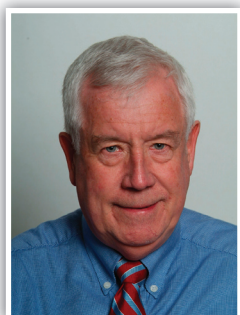


To our shareholders



**From Dr Doug Wilson, Executive Chairman, Phylogica
Former global head of Medicine, Boehringer Ingelheim**

Our new format newsletter is designed to keep you abreast of the activities of our company at these rapidly changing and exciting times. Our first major big Pharma contract has been signed and more are in the pipeline.

Advances internally have included significant upgrades to our Phylomer® peptide libraries and processes to improve our partnering capacity. Externally, we have been pursuing an aggressive international business development path, which has dramatically improved our deal pipeline.

A key outcome of this high profile marketing has been attendance as invited speakers at major international meetings. Phylogica is now becoming a well known competitive company in our specialist area of drug discovery service for the pharmaceutical industry. This approach now enables us to get access at the highest levels to many of the major pharmaceutical companies in the world and accelerates our access to the decision makers.

Many of the companies we speak to now have already heard of our capabilities and are interested in discussing concrete proposals for discovery alliances, around our unique Phylomer® libraries.

Phylogica has made significant progress on a number of fronts:

- i) A discovery contract was signed with Europe's largest pharmaceutical company Roche**
- ii) Collaborative agreement signed with Cambridge based Isogenica aimed at rapid optimization of our Phylomer peptides.**
- iii) Our libraries and screening processes have been significantly expanded and enhanced**

This improves the efficiency and robustness of our discovery process, to ensure that we are prepared for future partnerships with multiple pharmaceutical companies in parallel.

Phylogica's discovery alliance with Roche

A contract was recently signed with Roche, one of the world's largest pharmaceutical companies. Roche is now the largest in the 'biologics' (large molecule drugs) space with its ownership of Genentech in the USA, and the multi-billion dollar revenues from new biologics drugs such as Herceptin and Avastin, two antibody anticancer drugs.

We are not aware of such a contract discovery deal ever having been done by an Australian biotechnology company with Roche, so we are delighted to have been chosen as their partner. This deal not only provides Phylogica with a revenue stream and milestone payments, but also helps to validate our discovery-focussed business model (see below).

Phylogica is now working with Roche's biologics R&D team using Phylomers® as targeting agents, to enhance the opportunities for discovery of a number of different drugs by transporting them into cells. The project depends on the unique Phylomer® libraries that are the heart of Phylogica's assets. It reflects Roche's recognition that Phylogica is the partner to work with them in this area, given these libraries and our screening expertise.

Collaborative agreement with Isogenica, Cambridge UK

"The integration of the Isogenica's technology with ours has the potential to save months in our screening process and to allow greater scalability for large pharmaceutical partners"

In February this year, Phylogica entered into an agreement with Isogenica Ltd to use its technology to optimize the performance of three of Phylogica's lead compounds targeting CD40 ligand (CD40L). CD40L is a key protein involved in many inflammatory diseases including Rheumatoid Arthritis and Inflammatory Bowel Disease. This relationship serves two purposes for Phylogica: we confirm our capability, with Isogenica, to enhance the potency of our Phylomer® peptides. In addition, a resultant pilot drug, originating from the Phylomers®, could provide a serious medical advance for these serious inflammatory diseases, where current treatments are well short of providing satisfactory relief for all patients. This later opportunity has generated interest in our anti-inflammatory program from two pharmaceutical companies.

Isogenica is a company based in Cambridge UK, which specializes in protein and peptide chemistry with processes which are complementary to Phylogica. There are real and obvious synergies between the Phylomer® libraries and screening capabilities of the two companies. Isogenica in the last few years has entered contract relations with a number of major pharmaceutical companies including Amgen, AstraZeneca, Centocor, GE Healthcare, Invitrogen, Johnson and Johnson, Pfizer, UCB and Wyeth.

Phylogica enters the commercialisation phase: filling our deal pipeline

Following on with the success of the new business model and the first major drug discovery alliance with Roche, Phylogica had entered into negotiations with other significant pharmaceutical companies. We are now in discussions with a number of such companies who have expressed interest in using the Phylogica libraries to solve a range of problems. These proposals cover the spectrum from Phylogica screening for a lead Phylomer® against a disease target which the client supplies, to using the Phylomers as molecular probes to illuminate biological pathways that can be used to make the traditional small molecular drugs. Phylogica's versatility enables it to deal with molecular targets inside cells, outside cells and even against some intact cells themselves. This versatility translates to multiple commercialisation opportunities that few competing Biotech companies of our size can match.

The contract discovery deals that Phylogica is negotiating involve seven figures in upfront license fee and research funding, all payable within 12 months and within Phylogica's control. These profitable deals also generally involve 8 figures in additional milestone payments, as well as royalty payments as our Pharmaceutical partners take candidates forward in preclinical and clinical development.

While negotiations with potential partners can be protracted and complex, we are looking forward to signing a number of other discovery deals over the coming 12 months - **Phylogica expects at least two new big pharma deals to be completed within 6 months, providing further validation of the business model and monetising value from its unique intellectual property assets.**



Phylogica's Academic and Commercial Partners

Phylogica's Lower Risk, Discovery-Focused Business Model

"Improving the efficiency and robustness of our discovery process"

Our business model is now bearing fruit and justifies the recent strategic shift from drug developer, with all its huge associated risks, to concentrating on exploiting our drug discovery 'engine' to drive business. In this newsletter, and subsequent ones, we will review our business model which is becoming mainstream in our sector of the industry noting that a number of similar companies have generated hundreds of millions of dollars shareholder value in relatively short periods of time, by focusing on controlling the screening uniquely rich libraries of drug leads.

Phylogica's major assets are its vast and unique Phylomer® libraries, which are strongly protected with patents, combined with the sophisticated and robust screening processes which employ these libraries to solve various problems for big pharmaceutical/biotech clients. Having now validated our screening approach, we are now operating as such a contract discovery company, which is just entering the commercialisation stage of its growth.

This approach has three material advantages over the traditional Australian biotech model:

- 1) The Pharmaceutical client pays for the service so the financial risk transfers from the company to the client.
- 2) Depending on the outcome, there are agreed milestone payments and royalties which can add materially to the value of any product which might emerge from such commercial collaborations, and consequently add to the capital value of the company.
- 3) While the partner pharmaceutical company assumes the risk of failure during preclinical and clinical development, Phylogica still benefits from milestone payments and royalties, as drug candidates arising from drug leads which we discover move through the preclinical studies and clinical trials run by our pharmaceutical partners.

We become part of process of creating new drugs by providing the one part of that development which plays to our unique advantages. The big pharmaceutical partner does the rest.

In the next newsletter we will review a number of very successful drug discovery companies with similar business plans (such as Evotec, Galapagos NV and Morphosys AG), which reinforces the logical and the low-risk/high-return path that Phylogica is following.

Recent Technical Advances

New High Value Intracellular Targets

Having completed the optimisation of the screening processes and the upgrade of these libraries, we have set up a number of pilot projects to validate their versatility, to use as examples for partner companies, and to demonstrate the scalability of our processes.

We have selected as such examples several high value, commercially topical disease targets, where the enormous structural diversity of our libraries opens the door to finding unique structural leads. Some of these high value targets have generated significant financial returns for other discovery companies, even as validated leads for big pharmaceutical companies. Where we can show our libraries' versatility, while at the same time generating a commercially valuable program in itself around an attractive target, the benefits will be financially very rewarding. This validating ground-work is now moving ahead at full pace.

Cambridge University/MRC Hutchison Project for target discovery

We have commented previously on the independent

assessment of the target discovery project being run by the distinguished Hutchison MRC Unit at the University of Cambridge in the UK. The objective has been to test if Phylomer® libraries might assist in identifying new cancer targets for the discovery of new drugs. The Hutchison group has shown the Phylomers® can bind to defined targets linked to cancer cells and are many times more successful at this than traditional approaches used by pharmaceutical companies. Having achieved this aim, the next relevant step was to use the target binding as a tag to identify the key biological step in a pathway for which new drugs might be built. This was a complex exercise but it now opens the door for substantial use of the Phylomer® peptides as molecular probes to help discover new targets and create new drugs. This project has achieved all of its objectives and will serve as model of what the Phylomers® can do in the search for unique new drugs for complicated disease states.

Expanded Libraries for Extracellular Targets

Phylogica's current libraries are the most structurally diverse biologics discovery libraries available with billions of compounds from thousands of shape families. This vast diversity of shapes means more hits can be obtained against a wider variety of targets.

Over the past few months, as the company has been gearing up for its contracted commercial projects, there has been a strong focus on the expansion of all libraries and the optimising of the screening processes. As these are at the heart of our business, it has been imperative that we not only offer a range of the Phylomer® libraries as tools for generating high quality primary hits initially, but also show that these hits can be rapidly modified or engineered to improve their "drug-like" properties. The last feature is highly sought after by big pharma and represents a powerful value-adding process known as 'lead optimization'.

Encouragingly, efforts to improve the drug-like properties of hits in our advanced CD40L programme have met with significant success. For example, simply by optimising the screening conditions we have obtained hits which are 50-times as potent as our current lead candidates. They also offer improvements in a number of other critical areas which suggests we have significantly improved the quality of these lead compounds and hence their commercial value. These new lead compounds are currently being fast-tracked into animal models of disease to determine their biological activity and potency - key end points of interest to the large pharmaceutical companies, who are considering licensing these compounds for inflammatory diseases.

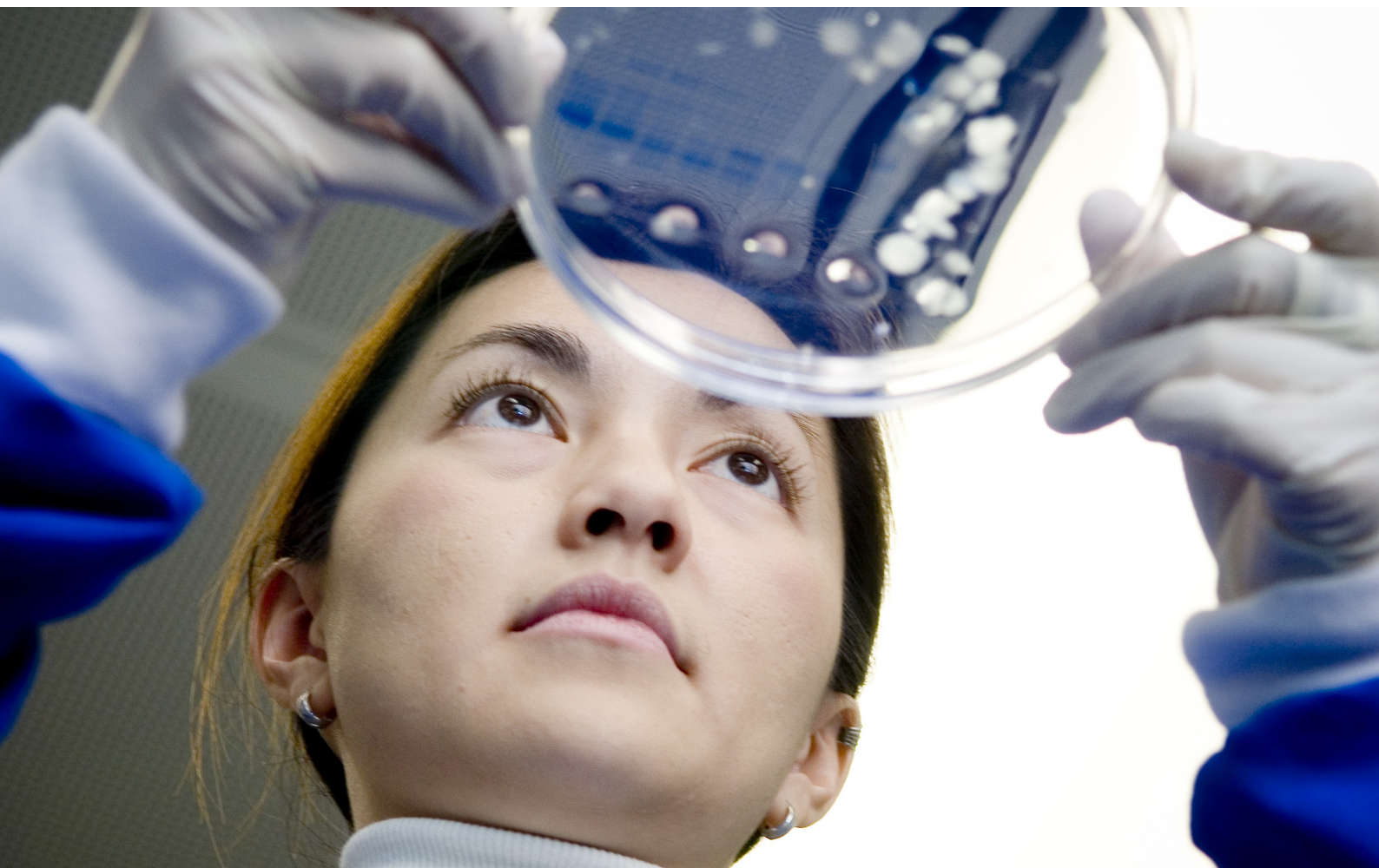
Key goals for Phylogica in 2010

Phylogica will be focussing on the following activities this year which should all help build its substantial value for our shareholders:

- Continue to grow the contract discovery business by closing more big pharma deals
- Continue to extend and validate Phylogica's peptide drug discovery engine to demonstrate its power and versatility
- Integrate complementary technologies to make Phylogica more efficient and competitive
- Build competitive tension around Phylogica's technology by continuing to deliver a world-class peptide discovery service and by communicating our capabilities to future partners
- Improve Phylogica's communication with its investors and discovery partners – including a revamp of our website around Phylogica's discovery focused business model

- Develop a comprehensive investor-relations package and conduct regular investor road-shows
- Develop strategies to access off-shore investment in Phylogica and greater trading liquidity
- Targeted presentations and detailed independent research to increase the number of sophisticated institutional investors on Phylogica's share register
- Stimulate a re-rating of Phylogica's share price to reflect its growing international reputation in the peptide discovery industry, alongside its international peers, most of which have valuations much higher than Phylogica (many >AU\$100 Million).

In conclusion, I'd like to thank you all for your continued support as shareholders, while looking forward to an exciting and rewarding year ahead.



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