BONE MEDICAL LIMITED

ACN 009 109 755

CLEANSING STATEMENT

17 January 2011

Issued under section 708(12C)(e) of the Corporations Act 2001 (Cth)
(as inserted by ASIC Class Order [CO 10/322])

This Cleansing Statement has been prepared for the purposes of section 708(12C)(e) of the Corporations Act 2001 (as inserted by ASIC Class Order [CO 10/322]) to enable fully paid ordinary shares in the capital of Bone Medical Limited (Bone Medical) to be issued on conversion of a convertible note issued by Bone Medical to La Jolla Cove Investors Inc. to be on-sold to retail investors.

This Cleansing Statement is important and should be read in its entirety.

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1.1 Background

On 5 October 2010, Bone Medical and La Jolla entered into the Bone Medical Funding Agreement (**Funding Agreement**) pursuant to which Bone Medical agreed to issue, and La Jolla agreed to acquire, up to 4 convertible notes (**Notes**), each with an issue price (or face value) of US$1,500,000 (**Purchase Price**).

This Cleansing Statement relates to the issue of the first Note.

An outline of the rights and liabilities attaching to the Note is provided in section 2 of this Cleansing Statement whilst a summary of some of the key terms of the Funding Agreement is provided in section 4.

1.2 La Jolla Cove Investors Inc.

La Jolla is a US-based private investment company. It considers itself a leader in financing small cap publicly listed companies and seeks to partner with businesses looking for capital and strategic advice to expand their current operations. La Jolla's expertise lies in creating flexible financial structures which enable a company to grow without impacting working capital needs.

Once La Jolla has made an investment, it seeks to add value to the company in which it has invested by providing financial resources, strategic advice and mergers and acquisitions expertise and implementation services.

1.3 The issue of the Note

Under the Funding Agreement, Bone Medical and La Jolla have agreed that the issue of the Notes will be sequential. In each case, the obligation of La Jolla to subscribe for, and Bone Medical to issue, a Note will arise only following the satisfaction of certain conditions. At the date of this Cleansing Statement, Bone Medical has either satisfied each of the relevant conditions (which are summarised in section 5.1) capable of satisfaction for the issue of the first Note, or they have been waived, and La Jolla will subscribe for, and Bone Medical will issue, the first Note to La Jolla on the date of, or the day following, the date of this Cleansing Statement (**Initial Closing Date**).

1.4 The payment of the Purchase Price of the Note

The payment of the Purchase Price of the first Note will be made by La Jolla in instalments, in the following manner:

(a) US$100,000 has already been paid on 2 November 2010; and

(b) commencing in the month following the Initial Closing Date, La Jolla will pay to Bone Medical, on a date in that month and each subsequent month as selected by La Jolla, an amount of not less than US$10,000 (or such lesser amount that equals the remaining amount of the Purchase Price to be paid by La Jolla on a Note) (**Monthly Payment**).

The Monthly Payment shall increase as follows:

(a) to $50,000 per month when the average Volume Weighted Average Share Price for any five consecutive Trading Days, prior to a Monthly Payment date, is A$0.11 to A$0.14;

(b) to $100,000 per month when the average Volume Weighted Average Share Price for any five consecutive Trading Days, prior to a Monthly Payment date, is A$0.141 to A$0.18;

(c) to $200,000 per month when the average Volume Weighted Average Share Price for any five consecutive Trading Days, prior to a Monthly Payment date is, A$0.181 to A$0.24; and

(d) to $325,000 per month when the average Volume Weighted Average Share Price for any five consecutive Trading Days, prior to a Monthly Payment date is, A$0.241 or higher.

La Jolla may, in its absolute discretion, pay to Bone Medical more than the Monthly Payment in respect of any month.

The obligation on La Jolla to make each Monthly Payment is conditional on the satisfaction of certain conditions at the time payment is required to be made under the Funding Agreement (refer to sections 4.1, 4.2 and 4.3 of this Cleansing Statement).

1.5 Purpose and effect of the issue of the Note on Bone Medical

The Note issued by Bone Medical will raise up to US$1,500,000 (less the expenses associated with the issue of the Note). The funds raised from the issue of the Note will be used for working capital and business expansion purposes (including consulting, research, development and patent-related costs).

In the current market environment, it is difficult, and costly, for a small-cap Australian company to undertake a successful equity capital raising and, for Bone Medical by reason of the nature of its business and asset base, to raise debt funding through Australian banks. Given these restrictions on its ability to fund working capital and/or expansion of its business, the Directors consider that the raising of capital by the issue of the Note is in the best interests of Bone Medical as it secures, on acceptable terms and at an important time to it, the funding likely to be required by Bone Medical in the ordinary course of the development and growth of its business in the short to medium term.

The Directors consider that the benefits of the issue of the Note to La Jolla include the following:

(a) the cost of the funds raised by Bone Medical from the issue of the Note and the interest rate on the moneys provided by La Jolla is competitive in the current market;

(b) Bone Medical will not be required to give security to secure repayment of the moneys advanced;

(c) Bone Medical will be able to leverage La Jolla's expertise and contacts to add additional value to its business; and

(d) the Conversion Price (refer to section 2.8) is, in the Directors' opinion, not dissimilar to the issue price that Bone Medical would have had to accept if it had elected to raise the required funding in the current market environment by an issue of any new Shares.

The principal effects of the issue of the Note on Bone Medical will be to:

(a) increase Bone Medical's cash reserves by US$100,000 (after deducting Bone Medical's expenses associated with the Note issue) immediately upon the Note being issued;

(b) subject to the terms of the Funding Agreement and satisfaction of the conditions applicable under that agreement with regard to Monthly Payments, increase Bone Medical's cash reserves by an additional US$1,400,000 in aggregate by way of Monthly Payments of not less than US$10,000 each;

(c) give rise to Bone Medical assuming a liability for the proceeds received from La Jolla for payment of the Purchase Price of the Note less any amount which has been the subject of a conversion into new Shares (**Principal Amount**);

(d) give rise to Bone Medical assuming an obligation to pay interest on the Principal Amount to La Jolla at the rate of 4.75% per annum monthly in arrears; and

(e) if the Note is converted, either in whole or in part, increase the number of Shares as a consequence of the issue of new Shares to La Jolla.

In relation to paragraph (e), the number of new Shares to be issued to La Jolla will depend on whether the Note is converted in whole or in part, the applicable Conversion Price (refer to section 2.8) and the prevailing US$/A$ exchange rate at the time of conversion.

1.6 The effect of the Note Issue on the capital structure of Bone Medical

The current issued capital of Bone Medical (before the issue of the first Note) is set out below.

Type of security	Securities prior to the Note Issue
Shares	98,455,174
Class C preference shares	9,999,204

Type of security	Securities prior to the Note Issue
Options expiring 15 March 2011 exercisable at $0.25	141,500
Options expiring 26 November 2011 exercisable at $0.40	450,000
Options expiring 26 November 2011 exercisable at $0.40	300,000
Options expiring 26 November 2012 exercisable at $0.40	300,000
Options expiring 26 November 2013 exercisable at $0.40	300,000
Options expiring 2 August 2012 exercisable at $0.20	1,767,510
Total Options	3,259,010

The number of these securities will not change directly following the issue of the Note. Bone Medical will have one Note on issue.

As noted in section 1.5, the number of new Shares to be issued to La Jolla (if any) will depend on whether the Note is converted in whole or in part, the applicable Conversion Price and the prevailing US$/A$ exchange rate at the time of conversion.

By way of example, if the Note is converted in whole at a time when the relevant Volume Weighted Average Share Price is A$0.043 (which reflects the Share price at the close of trade on 14 January 2011, being the last Business Day prior to issue of this Cleansing Statement) and the US$/A$ exchange rate is 99.64 US cents for every A$1.00 (which reflects the US$/A$ exchange rate on 14 January 2011, the last Business Day prior to issue of this Cleansing Statement (refer to section 1.8)), 43,762,195 new Shares would be issued to La Jolla as outlined below:

$$\frac{(\text{US\$1,500,000}/0.9964)}{(80\%\times \text{A\$0.043})^{*}} = \frac{\text{A\$1,505,419.51}}{0.0344}$$

$$= 43{,}762{,}195 \text{ new Shares}$$

* Also refer to section 2.8

Based on the number of Shares on issue at the date of this Cleansing Statement, as set out in the table below, the issue of 43,762,195 new Shares to La Jolla would give La Jolla a relevant interest in approximately 30.77% of the expanded total number of Shares. It is, however, important to note that this is an illustration only based on full conversion of the Note and the example Volume Weighted Average Share Price and US$/A$ exchange rate referred to above. The actual outcome, if La Jolla elects to convert the Note in whole or in part, will depend on that election and the Conversion Price and the prevailing US$/A$ exchange rate applicable at the time of conversion.

In addition, La Jolla is subject to an "Ownership Limitation" under the terms of the Funding Agreement. Bone Medical shall not effect any conversion of a Note, and La Jolla shall not have the right to convert any portion of a Note, to the extent that after giving effect to the conversion, on the applicable Conversion Notice, La Jolla (together with its Affiliates, and any other person or entity acting as a group together with La Jolla or any of La Jolla's Affiliates) would beneficially own in excess of 19.99% of Bone Medical ("**Ownership Limitation**").

Consequently, in this example, La Jolla would only be able to partially convert the Note and receive approximately 24,600,000 new Shares due to the Ownership Limitation.

Shareholder	Number of Shares	Percentage of Total Shareholding
Existing Shareholders	98,455,174	80.01%
La Jolla	24,600,000	19.99%, due to the Ownership Limitation
TOTAL	**123,055,174**	**100%**

1.7 Pro forma Statement of Financial Position of Bone Medical taking account of the Note Issue

Set out on the following page are the audited consolidated Statement of Financial Position as at 30 June 2010 and the pro forma consolidated Statement of Financial Position as at 30 June 2010 for Bone Medical prepared on the basis of the accounting policies normally adopted by Bone Medical.

The audited historical and pro forma financial information is presented in an abbreviated form in so far as it does not include all of the disclosures required by Australian Accounting Standards applicable to annual financial statements.

The pro forma consolidated Statement of Financial Position as at 30 June 2010 is based on the audited consolidated Statement of Financial Position as at 30 June 2010 and has been adjusted to reflect the Note Issue.

CONSOLIDATED ENTITY'S STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 2010

	Audited Consolidated Statement of Financial Position as at 30 June 2010	Pro Forma Adjustment	Pro Forma Consolidated Statement of Financial Position as at 30 June 2010
	$	$	$
ASSETS			
CURRENT ASSETS			
Cash & cash equivalents	33,210	1,500,000	1,533,210
Trade and other receivables	19,281		19,281
TOTAL CURRENT ASSETS	52,491		1,552,491
NON-CURRENT ASSETS			
Other financial assets	-		-
Property, plant & equipment	6,104		6,104
Intangible assets	-		-
TOTAL NON-CURRENT ASSETS	6,104		6,104
TOTAL ASSETS	**58,595**		**1,558,595**
LIABILITIES			
CURRENT LIABILITIES			
Trade and other liabilities	971,448		971,448
TOTAL CURRENT LIABILITIES	971,448		971,448
NON-CURRENT LIABILITIES			
Loans and borrowings	-	1,500,000	1,500,000
Deferred payables	883,755		883,755
Amounts owed to subsidiaries	-		-
TOTAL NON-CURRENT LIABILITIES	883,755		2,383,755
TOTAL LIABILITIES	**1,855,203**		**3,355,203**
NET ASSETS/(NET LIABILITIES)	**(1,796,608)**		**(1,796,608)**
EQUITY			
Issued capital	17,193,744		17,193,744
Accumulated losses	(19,590,820)		(19,590,820)
Reserves	600,468		600,468
TOTAL EQUITY/(DEFICIT)	**(1,796,608)**		**(1,796,608)**

1.8 US$/A$ exchange rate

As the Purchase Price of the Note is denominated in US dollars, the exchange rate between US dollars and Australian dollars at any given time will be relevant.

It is important to note that the US$/A$ exchange rate may vary from time. As at 14 January 2011 (the last Business Day prior to the issue of this Cleansing Statement), the US$/A$ exchange rate equated to approximately 99.64 US cents for every Australian dollar (ie. US$0.9964 = A$1.00).

The US$/A$ exchange rate will impact on the amount (in Australian dollars) owed by Bone Medical to La Jolla from time to time and is relevant, along with the Conversion Price, in determining the number of new Shares to be issued to La Jolla on the conversion of the Note.

2. RIGHTS AND LIABILITIES ATTACHING TO THE NOTE

A summary of the key terms of the Note is set out below:

2.1 Purchase Price

The Purchase Price of the Note is US$1,500,000.

2.2 Payment of the Purchase Price

The payment of the Purchase Price of the Note will be made by La Jolla in instalments in the manner set out in section 1.4.

2.3 Interest

Interest is payable on the Principal Amount at the rate of 4.75% per annum monthly in arrears in cash or, at the option of Bone Medical, in new Shares issued at the then applicable Conversion Price.

2.4 Maturity Date

The maturity date of the Note is the date which is 3 years from the Initial Closing Date (**Maturity Date**).

2.5 Security

The Note is unsecured and the Principal Amount ranks for repayment behind all secured debts owed by Bone Medical and equally with all other unsecured debts owed by Bone Medical.

2.6 Conversion

La Jolla may convert the Note, either in whole or in part, by the delivery to Bone Medical of a Conversion Notice, provided that the delivery of a Conversion Notice will constitute a contract between La Jolla and Bone

Medical, whereby La Jolla will be deemed (subject to the valid exercise of the Prepayment Right — refer to section 2.7) to have subscribed for the number of new Shares which it will be entitled to receive on conversion of the Note pursuant to the Conversion Notice.

2.7 Bone Medical's Prepayment Right

If on the day La Jolla issues a Conversion Notice, the Volume Weighted Average Share Price is below AU$0.045, Bone Medical will have the right, by no later than 3.00pm Perth time on the date that is 5 Business Days after its receipt of such Conversion Notice, to prepay that portion of the Principal Amount of the Note that La Jolla has sought to convert pursuant to the Conversion Notice, plus any accrued and unpaid interest, at 105% of such amount (**Prepayment Right**).

If Bone Medical elects to exercise its Prepayment Right in these circumstances, La Jolla has the right to withdraw its Conversion Notice, in which case no payment is required to be made by Bone Medical.

2.8 Conversion Price

The number of new Shares into which the Note may be converted is equal to the Principal Amount that is to be converted (as specified in the Conversion Notice) divided by the Conversion Price.

The Conversion Price is equal to the lesser of:

(a) AU$0.40 (as adjusted for any stock splits, stock dividends, combinations, subdivisions, recapitalisations or the like); or

(b) 80% of the average of the three (3) lowest Volume Weighted Average Share Price during the twenty (20) Trading Days prior to La Jolla's election to convert (the percentage figure being a **Discount Multiplier**).

2.9 Mandatory Redemption

In the event Bone Medical is prohibited from issuing Shares for any reason, or fails to timely deliver Shares on a Delivery Date, or upon the occurrence of an Event of Default (refer to section 4.5), then at La Jolla's election, Bone Medical must pay to La Jolla ten Business Days after request by La Jolla or on the Delivery Date (if requested by La Jolla) a sum of money determined by multiplying up to the Principal Amount (as defined in the Note) of the Note designated by La Jolla by 120%, together with accrued but unpaid interest thereon in redemption of such portion of the Note (**Mandatory Redemption Payment**).

2.10 Redemption

Unless converted, the Note will be automatically redeemed on the Maturity Date. In these circumstances, the redemption money payable in respect of the Note must be paid to La Jolla on the Maturity Date.

Bone Medical may not make any prepayments on the Note without the consent of La Jolla.

2.11 **Adjustment for Fundamental Corporate Change**

If a "Fundamental Corporate Change" occurs, then La Jolla will have the right to:

(a) require Bone Medical to prepay a Note for cash at one hundred ten percent (110%) of the Principal Amount, together with all accrued and unpaid interest payable to the date of prepayment;

(b) receive the number of securities of the successor or acquiring corporation or of Bone Medical, if it is the surviving corporation, and Other Property as is receivable upon or as a result of such Fundamental Corporate Change by a holder of the number of shares of Shares into which the outstanding portion of a Note may be converted at the Conversion Price applicable immediately prior to such Fundamental Corporate Change; or

(c) require Bone Medical, or such successor, resulting or purchasing corporation, as the case may be, to, without benefit of any additional consideration, execute and deliver to La Jolla a convertible note with substantially identical rights, privileges, powers, restrictions and other terms as a Note in an amount equal to the amount outstanding under a Note immediately prior to such Fundamental Corporate Change.

A Fundamental Corporate Change includes a reorganisation or reclassification of capital, consolidation or merger of Bone Medical with a third party, the sale, transfer or disposal of substantially all of the assets and business of Bone Medical, or any transaction or series of transactions whereby more than 50% of the voting power of the Company is disposed of.

2.12 **No Shareholder Right**

Except as otherwise provided in the Funding Agreement, the Funding Agreement shall not entitle La Jolla to any of the rights of a Shareholder, including, without limitation, the right to vote, to receive dividends and other distributions, or to receive any notice of, or to attend, meetings of Shareholders or any other proceedings of Bone Medical, unless and to the extent converted into Shares in accordance with the terms of the Note.

2.13 **Transferability**

The Notes shall not be transferable by La Jolla unless La Jolla first obtains the written consent of Bone Medical.

2.14 **Conversion limits**

Conversion of the Notes will not be permitted if that would cause La Jolla's (together with any Affiliates) voting power in Bone Medical to increase to more than 19.99%.

2.15 ASX listing

The Note will not be quoted on ASX or any other securities exchange.

Under the Funding Agreement, Bone Medical is required to apply to ASX for quotation of any new Shares issued on the conversion of the Note within 2 Trading Days of the issue of those new Shares.

3. RIGHTS AND LIABILITIES ATTACHING TO SHARES ISSUED ON THE CONVERSION OF THE NOTE

The new Shares to be issued to La Jolla on the conversion of the Note will rank equally in all respects with all of the existing Shares. The rights attaching to Shares, including the new Shares to be issued to La Jolla on the conversion of the Note, are set out in the Constitution and, in certain circumstances, regulated by the Corporations Act, the ASX Listing Rules and the general law.

The following is a summary of the principal rights attaching to those Shares:

3.1 Voting

Subject to any rights or restrictions attached to any class of Shares, every holder of Shares present in person or by proxy, attorney or representative at a meeting of Shareholders has one vote on a vote taken by a show of hands and, on a poll, one vote for every Share held by him or her.

A poll may be demanded by the chair of the meeting, by any 5 Shareholders present in person or by proxy, attorney or representative having the right to vote at the meeting or by any one or more Shareholders who are together entitled to not less than 5% of the total voting rights, or paid up value of the Shares, of all those Shareholders having the right to vote at that meeting.

3.2 Dividends

Dividends are payable out of Bone Medical's profits and are determined to be payable by the Directors, who may fix the amount, time and method of payment. The Company in general meeting may determine a dividend, but only if the Directors have recommended a dividend. Where there is more than one class of Shares, any dividend may be paid on the Shares of any one or more class or classes to the exclusion of the Shares of any other class or classes. Shares within each class must share equally in any dividend declared in respect of that class.

3.3 Transfer of Shares

A Shareholder may transfer Shares by a market transfer in accordance with any computerised or electronic system established or recognised by ASX or the Corporations Act for the purpose of facilitating transfers in Shares or in any manner required or permitted by law, the ASX Listing Rules and the ASTC Settlement Rules.

There is no restriction on the transfer or Shares except where permitted or required by law, the Listing Rules, the ASTC Settlement Rules or the Constitution. The Directors must not prevent, delay or interfere with the generation of a proper ASTC transfer or the registration of a paper-based transfer in registrable form of any securities.

3.4 **Meetings and notice**

Each Shareholder is entitled to receive notice of and to attend general meetings of Bone Medical and to receive all notices, accounts and other documents required to be sent to Shareholders under the Constitution, the Corporations Act or the ASX Listing Rules.

3.5 **Winding up**

If Bone Medical is wound up, a liquidator may, with the sanction of a special resolution, divide among the members in kind the whole or any part of the property of Bone Medical. The liquidator may set the value that it considers fair upon any property to be do divided and may determine how the division is to be carried out as between different classes of members.

3.6 **Issue of further Shares**

The Directors have control over issuing any new Shares, and may issue Shares to persons at times and on terms and conditions and such rights (including preferred, deferred or other special rights) or restrictions as the Directors see fit. However, the Directors must act in accordance with the Corporations Act, the ASX Listing Rules and any rights for the time being attached to the Shares.

3.7 **Dividend Reinvestment Plan and Bonus Share Plan**

The Constitution authorises the Directors (or the Company in general meeting) to establish and maintain dividend reinvestment plans (whereby any Shareholder may elect that dividends payable by Bone Medical be reinvested by way of subscription for new Shares) and bonus share plans (whereby any Shareholder may elect to forego any dividends payable on all or some of the Shares held by that Shareholder and to receive instead new Shares) and employee incentive plans.

3.8 **Unmarketable parcels**

The Constitution contains procedures to enable Bone Medical to seek to sell unmarketable parcels of Shares on behalf of Shareholders, unless the Shareholder requests otherwise, subject to the ASX Listing Rules.

3.9 **Variation of class rights**

The rights attaching to any class of shares may be varied, cancelled only:

(a) by special resolution of the Company; and

(b) either:

(i) with the written consent of members with at least 75% of the votes in that class; or

(ii) by a special resolution passed at a separate meeting of the holders of those shares.

Written notice of a variation or cancellation of rights must be provided to Shareholders in the class affected by the variation or cancellation.

3.10 ASX Listing Rules

While Bone Medical is admitted to the official list of ASX, if the ASX Listing Rules prohibit an act being done, the act must not be done despite anything in the Constitution. Nothing in the Constitution prevents an act being done that the ASX Listing Rules require to be done. If a provision of the Constitution is or becomes inconsistent with the ASX Listing Rules, the Constitution is deemed not to contain that provision to the extent of the inconsistency.

3.11 Shareholder liability

As the new Shares to be issued on conversion of the Note are fully paid, they are not subject to any calls for money by the Directors and will therefore not become liable for forfeiture.

3.12 Alteration of Constitution

The Constitution can only be amended by a special resolution passed by at least 75% of Shareholders present and voting at a general meeting.

4. SUMMARY OF THE KEY TERMS OF THE FUNDING AGREEMENT

The terms of issue of the Note (and any Subsequent Notes which may be issued by Bone Medical to La Jolla) are governed by the Funding Agreement. To the extent that the key terms of the Funding Agreement are not addressed in sections 1.1, 1.3, 1.4 and 2 above, a summary is outlined below.

4.1 Conditions precedent to the Note Issue

Under the Funding Agreement, Bone Medical and La Jolla have agreed that, on the satisfaction of certain conditions, Bone Medical will issue the Note to La Jolla. The conditions which are required to be satisfied include:

(a) the lodgement of this Cleansing Statement with ASX;

(b) any approvals required for the Note Issue having being obtained, including any approval required under ASX Listing Rule 7.1 and approval through the Foreign Investment Review Board ("**FIRB**");

(c) Bone Medical confirming to La Jolla that Bone Medical's board of Directors has authorised the execution of the Funding Agreement, the Note Issue and the transactions contemplated by the Funding Agreement;

(d) the representations and warranties made by Bone Medical to La Jolla in the Funding Agreement are confirmed by Bone Medical as being accurate;

(e) there being no suspension of trading in Shares in ASX, no declaration of a banking moratorium in the US or Australia and no material outbreak or escalation of hostilities in the US or Australia;

(f) there being no event or development which would reasonably and foreseeably have a material adverse effect on the business, properties, prospects, condition (financial or otherwise) or results of operations of Bone Medical or its subsidiaries or on the consummation of the transactions contemplated by the Funding Agreement;

(g) no Event of Default under the Funding Agreement has occurred;

(h) no law, order, ruling, judgement or writ which would restrain or prohibit the transactions contemplated by the Funding Agreement;

(i) La Jolla having received such documents, certificates, payments or other deliveries as it may reasonably request and as are customary to give effect to the transaction in the Funding Agreement; and

(j) a legal opinion is delivered to La Jolla issued by the Company's legal advisers regarding the enforceability of the Funding Agreement.

At the date of this Cleansing Statement, Bone Medical has satisfied each of the relevant conditions set out in the Funding Agreement capable of being satisfied, or they have been waived as the case may be, and will issue the Note on the date of this Cleansing Statement.

4.2 Conditions precedent to the making of Monthly Payments in respect of the Note

The obligation on La Jolla to make a Monthly Payment in respect of the Note is also subject to the satisfaction of certain conditions on or before the time the Monthly Payment is to be made. These conditions are essentially the same as the conditions that must be satisfied prior to the Note Issue, save and except that there is no condition regarding the lodgement of a cleansing statement, authorisation by the Board, provision of documents and issue of a legal opinion as referred to in sections 4.1(a), (c), (i) and (h) above. There is an additional condition that the Company must have honoured all Conversion Notices submitted by La Jolla as required and the Shares issued must have been transferable on ASX within one day of their issue.

4.3 Representations and warranties made by Bone Medical

The representations and warranties made by Bone Medical to La Jolla in the Funding Agreement include representations and warranties as to, among other things:

(a) Bone Medical being able to enter into the Funding Agreement and perform all of its obligations under the Funding Agreement including the issue of the Note (and the Subsequent Notes — refer to section 4.4) to La Jolla and the issue of new Shares to La Jolla on the conversion of the Note (and the Subsequent Notes);

(b) Bone Medical being solvent and able to pay all of its debts as and when they fall due;

(c) Bone Medical not being the subject of any actual or threatened litigation that might result in any material adverse change in the business, assets or condition of Bone Medical and its subsidiaries, taken as a whole;

(d) there being no event or development that reasonably could be expected to have a material adverse effect on the business, properties, prospects, condition or results of operations of Bone Medical or materially and adversely affect the ability of Bone Medical to perform its obligations under the Funding Agreement;

(e) all tax returns and regulatory filings with the ASX and ASIC have been completed in accordance with applicable laws; and

(f) no Event of Default has occurred and is continuing (refer to section 4.5).

4.4 The issue of Subsequent Notes

La Jolla has agreed to purchase three additional convertible notes, each with an issue price of US$1,500,000 (**Subsequent Notes**) during the 'Subsequent Note Period', being the period commencing on the date that the outstanding Principal Amount of the Note on issue is equal to, or less than, US$250,000 and ending 180 days thereafter.

The form and terms of each Subsequent Note, the purchase of the Subsequent Note and the payment of the Purchase Price for each Subsequent Note is the same as apply to the initial Note.

If a Subsequent Note is purchased by La Jolla, those conditions which must be satisfied before the issue of the Note and the making of the Monthly Payments in respect of the Note also apply in respect of the issue of any Subsequent Note and monthly payments in respect of a Subsequent Note.

If, on the date which is two years following the Initial Closing Date, the Volume Weighted Average Share Price is below AU$0.08, and La Jolla has funded only $10,000 per month for three consecutive months, then Bone Medical shall have the option, in its sole and absolute discretion, to terminate La Jolla's right to purchase any Subsequent Notes, by informing La Jolla of this decision in writing within five Business Days following the date which is two years following the Closing.

If, at the time La Jolla provides notice to Company that it intends to purchase the third Subsequent Note, the Volume Weighted Average Share Price is below AU$0.08, Bone Medical shall have the option, in its sole and absolute discretion, to terminate La Jolla's right to purchase the third and fourth Subsequent Notes, by informing La Jolla of its decision in writing within five Business Days following the receipt of La Jolla's notice of intent to purchase the third Subsequent Note.

4.5 Events of Default

If an Event of Default occurs and is continuing, La Jolla may in its sole and absolute discretion rescind any Conversion Notice and require the immediate repayment of all amounts owing or otherwise outstanding under the Note (and/or any Subsequent Notes) it has purchased. In these circumstances, Bone Medical must pay 110% of the outstanding Principal Amount, together with all accrued and unpaid interest.

Each of the following, among other events, constitute an Event of Default if they occur and are not cured by Bone Medical within 10 Business Days of becoming aware of the event occurring:

(a) Bone Medical defaults in the payment of principal of or interest on the Note (and/or any Subsequent Notes) and such default continues for five Business Days;

(b) Bone Medical fails to deliver to La Jolla either the new Shares set out in a Conversion Notice submitted by La Jolla or, if applicable, the amount of cash necessary to redeem the Note (and/or any Subsequent Notes);

(c) Bone Medical breaches the Funding Agreement and such breach continues for a period of ten Business Days after the delivery to Bone Medical of written notice that Bone Medical is in breach;

(d) any of the representations, warranties or covenants made by Bone Medical are false or misleading in a material respect;

(e) an insolvency event occurs in respect of Bone Medical or any of its subsidiaries;

(f) a judgment is entered against the Company for payment of money and remains undischarged for 30 days, where the aggregate amount outstanding exceeds $100,000;

(g) it becomes unlawful for Bone Medical to perform or comply with its obligations in any respect;

(h) the Shares no longer can be traded on the ASX, or shall be suspended from trading on the ASX, and shall not be reinstated, relisted or such suspension lifted within five days;

(i) Bone Medical fails to issue a cleansing statement in compliance with ASIC Class Order 10/322, in a form and substance acceptable to La

Jolla, with the ASX, as required by the terms of the Funding Agreement;

(j) the average Volume Weighted Average Share Price for any period of 3 consecutive Trading Days is less than $A0.005 per Share;

(k) the Shares issued to La Jolla on the conversion of the Note (and/or any Subsequent Notes) are not granted official quotation by ASX;

(l) Bone Medical fails to receive all necessary consents, including without limitation stockholder consents, necessary for the issuance of the Note or any Shares issuable upon conversion of the Note to La Jolla;

(m) Bone Medical fails to timely file all reports required to be filed by it under any applicable law, rule or regulation; and

(n) Bone Medical defaults in the payment of principal or interest under any indebtedness, individually or in the aggregate, of more than A$50,000.

4.6 Indemnity

Bone Medical agrees to indemnify La Jolla, its affiliates and their respective officers, directors, employees, consultants, partners, members and attorneys from and against any and all losses, claims, damages, judgements, penalties and liabilities, and agrees to reimburse these parties for all reasonable out-of-pocket expenses, incurred by these parties to the extent arising out of or in connection with a breach by Bone Medical of:

(a) any misrepresentation, omission of fact or breach of any of Bone Medical's representations or warranties contained in the Funding Agreement or other necessary documentation, or any instrument, agreement or certificate entered into or delivered by the Company pursuant to the Funding Agreement; and

(b) any failure by Bone Medical to perform any of its covenants, agreements, undertakings or obligations under the Funding Agreement or any instrument, certificate or agreement entered into or delivered by Bone Medical pursuant to the Funding Agreement.

4.7 Governing law

The Funding Agreement is governed by and interpreted in accordance with the laws of the State of California, US.

5. ADDITIONAL INFORMATION

5.1 Bone Medical is a "disclosing entity"

Bone Medical is a "disclosing entity" under the Corporations Act and, accordingly, is subject to regular reporting and disclosure obligations under both the Corporations Act and the ASX Listing Rules.

These obligations require Bone Medical to notify ASX of information about specific events and matters as they arise. In particular, Bone Medical has an obligation under ASX Listing Rule 3.1 and section 674 of the Corporations Act (subject to certain limited exceptions) to notify ASX immediately once it is or becomes aware of information concerning Bone Medical that a reasonable person would expect to have a material effect on the price or value of the Shares.

Bone Medical is also required to prepare and lodge with ASIC yearly and half-yearly financial statements accompanied by a Directors' statement and report, and an audit report or review. Copies of documents lodged with ASIC in relation to Bone Medical may be obtained from, or inspected at, an ASIC office (refer to section 5.2).

5.2 Copies of documents

Bone Medical will provide a copy of each of the following documents, free of charge, to any person on request:

(a) the annual financial report most recently lodged by Bone Medical with ASIC, being the financial report of Bone Medical for the year ended 30 June 2010 (**2010 Financial Report**);

(b) any half-year financial report lodged by Bone Medical with ASIC after the lodgement of the 2010 Financial Report and before the lodgement of this Cleansing Statement with ASX; and

(c) any continuous disclosure documents given by Bone Medical to ASX after the lodgement of the 2010 Financial Report and before the lodgement of this Cleansing Statement with ASX.

A list of the continuous disclosure documents given by Bone Medical to ASX after the lodgement of the 2010 Financial Report and before the lodgement of this Cleansing Statement with ASX is set out in the table below.

Date	Subject of Announcement
31 December 2010	Securities Trading Policy
20 December 2010	Change of Director`s Interest Notices
14 December 2010	Expiry of Options and Appendix 3B
30 November 2010	Results of Meeting
29 October 2010	Notice of Annual General Meeting/Proxy Form
29 October 2010	Annual Report to shareholders
29 October 2010	Appendix 4C - quarterly
5 October 2010	US$6 Million Convertible Note Facility
4 October 2010	Expiry of Options and Appendix 3B

5.3 **Information excluded from continuous disclosure notice**

Other than as set out in this Cleansing Statement, there is no information about the Note or the Funding Agreement that has been excluded from a continuous disclosure notice in accordance with the ASX Listing Rules, which is information that investors would reasonably expect to be included in this Cleansing Statement.

5.4 Glossary

2010 Financial Report means the annual financial report lodged by Bone Medical with ASIC in respect of the year ended 30 June 2010.

A$ means Australian dollars.

Affiliates means in relation to any entity:

(a) any entity it controls;

(b) any entity under common control with it by another entity; or

(c) any entity which controls it.

ASIC means the Australian Securities and Investments Commission.

ASX means ASX Limited ACN 008 624 691.

ASX Listing Rules means the listing rules of ASX.

Business Day means a day other than a Saturday, Sunday or any other day on which banks located in California, US and Victoria, Australia are authorised or obligated to close.

Bone Medical means Bone Medical Holdings Limited ACN 009 109 755.

Cleansing Statement means this cleansing statement issued on 17 January 2011 under section 708(12C)(e) of the Corporations Act (as inserted by ASIC Class Order [CO 10/322]).

Constitution means the constitution of Bone Medical at the date of this Cleansing Statement.

Conversion Notice means the notice by which La Jolla notifies Bone Medical that it wishes to convert the Note, either in whole or in part, into new Shares, as outlined in section 2.6.

Conversion Price means the price at which new Shares are issued on the conversion of the relevant Principal Amount (as specified in the relevant Conversion Notice), in accordance with the formula outlined in section 2.8.

Corporations Act means the Corporations Act 2001 (Cth).

Delivery Date means the date within two Business Days after receipt by the Company of a Conversion Notice.

Directors means the directors of Bone Medical at the date of this Cleansing Statement.

Event of Default means an event outlined in section 4.5.

Fundamental Corporate Change has the meaning given to that term in section 2.11.

Funding Agreement means the funding agreement dated 5 October 2010 between Bone Medical and La Jolla, pursuant to which the Note (and any Subsequent Notes) will be issued to La Jolla.

Initial Closing Date has the meaning set out in section 1.3.

Initial Payment means the initial payment of US$100,000 already made by La Jolla as at the Initial Closing Date as part payment of the Purchase Price.

La Jolla means La Jolla Cove Investors, Inc., a corporation registered in California, US of Suite 218, 1150 Silverado Street, La Jolla, California, US.

Maturity Date means the date which is 3 years from the Initial Closing Date.

Monthly Payments means the monthly payments to be made by La Jolla towards the payment of the Purchase Price in the manner outlined in section 1.4.

Note means the convertible note to be issued by Bone Medical to La Jolla under the Funding Agreement on the Initial Closing Date, or a Subsequent Note, as the context requires.

Note Issue means the issue of the Note to La Jolla pursuant to the Funding Agreement.

Option means an option to acquire a Share.

Other Property means any cash, shares or other securities or property of any nature whatsoever (including warrants or other subscription rights) in addition to or in lieu of shares of any successor or acquiring corporation.

Prepayment Right means Bone Medical's right, in certain circumstances, to prepay that portion of the Principal Amount of the Note that La Jolla has sought to convert, plus any accrued and unpaid interest, at 105% of such amount, as outlined in section 2.7.

Principal Amount means, at any time, the then outstanding principal amount of the Note, but only such amount in respect of which La Jolla has actually advanced and not furnished a Conversion Notice.

Purchase Price means the purchase price (or face value) of the Note, being US$1,500,000.

Share means a fully paid ordinary share in the capital of Bone Medical.

Shareholder means a shareholder of Bone Medical.

Subsequent Notes means up to three additional convertible notes which La Jolla may purchase under the Funding Agreement.

Trading Day means any day on which the ASX was open.

US means the United States of America.

US$ means US dollars.

Volume Weighted Average Share Price means for any date, the daily volume weighted average sale price of the Shares for such date on ASX.

CORPORATE DIRECTORY

DIRECTORS	Mr Leif Helth Jensen (Non Executive Chairman, CEO) Mr Leon Ivory (CEO, Director) Prof. Peter Brooks MD (Executive Director) Dr Roger New (Executive Director) Dr Barry Walker (Executive Director)
SECRETARY	Mr Mark Clements
REGISTERED AND PRINCIPAL OFFICE	PO Box 1110 Bentley DC WESTERN AUSTRALIA 6983 Telephone: +61 8 9355 5123 Facsimile: +61 8 9355 5210
ASX CODE	BNE
WEBSITE	www.bone-ltd.com