Phylogica Limited

ACN 098 391 961

Financial Report

30 June 2007

Phylogica Limited
ACN 098 391 961

Directors

Mr Joachim von Roy
Independent Non-executive Chairman

Mr Harry Karelis
Non-executive Director

Mr Bruce McHarrie
Non-executive Director

Dr Mark Pierce
Independent Non-executive Director

Dr Stewart Washer
Executive Director

Dr Paul Watt
Executive Director

Contents

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Auditors
KPMG
Central Park
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Incorporated in Western Australia, October 2001
Listed on the Australian Stock Exchange (ASX)
Home Exchange: Perth
Code: PYC ordinary shares

The directors present their report on Phylogica Limited (referred to in these financial statements as ñthe Companyò or ñPhylogicaò) together with the financial report for the year ended 30 June 2007 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

Mr Joachim von Roy Independent Non ï Executive Chairman	62	Appointed 24th August 2004. Current term ends November 2007. Joachim (Aki) von Roy was the founding CEO of CoDa Therapeutics Ltd and of Proacta Therapeutics Ltd, both private biotechnology companies based in New Zealand. He also serves on a number of boards of both commercial and not-for-profit organisations based in Australia, New Zealand and the United States. Before founding the consulting firm of RvR Associates in 1997, Mr von Roy was president of Bristol-Myers Squibb, Europe, an organisation with sales of US$2.2billion and more than 7,500 employees. Previously he was with Schering AG as Assistant to the Board of Management in the United Kingdom, moved to Managing Director in New Zealand, then to Scandinavia and subsequently to the United States to introduce Scheringõs first product since 1945. He ultimately co-headed the pharmaceutical division of Schering AG in Germany. He went on to join Squibb-von Heyden as President, Germany, later taking on responsibility for Austria, Switzerland and Eastern Europe as well. It was shortly after the merger of Bristol-Myers Squibb that he was appointed President, Europe. Directorships which he currently holds include: Genesis Research Corporation Ltd, Biomatters Ltd, Phytomedics Inc. Corra Life Sciences Inc. Directorships relinquished during the last three years were with Proacta Corporation Ltd and Dentman AG.
Mr Harry Karelis BSc(Hons) MBA F.Fin CFA FAICD Non-executive Director	37	Appointed 25 January 2005. Current term ends January 2008. Mr Karelis is the founder and Managing Director of Titan BioVentures Management Pty Ltd. Titan is the investment manager of BioTech Capital Ltd (one of the largest life-science focused private equity funds in Australia) and Harry was instrumental in the establishment and ongoing management of this company. BioTech Capital is considered a leading life sciences fund in Australia. Harry has led investments in drug discovery, regenerative medicine, medical devices and several other technology platform areas.

		Mr Karelis graduated from The University of Western Australia with Bachelors and Honours in Science majoring in Biochemistry and Microbiology as well as a Masters in Business Administration. He is a Fellow of the Financial Services Institute of Australia, a Fellow of the Australian Institute of Company Directors and has qualified as a Chartered Financial Analyst (CFA) from the CFA Institute in the United States. Prior to establishing BioTech Capital, Mr Karelis worked in the financial services industry with roles in financial analysis and funds management both in Australia and overseas. He has diversified experience in the financial services sector including fundamental analysis, funds management and private equity investing. He has also been a successful angel investor in several biotechnology companies and sits on the boards of several private and public life-science companies. In 2004 he co-founded Gateway Capital Ltd as a specialist life-science investment bank focused on commercialising promising early stage technologies. Mr Karelis has been a director of Biotech Capital Ltd since 18 May 2000 and of Stem Cell Sciences plc since 23 July 2003. He was a director of Clinical Cell Culture Ltd for the period 13 August 2003 to 22 October 2004.
Mr Bruce McHarrie BCom CA Non-executive Director	49	Appointed 9 August 2002. Current term ends November 2007. Mr McHarrie has been in the biotechnology industry for over 12 years. Currently he is the Chief Financial Officer 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.
Dr Mark Pierce MD PhD Independent Non-executive Director	59	Appointed 20 February 2007. Current term ends November 2007. Dr Pierce is the recently retired former Senior Vice President of Clinical Research at Pfizer, Inc. (the world's largest pharmaceutical company with revenues over US$50 billion). Dr Pierce graduated from Northwestern University Medical

		School in Chicago and received his postgraduate training in internal medicine at the Peter Bent Brigham Hospital and Massachusetts General Hospital in Boston. Subsequently, he was Senior Vice President of Clinical Research at Pfizer, after directing clinical development at Abbott Laboratories and Warner Lambert Company. Dr Pierce has a wealth of international drug development experience.
Dr Saliba Sassine BEc(Hons) PhD Independent Non-executive Director	53	Appointed 9th October 2001. Resigned 26 November 2006. He is Executive Chairman of Allegra Capital Pty Ltd, a niche investment advisory firm focused on biotechnology, renewable energy and natural resources. Dr Sassine is an economist with many years experience in the management of publicly listed and privately-held, emerging and innovative technology and natural resources companies. Dr Sassine has held positions at Chairman or CEO level in a number of technology and emerging companies and has directed and advised on the activities of a number of start-up and early stage enterprises at pre and post-IPO.

Executive

Dr Stewart Washer BSc (Hons) PhD Executive Director, Chief Executive Officer (CEO) and Managing Director	38	Appointed 25 January 2005. The position of Managing Director is not subject to retirement by rotation. Dr Washer has over 12 years of senior executive and board experience in commercial technology companies in healthcare, food, agricultural and environmental sectors. He has extensive international capital experience, having raised over $38 million in private shareholder and government funds. Dr Washer was Chief Executive Officer of Celentis Ltd, prior to his appointment at Phylogica and managed the commercialisation of intellectual property from the largest Crown Research Institute in New Zealand with 650 scientists and $130 million in revenues. During this time he formed and governed a number of successful biotechnology company spin-offs that employed over 100 staff and realised profitable annual product revenues of $30 million per annum. Before this he was based in Australia where he also formed a number of successful biotechnology companies. He is presently also a director of Genesis Research Corporation Ltd.
Dr Paul Watt BSc(Hons) D Phil Executive Director Vice President Research	42	Appointed 9 August 2002. Current term ends November 2008. Dr Watt is Director and Vice President Research of Phylogica Ltd. As a top graduate from the University of Western Australia, Dr Watt won a Commonwealth Overseas Scholarship and completed his doctorate at the University of Oxford. After completing Post Doctoral appointments at Oxford and Harvard Universities, he returned to Perth in 1996 as a scientist at the

		Telethon Institute for Child Health Research (the Institute). He now holds an appointment at the Institute as honorary Research Fellow. Specialising in biotechnology, he has attracted over $2.5 million in research funding from Australia and the United States for the technology underpinning Phylogica Ltd. Appointed by the University of Western Australia as adjunct Associate Professor, Dr Watt has published widely in high impact journals and has filed 16 patent applications for the products of his research work. He is also director of InfaMed Ltd, a medical devices company, founded by him, which was acquired by Visiomed Group Limited, a profitable public company of which he is a non-executive director which markets medical devices internationally.

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

2. Company Secretary

Mr David Berinson DipCM, FCIS FAICD AFAIM MHRI MIAA (Aust) Company Secretary at 30 June 2007	63	Appointed 16 March 2007. Resigned 17 August 2007 Mr Berinson was appointed Vice President Finance and Administration on 5 January 2007. He was the Company Secretary at 30 June 2007.
Mr Graeme R Boden BEc(Hons) FAICD FCPA Company Secretary at the date of this report	58	Mr Boden served as secretary of Phylogica for over six years, from incorporation until March 2007, and was reappointed in August 2007. He has held company secretarial positions for 25 years and has over 15 years experience as a director or secretary of ASX listed companies.

3. DirectorsôMeetings

The number of directorsômeetings (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**		**Remuneration Committee**	
	A	B	A	B	A	B
J von Roy	8	7			3	3
H Karelis	8	7	3	3		
B McHarrie	8	8	3	3	3	3
M Pierce	3	3				
S Sassine	3	3	1	1		
S Washer	8	8			3	3
P Watt	8	8				

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 discovery and development of novel therapeutics directed at proteins and their interactions.

5. Operating Results

The Company's operating loss after tax for the financial period ended on 30 June 2007 was $3,888,673 (2006 loss: $3,991,475). The Company's net assets at 30 June 2007 were $2,196,662 (2006: $2,114,304).

6. Review of Operations, likely Developments and Expected Results

The year ended 30 June 2007 saw Phylogica make a loss of $3,888,673. The nature of the Company's business is such that future performance will depend upon the success of its technologies and their amenity to commercialisation. Expenditure continues to be in line with budget.

Highlights of the period include:

- Phylogica signed a commercialisation agreement with the McComb Foundation in order to take the promising burns treatment PYC35B further into drug development.

- The co-development agreement with Irish biotechnology company Opsona Therapeutics, advanced significantly, with Phylogica delivering over 50 hits against an intracellular target in the Toll-Like receptor (TLR) pathways to Opsona; over half of these hits were biologically active, and are being developed further for testing in animal models.

- A new Phylomer® peptide directed against the intracellular target AP-1, demonstrated significant biological activity in an animal model of Acute Respiratory Distress Syndrome (ARDS), and is being developed for acute lung failure disease indications.

- Dr Douglas Francis, formerly of Pharmaxis, was appointed as Vice President Drug Development, in order to advance Phylogica's drug pipeline through preclinical development to an IND-ready state.

- Phylogica was awarded a three year grant from the Western Australian Neurotrauma Research Program to further develop its drug candidates for treatment of traumatic brain injury.

- Phylogica announced that it had achieved a major aim of its Commercial Ready Grant-funded program in Rheumatoid Arthritis (RA), by generating multiple drug candidates with high binding strength to several key targets in inflammation diseases such as RA.

- A major US patent was allowed, extending coverage of our Phylomer® libraries and construction methods and confirming our ownership of this approach to drug discovery, as well as validating the novelty of the Phylomer® approach.

- The former Vice President of Clinical Research at Pfizer Inc., Dr Mark Pierce, joined the Phylogica Board of Directors, strengthening the expertise and international pharmaceutical industry experience of the Phylogica Board

Phylogica continues to build on its strategy of collaboration with Australian and internationally recognised centres of excellence and scientists in the pursuit of its objectives.

The Directors do not consider that forecasting future performance is anything other than speculative, as it will depend upon the success of the Company's further development and commercialisation of its intellectual property into drug candidates or licensing opportunities.

7. Significant Changes in the State of Affairs

During the year, a total of 14,238,728 shares were issued to raise $4,076,922.

A Shareholder Share Purchase Plan in October 2006 resulted in 4,413,724 shares being issued at $0.29 and a placement conducted contemporaneously saw a further 8,517,258 shares being issued, also at $0.29. In conjunction with these issues, 7,482,409 options were granted, exercisable at $0.25 on or before 31August 2007.

Throughout the year, 1,307,746 options expiring 31 August 2007 were exercised at $0.25 per share.

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

Subsequent to the year end and prior to expiry on 31 August 2007, a total of 17,946,768 options were exercised at $0.25, raising $4,486,692. The exercise of the options was underwritten and shares, relating to the 2,743,997 options which were not exercised, were issued subsequently, raising a further $686,000.

At the date of this report the issued capital of the Company is 143,501,764 shares.

10. DirectorsôInterests

The relevant interest of each director in the shares and options over shares issued by the Company 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**
J von Roy	687,241	750,000
H Karelis	29,166,667	-
B McHarrie	1,870,479	-
M Pierce	-	-
S Washer	2,720,670	3,000,000
P Watt	4,527,031	2,000,000

11. Indemnification and Insurance of Directors and Officers

11.1 Directors' and officers' indemnity

The Company has agreed to indemnify each Director and the Company Secretary (Officers) against all liabilities or loss (other than the Company or a related body corporate) that may arise from their position as Officers of the Company and its controlled entities, except where the liability arises out of conduct involving a lack of good faith, or indemnification is otherwise not permitted under the Corporations Act. The indemnity stipulates that the Company 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 Company.

The Company has also indemnified the current directors and certain members of its senior management for all liabilities and loss (other than the Company 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 Company has executed deeds of indemnity, access and insurance in favour of each Officer of the Company.

11.2 Directors' and officers' insurance

The Company has paid insurance premiums for one year cover in respect of directorsôand officersôliability insurance contracts, for Officers of the Company. The insurance cover is on standard industry terms and provides cover for loss and liability for wrongful acts in relation to the relevant personɒs 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 Company or of a related body corporate of the Company.

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, KPMG, the Companyɒs 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 auditorɒs 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 to KPMG and its related practices for audit and non-audit services provided during the year are set out below.

	$
Audit and review of financial report	31,824
Government grant audit services	6,550
Tax advisory services	2,000
	40,374

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 contracts of executive employment for Dr S Washer and Dr P Watt.

14. Unissued Shares Under Option

At 30 June 2007, ordinary shares of the Company under option were 27,860,765, exercisable on or before 31 August 2007 or 30 June 2010 (2006: 21,686,102 options).

	Exercisable at $0.25	Exercisable at $0.30	Total
Number of options issued 30 June 2007	27,340,765	520,000	27,860,765
Number of options vested 30 June 2007	27,040,765	366,667	27,407,432

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. Corporate Governance Statement

Since the introduction of the ASX Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations* (ASX Principles and Recommendations), Phylogica Limited (the Company) has made it a priority to adopt systems of control and accountability as the basis for the administration of corporate governance. Some of these policies and procedures are summarised in this report. Commensurate with the spirit of the ASX Principles and Recommendations, the Company has followed each recommendation where the Board has considered the recommendation to be an appropriate benchmark for corporate governance practices, taking into account factors such as the size of the Company and the Board, resources available and activities of the Company. Where, after due consideration, the Company's corporate governance practices depart from the ASX Principles and Recommendations, the Board has offered full disclosure of the nature of, and reason for, the adoption of its own practice.

Further information about the Company's corporate governance practices is set out on the Company's website at www.phylogica.com. In accordance with the ASX Principles and Recommendations, information published on the Company's website includes charters (for the board and its sub-committees), the Company's code of conduct and other policies and procedures relating to the Board and its responsibilities.

Explanations for Departures from Best Practice Recommendations

Principle 2
Recommendation 2.1: A majority of the Board should be independent directors

Notification of departure
The Board does not have a majority of independent directors. It currently comprises 2 independent and 4 non-independent directors.

Explanation for departure
The Board considers that its current structure is appropriate given the small size of the Company and the early stage of development of its key projects. Further, the Board considers the current directors provide the necessary diversity of skills and experience needed to serve the Company's interests at this time. The Board has an independent director, Mr von Roy, as Chairman. Further, the Board notes only two of the six directors are executive, therefore the majority of directors on the Board do not have a role in the day-to-day management of the Company, nor do those directors participate in the preparation of the accounts. The Board will continue to monitor the effectiveness of its structure and will make any changes as are deemed desirable as the Company continues to grow.

Principle 2
Recommendation 2.4: The Board should establish a nomination committee

Notification of departure:
No separate nomination committee has been established

Explanation for departure:
The full Board considers those matters that would usually be the responsibility of a nomination committee. The Board considers that no efficiencies or other benefits would be gained by establishing a separate nomination committee. The Board has adopted a Nomination Committee Charter, which it applies when convening as the nomination committee.

Recommendation: 4.3: Audit committee be composed of majority of independent directors and independent Chairperson

Notification of departure:
The audit committee does not meet the requirements for size and composition. There are no independent directors as members of the audit committee, which consists of two directors rather than three.

Explanation for departure:
Due to the current structure of the Board, Messrs McHarrie and Karelis are the most appropriate members to serve on the Audit Committee. Although there are two independent member of the Board, Mr von Roy and Dr Pierce, the Board considers that it would not be suitable for them to sit on the Audit Committee as they reside in New Zealand and the United States of America, respectively. The Board considers the composition of the Audit Committee satisfactory to ensure the integrity of the financial accounts, particularly as neither of the non-independent members is involved in preparing the financial reports, nor holds an executive position. Mr McHarrie is the Chief Financial Officer of the Telethon Institute for Child Health Research which has a 16.78% shareholding and has contracts with the Company. Mr Karelis is a shareholder in a company which has a 23.75% shareholding in the Company. Both of these interests are aligned with all shareholders interest in ensuring integrity of the Company's financial information.

17. Nomination Committee

The full Board carries out the function of the nomination committee. During the reporting period, the Board had discussions regarding the composition of the Board and the composition of the Scientific Advisory Board. These discussions took place on 3 occasions with a majority of the Board being present.

18. Audit Committee

The audit committee is comprised of:
Mr McHarrie (Chairman)
Mr Karelis.

The audit committee met three times during the reporting period and all committee members were present.

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

19. Remuneration Committee

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

Details of remuneration, including the CompanyÕs policy on remuneration, are contained in the ÒRemuneration ReportÓ which forms of part of the DirectorsÕ report.

The members of the remuneration committee during the year were:

Mr J (Aki) von Roy	-	Independent Non-Executive
Dr S Washer	-	Executive
Mr B McHarrie		Non-Executive

Dr Washer attends remuneration committee meetings to discuss the performance of executive officers and remuneration arrangements but does not attend meetings involving matters pertaining to him.

The remuneration committee meet at least twice a year and as required. The committee met three times during the year and committee membersÕ attendance record is disclosed in the table of directorsÕ meetings on page 4.

The remuneration committeeÕs charter is available on the companyÕs website.

20. Other

20.1 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 in the Directors' report.

20.2 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 CompanyÕs website.

Applying the independence criteria, the Board considers that Mr Joachim (Aki) von Roy and Dr Mark Pierce are independent.

20.3 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.

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

During the reporting period, an evaluation of the Board and its members was carried out. The evaluation process was an internal self-assessment based on questions and an analysis of answers with round table discussions. All members of the Board and the Vice President Corporate Development, Dr Greg Pullen, participated in the assessment.

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

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

21. Remuneration Report

Remuneration is referred to as compensation throughout this report.

21.1 Principles of compensation - audited

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.

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 executivesôcapability and experience, level of responsibility and ability to contribute to the Companyφs performance, including, in particular, the establishment of revenue streams and growth in the Companyφs share price.

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

21.2 Fixed Remuneration - audited

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.

21.3 Performance linked remuneration - audited

Performance linked compensation includes short term incentives (STI), in the form of cash bonuses paid only 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. In the case of Executive Directors, the number and conditions of the options are approved by the shareholders in general meeting.

21.4 Short term incentive Bonus (STI) - audited

The remuneration committee or the Chief Executive Officer (CEO), as appropriate, has set KPIs in conjunction with each of the executive directors or senior executives.

Each of the Companyφs employees is set KPIs and a bonus is payable on achievement of these KPIs. This is either an amount equal to between 5% and 20% of the base salary or a fixed sum per KPI determined at the beginning of the financial year. The objectives include such targets as: control of actual expenditure to budget, successful negotiation of commercial deals, achieving project milestones on time and publication of significance in a scientific journal.

The proportion of the maximum bonus to be allocated to each KPI is set in advance, ranging between 10% and 40% of the total for each of four or five KPIs. At the end of the year, the remuneration committee or CEO assesses the extent to which KPIs have been achieved and the aggregate achievement of all set KPIs for the individual determines the bonus to be paid.

21.5 Long term incentives (LTI) - audited

The Employee Share Option Plan (ESOP) was established during the 2006 financial year and is open to all employees. Options are granted for no consideration. Options are granted for a three year period. One third of those options allocated will vest immediately and, unless agreed by the Directors, one third will vest on each of the two subsequent anniversaries of issue. The exercise price of the ESOP options is set in July for the following fiscal year on the basis of the volume average weighted price of trading in June. Allocations made during the year were 60,000 options exercisable at $0.30, expiring 30 June 2010. Of this allocation, 20,000 vested during the year.

21.6 Short-term and long-term incentive structure – audited

The Company was listed in March 2005 so there is only a short history of the compensation structure. The remuneration committee and the directors consider that the Company's progress to date and the share price levels achieved do not provide any indication that the compensation structure is inappropriate given the objectives set out earlier in this report.

21.7 Consequences of performance on shareholders' wealth – unaudited

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 and others that relate to the scientific progress of the Company's projects, grants awarded, deals concluded, 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 other than the CEO for whom the Company's share price is included within the overall measure of performance against individual objectives.

21.8 Service agreements - audited

Four senior executives of the Company, who are full time employees, each have employment contracts for a term of two years. Either party may terminate the agreement without cause by giving written notice of three months. There is no termination fee payable other than during the term of notice.

The present Company Secretary is a contractor on an interim basis. During the year a full time executive held the position of Company Secretary, without a contractual arrangement other than implied by legislation, and he resigned subsequent to year end.

21.9 Non-executive directors - audited

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 director is presently $25,000 pa and for the chairman $45,000 pa. 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.

The Chairman received an allocation of 750,000 options on the same terms as the executive directors ratified by shareholders in November 2005. These options are exercisable at $0.25 and expire 30 June 2010.

21.10 Equity Instruments

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 - audited

During the reporting period no options over ordinary shares in the Company were granted as compensation to any key management person.

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

Directors	Number of options outstanding at 30 June 2007	Grant date	Fair value per option at grant date ($)	Exercise price per option ($)	Expiry date	Number of options vested during 2007
Mr J von Roy	750,000 (1)	25 November 2005	0.04	0.25	30 June 2010	-
Dr S Washer	3,000,000 (1)	25 November 2005	0.04	0.25	30 June 2010	-
Dr P Watt	2,000,000 (1)	25 November 2005	0.04	0.25	30 June 2010	-
Executives						
Dr G Pullen	600,000(2)	25 November 2005	0.04	0.25	30 June 2010	200,000

No options have been granted since the end of the year. Options granted in fiscal 2006 were provided at no cost to the recipients.

(1) These options expire on 30 June 2010. They are exercisable at the discretion of the individual until this date. All options vested during the year ended 30 June 2006.

(2) 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. 400,000 options are exercisable at the discretion of the individual until they expire. The remaining 200,000 options will be exercisable at the discretion of the individual between 25 November 2007 and the expiry date of the options.

Further details, including grant dates and exercise dates regarding options granted to executives under the ESOP are in note 17 to the financial statements.

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

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 - audited

During the reporting period, no options previously granted as compensation were exercised.

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

Details of vesting profiles of the options granted as remuneration to each director of the Company and each of the two named Company executives are detailed below:

	Options granted					Value yet to vest $	
Directors	**Number**	**Date**	**% vested in year**	**Forfeited in year (A)**	**Financial years in which grant vests**	**Minimum (B)**	**Maximum (C)**
Mr J von Roy	750,000	25 November 2005	100%	-%	1 July 2005	-	-
Dr S Washer	3,000,000	25 November 2005	100%	-%	1 July 2005	-	-
Dr P Watt	2,000,000	25 November 2005	100%	-%	1 July 2005	-	-
Executives							
Dr G Pullen	200,000	25 November 2005	100%	-%	1 July 2005	-	-
	200,000	25 November 2005	100%	-%	1 July 2006	-	-
	200,000	25 November 2005	-%	-%	1 July 2007	Nil	200,000
Ms R Kumar	100,000	25 November 2005	100%	-%	1 July 2005	-	-
	100,000	25 November 2005	100%	-%	1 July 2006	-	
	100,000	25 November 2005	-%	-%	1 July 2007	Nil	100,000

(A) The % forfeited in the year represents the reduction from the maximum number of options available to vest due to the highest level of performance criteria not being achieved.

(B) The minimum value of options yet to vest is $Nil as the performance or service criteria may not be met and consequently the option may not vest.

(C) The maximum value of options yet to vest is not determinable as it depends on the market price of shares of the Company on the Australian Stock Exchange at the date the option is exercised. The maximum values presented above are based on the assumptions that the share price on the date the option is exercised does not exceed $1.00 for the grants issued on 25 November 2005. This share price represents a maximum price included in the volatility assumptions within the valuation of the options.

(e) Analysis of Movements in options – unaudited

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.

(f) Payments to persons before taking office - unaudited

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.

Phylogica Limited
Directors' Report (continued)
For the year ended 30 June 2007

(g) Directors' and executive officers' remuneration - audited
Details of the nature and amount of each major element of remuneration of each director and each of the four executive employees of the Company are:

		Short term employee benefits		Post Employment Benefits	Share-based payments			
	Year	Salary & fees $	STI cash bonus $	Superannuation benefits $	Value of options $	Total $	Proportion of remuneration performance related (%)	Value of options as proportion of remuneration (%)
Directors								
Non-executive								
Mr J von Roy	2007	45,000	-	4,050	-	49,050	-	-
	2006	45,000	-	4,050	24,000	73,050	-	32.9
Mr H Karelis	2007	25,000	-	2,250	-	27,250	-	-
	2006	25,000	-	2,250	-	27,250	-	-
Mr B McHarrie	2007	25,000	-	2,250	-	27,250	-	-
	2006	25,000	-	2,250	-	27,250	-	-
Dr M Pierce (appointed 20/2/07)	2007	8,225	-	740	-	8,965	-	-
	2006	-	-	-	-	-	-	-
Dr S Sassine (resigned 29/11/06)	2007	12,490	-	-	-	12,490	-	-
	2006	27,250	-	-	-	27,250	-	-
Executive								
Dr S Washer, Chief Executive Officer	2007	263,683	49,904	46,967	-	360,554	13.8	-
	2006	179,440	71,450 (1)	60,360	96,000	407,250	17.5	23.6
Dr P Watt, Chief Scientific Officer	2007	170,000	22,325	15,300	-	207,625	10.8	-
	2006	150,000	36,000 (1)	13,500	64,000	263,500	13.7	24.3
Dr G Pullen, VP Corporate Development	2007	152,953	35,020	65,047	6,400	259,420	13.5	2.5
	2006	184,000	60,000 (1)	16,560	6,400	266,960	22.5	2.4
Total Key Management Personnel	**2007**	**702,351**	**107,249**	**136,604**	**6,400**	**952,604**	**11.3**	**0.7**
	2006	**635,690**	**167,450**	**98,970**	**190,400**	**1,092,510**	**15.3**	**17.4**
Other Executive								
Ms R Kumar	2007	100,000	13,133	9,895	3,200	126,227	10.4	2.5
	2006	85,000	21,674 (1)	8,625	3,200	118,499	18.3	2.7

Phylogica Limited
Directors' Report (continued)
For the year ended 30 June 2007

Directors' and executive officers' remuneration – audited (continued)

Secretary								
Mr David Berinson (appointed 16/3/07)	2007	44,032	11,475	3,963	-	59,470	19.3	-
	2006	-	-	-	-	-	-	-
Mr G Boden (resigned 16/3/07)	2007	34,284	-	-	-	34,284	-	-
	2006	60,191	-	-	-	60,191	-	-

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

(1) Bonuses of $189,124 in 2006 included $51,412 relating to 2005 for KPIs achieved and were determined after the date of the 2005 Directorsôreport and thus included in 2006 year. The proportion of performance related remuneration had that amount been included in the year to which it related, would therefore be 10.8% (2006) and 16.5% (2005).

(2) 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.

(3) The Company pays an insurance premium for company reimbursement and directorsôand officersôliability insurance as a combined amount. The portion of the premium which relates to directors and officers has not been included as part of remuneration.

(h) Analysis of bonuses included in remuneration – unaudited

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 three named Company executives is detailed below.

Directors	Included in remuneration $ (A)	% vested in year	% forfeited in year (B)
Dr S Washer	49,904	88%	12%
Dr P Watt	22,325	88%	12%
Executives			
Dr G Pullen	35,020	88%	12%
Ms R Kumar	13,133	88%	12%
Mr D Berinson	11,475	85%	15%

(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 2007 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.

22. Ethical Standards

All directors, managers and employees are expected to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of the Company. Every employee has a nominated supervisor to whom they may refer any issues arising from their employment. The board regularly reviews the processes in place to promote and communicate its policies.

(a) Conflict of interest

Directors must keep the board advised, on an ongoing basis, of any interest that could potentially conflict with those of the Company. The board has developed procedures to assist directors to disclose potential conflicts of interest.

Where the board believes that a significant conflict exists for a director on a board matter, the director concerned does not receive the relevant board papers and is not present at the meeting whilst the item is considered.

Details of director related entity transactions with the Company and the group are set out in note 24 to the financial statements.

(b) Code of conduct

The Company has advised each director, manager and employee that they must comply with the Company's ethical standards and policies. The Company's Code of conduct may be viewed on the Company's website. It covers the following:

* Commitment of the Board and Management to Corporate Code of Conduct
* Responsibilities to Shareholders and the Financial Community Generally
* Responsibilities to Clients, Customers and Consumers
* Employment Practices
* Responsibility to the Community
* Responsibility to the Individual
* Obligations Relative to Fair Trading and Dealing
* Conflicts of Interest
* Compliance with the Code of Conduct
* Periodic Review of Code
* Incorporation of Code of Conduct for Company Executives

The Code of Conduct for Company Executives forms part of the Corporate Code of Conduct.

(c) Trading in general Company securities by directors and employees

The Board has adopted a policy and procedure on dealing in the Company's securities by directors and employees, which prohibits dealing in the Company's securities when those persons possess inside information. The policy also provides that the written acknowledgement of the chairperson or chief executive officer should be obtained prior to trading.

Lead Auditor's Independence Declaration

The lead auditor's independence declaration is set out on page 20 and forms part of the Directors' report for the year ended 30 June 2007.

Signed in accordance with a resolution of the directors:

Bruce McHarrie
Director

Perth
26th September 2007

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of Phylogica Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 30 June 2007 there have been:

(i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and

(ii) no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

T R HART
Partner

Perth
26 September 2007

Phylogica Limited
Income statement

For the year ended 30 June 2007

	Note	2007	2006
		$	$
Government grant income	*4(i)*	**667,950**	488,702
Commercial income	*4(ii)*	**275,385**	-
Contract research costs		**(1,342,719)**	(1,376,369)
Personnel expenses	*5*	**(1,837,166)**	(1,500,624)
Depreciation, amortisation and impairment	*6*	**(26,278)**	(484,413)
Professional services		**(446,017)**	(314,712)
Travel and accommodation		**(265,317)**	(352,625)
Licenses		**(62,478)**	(154,876)
Intellectual property maintenance		**(486,665)**	(300,057)
Laboratory consumables		**(272,496)**	(137,232)
Occupancy costs		**(72,836)**	(86,061)
Other operating expenses		**(221,664)**	(291,042)
Loss from operating activities		**(4,090,301)**	(4,509,309)
Interest income		**201,628**	231,821
Loss before income tax		**(3,888,673)**	(4,277,488)
Income tax (expense)/benefit	*7*	**-**	286,013
Loss for the year attributable to the members of Phylogica Limited	*18(ii)*	**(3,888,673)**	(3,991,475)

	Note	**Cents**	Cents
Basic earnings per share	*19*	**(3.32)**	(3.69)
Diluted earnings per share	*19*	**(3.32)**	(3.69)

The income statement is to be read in conjunction with the notes to the financial statements set out on pages 25 to 41.

Phylogica Limited
Balance sheet

For the year ended 30 June 2007

	Note	2007	2006
		$	$
Current assets			
Cash and cash equivalents		**3,369,322**	2,638,872
Trade and other receivables	*8*	**29,570**	77,427
Other	*9*	**20,549**	41,517
Total current assets		**3,419,441**	2,757,816
Non-current assets			
Property, plant and equipment	*10*	**114,543**	74,397
Total non-current assets		**114,543**	74,397
Total assets		**3,533,984**	2,832,213
Current liabilities			
Trade and other payables	*12*	**830,632**	370,749
Non interest-bearing liabilities	*13*	**9,679**	12,704
Employee benefits	*17*	**246,287**	189,270
Deferred government grants and commercial income		**239,516**	145,186
Total current liabilities		**1,326,114**	717,909
Non-current liabilities			
Employee benefits	*17*	**11,208**	-
Total non-current liabilities		**11,208**	-
Total liabilities		**1,337,322**	717,909
Net assets		**2,196,662**	2,114,304
Equity			
Issued capital	*18(i)*	**11,709,889**	7,820,452
Accumulated losses	*18(ii)*	**(9,513,227)**	(5,706,148)
Total equity attributable to members of Phylogica Limited		**2,196,662**	2,114,304

The balance sheet is to be read in conjunction with the notes to the financial statements set out on pages 25 to 41.

Phylogica Limited
Statement of cash flows

For the year ended 30 June 2007

	Note	2007 $	2006 $
Cash flows from operating activities			
Government grants received		**736,175**	601,035
Commercial income received		**293,615**	-
Cash paid to suppliers and employees		**(4,320,130)**	(3,911,470)
Cash generated from operations		**(3,290,340)**	(3,310,435)
Interest received		**198,603**	216,092
Income taxes rebated		**-**	286,013
Net cash used in operating activities	*20*	**(3,091,737)**	(2,808,330)
Cash flows from investing activities			
Acquisition of property, plant and equipment	*10*	**(67,250)**	(52,489)
Net cash used in investing activities		**(67,250)**	(52,489)
Cash flows from financing activities			
Proceeds from the issue of share capital	*18*	**4,076,937**	52,083
Repayment of borrowings		**-**	(5,000)
Payment of transaction costs	*18*	**(187,500)**	(52,520)
Net cash from/(used in) financing activities		**3,889,437**	(5,437)
Net increase/ (decrease) in cash and cash equivalents		**730,450**	(2,866,256)
Cash and cash equivalents at 1 July		**2,638,872**	5,505,128
Cash and cash equivalents at 30 June		**3,369,322**	2,638,872

This statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 25 to 41.

Phylogica Limited
Statement of changes in equity

For the year ended 30 June 2007

	Note	**2007**	2006
		$	$
Total equity at the beginning of the year		**2,114,304**	5,780,882
Loss for the period		**(3,888,673)**	(3,991,475)
Issue of share capital		**4,076,937**	152,083
Share capital transaction costs		**(187,500)**	(52,520)
Share based payments expense for the period		**81,594**	225,334
Total equity at the end of the year		**2,196,662**	2,114,304

This statement of changes in equity is to be read in conjunction with the notes to the financial statements set out on pages 25 to 41.

1. Reporting Entity

Phylogica is a company domiciled in Australia. The financial report of the Company for the financial year ended 30 June 2007 was authorised for issue by the directors on 26th September 2006.

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 (AASBs) adopted by the Australian Accounting Standards Board (AASB) and the Corporations Act 2001. The financial report of the Company also complies with IFRSs and interpretations adopted by the International Accounting Standards Board.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis and is 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.

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.

In order to fund the desired level of future research and to pursue the objectives of the company, additional capital will be required during the 2008 financial year. Note 15 discloses information in relation to capital raisings completed subsequent to 30 June 2007.

3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. Certain comparative amounts have been reclassified to conform with the current year's presentation.

(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 sheet 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 income statement.

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.

3. Significant accounting policies (cont.)

(b) Property, plant and equipment

(i) Recognition and measurement

The Company holds no property. Items of plant and equipment are stated at cost less accumulated depreciation and impairment losses (see accounting policy h). Cost includes expenditures that are directly attributable to the acquisition of the asset.

(ii) Leased assets

Leases in terms of which the Company 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 accounting policy o.

(iii) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated 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, if not insignificant, is reassessed annually.

(c) Intangible assets

The intangible asset of intellectual property evidenced by patent costs, is stated at cost less accumulated amortisation (accounting policy f) and impairment loss (accounting policy h).

(d) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement 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.

(e) Trade and other receivables

Trade and other receivables are stated at their amortised cost less impairment losses (see accounting policy h). Trade receivables are due for settlement in no more than 30 days and the notional amount is deemed to reflect fair value.

(f) Amortisation

Amortisation is charged to the income statement on a straight line basis over the estimated useful lives of the intangible assets which was assessed to be 3 years (2006: 3 years).

(g) Cash and cash equivalents

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

(h) Impairment

The carrying amounts of the Company's assets, other than deferred tax assets (see accounting policy p), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated (see accounting policy h (i)).

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement unless the asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the income statement.

3. Significant accounting policies (cont.)

Impairment

Impairment of receivables is not recognised until objective evidence is available that a loss event has occurred. Significant receivables are individually assessed for impairment.

(i) Calculation of recoverable amount

The recoverable amount of other 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.

(ii) 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.

(i) 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.

(j) Transaction costs

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

(k) 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 balance sheet 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 Company expects to pay as at reporting date including related on-costs, such as workers compensation insurance and payroll tax.

3. Significant accounting policies (cont.)

Wages, salaries, annual leave and non-monetary benefits

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 income statement as incurred.

(l) Provisions

A provision is recognised in the balance sheet when the Company 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.

(m) Trade and other payables

Trade and other payables are stated at their amortised cost. Liabilities are recognised for amounts to be paid in the future for goods or services received. Trade accounts payable are unsecured and normally settled within 30 days of recognition.

(n) Revenue

(i) 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.

(ii) Interest

Interest income is recognised in the income statement as it accrues, using the effective interest method.

(iii) Government grants

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

(o) Expenses

Operating lease payments

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

(p) Income tax

Income tax in the income statement for the periods presented comprises current and deferred tax. Income tax is recognised in the income statement 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 balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

3. Significant accounting policies (cont.)

Income tax

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 balance sheet 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.

(q) Segment reporting

The Company 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 income statement and balance sheet.

(r) 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 balance sheet.

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.

(s) New standards and interpretations not yet adopted

The following standards, amendments to standards and interpretations are available for early adoption at 30 June 2007, but have not been applied in preparing these financial statements:

- AASB 101 *Presentation of Financial Statements* (October 2006) has deleted the Australian specific Illustrative Financial Report Structure and reinstated the current IASB 1 guidance on Illustrative Financial Statement Structure. The revised AASB 101 is applicable for annual reporting periods beginning on or after 1 January 2007.

- *AASB 7 Financial Instruments: Disclosures* (August 2005) replaces the presentation requirements of financial instruments in AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after 1 January 2007, and is expected to only impact disclosures within the financial report.

- AASB 2005-10 Amendments to Australian Accounting Standards (September 2005) makes consequential amendments to AASB 132 *Financial Instruments: Disclosure and Presentation,* AASB 101 *Presentation of Financial Statements*, AASB 114 *Segment Reporting*, AASB 117 *Leases*, AASB 133 *Earnings Per Share*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards*, AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts arising from the release of* AASB 7. AASB 2005-10 is applicable for annual reporting periods beginning on or after 1 January 2007 and is expected to only impact disclosures contained within the financial report.

Interpretation 8 *Scope of AASB 2 Share-based Payment* addresses the accounting for share-based payment transactions in which some or all of goods or services received cannot be specifically identified. Interpretation 8 will become mandatory for the Group 2007 financial report, with retrospective application required. The Company has not yet determined the potential effect of the interpretation.

3. Significant accounting policies (cont.)

- Interpretation 9 *Reassessment of Embedded Derivatives* requires that a reassessment of whether embedded derivative should be separated from the underlying host contract should be made only when there are changes to the contract. Interpretation 9, which becomes mandatory for the Company's 2007 financial report, is not expected to have any impact on the financial report.

- Interpretation 10 *Interim Financial Reporting and Impairment* prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. Interpretation 10 will become mandatory for the Company's 2007 financial statements, and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Company first applied the measurement criteria of AASB 136 and AASB 139 respectively. The adoption of Interpretation 10 is not expected to have any impact on the financial report.
- Interpretation 11 AASB *2 Share-based Payment -- Group and Treasury Share Transactions* addresses the classification of a share-based payment transaction (as equity or cash settled), in which equity instruments of the parent or another group entity are transferred, in the financial statements of the entity receiving the services. Interpretation 11 will become mandatory for the Company's 2008 financial report. Interpretation 11 is not expected to have any impact on the financial report. The potential effect of the Interpretation on the Company's financial report has not yet been determined.
- AASB 2007-1 Amendments to Australian Accounting Standards arising from AASB Interpretation 11 amends AASB 2 *Share-based Payments* to insert the transitional provisions of IFRS 2, previously contained in AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*. AASB 2007-1 is applicable for annual reporting periods beginning on or after 1 March 2007 and is not expected to have any impact on the consolidated financial report. The potential impact on the Company has not yet been determined.
- Interpretation 12 *Service Concession Arrangements* addresses the accounting for service concession operator, but not grantors, for public to private service concession arrangements. Interpretation 12 will apply for the Company's 2009 financial report. The potential effect of the interpretation on the financial report has not yet been determined. At this time an entity must adopt the revised Interpretation 4 *Determining when an arrangement contains a lease* and Interpretation 129 *Service Concession Arrangements: Disclosures*.
- AASB 2007-2 Amendments to Australian Accounting Standards arising from AASB Interpretation 12 makes amendments to AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, AASB 117 *Leases*, AASB 118 *Revenue,* AASB 120 *Accounting for Government Grants and Disclosure of Government Assistance*, AASB 121 *The Effects of Changes in Foreign exchange Rates*, AASB 127 *Consolidated and Separate Financial Statement*, AASB *131 Interest in Joint Ventures*, and AASB 139 *Financial Instruments: Recognition and Measurement*. AASB 2007-2 is applicable for annual reporting periods beginning on or after 1 January 2008 and must be applied at the same time as Interpretation 12 Service Concession Arrangements.
- AASB 2007-2 Amendments to Australian Accounting Standards also amends references to 'UIG Interpretation' to interpretations. This amending standard is applicable to annual reporting periods ending on or after 28 February 2007.

4 Income

(i) Government grant income

The Company has been awarded 3 government grants and these are recognised as revenue in the income statement in the same period as which the related expenses are incurred. $541,682 was recognised in the year ended 30 June 2007 (2006: $409,287). Future income under these grants will be received only if the Company continues to meet the conditions of the grant agreement. $126,268 was also received through the Export Market Development Grant Scheme (2006: $72,220) and $Nil from the Synapse Art and Science Artists Residencies Program (2006: $7,195), which have 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 set full time equivalent research salaries and milestone payments. $275,385 was received from contract payments during the year (2006:$nil).

5 Personnel expenses

	2007	2006
	$	$
Wages and salaries	**1,504,153**	1,102,428
Other associated staff costs	**93,592**	64,170
Contributions to defined contribution superannuation funds	**120,334**	80,891
Increase in annual leave provision	**37,493**	27,801
Share based compensation	**81,594**	225,334
	1,837,166	1,500,624

6 Depreciation, amortisation and impairment

Depreciation of equipment		**26,278**	18,135
Impairment of intellectual property	*(i)*	**-**	466,278
		26,278	484,413

(i) In 2006, the recoverable amount of intellectual property was determined by assessing its value in use. Uncertainties as to the timing of commercialisation of capitalised intellectual property costs resulted in future cash flows not being able to be reliably estimated. Accordingly, its recoverable amount was determined to be $Nil.

7 Income Tax

(i) Income tax expense/(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%	**(1,166,602)**	(1,283,246)
Tax effect of permanent differences	**(219,262)**	(50,200)
Current period deferred income tax not recognised	**11,393**	242,707
Current period tax losses and temporary benefits not brought to account	**1,374,471**	1,090,739
Australian Taxation office rebate	**-**	(286,013)
Income tax expense/(benefit) attributable to operating loss before income tax	**-**	(286,013)

(ii) Unrecognised deferred tax asset

Deferred tax assets have not been recognised in respect of the following items:

	2007	2006
	$	$
Deductible temporary differences	**11,393**	242,707
Tax losses	**2,958,527**	1,352,307
	2,969,920	1,595,014

The deductible temporary differences and tax losses do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available against which the Company can utilise the benefits from.

8 Trade and other receivables

GST receivable	**27,502**	66,177
Sundry debtors	**2,068**	11,250
	29,570	77,427

9 Other assets

Prepayments	**20,549**	41,517
	20,549	41,517

10 Property, plant and equipment

Office and research equipment at cost	**163,508**	99,294
Accumulated depreciation	**(48,965)**	(24,897)
	114,543	74,397

Reconciliation

Carrying amount at the beginning of the year	**74,397**	40,294
Acquisitions	**67,250**	52,489
Disposals	**(826)**	(251)
Depreciation	**(26,278)**	(18,135)
	114,543	74,397

11 Intangible assets

Intellectual property

Reconciliation

Carrying amount at the beginning of the year	**-**	466,278
Acquisitions	**-**	-
Impairment losses	**-**	(466,278)
Amortisation	**-**	-
	-	-

12 Trade and other payables

Trade payables	**578,871**	220,909
Accrued expenses	**107,167**	123,594
Other	**144,594**	26,246
	830,632	370,749

13 Non interest bearing liabilities

	2007	2006
	$	$
Unearned interest income	**9,679**	12,704
	9,679	12,704

14 Segment information

The Company 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 income statement and bal ance sheet.

15 Events subsequent to balance date

Subsequent to the year end and prior to expiry on 31 August 2007, a total of 17,946,768 options were exercised at $0.25, raising $4,486,692. The exercise of the options was underwritten and shares, relating to the 2,743,997 options which were not exercised, were issued subsequently, raising a further $686,000.

The issued capital of the company after these issues was 143,501,764 shares.

16 Contingent liabilities and contingent assets

There are no known significant liabilities or contingent assets as at the date of this report.

17 Employee benefits

	2007	2006
	$	$
Current		
Liability for annual leave	**80,051**	42,558
Incentive provision	**166,236**	146,712
Non Current		
Liability for Long Service Leave	**11,208**	-
	257,495	189,270
Number of employees at year end	**11**	8

Remuneration for all employees other than non executive directors includes an at risk performance component. Provision has been made at 30 June 2007 for amounts payable in respect of performance for the financial year as determined by the Board on an employee by employee basis against agreed criteria. A reconciliation of movement for the year in employee provisions is as follows:

	Long Service Leave $	Annual Leave $	Incentive Provision $
Balance as 1 July 2006	-	42,558	146,712
Payments made	-	(44,432)	(155,077)
Charges raised	11,208	81,924	174,601
Balance at the end of the year	11,208	80,051	166,236

(i) Share-based payments

In 2005 the Company established a employee share option programme (ESOP) that entitles key management personnel and senior employees to purchase shares in the Company. The terms and conditions of the ESOP are disclosed in the Offer Information Statement released to the Australian Stock

Exchange on 19 October 2005. During the year ended 30 June 2007 60,000 options were granted under the ESOP.

(ii) Fair value of share options and assumption s

All options refer to options over ordinary shares of Phylogica Ltd which are exercisable on a one for one basis. The options have been issued under the ES OP. The fair value of the options is calculated at balance date using a Blackï 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:

Number and recipient/s 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 2007
30,000 ESOP	1-Sep-06	30-Jun-10	$0.36	$0.30	$0.46	5.71	30.0	10,000
30,000 ESOP	11-Sep-06	30-Jun-10	$0.32	$0.30	$0.42	5.77	30.0	10,000

In the table above, the following vesting profiles have been adopted:
(i) 20,000 options vested immediately.
(ii) The remaining two thirds vest on the first anniversary.

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. A discount factor of 20% for the lack of negotiability has been applied.

No employee options were exercised during the year.

18 Issued capital and accumulated losses

(i) Issued and paid up capital

	2007	2006
	$	$
122,810,999 (2006: 108,572,271) ordinary shares fully paid	**11,709,889**	7,820,452

Movements in issued capital during the year

Ordinary Shares

Shares issued during the year	**2007 Shares**	**2007 $**	**2006 Shares**	**2006 $**
Opening balance	108,572,271	7,820,452	107,863,938	7,720,889
Shares issued at $0.29	12,930,982	3,750,000	-	-
Share issue costs	-	(187,500)	-	(52,520)
Shares issued for technology licence at $0.20	-	-	500,000	100,000
Share options exercised at $0.25	1,307,746	326,937	208,333	52,083
	122,810,999	11,709,889	108,572,271	7,820,452

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 shareholdersômeetings.
In the event of winding up of the Company, 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) Accumulated losses

	2007 $	2006 $
Opening balance	**(5,706,148)**	(1,940,007)
Loss for the period	**(3,888,673)**	(3,991,475)
Share based compensation	**81,594**	225,334
Balance at the end of the year	**(9,513,227)**	(5,706,148)

(iii) Options

Options on issue at end of the year

	2007	2006
(a) Options exercisable at $0.30 on or before 30 June 2010:		
Balance at beginning of year *	**520,000**	-
Issued during the year **	**60,000**	520,000
Forfeited	**(60,000)**	-
Balance at end of year	**520,000**	520,000

* Options vested on:

Date	No. of Options
17/2/06	60,000
1/3/06	100,000
26/4/06	13,334
17/2/07	60,000
1/3/07	100,000
26/4/07	13,333
Total	346,667

** Options vested on:

11/9/06	10,000
1/9/06	10,000
Total	20,000
Total options vested	366,667

	2007	2006
(b) Options exercisable at $0.25 on or before 30 June 2010:		
Balance at beginning of year *	**6,650,000**	-
Issued during the year	**-**	6,650,000
Balance at end of year	**6,650,000**	6,650,000

* Options vested on:

Date	No. of Options
25/11/05	6,050,000
25/11/06	300,000
Total options vested	6,350,000

	2007	2006
(c) Options exercisable at $0.25 on or before 31 August 2007:		
Balance at beginning of year	**14,516,102**	14,724,435
Issued during the year	**7,482,409**	-
Exercised during the year	**(1,307,746)**	(208,333)
Surrendered during the year	**-**	-
Balance at end of year	**20,690,765**	14,516,102
Total options on issue	**27,860,765**	21,686,102

19 Earnings per share

(i) Loss attributable to ordinary shareholders

	2007 $	2006 $
Loss for the period:		
Basic earnings	**(3,888,673)**	(3,991,475)
Diluted earnings*	**(3,888,673)**	(3,991,475)

(ii) Weighted average number of ordinary shares

	2007	2006
Weighted average number of shares used for basic earnings per share	**117,067,277**	108,150,011

* As the Company incurred a loss for the year ended 30 June 2007, the options on issue have an antidilutive effect therefore the diluted earnings per share is equal to the basic earnings per share.

20 Note to the statement of cash flows

Reconciliation of loss after income tax to net cash used in operating activities:

	2007 $	2006 $
Operating loss after income tax	**(3,888,673)**	(3,991,475)
Depreciation & loss on disposal	**27,104**	18,135
Impairment loss	**-**	466,278
Share based payment expense	**81,594**	225,334
Share issue in exchange for licence	**-**	100,000
Increase in provisions for employee entitlements	**68,225**	174,513
Increase/(decrease) in payables	**551,188**	245,034
(Increase)/decrease in receivables & prepayments	**68,825**	(46,149)
Net cash used in operating activities	**(3,091,737)**	(2,808,330)

21 Financial instruments

(i) Interest rate risk

The Companyȇs exposure to interest rate risks and the effective weighted average interest rates of financial assets and financial liabilities are as follows:

	Floating interest rate		**Non-interest bearing**		**Total**		**Effective interest rate (%)**	
(a) Assets	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
Cash	3,369,322	2,638,872	-	-	3,369,322	2,638,872	5.08	5.73
Receivables & other	-	-	50,119	118,944	50,119	118,944		
Total Financial Assets	3,369,322	2,638,872	50,119	118,944	3,419,441	2,757,816		
(b) Liabilities								
Trade creditors and accruals	-	-	830,632	370,749	830,632	370,749		
Other	-	-	506,690	347,160	506,690	347,160		
Total Financial Liabilities	-	-	1,337,322	717,909	1,337,322	717,909		

(ii) Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. The Company undertakes due diligence prior to entering into any collaboration, co-development or licensing agreement with a counterparty that exposes the Company to credit risk.

(iii) Net fair values of financial assets and liabilities

For receivables and payables with a remaining life of less than one year, the notional amount is deemed to reflect fair value. All other receivables and payables are discounted to determine fair value.

(iv) Foreign exchange risk

The Company is exposed to foreign currency risk on income and purchases that are denominated in a currency other than the AUD. The value of transactions are not of a level that Management warrant entering into forward exchange contracts and so are translated into AUD at the foreign exchange rate ruling at the date of the transaction. As at the reporting date there was USD$30,000 payable which was unhedged and there were no amounts receivable in foreign currencies.

22 Commitments

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

	2007	2006
	$	$
Within one year	**33,990**	36,000
One year or later and no later than five years	**33,990**	-
Later than five years	**-**	-
	67,980	36,000

The Company leases office space under a two year non-cancellable lease.

23 Related parties

(i) Key management personnel compensation

Disclosures of remuneration policies, service contracts, details of remuneration and other equity instruments are included in the Remuneration Report on pages 10 to 14. The following were key management personnel of the Company at any time during the reporting period and unless otherwise indicated, were directors or executives for the entire period:

Non–executive directors		**Executive directors**
Mr J von Roy		Dr S Washer
Mr S Sassine	(Resigned 29/11/06)	Dr P Watt
Mr H Karelis		**Executives**
Mr B McHarrie		Dr G Pullen (VP Corporate Development)
Dr M Pierce	(Appointed 20/2/07)	Mr D J Berinson (Company Secretary) (Appointed 16/3/07) (Resigned 17/8/07)

The key management personnel compensation included in ‘personnel expenses’ (see note 5) are as follows:

	2007	2006
	$	$
Short-term employee benefits	**809,600**	**803,140**
Post-employment benefits	**136,604**	**98,970**
Share based payment	**6,400**	**190,400**
Total compensation	**952,604**	**1,092,510**

Apart from details disclosed in this note, no director has entered into a material contract with the Company since the end of the previous financial year and there were no material contracts involving directorsô 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 Company 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 armô s length basis.

(ii) Key management personnel

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

Key management persons	Transaction	Note	2007 $	2006 $
Mr H Karelis	Share issue costs	(a)	**-**	**20,000**
Mr B McHarrie	Contract research services	(b)	**1,147,829**	**939,576**

(a) Due diligence cost associated with the share issue in February 2005 were reimbursed to Biotech Capital Ltd, of which Mr Karelis is a director.

(b) The Telethon Institute of Child Heath Research, of which Mr McHarrie is the Chief Financial Officer, has signed a Research and Development agreement with the Company for provision of services in developing the Companyô 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 transactions were as follows:

	2007 $	2006 $
Current payables		
Trade creditors	**200,006**	91,894
Accrued expenses	**-**	-
Total	**200,006**	91,894

(iii) Options over equity instruments

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

Directors	Held as at 1 July 2006	Granted as compensation	Exercised	Other changes *	Held at 30 June 2007	Vested during the year	Vested and exercisable at 30 June 2007
Mr J von Roy	750,000	-	-	-	750,000	-	750,000
Dr S Washer **	3,333,333	-	-	-	3,333,333	-	3,333,333
Dr P Watt **	2,000,000	-	-	-	2,000,000	-	2,000,000
Executives							
Dr G Pullen	600,000	-	-	-	600,000	200,000	400,000

Directors	Held as at 1 July 2005	Granted as compensation	Exercised	Other changes *	Held at 30 June 2006	Vested during the year	Vested and exercisable at 30 June 2006
Mr J von Roy	-	750,000	-	-	750,000	750,000	750,000
Dr S Washer **	333,333	3,000,000	-	-	3,333,333	3,000,000	3,333,333
Dr P Watt **	-	2,000,000	-	-	2,000,000	2,000,000	2,000,000
Executives							
Dr G Pullen	-	600,000	-	-	600,000	200,000	200,000

* Other changes represent options that expired or were forfeited during the year.

** Options held by key management personnel related parties.

No options held by key management personnel are vested but not exercisable at 30 June 2006 and 2007.

(iv) Equity holdings and transactions

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

Directors	Held at 1 July 2006	Purchases	Received on exercise of options	Sales	Held at 30 June 2007
Mr J von Roy	670,000	17,241	-	-	687,241
Mr H Karelis	29,166,667	-	-	-	29,166,667
Mr B McHarrie	1,838,238	32,241	-	-	1,870,479
Dr S Sassine (1)	5,264,713	-	-	-	-
Dr M Pierce (2)	-	-	-	-	-
Dr S Washer	2,634,118	86,552	-	-	2,720,670
Dr P Watt	4,472,790	54,241	-	-	4,527,031
Executives			-	-	
Dr G Pullen	-	62,241			62,241
Mr David Berinson	-	-	-	-	-

Directors	Held at 1 July 2005	Purchases	Received on exercise of options	Sales	Held at 30 June 2006
Mr J von Roy	670,000	-	-	-	670,000
Mr H Karelis	29,166,667	-	-	-	29,166,667
Mr B McHarrie	1,838,238	-	-	-	1,838,238
Dr S Sassine (1)	5,264,713	-	-	-	5,264,713
Dr S Washer	2,600,000	34,118	-	-	2,634,118
Dr P Watt	4,444,123	28,667	-	-	4,472,790
Executives					
Dr G Pullen	-	-	-	-	-

1. Dr Sassine resigned as a director on 29 November 2006.
2. Dr Pierce was appointed a director on 20 February 2007.
3. Mr Berinson was appointed secretary on 16 March 2007 and resigned on 17 August 2007.
4. Subsequent to reporting date, Dr S Washer transferred 333,333 options exercisable by 31 August 2007 to the underwriter of the shortfall.
5. No shares were granted to key management personnel during the reporting period as compensation in 2006 and 2007.

24 Auditor's remuneration

	2007 $	2006 $
Audit services		
Auditors of the Company – KPMG Australia		
Audit of financial reports	**31,824**	28,000
Other regulatory audit services	**6,550**	4,500
	38,374	32,500
Non audit services		
Auditors of the Company – KPMG Australia		
Taxation services	**2,000**	2,825
	40,374	35,325

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 10 to 14, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Company as at 30 June 2007 and of 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 10 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 2007 pursuant to Section 295A of the Corporations Act 2001.

Dated at Perth this 26th day of September, 2007

Signed in accordance with a resolution of the directors:

Bruce McHarrie
Non-Executive Director

Independent auditor's report to the members of Phylogica Limited

Report on the financial report and AASB 124 remuneration disclosures contained in the directors' report

We have audited the accompanying financial report of Phylogica Limited (the Company), which comprises the balance sheet as at 30 June 2007, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a description of significant accounting policies and other explanatory notes and the directors' declaration of the Company.

As permitted by the *Corporations Regulations 2001*, the Company has disclosed information about the remuneration of directors and executives (remuneration disclosures), required by Australian Accounting Standard AASB 124 *Related Party Disclosures*, under the heading "remuneration report" in sections 21.1 to 21.6, 21.8 to 21.9 and 21.10(a), (b), (c) and (g) of the directors' report and not in the financial report. We have audited these remuneration disclosures.

Directors' responsibility for the financial report and the AASB 124 remuneration disclosures contained in the directors' report

The directors of the Company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001.* This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In note 2(a), the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial report of the Company, comprising the financial statements and notes, complies with International Financial Reporting Standards.

The directors of the Company are also responsible for the remuneration disclosures contained in the directors' report.

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. These Auditing 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. Our responsibility is also to express an opinion on the remuneration disclosures contained in the directors' report based on our audit.

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

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards (including the Australian Accounting Interpretations), a view which is consistent with our understanding of the Company's financial position and of its performance and whether the remuneration disclosures are in accordance with Australian Accounting Standard AASB 124.

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

Auditor's opinion on the financial report

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 Company's financial position as at 30 June 2007 and of its performance for the year ended on that date; and

  (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2(a).

Auditor's opinion on AASB 124 remuneration disclosures contained in the directors' report

In our opinion the remuneration disclosures that are contained in sections 21.1 to 21.6, 21.8 to 21.9 and 21.10(a), (b), (c) and (g) of the directors' report comply with Australian Accounting Standard AASB 124 *Related Party Disclosures*.

KPMG

KPMG

T R HART
Partner

Perth
26 September 2007

ASX Additional Information

1. Listed Securities

The security holders information set out below was applicable as at 17 September 2007.

(i) Distribution of Security Numbers

	Ordinary Shares	
Category (size of holding)	**Shareholders**	**Shares**
1 ï 1,000	68	26,660
1,001 ï 5,000	175	570,751
5,001 ï 10,000	188	1,628,568
10,001 ï 100,000	514	19,599,168
100,001 and over	143	118,932,620
Total	1088	140,757,767

There are 87 shareholders holding less than a marketable parcel at a price of $0.31, totalling 53,157 shares.

(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**
Biotech capital Pty Ltd	29,166,667	20.72
Telethon Instutute of Child Health Research	20,605,501	14.64
ANZ Nominees Ltd	4,880,134	3.47
Watt Paul Michael	4,044,123	2.87
Mal Washer Nominees PL	2,617,241	1.86
Sassine & Associates PL	2,094,123	1.49
Australian Heritage Group PL	1,888,596	1.34
McHarrie Bruce Fielding	1,838,238	1.31
Thomas Wayne Robert	1,838,238	1.31
Henley Park Estate PL	1,808,873	1.29
Merrill Lynch Aust Nominees PL	1,679,529	1.19
Laissez Faire Et Cie PL	1,500,350	1.07
Fortis Clearing Nominees PL	1,500,000	1.07
Sassine Saliba	1,284,465	0.91
Jelbart John A + M H	1,105,000	0.79
Henley Park Estate PL	1,050,000	0.75
Australian Investement Initiatives PL	1,047,000	0.74
Australian Heritage Group PL	1,000,000	0.71
Hawaiian Investment PL	1,000,000	0.71
Barton Anthony P + C H	1,000,000	0.71
Total	**82,948,078**	**58.95**

(iv) Substantial Shareholders

The names of the substantial shareholders listed in the Company's share register as at 17 September 2007 were:

Name	Number of Ordinary Shares	% of Issued Capital
Biotech Capital Pty Ltd	29,166,667	20.72
Telethon Institute of Child Health Research	20,605,501	14.64
Anthony Barton & associates	8,642,350	6.14
Total	**58,414518**	**41.50**

(v) On market buy back

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

2. Unlisted option holder information

The information on unlisted option holders set out below was applicable as at 17 September 2007.

(i) Distribution of unlisted option holder numbers

Category (size of holding)	No of option holders	No of options
10,001 – 100,000	3	100,000
100,001 and over	7	7,070,000
Total	**10**	**7,170,000**