<i>20(i)</i> (120,000)	-	-	(120,000)	
Share-based payments	<i>20(ii)</i> -	-	454,399	454,399	
Convertible notes equity component	<i>20(ii)</i> -	-	(109,898)	(109,898)	
Balance at 30 June 2010	21,973,323	(23,425,525)	1,015,122	(437,080)	
Balance at 1 July 2010	21,973,323	(23,425,525)	1,015,122	(437,080)	
Loss attributable to members of the consolidated entity	-	(3,605,169)	-	(3,605,169)	
Other comprehensive income	-	-	-	-	
Total comprehensive income/(loss)	-	(3,605,169)	-	(3,605,169)	
Shares issued during the year	<i>20(i)</i> 8,949,478	-	-	8,949,478	
Share capital transaction costs	<i>20(i)</i> (555,413)	-	-	(555,413)	
Share-based payments	<i>20(ii)</i> -	-	103,216	103,216	
Convertible notes equity component	<i>20(ii)</i> -	-	(102,309)	(102,309)	
Balance at 30 June 2011	30,367,388	(27,030,694)	1,016,029	4,352,723	

This statement of changes in equity is to be read in conjunction with the notes to the financial statements set out on pages 20 to 37.

Phylogica Limited
Notes to the Financial Statements
For the Year Ended 30 June 2011

1. Reporting Entity

Phylogica is a Company domiciled in Australia. The financial report of the Consolidated Entity comprising the Company and its wholly owned subsidiary for the financial year ended 30 June 2011 was authorised for issue by the directors on 27 September 2011. The Company is primarily involved in the provision of peptide drug discovery services to the pharmaceutical industry.

2. Basis of Preparation

(a) Statement of Compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AAS's) which includes Australian equivalents to International Financial Reporting Standards (IFRS) adopted by the Australian Accounting Standards Board (AASB), and the Corporations Act 2001. Compliance with AIRFS ensures that the financial report, comprising the financial statements and notes thereto, complies with International Financial Reporting Standards (IFRS's).

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis and are presented in Australian dollars.

(c) Use of estimates and judgements

The preparation of a financial report requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The areas of estimation and uncertainty where judgement is used in applying accounting principles and where there may be an impact in the accounting revenue or expense are described in the following notes:

- Note 5(i) – government grant income, where the grant income for the succeeding quarter is shown on the statement of financial position as unearned income at balance date and relies upon satisfactory progress towards R&D milestones for the income to be earned. Amount at 30 June 2011 is nil to be earned (2010: \$44,727).
- Note 18(i) – share based payments which include projections of future values, amount expensed for 2011 is \$103,216 (2010: \$454,399).
- Note 16 – employee benefits, where the rate of pay may change between balance date and payment and where long service leave utilisation may change.

(d) Going Concern

The financial report has been prepared on a going concern basis which assumes the settlement of liabilities and the realisation of assets in the normal course of business. For the year ended 30 June 2011 the Company has incurred a loss of \$3,605,169 (2010: loss of \$4,572,825) and at year end the Company had a working capital of \$4,115,840 (2010: deficiency \$576,251) including a cash and cash equivalents balance of \$5,199,473 (2010: \$1,281,044). Cash used in operating activities in 2011 was \$2,942,597 (2010: \$3,628,684).

The Directors believe that it is appropriate to prepare the financial report on a going concern basis because:

- There is capacity for the Company to reduce its operating cost structure.
- Cash flow forecasts for the next twelve months demonstrate the ability of the Company to continue as a going concern on the basis that expected revenue is received and/ or further capital is raised.
- To the extent that further equity is required the Directors are confident that a sufficient capital raising can be completed.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

2. Basis of Preparation (Cont.)

(e) Basis of consolidation

The consolidated financial statements incorporate the assets and liabilities of the subsidiary of Phylogica Limited ('company' or 'parent entity') as at 30 June 2011 and the results of its subsidiary for the year then ended. Phylogica Limited and its subsidiary are referred to in this financial report as the Group or the consolidated entity.

The financial statements of the subsidiary are prepared for the same reporting period as the parent entity, using consistent accounting policies.

In preparing the consolidated financial statements, all intercompany balances and transactions, income and expenses and profit and losses resulting from intra-group transactions have been eliminated in full.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Control exists where the company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing when the Group controls another entity.

Unrealised gains or transactions between the Group and its associates are eliminated to the extent of the Group's interests in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

When the Group ceases to have control, joint control or significant influence, any retained interest in the entity is remeasured to its fair value with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint controlled entity or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

3. Significant accounting policies

(a) Foreign currency

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair value was determined.

(b) Property, plant and equipment

(i) Recognition and measurement

The Group holds no property. Items of plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses - see note 3(f). Cost includes expenditures that are directly attributable to the acquisition of the asset.

(ii) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. The Company has no finance leases. Leases other than finance leases are classified as operating leases and are accounted for as described in note 3(p).

(iii) Depreciation

Depreciation is charged to the statement of comprehensive income on a straight-line basis over the estimated

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

3. Significant accounting policies (Cont.)

useful lives of each part of an item of plant and equipment. The estimated useful lives in the current and comparative periods are as follows:

Office and research equipment 2-13 years

The residual value, depreciation method and useful lives if not insignificant, are reassessed annually.

(c) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the statement of comprehensive income as an expense as incurred. The Company does not currently undertake development activities as defined in AASB 138 *Intangible Assets* and therefore has not capitalised development expenditure.

(d) Trade and other receivables

Trade and other receivables are initially measured at fair value and are subsequently measured at their amortised cost less any impairment losses (see note 3(f)). Trade receivables are due for settlement in no more than 30 days and the notional amount is deemed to reflect fair value.

(e) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and short term deposits with an original maturity of three months or less.

(f) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost, the reversal is recognised in profit or loss.

(ii) Non- Financial Assets

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit"). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

(iii) Calculation of recoverable amount

The recoverable amount of non-financial assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

3. Significant accounting policies (Cont.)

(iv) Reversals of impairment

An impairment loss in respect of a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. In respect of other assets, an impairment loss is reversed if there has been a change in estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the asset's carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(g) Earnings per share

Basic earnings per share (EPS) is calculated by dividing the income or loss attributable to the members of the Company for reporting period, after exclusion of any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the half year, adjusted for any bonus elements.

Diluted EPS adjusts the figures used in the determination of basic EPS to take into account the after tax effect of interest recognised associated with the dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares adjusted for any bonus elements.

(h) Transaction costs

Transaction costs of an equity transaction are accounted for as a deduction from equity, net of any related income tax.

(i) Employee benefits

(i) Long-term service benefits

The Company's net obligation in respect of long-term service benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using expected future increases in wage and salary rates including related on-costs and expected settlement dates, and is discounted using the rates attached to the Commonwealth Government bonds at the reporting date which have maturity dates approximating to the terms of the Company's obligations.

(ii) Share based payment transactions

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

(iii) Wages, salaries, annual leave and non-monetary benefits

Liabilities for employee benefits for wages, salaries, annual leave and sick leave that are expected to be settled within 12 months of the reporting date represent present obligations resulting from employees' services provided to reporting date, are calculated at undiscounted amounts based on remuneration wage and salary rates that the Group expects to pay as at reporting date including related on-costs, such as workers compensation insurance and payroll tax.

No provision is made for non vesting sick leave as the anticipated pattern of future sick leave taken indicates that accumulated non-vesting sick leave will never be paid.

(iv) Defined contribution superannuation funds

Obligations for contributions to defined contribution superannuation funds are recognised as an expense in the statement of comprehensive income as incurred.

(j) Provisions

A provision is recognised in the statement of financial position when the Group has a present legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, when appropriate, the risks specific to the liability.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

3. Significant accounting policies (Cont.)

(k) Trade and other payables

Trade and other payables are initially recognised at fair value and are subsequently measured at their amortised cost. These amounts represent liabilities for goods and services provided to the Group prior to the end of the financial year which are unpaid. The amounts are unsecured and normally settled within 30 days of recognition.

(l) Revenue

Goods sold and services rendered

Revenues are recognised at fair value of the consideration received net of the amount of Goods and Services Tax (GST) payable to the taxation authority.

(m) Commercial income

Commercial income is recognised in the statement of financial position initially as deferred income when there is reasonable assurance that it will be received and that the Group will comply with the conditions attaching to it. Commercial income which compensates the Group for expenses incurred is recognised as revenue in the statement of comprehensive income on a systematic basis in the same periods in which the related expenses are incurred.

(n) Finance income and expense

Finance income comprises interest income on funds invested. Interest income is recognised as it accrues in profit or loss, using the effective interest method. Dividend income is recognised in profit or loss on the date that the Group's right to receive payment is established, which in the case of quoted securities is the ex-dividend date. Finance expenses comprise interest expense on borrowings.

(o) Government Grants

Government grant income is recognised in the statement of financial position initially as deferred income when there is reasonable assurance that it will be received and that the Group will comply with the conditions attaching to it. Grants that compensate the Group for expenses incurred are recognised as revenue in the statement of comprehensive income on a systematic basis in the same periods in which the related expenses are incurred.

(p) Expenses

Operating lease payments

Payments made under operating leases are recognised in the statement of comprehensive income on a straight-line basis over the term of the lease.

(q) Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Cash and cash equivalents comprise cash balances and call deposits.

Accounting for finance income and expense is discussed in note 3(n).

Other: Other non-derivative financial instruments are subsequently measured at amortised cost using the effective interest method, less any impairment losses.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

3. Significant accounting policies (Cont.)

(ii) Share capital
Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributed to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects.

(r) Income tax

Income tax in the statement of comprehensive income for the periods presented comprises current and deferred tax. Income tax is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The following temporary differences are not provided for: initial recognition of goodwill, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(s) Segment reporting

The Group comprises a single business segment comprising discovery and development of novel therapeutics and a single geographical location being Australia. The segment details are therefore fully reflected in the results and balances reported in the statement of comprehensive income and statement of financial position.

(t) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the taxation authority is included as a current asset or liability in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis. The GST component of cash flows arising from investing and financing activities which are recoverable from, or payable to, the taxation authority, are classified as operating cash flows.

(u) New standards and interpretations not yet adopted

In the year ended 30 June 2011, the Group has reviewed all of the new and revised Standards and Interpretations issued by the AASB that are relevant to its operations and effective for the current annual reporting period.

It has been determined by the Group that there is no impact, material or otherwise, of the new and revised Standards and Interpretations on its business and, therefore, no change is necessary to Group accounting policies.

The Group has also reviewed all new Standards and Interpretations that have been issued but are not yet effective for the year ended 30 June 2011. As a result of this review the Directors have determined that there is no impact, material or otherwise, of the new and revised Standards and Interpretations on its business and therefore, no change necessary to Group accounting policies.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

4. Financial risk management

Overview

The Company has exposure to the following risks from their use of financial instruments:

- credit risk
- liquidity risk
- market risk

This note presents information about the Company's exposure to each of the above risks, their objectives, policies and processes for measuring and managing risk, and the management of capital. Further quantitative disclosures are included throughout this financial report. The Board of Directors has overall responsibility for the establishment and oversight of the risk management framework. The Board has delegated to the Audit Committee, the responsibility for developing and monitoring risk management policies.

Risk management policies are established to identify and analyse the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

The Company, through their training and management standards and procedures, aim to develop a disciplined and constructive control environment in which all employees understand their roles and obligations.

The Audit Committee oversees how management monitors compliance with the Company's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Company.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company receivables and cash investments.

Trade and other receivables

The Group had no material credit risk at 30 June 2011 or 2010.

Cash investments

The Group limits its exposure to credit risk by banking only with Australia and New Zealand Banking Group. Given that bank's credit rating, management does not expect it to fail to meet its obligations.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

The Group does not presently use financial derivatives as a risk management tool.

Currency risk

The Group is exposed to currency risk on some purchases that are denominated in a currency other than the functional currency of the Group, the Australian dollar (AUD). As the exposure is immaterial in value and of short term duration, the Group does not employ any hedging strategies for foreign currency risk management.

Interest rate risk

The Group does not have any borrowings. The Group invests temporarily idle funds at call at variable interest rates.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

4. Financial risk management (Cont.)

Capital management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board's target is for employees and directors of the Group to hold between five and ten percent of the Group's ordinary shares. At present employees hold approximately 6% of fully diluted issued capital, assuming that all outstanding share options vest and / or are exercised. This proportion would increase to approximately 11% if allocations under the Loan Funded Share Plan are approved by shareholders.

There were no changes in the Group's approach to capital management during the year.

The Group is not subject to externally imposed capital requirements.

5. Income

(i) Government grant income

The Group had been awarded a government grant which is recognised as revenue in the statement of comprehensive income in the same period as which the related expenses are incurred. The amount of \$44,727 was recognised in the year ended 30 June 2011 (2010: \$124,847). A rebate of \$125,311 was also received through the Export Market Development Grant Scheme (2010: \$38,289) which has been recorded as income in the period of receipt.

(ii) Commercial income

Commercial income is derived from contracts to fund research and is based upon a mixture of funding full time equivalent research salaries and milestone payments. A total of \$2,188,190 was received from contract payments during the year (2010: \$433,120).

6. Accumulated expenditure capitalised

The accounting standards do not permit the capitalisation of research and development expenditure in circumstances where the company cannot demonstrate sustainable revenue generation derived from the results of the expenditure. The expenditure incurred in relation to obtaining and maintaining patent protection is allowed to be capitalised under the standards but the Company has adopted a policy of expensing such expenditure as it is incurred.

Since incorporation, Phylogica has raised \$32.4 million in capital, reduced to \$30.4 million after netting capital raising fees. From this amount the following expenditures have been undertaken (all amounts \$ million):

	<u>Prior to 2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
Research & Development:				
Contract Research	6.71	1.89	2.25	10.85
Personnel (allocation)	3.27	0.67	0.75	4.69
Laboratory Consumables	1.51	0.81	0.50	2.82
	11.49	3.37	3.50	18.36
IP Maintenance	1.62	0.31	0.29	2.22
	13.11	3.68	3.79	20.58

Hence, if the company had been able to capitalise research and development expenditure, the net assets of the company would be as set out below.

	<u>2010</u>		<u>2011</u>	
	<u>\$ million</u>	<u>Cents/ Share</u>	<u>\$ million</u>	<u>Cents/ Share</u>
Reported Net Assets	(0.44)	(0.2)	4.35	1.5
Research & Development	14.86	6.6	18.36	6.3
	14.42	6.4	22.71	7.8

The situation with IP maintenance is not as clear as only expenditures on currently held patents could be capitalised and the expenditures would need to be amortised over the patent life.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

		Consolidated	
		2011	2010
7. Personnel expenses		\$	\$
Wages and salaries		1,238,358	790,386
Other associated staff costs		27,536	14,558
Contributions to defined contribution superannuation funds		60,696	49,187
Increase in annual leave accrual		62,161	30,681
Share based compensation- Note 19		103,216	454,399
		1,491,967	1,339,211
8. Depreciation			
Depreciation of equipment		154,536	66,941
		154,536	66,941
9. Income Tax			
(i) Income tax benefit			
The prima facie tax on the operating loss is reconciled to the income tax provided in the accounts as follows:			
Prima facie tax benefit on operating loss before income tax at 30%		(1,081,551)	(1,371,848)
Tax effect of permanent differences		(286,818)	(201,159)
Current period tax losses and temporary differences not brought to account		1,368,369	1,573,007
Income tax benefit attributable to operating loss before income tax		-	-
(ii) Unrecognised deferred tax asset			
Deferred tax assets have not been recognised in respect of the following items:			
Deductible/(Assessable) temporary differences		(142,908)	(12,345)
Tax losses		9,528,178	8,020,244
		9,385,270	8,007,899
Tax losses do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it cannot yet be considered probable that future taxable profit will be available against which the Company can utilise the benefits therefrom.			
10. Trade and other receivables		Consolidated	
		2011	2010
		\$	\$
GST receivable		108,890	78,883
Accrued Interest		3,954	765
Other receivables		-	44,769
		112,844	124,417
11. Prepayments			
Prepaid Plant & Equipment		62,216	-
		62,216	-
12. Plant and equipment			
Office and research equipment at cost		659,878	383,377
Accumulated depreciation		(373,334)	(218,798)
		286,544	164,579
Reconciliation			
Carrying amount at the beginning of the year		164,579	72,740
Acquisitions		276,501	158,780
Disposals		-	-
Depreciation		(154,536)	(66,941)
		286,544	164,579

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

	Consolidated	
	2011	2010
13. Trade and other payables	\$	\$
Trade payables	542,518	561,261
Accrued expenses	144,823	26,567
Other	24,754	16,163
	712,095	603,991
14. Interest bearing liabilities		
Current		
Convertible note face value	1,340,000	1,340,000
Transferred to equity reserve	-	(102,309)
Transferred to Issued Capital on conversion	(1,340,000)	-
Interest bearing liability	-	1,237,691

The convertible notes were issued at nil interest and matured on 30 April 2011. The notes were converted at maturity at \$0.04 per share resulting in the issue of 33,500,000 shares with a value of \$1,340,000.

15. Segment information

The Company comprises a single business segment being the provision of drug discovery services to the international pharmaceutical industry utilising the Company's Phylomer® peptide libraries and proprietary screening capabilities; and a single geographical location being Australia. The segment details are therefore fully reflected in the results and balances reported in the statement of comprehensive income and statement of financial position.

16. Events subsequent to balance date

On 31 July 2011, 400,000 unlisted options, exercisable at \$0.25 expired unexercised.

During August 2011, 160,065 ordinary shares were issued after the exercise of options by payment of \$24,009.75 to the Company. The remaining 46,990,288 options exercisable at \$0.15 lapsed unexercised on the expiry date 31 August 2011.

17. Contingent liabilities

At balance date there were no known contingent liabilities.

18. Loan Funded Share Plan

In June 2011 the directors resolved to establish a Loan Funded Share Plan and offered allocations under the scheme to two directors and a senior executive, all subject to shareholder approval.

A total of 21 million shares has been offered under the proposed plan. A valuation at 3 June 2011, using a Black and Scholes options pricing algorithm, gives a total value of \$909,552 for these securities.

In accordance with the accounting standards, if the Plan and allocations are approved by shareholders amortisation of this amount over the vesting periods would lead to the following expense and corresponding increase in the Share Based Payment Reserve:

	\$
2012 financial year	164,540
2013 financial year	282,068
Three years 2014 to 2016	462,944
	909,552

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

19. Employee benefits

	Consolidated	
	2011	2010
Current	\$	\$
Liability for annual leave	144,543	82,382
Superannuation payable	24,079	12,921
Incentive payable	377,976	-
	546,598	95,303
Non-Current		
Liability for Long Service Leave	49,661	25,408
	49,661	25,408
Number of employees at year end	6	5

Remuneration for all employees other than non-executive directors includes an at risk performance component.

	Incentive Provision	Long Service Leave	Annual Leave
	\$	\$	\$
Consolidated:			
Balance as 1 July 2010	-	25,408	82,382
Payments made	-	-	(31,571)
Charges raised or written back	377,976	24,253	93,732
Balance as 30 June 2011	377,976	49,661	144,543

(i) Share-based payments

In 2005 the Group established an employee share option programme (ESOP) that entitles key management personnel and senior employees to purchase shares in the Group. The ESOP was renewed at the Annual General Meeting in November 2010.

During the year ended 30 June 2011, 7,237,500 options were granted under the ESOP, of which 6,537,500 vested immediately upon grant and 700,000 will vest on 22 April 2012, all with an expiry date of 31 March 2013.

During the year ended 30 June 2010, 4,806,164 options were granted under the ESOP, of which 2,403,082 vested immediately upon grant and 2,403,082 vested 31 March 2010 with an expiry date of 31 March 2012. A further 5,000,000 options were granted outside the ESOP to unrelated parties after shareholder approval in September 2009, all 5,000,000 options vested immediately and have an expiry date of 31 March 2012.

During the year ended 30 June 2009, 5,300,000 options were granted under the ESOP, of which 2,650,000 vested immediately upon grant and 2,650,000 vested 31 March 2010 with an expiry date of 31 March 2012. A further 400,000 options were granted to two directors after shareholder approval in November 2008, with 100,000 vesting immediately and 100,000 options vesting on 31 July 2009 and 100,000 on 31 July 2010 all with an expiry date of 31 July 2011, at which time they expired unexercised.

(ii) Fair value of share options and assumptions

All options refer to options over ordinary shares of Phylogica Ltd which are exercisable on a one for one basis. Options granted under the ESOP total 7,237,500 in 2011 and 4,806,164 in 2010 with 5,000,000 granted outside the ESOP also in 2010. The fair value of the options is calculated at grant date using a Black-Scholes pricing model and allocated to each reporting period in accordance with the vesting profile of the options. The value recognised is the portion of the fair value of the options allocated to the reporting period. The factors and assumptions used in determining the fair value on grant date of options issued during the financial year as follows:

Granted during 2011:

Number of options	Grant Date	Expiry Date	Fair Value per Option	Exercise Price	Price of shares on grant date	Risk Free Interest Rate (%)	Estimated Volatility (%)	Number vested at 30 June 2011
3,400,000	30/11/2010	31/03/2013	\$0.024	\$0.075	\$0.049	5.0	100	2,700,000
3,837,500	17/12/2010	31/03/2013	\$0.018	\$0.075	\$0.036	5.2	100	3,837,500

In the table above, the following vesting profiles have been adopted:

1. 5,837,500 options vested immediately upon grant.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

19. Employee benefits (Cont.)

2. 700,000 options vested on 22 April 2011.
3. 700,000 options will vest on 22 April 2012.

Granted during 2010:

Number of options	Grant Date	Expiry Date	Fair Value per Option	Exercise Price	Price of shares on grant date	Risk Free Interest Rate (%)	Estimated Volatility (%)	Number vested at 30 June 2010
4,806,164	30/09/2010	31/03/2012	\$0.074	\$0.075	\$0.11	4.8	100	4,806,164
2,500,000	30/09/2010	31/03/2012	\$0.074	\$0.075	\$0.11	4.8	100	2,500,000
2,500,000	30/09/2010	31/03/2012	\$0.068	\$0.100	\$0.11	4.8	100	2,500,000

In the table above, the following vesting profiles have been adopted:

1. 7,403,082 options vested immediately upon grant.
2. 2,403,082 options vested on 31 March 2010.

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information. No dividends have been assumed to be paid during the life of the options. No employee options were exercised during the year. The weighted average life of the options granted during the year was 843 days.

20. Issued capital and accumulated losses

(i) Issued and paid up capital

405,197,346 (2010: 235,751,764) ordinary shares fully paid.

Consolidated	
2011	2010
\$	\$
30,367,388	21,973,323

Movements in issued capital during the year:

	Consolidated		Consolidated	
	2011	2011	2010	2010
	Shares	\$	Shares	\$
Opening balance	235,751,764	21,973,323	215,751,764	20,093,323
Shares issued during the year:				
Issued at \$0.10	-	-	20,000,000	2,000,000
Issued at \$0.05	47,150,353	2,357,518	-	-
Issued at \$0.08	524,500	41,960	-	-
Issued at \$0.074	135,135	10,000	-	-
Issued at \$0.059	28,000,000	1,652,000	-	-
Issued at \$0.04 on conversion of convertible notes (see note 12)	33,500,000	1,340,000	-	-
Issued at \$0.059	60,135,594	3,548,000	-	-
Share issue costs	-	(555,413)	-	(120,000)
Closing balance	405,197,346	30,367,388	235,751,764	21,973,323

Terms and Conditions

Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings. In the event of winding up of the Group, ordinary shareholders rank after all other shareholders and creditors and are fully entitled to any proceeds of liquidation.

The shares have no par value.

(ii) Reserves

Opening balance
 Share based payments for the period
 Equity component of convertible note
 Balance at the end of the year

Consolidated	
2011	2010
\$	\$
1,015,122	670,621
103,216	454,399
(102,309)	(109,898)
1,016,029	1,015,122

Nature and purpose of reserves:

Share based payments reserve

This reserve is used to record the value of equity benefits provided to employees and directors as part of their

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

20. Issued capital and accumulated losses (cont.)

remuneration. Refer to Note 19 and the Remuneration Report for further details of these plans.

Equity component of convertible note reserve

This reserve is used to record the interest component of the unexpired period of the convertible notes. Refer to Note 14 for further details.

	Consolidated	
	2011	2010
	\$	\$
(iii) Accumulated losses		
Opening balance	(23,425,525)	(18,852,700)
Loss for the period	(3,605,169)	(4,572,825)
Balance at the end of the year	(27,030,694)	(23,425,525)

(iv) Options

	Weighted Av. Exercise Price 2011	Number of Options 2011	Weighted Av. Exercise Price 2010	Number of Options 2010
Options on issue at end of the year:				
(a) Options exercisable at \$0.30 on or before 31 July 2010:				
Balance at beginning of year	\$0.30	114,000	\$0.30	534,000
Issued during the year	-	-	-	-
Lapsed	\$0.30	(114,000)	\$0.30	(420,000)
Balance at end of year	-	-	\$0.30	114,000
(b) Options exercisable at \$0.25 on or before 31 July 2011:				
Balance at beginning of year	\$0.25	400,000	\$0.25	400,000
Issued during the year	-	-	-	-
Lapsed	-	-	-	-
Balance at end of year	\$0.25	400,000	\$0.25	400,000
(c) Options exercisable at \$0.15 on or before 31 August 2011:				
Balance at beginning of year	-	-	-	-
Issued during the year	\$0.15	47,150,353	-	-
Lapsed	-	-	-	-
Balance at end of year	\$0.15	47,150,353	-	-
(d) Options exercisable at \$0.075 on or before 31 March 2012:				
Balance at beginning of year	\$0.075	12,356,164	\$0.075	5,300,000
Issued during the year	\$0.075	7,237,500	\$0.075	7,306,164
Forfeited during the year	-	-	\$0.075	(250,000)
Balance at end of year	\$0.075	19,593,664	\$0.075	12,356,164
(e) Options exercisable at \$0.10 on or before 31 March 2012:				
Balance at beginning of year	\$0.10	2,500,000	-	-
Issued during the year	-	-	\$0.10	2,500,000
Lapsed	-	-	-	-
Balance at end of year	\$0.10	2,500,000	\$0.10	2,500,000
(f) Options exercisable at \$0.09 on or before 30 June 2016:				
Balance at beginning of year	-	-	-	-
Issued during the year	\$0.09	44,067,802	-	-
Lapsed	-	-	-	-
Balance at end of year	\$0.09	44,067,802	-	-

(g) Fair value:

The options outstanding at 30 June 2011 have exercise prices of \$0.075, \$0.09, \$0.10, \$0.15 or \$0.25. No options were exercised during the year ended 30 June 2011.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

20. Issued capital and accumulated losses (cont.)

The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using the Black – Scholes option pricing formula.

Fair value of share options and assumptions	Employees 2011	Key Mgmt Personnel 2011	Key Mgmt Personnel 2010
Grant date	17/12/2010	30/11/2010	30/09/09
Fair value at grant date	\$0.015	\$0.024	\$0.074
Share price	\$0.036	\$0.049	\$0.11
Exercise price	\$0.075	\$0.075	\$0.075
Expected volatility (weighted average)	100%	100%	100%
Option life (expected weighted average)	2.29 yrs	2.40 yrs	2.50 yrs
Expected dividends	-	-	-
Risk free interest rate (based on government bonds)	5.15%	4.98%	4.83%

	Consolidated	
	2011	2010
(h) Employee Expense:	\$	\$
Share options granted- all equity settled:		
In 2011	102,893	-
In 2010	-	452,979
In 2009	323	1,420
Total recognised as employee expense	103,216	454,399

21. Earnings per share

(i) Loss attributable to ordinary shareholders

Loss for the period:

Basic earnings	(3,605,169)	(4,572,825)
Diluted earnings*	(3,605,169)	(4,572,825)

(ii) Weighted average number of ordinary shares

Weighted average number of shares used for basic earnings per share	290,310,178	226,107,928
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*As the Group incurred a loss for the year ended 30 June 2011, the options on issue have an antidilutive effect, therefore the diluted earnings per share is equal to the basic earnings per share.

22. Note to the statement of cash flows

	Consolidated	
	2011	2010
Reconciliation of loss for the year to net cash used in operating activities:	\$	\$
Loss for the year	(3,605,169)	(4,572,825)
Depreciation, amortisation & impairment	154,536	66,941
Share based payment expense	103,216	454,399
Increase/(decrease) in provisions for employee entitlements	451,295	55,553
Increase/(decrease) in payables and deferred income	(46,332)	165,692
(Increase)/decrease in receivables & prepayments	(143)	201,556
Net cash used in operating activities	(2,942,597)	(3,628,684)

23. Financial instruments

(i) Interest rate risk

Profile: At reporting date the interest rate profile of the Group's interest bearing financial instrument was:

Variable rate instruments:

-Financial assets	5,199,473	1,281,044
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Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

23. Financial instruments (Cont.)

Fair value sensitivity analysis for fixed rate instruments:

The Group does not account for any fixed rate financial assets and liabilities at fair value through the profit and loss.

Cash flow sensitivity analysis for variable rate instruments:

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables remain constant. The analysis is performed on the same basis for 2010.

	Consolidated			
	2011		2010	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
Variable rate instruments	51,995	(51,995)	12,810	(12,810)

(ii) Fair value

The financial assets and financial liabilities of the Group are all current so that fair value is equal to carrying value. Consequently the Group does not make any adjustments through the statement of comprehensive income or on the statement of financial position to restate the carrying value of the financial assets and liabilities.

(iii) Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. The Group undertakes due diligence prior to entering into any collaboration, co-development or licensing agreement with a counterparty that exposes the Group to credit risk. No receivables are past due or considered impaired in 2011 or 2010.

(iv) Foreign exchange risk

The Group is exposed to foreign currency risk on purchases that are denominated in a currency other than the AUD. Management does not consider the value of transactions is sufficient to warrant entering into forward currency contracts.

(v) Capital management

The operations of the Group are not presently cash positive and the Group is reliant upon developing additional revenue and raising further capital. The Group's policy on capital management is set out in note 4.

(vi) Liquidity risk

The following are the contractual maturities of the Group's financial liabilities.

	Carrying Amount	Contractual Cash Flows	6 months or less
	\$	\$	\$
Trade and other payables:			
at 30 June 2011	712,905	(712,095)	(712,095)
at 30 June 2010	603,991	(603,991)	(603,991)

24. Commitments

Future operating lease commitments not provided for in the financial statements and payable:

Within one year

Consolidated	
2011	2010
\$	\$
-	60,000
-	60,000

25. Related parties

(i) Key management personnel compensation

As permitted by the Corporations Regulations 2M.3.03, disclosures of remuneration policies, service contracts, details of remuneration and other equity instruments are included in the Director's Report on pages 1 to 14. The following were key management personnel of the Group at any time during the reporting period and unless otherwise indicated, were directors or executives for the entire period:

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

25. Related parties (Cont.)

Non-Executive Directors

Mr B McHarrie
 Mr H Karelis (Resigned 06/12/10)
 Mr A Barton (Resigned 13/07/10)
 Mr N Woolf (Non-Executive to 08/10/10)

Executive Directors

Dr P Watt
 Mr N Woolf (Executive from 08/10/10)

Dr D Wilson

Executives

Dr R Hopkins (Chief Operating Officer)
 Mr G Boden (Company Secretary Appointed 04/04/11)
 Mr G MacMillan (Company Secretary Resigned 04/04/11)

	Consolidated	
	2011	2010
The key management personnel compensation included in 'personnel expenses' (see note 7) are as follows:	\$	\$
Short-term employee benefits	1,092,588	640,397
Post-employment benefits	45,960	38,700
Long term employee benefits	46,241	32,286
Share based payments	69,710	247,919
Total compensation	1,254,499	959,302

Apart from details disclosed in this note, no director has entered into a material contract with the Group since the end of the previous financial year and there were no material contracts involving directors' interests existing at year-end.

A number of key management persons, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities.

A number of these entities transacted with the Group or its subsidiaries in the reporting period. The terms and conditions of the transactions with management persons and their related parties were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-director related entities on an arm's length basis.

(ii) Key management personnel transactions

The aggregate amounts recognised during the year relating to key management personnel and their related parties were as follows:

Key management persons	Transaction	Note	2011	2010
			\$	\$
Mr B McHarrie	Contract research services	(a)	2,811,328	2,046,675

- (a) The Telethon Institute of Child Health Research, of which Mr McHarrie is the Director of Finance and Business Development, has signed a Research and Development agreement with the Group for provision of research and development services in relation to the Group's technology. Service fees were billed based on normal market rates for such services and were due and payable under normal payment terms.

Amounts payable to key management personnel at reporting date arising from these contract R&D services were as set below:

	Consolidated	
	2011	2010
Current payables	\$	\$
Trade and other payables	355,368	380,113
	355,368	380,113

(iii) Options over equity instruments

The movement during the reporting period in the number of options over ordinary shares in the Group held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

25. Related parties (Cont.)

	Balance 1 July 10	Granted As Compensation	Exercised	Other Changes	Balance 30 June 11	Vested During The Year	Vested & Exercisable 30 June 11
Directors							
Dr D Wilson	918,337	500,000	-	-	1,418,337	600,000	1,418,337
Mr B McHarrie	368,700	-	-	384,097	752,797	-	752,797
Mr H Karelis	368,700	-	-	-	n/a	n/a	n/a
Dr P Watt	3,000,000	1,500,000	-	1,157,233	5,657,233	2,657,233	5,657,233
Mr N Woolf	-	1,400,000	-	423,728	1,823,728	1,123,728	1,123,728
Executives							
Dr R Hopkins	750,000	1,000,000	-	473,047	2,223,047	1,473,047	2,223,047
	Balance 1 July 09	Granted As Compensation	Exercised	Other Changes	Balance 30 June 10	Vested During The Year	Vested & Exercisable 30 June 10
Directors							
Dr D Wilson	300,000	618,337	-	-	918,337	718,337	818,337
Mr B McHarrie	-	368,700	-	-	368,700	368,700	368,700
Mr H Karelis	-	368,700	-	-	368,700	368,700	368,700
Dr P Watt **	2,000,000	3,000,000	-	(2,000,000)	3,000,000	3,000,000	3,000,000
Mr N Woolf	-	-	-	-	-	-	-
Executives							
Dr R Hopkins	1,050,000	-	-	(300,000)	750,000	375,000	750,000

** Options held by key management personnel related parties.

(iv) Equity holdings and transactions

The movement during the reporting period in the number of ordinary shares in the Group held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

	Balance 1 July 2010	Purchases	Options Exercised	Sales	Balance 30 June 2011
Directors					
Mr H Karelis (3)	29,166,667	-	-	-	n/a
Mr B McHarrie	1,920,479	384,097	-	-	2,304,576
Mr A Barton (1)	28,410,323	-	-	-	n/a
Mr N Woolf	-	1,971,956	-	-	1,971,956
Dr P Watt	4,967,031	1,826,699	-	-	6,793,730
Dr D Wilson	-	250,000	-	-	250,000
Executives					
Dr R Hopkins	1,659,203	1,018,457	-	-	2,677,660
Mr G MacMillan (4)	8,102,908	-	-	-	n/a
Mr G Boden (5)	n/a	-	-	-	422,917
	Balance 1 July 2009	Purchases	Options Exercised	Sales	Balance 30 June 2010
Directors					
Mr H Karelis	29,166,667	-	-	-	29,166,667
Mr B McHarrie	1,920,479	-	-	-	1,920,479
Mr A Barton	28,160,323	250,000	-	-	28,410,323
Mr N Woolf (2)	n/a	-	-	-	-
Dr D Wilson	-	-	-	-	-
Dr P Watt	4,777,031	190,000	-	-	4,967,031
Executives					
Dr R Hopkins	1,397,749	261,454	-	-	1,659,203
Mr G MacMillan	8,102,908	-	-	-	8,102,908

1 Mr A Barton resigned as a director on 13 July 2010.

2 Mr N Woolf was appointed as a director on 22 April 2010 and became an executive on 8 October 2010.

3 Mr H Karelis resigned as a director on 6 December 2010.

4 Mr G MacMillan resigned as secretary on 4 April 2011.

5 Mr Boden was appointed as secretary on 4 April 2011.

Phylogica Limited
Notes to the Financial Statements (Cont.)
For the Year Ended 30 June 2011

25. Related parties (Cont.)

(v) Proposed Loan Funded Share Plan

In June 2011 the directors approved a Loan Funded Share Plan ("Plan") for the Key Management Personnel ("KMP") of the Group (see note 18). If the Plan and the proposed allocations are approved at the general meeting it will have the following effect on the shareholdings of Dr P Watt, Mr N Woolf and Dr R Hopkins, as set out below.

KMP	Balance 30 June 2011	Shares to be issued under the Plan	Balance of Shareholding
Dr P Watt	6,793,730	9,000,000	15,793,730
Mr N Woolf	1,971,956	6,000,000	7,971,956
Dr R Hopkins	2,677,660	6,000,000	8,677,660

(vi) Subsidiaries

The consolidated financial statements include the financial statements of Phylogica Limited and the subsidiaries listed in the following table.

Name	Country of Incorporation	Equity Interest (%)		Investment (\$)	
		2011	2010	2011	2010
Dynamic Microbials Limited	Australia	100	100	1,012,500	1,012,500

Phylogica Limited is the ultimate Australian parent entity and ultimate parent of the Group.

26. Parent Entity Disclosures

(i) Financial position

Assets

	2011	2010
	\$	\$
Current assets	5,374,533	1,405,461
Non-current assets	286,544	164,579
Total assets	5,661,077	1,570,040

Liabilities

Current liabilities	1,258,693	744,021
Non-current liabilities	49,661	1,263,099
Total liabilities	1,308,354	2,007,120

Equity

Issued capital	30,367,388	21,973,323
Accumulated losses	(27,030,694)	(23,425,525)
Reserves:		
-Share-based payments	1,016,029	912,813
-Equity component of convertible note	-	102,309
Total equity	4,352,723	(437,080)

(ii) Financial performance

	Year Ended 30 June 2011	30 June 2010
	\$	\$
(Loss) for the year	(3,605,169)	(4,569,308)
Other comprehensive income	-	-
Total comprehensive loss	(3,605,169)	(4,569,308)

27. Auditor's remuneration

	Consolidated	
	2011	2010
	\$	\$
Audit services		
-Audit and review of financial reports	31,550	27,750
-Other regulatory audit services	1,000	2,600
	32,550	30,350
Non audit services	-	-
	32,550	32,350

Directors' declaration

- 1 In the opinion of the directors of Phylogica Limited (the Company):
 - (a) the financial statements and notes and the audited remuneration disclosures that are contained in the Remuneration Report in the Directors' Report, set out on pages 8 to 14, are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the Group as at 30 June 2011 and of its performance, as represented by the results of operations and its cash flows, for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
 - (iii) the financial report also complies with International Financial Reporting Standards as disclosed in note 2 (a); and
 - (b) The audited remuneration disclosures of the Remuneration Report in the Directors' Report (page 8 to 14) comply with Australian Accounting Standard AASB 124 Related Party Disclosures; and
 - (c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- 2 The directors have been given the declarations by the chief executive officer and chief financial officer for the financial year ended 30 June 2011 pursuant to Section 295A of the Corporations Act 2001.

Dated at Perth this 27 day of September 2011

Signed in accordance with a resolution of the directors:



Mr Nicholas Woolf
Director

INDEPENDENT AUDITOR'S REPORT

To the members of Phylogica Limited

Report on the Financial Report

We have audited the accompanying financial report of Phylogica Limited ("the company"), which comprises the statement of financial position as at 30 June 2011, the statement of comprehensive income, the statement of changes in equity and the 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 for the consolidated entity. The consolidated entity comprises the company and the entities it controlled at the year's end or from time to time during the financial year.

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 2(a), the directors also state, in accordance with Accounting Standard AASB 101: *Presentation of Financial Statements* that the consolidated financial report complies 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 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 judgement, 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 company'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 company'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.

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

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

Matters relating to the electronic presentation of the audited financial report

This auditor's report relates to the financial report and remuneration report of Phylogica Limited for the financial year ended 30 June 2011 included on Phylogica Limited's website. The company's directors are responsible for the integrity of the Phylogica Limited website. We have not been engaged to report on the integrity of this web site. The auditor's report refers only to the financial report and remuneration report identified in this report. It does not provide an opinion on any other information which may have been hyperlinked to/from the financial report. If users of the financial report are concerned with the inherent risks arising from publication on a website, they are advised to refer to the hard copy of the audited financial report and remuneration report to confirm the information contained in this website version of the financial report.

INDEPENDENT AUDITOR'S REPORT (continued)

Independence

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

Auditor's Opinion

In our opinion:

- (a) the financial report of Phylogica 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 2011 and of its 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 2(a).

Report on the Remuneration Report

We have audited the Remuneration Report included in the directors' report for the year ended 30 June 2011. 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.

Auditor's Opinion

In our opinion, the Remuneration Report of Phylogica Limited for the year ended 30 June 2011 complies with section 300A of the *Corporations Act 2001*.



HLB MANN JUDD
Chartered Accountants



N G NEILL
Partner

Perth, Western Australia
27 September 2011

Phylogica Limited

Corporate Governance Statement (Cont.)

This statement outlines the main corporate governance practices in place throughout the financial year, which comply with the ASX Corporate Governance Council recommendations, unless otherwise stated.

As the framework of how the Board of Directors at Phylogica Limited ("Company") carries out its duties and obligations, the Board has considered the eight principles of corporate governance as set out in the ASX Corporate Governance Principles and Recommendations.

Principle 1 – Lay solid foundations for management and oversight

Companies should establish and disclose the respective roles and responsibilities of Board and management.

Recommendation 1.1: Companies should establish the functions reserved to the Board and those delegated to senior executives and disclose those functions.

The Directors monitor the business affairs of the Company on behalf of Shareholders and have formally adopted a corporate governance policy which is designed to encourage Directors to focus their attention on accountability, risk management and ethical conduct.

The Company's main corporate governance policies and practices are outlined below:

The Board of Directors

The Company's Board of Directors is responsible for corporate governance of the Company. The Board develops strategies for the Company, reviews strategic objectives and monitors performance against those objectives. The goals of the corporate governance processes are to:

- (a) maintain and increase Shareholder value;
- (b) ensure a prudential and ethical basis for the Company's conduct and activities; and
- (c) ensure compliance with the Company's legal and regulatory objectives.

Consistent with these goals, the Board assumes the following responsibilities:

- (a) developing initiatives for profit and asset growth;
- (b) reviewing the corporate, commercial and financial performance of the Company on a regular basis;
- (c) acting on behalf of, and being accountable to, the Shareholders; and
- (d) identifying business risks and implementing actions to manage those risks and corporate systems to assure quality.

The Company is committed to the circulation of relevant materials to Directors in a timely manner to facilitate Directors' participation in the Board discussions on a fully-informed basis.

Composition of the Board

Election of Board members is substantially the province of the Shareholders in general meeting. However, subject thereto, the Company is committed to the following principles:

- (a) the Board is to comprise Directors with a blend of skills, experience and attributes appropriate for the Company and its business; and
- (b) the principal criterion for the appointment of new Directors is their ability to add value to the Company and its business.

No formal nomination committee or procedures have been adopted for the identification, appointment and review of the Board membership, but an informal assessment process, facilitated by the Chairman in consultation with the Company's professional advisors, has been committed to by the Board.

Independent professional advice

The Directors may obtain independent professional advice on issues arising in the course of their duties.

Phylogica Limited

Corporate Governance Statement (Cont.)

Remuneration arrangements

The remuneration of an Executive Director will be decided by the Board, without the affected Executive Director participating in that decision-making process.

The total cash remuneration of Non-Executive Directors is the subject of a Shareholder resolution in accordance with the Company's Constitution, the Corporations Act and the ASX Listing Rules, as applicable. The determination of Non-Executive Directors' remuneration within that maximum will be made by the Board having regard to the inputs and value to the Company of the respective contributions by each Non-Executive Director. The current limit, which may only be varied by Shareholders in general meeting, is an aggregate cash amount of \$200,000 per annum.

The Board may award additional remuneration to Non-Executive Directors who are called upon to perform extra services or make special exertions on behalf of the Company.

External audit

The Company in general meeting is responsible for the appointment of the external auditors of the Company, and the Board from time to time will review the scope, performance and fees of those external auditors.

Audit committee

The Company has established a separately constituted audit committee.

Identification and management of risk

The Board's collective experience will enable accurate identification of the principal risks that may affect the Company's business. Key operational risks and their management will be recurring items for deliberation at Board meetings.

Ethical standards

The Board is committed to the establishment and maintenance of appropriate ethical standards.

Recommendation 1.2: Companies should disclose the process for evaluating the performance of senior executives.

The Board and senior executives collaborate on the company's strategic direction at regular intervals, and at monthly intervals review operational progress. During these review sessions the roles of the senior executives are assessed for their contributions to the corporate goals and to new and ongoing contract deliverables. Annual appraisals are conducted by line managers around KPIs set as the beginning of the financial year.

Principle 2 – Structure the Board to add value

Companies should have a Board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.

Recommendation 2.1: A majority of the Board should be independent directors.

The Board has four Directors comprising one executive chairman, two executive director's and one non-executive director who is classified as non-independent because of his employment by the major contributor to the Company.

Recommendation 2.2: The chair should be an independent director.

The chairman is not independent. The Board has other directors and believe that the position of the Chairman as an executive does not prejudice the Company's corporate governance.

Recommendation 2.3: The roles of the chair and Chief Executive Officer should not be exercised by the same individual.

Corporate Governance Statement (Cont.)

The roles of chief executive officer and chairman are not held by the same person.

Recommendation 2.4: The Board should establish a nomination committee.

The Board has not established a separate nomination committee. The Board, as a whole, deals with areas that would normally fall within the charge of the Nomination Committee. These include matters relating to the renewal of Board Members and Board Performance.

Recommendation 2.5: Companies should disclose the process for evaluating the performance of the Board, its committees and individual directors.

The Remuneration Committee has developed a formal process for performance evaluation of the Board. No evaluation of the performance of the board and its members was carried out during the reporting period. Subsequent to the end of the reporting period an evaluation has been conducted. The evaluation process was an internal self- assessment based on questions and analysis of answers with round table discussions. All members of the Board participated in the assessment.

Principle 3 – Promote ethical and responsible decision-making

Companies should actively promote ethical and responsible decision-making.

Recommendation 3.1: Companies should establish a code of conduct and disclose the code or a summary of the code as to:

- The practices necessary to maintain confidence in the company's integrity.
- The practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders.
- The responsibility and accountability of individuals for reporting and investigating reports of unethical practices.

The Company is committed to Directors and employees maintaining high standards of integrity and ensuring that activities are in compliance with the letter and spirit of both the law and Company policies.

Directors acquaint themselves with obligations imposed on them and the Company by the Corporations Act. They will also familiarise themselves with other documents prepared by the Company to meet corporate governance requirements:

- the Employee Code of Conduct –sets out minimum standards of conduct and integrity to be observed by all employees and Directors; and
- the Corporate Governance Statement – advises Shareholders and ASX of the corporate governance practices put in place by the Board.

Recommendation 3.2: Companies should establish a policy concerning diversity and disclose the policy or a summary of that policy. The policy should include requirements for the board to establish measureable objectives for achieving gender diversity for the board to assess annually both the objectives and the progress in achieving them.

The Company has not yet established a diversity policy. Notwithstanding this the company has policies in accordance with its code of conduct which:

- provide for equal opportunity in employment;
- has recruitment and selection processes which are based on the merits of appropriate candidates; and
- has grievance procedures to manage conflict, misconduct, discrimination and harassment.

Recommendation 3.3: Companies should disclose in each annual report the measureable objectives for achieving gender diversity set by the board in accordance with the diversity policy and progress towards achieving them.

The Company has not established measurable guidelines in relation to diversity and may not. In an organisation of a handful of people establishing diversity on the basis of gender, age, ethnicity and cultural background is going to be difficult to design let alone achieve.

Phylogica Limited

Corporate Governance Statement (Cont.)

Recommendation 3.4: Companies should disclose in each annual report the proportion of women employees in the whole organisation, women in senior executive position and women on the board.

The gender balance throughout the organisation at 30 June was as follows:

	2011		2010	
	Female	Total	Female	Total
Board	-	4	-	6
Other Key Management Personnel	-	2	-	2
Professional Staff	2	3	2	3
Research Contractor	15	20	12	17

Principle 4 – Safeguard integrity in financial reporting

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.

Recommendation 4.1: The Board should establish an audit committee.

The board has established an Audit Committee consisting of Bruce McHarrie (Chairman) and Dr Doug Wilson.

Recommendation 4.2: The audit committee should be structured so that it:

- consists of only non-executive directors
- consists of a majority of independent directors
- is chaired by an independent chair, who is not chair of the Board
- has at least three members.

The Company's current Audit Committee only consists of 2 board members who are non-independent directors. The Chairperson is a non-independent non-executive director and the other member is an executive director.

Recommendation 4.3: The audit committee should have a formal charter.

The audit committee charter is available on the Company website.

Principle 5 – Make timely and balanced disclosure

Companies should promote timely and balanced disclosure of all material matters concerning the company.

Recommendation 5.1: Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.

The Company has obligations under the Corporations Act and ASX Listing Rules to keep the market fully informed of information which may have a material effect on the price or value of its securities. The Company discharges these obligations by releasing information to ASX in the form of an ASX release or disclosure in other relevant documents (e.g. the Annual Report).

The Company has a continuous disclosure program in place designed to ensure the compliance with ASX Listing Rule disclosure and to ensure accountability at a senior executive level for compliance and factual presentation of the Company's financial position.

Principle 6 – Respect the rights of shareholders

Companies should respect the rights of shareholders and facilitate the effective exercise of those rights.

Recommendation 6.1: Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.

The Company is committed to the promotion of investor confidence by ensuring that trade in its securities takes place in an efficient, competitive and informed market. The Board Charter recognises the importance of forthright

Corporate Governance Statement (Cont.)

communication as a key plank in building shareholder value and that to prosper and achieve growth the Company must (among other things) earn the trust of employees, customers, suppliers, communities and security holders by being forthright in its communications and consistent in its fulfilment of obligations.

Principle 7 – Recognise and manage risk

Companies should establish a sound system of risk oversight and management and internal control.

Recommendation 7.1: Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.

Management determines the Company's risk profile and is responsible for overseeing and approving risk management strategy and policies, internal compliance and internal control. The Company's process of risk management and internal compliance and control includes:

- establishing the Company's goals and objectives, and implementing and monitoring strategies and policies to achieve these goals and objectives;
- continuously identifying and reacting to risks that might impact upon the achievement of the Company's goals and objectives, and monitoring the environment for emerging factors and trends that affect these risks;
- formulating risk management strategies to manage identified risks and designing and implementing appropriate risk management policies and internal controls; and
- monitoring the performance of, and continuously improving the effectiveness of, risk management systems and internal compliance and controls, including an ongoing assessment of the effectiveness of risk management and internal compliance and control.

Recommendation 7.2: The Board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The Board should disclose that management has reported to it as to the effectiveness of the Company's management of its material business risks.

The responsibility for undertaking and assessing risk management and internal control effectiveness is delegated to management. Management is required by the Board to report back on the efficiency and effectiveness of risk management, inter alia, by benchmarking the Company's performance against industry standards.

The risk profile of the Company contains both financial and non-financial factors including material risks arising from pricing, competitive position, currency movements, operational efficiency, product quality, investments in new projects.

To mitigate these risks, the company has in place an experienced Board, regular Board meetings, financial annual audit and half year review, rigorous appraisal of new investments, and advisers familiar with the company. The Board's collective experience will enable accurate identification of the principal risks that may affect the Company's business. Key operational risks and their management are recurring items for deliberation at Board Meetings.

Recommendation 7.3: The Board should disclose whether it has received assurance from the chief executive officer (or equivalent) that the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.

The Chief Executive Officer and the Chief Financial Officer confirm in writing to the Board that the financial reports of the Company for the financial year:

- present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards;
- the statement given in paragraph (a) above is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board; and
- the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects.

Principle 8 – Remunerate fairly and responsibly

Phylogica Limited

Corporate Governance Statement (Cont.)

Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to performance is clear.

Recommendation 8.1: The Board should establish a remuneration committee.

The Board has established a remuneration committee. The Committee consists of Doug Wilson, Nicholas Woolf and Bruce McHarrie (Chairperson).

Recommendation 8.2: Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.

Executive Directors remuneration packages may comprise of:

- (a) salary and associated superannuation;
- (b) fixed directors fees; and
- (c) performance based bonuses.

Non-Executive Directors receive fixed directors fees only, and do not participate in any performance-based remuneration. Fixed directors' fees may be paid in the form of cash, shares, share options or a combination of these. Shares and share options are issued on similar terms to previous issues by the entity and are considered to be in lieu of cash, not based on performance of the entity.

Full remuneration disclosure, including superannuation entitlements, and the number of meetings of the Remuneration Committee is provided by the Company in its annual report. The Remuneration Committee ensures that all equity based executive remuneration is made within the guidelines set by plans approved by Shareholders.

Departure from Best Practice Recommendations

From 1 July 2010 to 30 June 2011, the Company complied with each of the Eight Essential Corporate Governance Principles and Best Practice Recommendations published by the ASX Corporate Governance Council, other than in relation to the table below.

Recommendation	Notification of Departure	Explanation from Departure
2.1	The majority of the Board is not comprised of independent of independent directors.	The Board has reviewed its composition and considers that the relationships which define all of the four directors as non-independent have been and continue to be of benefit to the Company. It is not considered that the relationships of non-independent directors affect their capacity to bring independent judgement to bear on Board decisions.
2.2	The chair should be an independent director.	The Board has three other directors and believe that the position of the Chairman as an executive does not prejudice the Company's corporate governance.
2.4	The Board has not established a nomination committee.	The whole Board carries out the duties which would otherwise be undertaken by the nomination committee. The need for a nomination committee will be reviewed annually.
4.2	The audit committee is not comprised of three members, the majority of whom should be independent, with an independent chair.	The audit committee is comprised of two directors, both defined as non-independent. The Board considers that the membership of the audit committee is the most appropriate which can be made from the present membership of the Board. The Board considers that the expertise of the audit committee enables it to fulfil its charter and does not consider the appointment of further or different directors to be desirable merely to change the composition of the audit committee.

The Phylogica Limited Corporate Governance Principles & Practices Manual is available on the Company's website www.phylogica.com.au.

Phylogica Limited

ASX Additional Information (Cont.)

1. Listed Securities

The security holder information set out below was applicable as at 22 September 2011.

(i) Distribution of Security Numbers

Category (size of holding)	Ordinary Shares		Listed Options	
	Shareholders	Shares	Optionholders	Options
1 – 1,000	78	20,307	2	101
1,001 – 5,000	117	389,044	1	4,000
5,001 – 10,000	229	1,998,403	-	-
10,001 – 100,000	820	36,804,841	56	3,312,295
100,001 and over	501	366,144,816	57	40,751,406
Total	1,745	405,357,411	116	44,067,802

There are 291 shareholders holding less than a marketable parcel at a price of \$0.057, totalling 1,092,671 shares.

There are 4 optionholders holding less than a marketable parcel at a price of \$0.036, totalling 14,473 options.

(ii) Voting Rights

On a show of hands every person present who is a member or a proxy, attorney or representative of a member has one vote and upon a poll every person present who is a member or a proxy, attorney or representative of a member shall have one vote for each share held.

(iii) Twenty Largest Security Holders

The names of the twenty largest holders of ordinary shares are listed below:

Name	Number of Ordinary Shares	% of Issued Capital
CITICORP NOM PTY LTD	66,576,117	16.42
TELETHON INST FOR CHILD HEALTH RESEARCH	20,605,501	5.08
MONSLIT PTY LTD	11,400,000	2.81
AUST HERITAGE GRP PTY LTD	9,709,972	2.40
YELLOWROCK PTY LTD	7,761,298	1.91
JELBART JOHN A + M H	7,450,000	1.84
WATT P M + ENRIQUEZ-WATT	6,365,530	1.57
BARTON ANTHONY P + C H	6,312,000	1.56
L & E FISHER NOM PTY LTD	6,038,046	1.49
LAISSEZ FAIRE ET CIE PL	5,850,000	1.44
SCHENK ACHIM + LAZZARO V	4,400,400	1.09
HSBC CUSTODY NOM AUST LTD	3,546,000	0.87
FITEL NOM LTD	2,978,730	0.73
ABN AMRO CLEARING SYDNEY	2,917,225	0.72
JP MORGAN NOM AUST LTD	2,899,716	0.72
AYMON PACIFIC PTY LTD	2,500,000	0.62
WARD BARON TREVOR	2,400,000	0.59
HENLEY PARK ESTATE PTY LTD	2,323,552	0.57
INGLEWOOD LODGE PTY LTD	2,318,439	0.57
GDM SVCS PTY LTD	2,280,000	0.56
Total	176,632,526	43.56

Phylogica Limited

ASX Additional Information (Cont.)

The names of the twenty largest holders of listed options are listed below:

Name	Number of Listed Options	% of Issued Capital
CITICORP NOM PTY LTD	8,474,576	19.23
JELBART JOHN A + M H	4,153,894	9.43
YELLOWROCK PTY LTD	3,237,289	7.35
SVENSON SHANE THOMAS	2,650,027	6.01
CADEX PETROLEUM PTY LTD	1,606,900	3.65
SLANEY DEREK RONALD	1,490,000	3.38
SCINTILLA STRATEGIC INV LTD	1,271,187	2.88
GIDDY SYBIL MARIE	1,062,500	2.41
MAINVIEW HLDGS PTY LTD	1,000,000	2.27
NOONBEAU PTY LTD	940,000	2.13
POOL KLAAS + HEATHER J	847,457	1.92
MEARES ANDREW DANIEL	700,000	1.59
WENDE NOM PTY LTD	619,700	1.41
THORNILEY GARY R + I C	600,650	1.36
SWEENEY DIRK JONATHON	580,053	1.32
GIDDY PETER S + L M	550,000	1.25
OAKLEY DAVID FREDERICK	546,600	1.24
BUCKLAND CAP PTY LTD	500,000	1.13
FINKELSTEIN ESTHER	491,100	1.11
FITEL NOM LTD	471,865	1.07
Total	31,793,798	72.14

(iv) Substantial Shareholders

The names of the substantial shareholders listed in the Company's share register as at 22 September 2011 were:

Name	Number of Ordinary Shares	% of Issued Capital
CITICORP NOM PTY LTD	66,576,117	16.42
ANTHONY BARTON & ASSOCIATES	30,006,735	7.40
TELETHON INST FOR CHILD HEALTH RESEARCH	20,605,501	5.08
Total	117,188,353	28.90

(v) On market buy back

There is no on-market buy-back scheme in operation for the company's listed shares or listed options.

2. Unquoted Option holder Information

The information on unquoted option holders set out below was applicable as at 22 September 2011.

(i) Distribution of unquoted option holder numbers

Category (size of holding)	No of option holders	No of options
100,001 and over	27	22,093,664
Total		22,093,664

(ii) Voting Rights

Unlisted options do not entitle the holder to any voting rights.

Phylogica Limited

ASX Additional Information (Cont.)

(iii) Holders of more than 20% of unquoted options

	No of options	%
AYMON PACIFIC PTY LTD	5,000,000	22.63
Total	5,000,000	22.63