Phylogica Limited

ACN 098 391 961

Financial Report

30 June 2010

Phylogica Limited
ACN 098 391 961

Corporate Information

Directors
Dr Doug Wilson
Executive Chairman

Mr Harry Karelis
Non- Executive Deputy Chairman

Mr Bruce McHarrie
Non-Executive Director

Mr Nick Woolf
Non- Executive Director

Dr Paul Watt
Executive Director

Company Secretary
Mr Greg MacMillan
Telephone: 08 9325 8888
Facsimile: 08 9325 8088
Email: gmacmillan@australianheritage.com.au

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

Bankers
Australia and New Zealand Banking Group
Subiaco Branch
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Subiaco
Western Australia 6008

Auditors
HLB Mann Judd
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130 Stirling Street
Perth
Western Australia 6000

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Subiaco East
Western Australia 6008
Website: www.phylogica.com

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

Incorporated in Western Australia, October 2001
Listed on:

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

Frankfurt Exchange
Code: PH7 ordinary shares

The directors present their report on the consolidated group, comprising Phylogica Limited (referred to in these financial statements as "the Company" or "Phylogica") and its wholly owned subsidiary, together with the financial report for the year ended 30 June 2010 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 Harry Karelis BSc(Hons) MBA F.Fin CFA FAICD Non- Executive Deputy Chairman	40	Appointed 25 January 2005. Current term ends November 2012. Mr Karelis is the founder and Managing Director of Titan BioVentures Management Pty Ltd. Titan is the investment manager of BioTech Capital Ltd. 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. Mr Karelis has been a director of Biotech Capital Ltd since 18 May 2000 and of Neurodiscovery Ltd since 9 June 2009. He was previously a Director of Stem Cell Sciences plc for the period since 23 July 2003 to 22 October 2009 and of Clinical Cell Culture Ltd for the period 13 August 2003 to 22 October 2004.
Mr Bruce McHarrie BCom FCA Non-Executive Director	52	Appointed 9 August 2002. Current term ends November 2010. Mr McHarrie has been in the biotechnology industry for over 15 years. Currently he is the Director of Finance and Business Development at the Telethon Institute for Child Health Research (the Institute), responsible for the executive management of the Institute with a particular focus on commercialisation activities. Mr McHarrie joined the Institute in 1999 after returning to Perth from the United Kingdom where he was Assistant Director in the Bioscience Unit at Rothschild Asset Management. The Bioscience Unit focused on investing in biotechnology and healthcare companies from the early start-up stage through to the publicly listed stage. In this capacity Mr McHarrie was invited to join the board of a number of United Kingdom based biotechnology companies. Prior to joining Rothschild Asset Management, Mr McHarrie was with Coopers and Lybrand in London servicing a client base primarily in the financial services industry. He holds a Bachelor of Commerce Degree from the University of Western Australia and qualified as a Chartered Accountant with Deloitte.

Mr Nick Woolf MA (Oxom) FCCA Non-Executive Director	42	Appointed 22 April 2010. Current term ends November 2010. Mr Woolf is an accomplished biotechnology professional with 18 years experience in industry, equity research and investment banking. He was formerly Chief Business Officer and Executive Director of Oxford BioMedica, a London-listed biotechnology company. Previously, he was Head of European Biotechnology Research at ABN Amro and he has held similar roles at Robertson Stephens, Nomura and SBC Warburg. Mr Woolf is a qualified accountant and has an MA in Chemistry from the University of Oxford.
Mr Anthony Barton B.Bus (Accountancy) Non-Executive Director	52	Appointed 22 May 2009. Resigned 13 July 2010. Mr Barton has been involved in founding and growing a number of successful listed public companies. Mr Barton has extensive experience in capital markets, corporate finance, funds management and venture capital. Mr Barton has had advisory roles in the incorporation and listing of many Australian based companies, including Mineral Securities Limited, Sally Malay Mining Ltd and CopperCo Limited. Mr Barton is the founding Executive Chairman of the boutique investment bank Australian Heritage Group. Mr Barton is a graduate of the Royal Melbourne Institute of Technology with a Bachelor of Business (Accountancy) degree and he has 30 years of commercial experience encompassing capital markets, corporate finance, funds management and venture capital. Mr Barton has acted in senior executive and director capacities for two leading Australian stockbroking firms. Mr Barton is non executive chairman of ASX listed Niplats Australia Limited.

Executive

Dr Paul Watt BSc(Hons) D Phil Executive Director Vice President Corporate Development Chief Executive Officer	45	Appointed 9 August 2002. Current term ends November 2010. Dr Watt is a leading graduate from The University of Western Australia. Dr Watt completed his doctorate in Molecular Biology at Oxford University before taking up postdoctoral appointments in yeast genetics at Harvard and Oxford Universities. Working in genomic instability and cancer research, Dr Watt discovered three novel genes, including the yeast homologue of the human Bloom's and Werner's syndrome genes. As an Honorary Research fellow at the Telethon Institute for Child Health Research, Dr Watt was appointed Adjunct Professor at the school of Paediatrics and Child Health of the University for Western Australia. Dr Watt has published more than 40 peer reviewed scientific papers. As primary inventor on approximately 20 patents, Dr Watt has experience commercialising intellectual property. Dr Watt founded InfaMed Ltd., now owned by Avita Medical Ltd, which is commercialising a drug delivery device, which he developed for asthmatic children. This device has received US regulatory clearance from the FDA, is CE marked and is currently marketed in Australia and overseas.

Dr Doug Wilson MB, ChB, FRACP, FRCPA Executive Chairman	73	Appointed 10 December 2007. Current term ends November 2012. A New Zealand medical graduate with post graduate experience in London at St Thomas Hospital Medical School, and at Walter and Eliza Hall Institute Melbourne. Joined the international pharmaceutical industry and became Senior Vice president for Boehringer Ingeleim for Medicine and regulatory affairs in the USA responsible for all dealings with FDA. Moved to Ingelheim and had the same responsibilities world wide. Headed the company's International Labelling Committee, deputy head of the International Medical Committee which oversaw all drugs in clinical development globally. During his tenure he saw ten drugs approved in the USA. Is now a consultant and is on the board of Neuren Pharmaceuticals and other companies and consults widely on biotech and pharmaceutical issues.

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 Greg MacMillan Company Secretary	51	Greg MacMillan has wide ranging corporate, financial, capital markets and commercial experience over the last 30 years. Greg has held the positions of director, company secretary, chief financial officer, and corporate finance executive in numerous companies across the finance, mining and commercial sectors. Greg holds a Bachelor of Business degree, is a Certified Practicing Accountant and a Chartered Company Secretary.

3. Directors' Meetings

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

	Directors' Meetings		Audit Committee		Nomination Committee		Remuneration Committee	
	A	B	A	B	A	B	A	B
H Karelis	8	6	1	1	2	2	2	2
B McHarrie	8	8	1	1	2	2	2	2
A Barton	8	8	-	-	2	2	2	2
N Woolf	2	1	-	-	-	-	-	-
P Watt	8	8	-	-	2	2	-	-
D Wilson	8	7	-	-	2	2	2	2

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 consolidated operating loss after tax for the financial period ended on 30 June 2010 was $4,572,825 (2009 loss: $4,490,920). At 30 June 2010, there was a deficency in net assets of ($437,080).

The deficiency in net assets arises because the accounting standards require convertible notes with a face value of $1,340,000 to be recorded as a current liability of $1,237,691 (2009: non-current liability $1,027,793).

The notes are redeemable by the Company by payment of $1,675,000 and are convertible by the noteholders at $0.05 per share. If neither of these events occur prior to the maturity date of 30 April 2011, then notes automatically convert at $0.04 per share, which would result in the issue of 33,500,000 ordinary shares fully paid.

The directors therefore consider that the net assets deficiency will be corrected in the normal course of business during the 2011 financial year.

6. Review of Operations, likely Developments and Expected Results

The year ended 30 June 2010 saw Phylogica Group incur a loss of $4,572,825. The nature of the Group'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:

- Shift from a traditional development focused Biotech company to an international commercial entity, focussed on contract discovery for big Pharma.
- Commercial contract with a major international drug company Roche, to use Phylomers as transporters of biologic drugs into cells. The report from the first Phase of the Roche alliance has recently been delivered (FY2010-2011)
- Advanced discussions with other large pharmaceutical and biotechnology groups regarding new discovery partnerships (note a large deal with MedImmune, a subsidiary of the large pharmaceutical company AstraZeneca has recently been signed (FY2010-2011)
- Established relationships with multinational pharmaceutical and biotechnology companies and world-class research institutes.
- Advancements in Phylogica's Internal projects:
  - Intracellular targets
    - to get Phylomers inside cells and to target different diseases
    - to block a cancer causing signalling pathway, known as the 'hedgehog' pathway, which is a major focus for many drug companies. In conjunction with the Hutchison MRC Unit at the University of Cambridge in the UK Phylomers we have identified against hedgehog targets are to be tested for their anti-cancer qualities.
  - Anti-inflammatory target (CD40L)
    - to treat diseases such as rheumatoid arthritis, Lupus erythematosis and Inflammatory Bowel Disease
  - Antimicrobials
    - to develop a novel class of antibiotics based on Phylomer libraries

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.

6. Review of Operations, likely Developments and Expected Results (Cont.)

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 ended 30 June 2010 the Company issued 20,000,000 ordinary shares at $0.10 per share to raise $2,000,000 for working capital purposes. The Company also issued $100,000 of convertible notes, issued interest free with a maturity date of 30 April 2011. The notes are convertible by noteholders before the maturity date at $0.05 per share or convert at maturity at $0.04 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

On 13 July 2010, Non-Executive director Mr Anthony Barton resigned as a director of Phylogica Limited.

On 18 August 2010, Phylogica Limited announced that is has entered into an agreement with MedImmune to evaluate Phylogica's proprietary Phylomer® peptide library for novel antimicrobial peptides. The signing of this agreement results in an upfront payment of US$750,000 to Phylogica and a further US$750,000 in committed research funding for an inital 12 month term. In addition to this Phylogica is eligible to receive development, regulatory and commercial milestone lump sum payments, in addition to royalties on potential worldwide sales.

On 30 August 2010, Phylogica lodged a prospectus for a renounceable rights issue to shareholders on the basis of one (1) New Share and one (1) New Option for every five (5) shares held at the record date, issued at a price of 5 cents per New Share. The New Options will have an exercise price of 15 cents and will expire on 31 August 2011. The rights issue has been fully underwritten. This rights issue will raise approximately $2,357,518 for working capital purposes and result in approximately 47,150,353 New Shares and 47,150,353 New Options being issued. The closing date for acceptances of this offer has been set as 24 September 2010.

10. Directors' Interests

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	Convertible Notes
D Wilson	-	918,337	10,000
H Karelis	29,166,667	368,700	1,000,000
B McHarrie	1,920,479	368,700	-
N Woolf	-	-	-
P Watt	4,967,031	3,000,000	20,000

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

11. Indemnification and Insurance of Directors and Officers (Cont.)

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 directors' and officers' liability 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 person's role as an Officer, except that cover is not provided for loss in relation to Officers gaining any profit or advantage to which they were not legally entitled, or Officers committing any criminal, dishonest, fraudulent or malicious act or omission, or any knowing or wilful violation of any statute or regulation. Cover is also only provided for fines and penalties in limited circumstances and up to a small financial limit.

The insurance does not provide cover for the independent auditors of the 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, HLB Mann Judd, the Company's auditor, has performed certain other services in addition to their statutory duties.

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

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

	$
Audit and review of financial reports	25,750
Government grant audit services	6,600
	32,350

13. Interests in Contracts or Proposed Contracts with the Company

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

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

14. Unissued Shares Under Option

At the date of this report, ordinary shares of the Company under option totalled 15,256,164 exercisable on or before 31 March 2012 (2009: 12,884,000 options exercisable on or before 31 March 2012).

Number of options	Exercisable at $0.25	Exercisable at $0.075	Exercisable at $0.10	Total
Issued at 30 June 2010	400,000	12,356,164	2,500,000	15,256,164
Vested at 30 June 2010	300,000	12,356,164	2,500,000	15,156,164

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

15. Environmental Regulation and Performance

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

16. Nomination Committee

The full Board carries out the function of the nomination committee. During the reporting period, the Board made decisions regarding its composition on two occasions with a majority of the Board being present.

17. Audit Committee

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

The audit committee met once 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 Directors' report.

18. Remuneration Committee

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

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

The members of the remuneration committee during the year were:
Mr B McHarrie - Non-Executive
Mr A Barton - Non-Executive
Mr H Karelis - Non-Executive
Dr D Wilson - Executive

The remuneration committee meet at least twice a year and as required. The committee met twice during the year and committee members' attendance record is disclosed in the table of directors' meetings on page 3.

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

19. Other

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

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

19.2 Identification of independent directors

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

Applying the independence criteria, only one of the present directors is classified as independent.

19.3 Statement concerning availability of independent professional advice

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

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

No evaluation of the performance of the board and its members was carried out during the reporting period.

19.5 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 directors' fees.

20. Remuneration Report - Audited

Remuneration is referred to as compensation throughout this report.

20.1 Principles of compensation

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

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

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

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

20. Remuneration Report - Audited (Cont.)

20.2 Fixed remuneration

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

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

20.3 Performance linked remuneration

Performance linked compensation includes short term incentives (STI), in the form of cash bonuses paid 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.

20.4 Short term incentive bonus (STI)

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 Company's employees is set KPIs and a bonus is payable on achievement of these KPIs. This is either an amount equal to between 5% and 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.

For the 2010 financial year, payment of bonuses has been deferred for review in December 2010.

20.5 Long term incentives (LTI)

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

On 26 August 2009 the Company issued a notice of General Meeting to obtain shareholder approval for the grant of 4,806,164 ESOP options to Dr P Watt, Mr D Wilson, Mr B McHarrie, Mr H Karelis and Mr A V Roy, on the same terms as those issued under the ESOP during 2009.

20.6 Short-term and long-term incentive structure

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.

20.7 Consequences of performance on shareholders' wealth

The Board has regard to a broad range of factors in considering the Company's performance and how best to generate shareholder value. These include financial factors 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

20. Remuneration Report - Audited (Cont.)

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.

20.8 Service agreements

Two 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 in one case and one month in the other. There is no termination fee payable other than during the term of notice.

Dr Doug Wilson, the Executive Chairman is a contractor paid a fixed fee of $A15,000 per month.

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

20.9 Non-executive directors

The aggregate remuneration of all non-executive directors was set at $200,000 per annum at the annual general meeting held on 26 November 2004. The base fee for a 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. For a period of 6 months during the 2009 financial year, non-executive directors reduced their fees by half. The directors received shareholder approval for the grant of a total of 1,806,164 options in lieu of the directors' fees forgone. Since the resignation of a full time CEO and, subsequently, other senior corporate staff of the Company, several of the directors have provided additional management services on a consultancy basis.

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

Dr D Wilson (then a non-executive director) was issued on 26 November 2008 a total of 300,000 options, exercisable at $0.25 and expiring 31 July 2011.

20.10 Equity Instruments

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

(a) <u>Options and rights over equity instruments granted as compensation</u>

During the reporting period 4,806,164 options over ordinary shares in the Company were granted as compensation to key management personnel.

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

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

20. Remuneration Report - Audited (Cont.)

Directors	Number of options outstanding at 30 June 2009	Grant date	Fair value per option at grant date ($)	Exercise price per option ($)	Expiry date	Number of options vested during 2009
Dr D Wilson	300,000 (2)	26 November 2008	0.016	0.250	31 July 2011	100,000
Dr P Watt	2,000,000 (1)	25 November 2005	0.040	0.250	30 June 2010	-
Executives						
Dr R Hopkins	750,000 (2)	31 March 2009	0.023	0.075	31 March 2012	375,000
	300,000 (1)	1 March 2006	0.025	0.300	30 June 2010	-

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

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

Further details, including grant dates and exercise dates regarding options granted to executives under the ESOP are in note 17 to the financial statements. No options have been granted since the end of the year.

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

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

(c) Exercise of options granted as compensation

During the reporting period, no options previously granted as compensation were exercised (2009: Nil).

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

Details of vesting profiles of the options granted as remuneration to two non-executive directors of the Company and the named Company executive are detailed on the following page:

	Options Granted		Vested in year (%)	Forfeited in year (%)	Financial years in which grant vests	Value yet to vest	
Directors	Number	Date				Minimum ($)	Maximum ($)
Mr B McHarrie	184,350	30 September 2009	100	-	1 July 2009	-	-
	184,350	30 September 2009	100	-	1 July 2009	-	-
Mr H Karelis	184,350	30 September 2009	100	-	1 July 2009	-	-
	184,350	30 September 2009	100	-	1 July 2009	-	-
Dr D Wilson	100,000	26 November 2008	-	-	1 July 2008	-	-
	100,000	26 November 2008	100	-	1 July 2010	-	-
	100,000	26 November 2008	-	-	1 July 2011	-	1,600
	309,168	30 September 2009	100	-	1 July 2009	-	-
	309,168	30 September 2009	100	-	1 July 2009	-	-
Dr P Watt	1,500,000	30 September 2009	100	-	1 July 2009	-	-
	1,500,000	30 September 2009	100	-	1 July 2009	-	-
Executives							
Dr R Hopkins	375,000	31 March 2009	-	-	1 July 2008	-	-
	375,000	31 March 2009	100%	-	1 July 2009	-	-

20. Remuneration Report - Audited (Cont.)

(e) Analysis of Movements in options

There were no movements during the reporting period of options over ordinary shares in the Company held by each Company director and other key management personnel, other than the grant of 4,806,164 options on 30 September 2009 to Dr P Watt (3,000,000), Mr D Wilson (618,337), Mr B McHarrie (368,700), Mr H Karelis (368,700) and Mr A V Roy (450,427) (resigned as a director 22/05/2009).

(f) Payments to persons before taking office

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

(g) Directors' and executive officers' remuneration

Details of the nature and amount of each major element of remuneration of each director and each of the three (in 2010) or four (in 2009) executives of the Company who receive the highest remuneration (Key Management Personnel) are as set out on the following two pages.

20. Remuneration Report - Audited (Cont.)

(g) Directors' and executive officers' remuneration (Cont.)

		Short Term Benefits		Total	Long Term Benefits	Post Employment Benefits	Share-Based Payments	Total	Proportion of remuneration performance related	Value of options as proportion of Remuneration
Directors:	Year	Salary & Fees	Cash Bonus		Long Service Leave	Superannuation	Value of Options			
Non-Executive		$	$	$	$	$	$	$	%	%
Mr J von Roy (resigned 22/5/09)	2010	-	-	-	-	-	-	-	-	-
	2009	28,125	-	28,125	-	2,531	-	30,656	-	-
Mr H Karelis	2010	25,000	-	25,000	-	2,250	17,292	44,542	-	38.8
	2009	58,708	-	58,708	-	5,284	-	63,992	-	-
Mr B McHarrie	2010	25,000	-	25,000	-	2,250	17,292	44,542	-	38.8
	2009	22,708	-	22,708	-	2,044	-	24,752	-	-
Dr M Pierce (resigned 4/12/08)	2010	-	-	-	-	-	-	-	-	-
	2009	19,113	-	19,113	-	-	1,549	20,662	-	7.5
Dr D Wilson (executive from 22/12/08)	2010	-	-	-	-	-	-	-	-	-
	2009	46,125	-	46,125	-	-	-	46,125	-	-
Mr A Barton (appointed 22/5/09)	2010	27,250	-	27,250	-	-	-	27,250	-	-
	2009	2,795	-	2,795	-	-	-	2,795	-	-
Mr N Woolf (appointed 22/4/10)	2010	5,147	-	5,147	-	-	-	5,147	-	-
	2009	-	-	-	-	-	-	-	-	-
Executive										
Dr P Watt, Chief Scientific Officer	2010	220,000	-	220,000	21,511	19,800	177,936	439,247	-	40.5
	2009	210,000	33,600	243,600	10,625	25,524	-	279,749	12.0	-
Dr D Wilson (executive from 22/12/08)	2010	178,000	-	178,000	-	-	29,000	207,000	-	14.0
	2009	90,000	-	90,000	-	-	2,904	92,904	-	3.1
Management:										
Dr G Pullen, VP Corporate Develop	2010	-	-	-	-	-	-	-	-	-
(resigned 8/04/09)	2009	199,295	-	199,295	-	14,040	-	213,335	-	-
Dr R Hopkins Chief Operating Officer	2010	160,000	-	160,000	10,775	14,400	6,399	191,574	-	3.3
(appointed COO 21/05/09)	2009	120,000	14,400	134,400	2,832	11,196	10,665	159,093	9.0	6.7
Total Key Management Personnel	**2010**	**640,397**	**-**	**640,397**	**32,286**	**38,700**	**247,919**	**959,302**	**-**	**25.8**
	2009	796,869	48,000	844,869	13,457	60,619	15,118	934,063	5.1	1.6

20. Remuneration Report- Audited (Cont.)

(g) Directors' and executive officers' remuneration (Cont.)

		Short Term Benefits		Total	Long Term Benefits	Post Employment Benefits	Share-Based Payments	Total	Proportion of remuneration performance related	Value of options as proportion of Remuneration
Secretary and Chief Financial Officer:	Year	Salary & Fees	Cash Bonus		Superannuation	Value of Options	Value of options			
		$	$	$	$	$	$	$	%	%
Mr G Boden (resigned 29/05/09) (3)	2010	-	-	-	-	-	-	-	-	-
(appointed 17/08/07)	2009	93,063	-	93,063	-	-	-	93,063	-	-
Mr G MacMillan (appointed 29/05/09) (4)	2010	36,000	-	36,000	-	-	-	36,000	-	-
	2009	3,000	-	3,000	-	-	-	3,000	-	-

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

(1) The fair value of the options is calculated at the date of grant using a Black-Scholes pricing model and allocated to each reporting period in accordance with the vesting profile of the options. The value recognised is the portion of the fair value of the options allocated to the reporting period. In valuing the options, market conditions have been taken into account.

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

(3) Payments made to Boden Corporate Services Pty Ltd (BCS) include time spent on Company activities by G Boden and other employees of BCS.

(4) Payments made to Australian Heritage Group Pty Ltd (AHG) are for time spent on Company activities by G MacMillan and other employees of AHG.

20. Remuneration Report- Audited (Cont.)

(h) Analysis of bonuses included in remuneration

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

Director	Included in remuneration $ (A)	% vested in year	% forfeited in year (B)
Dr P Watt	-	-	-
Executive			
Dr R Hopkins	-	-	-

(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 2010 and earlier financial years.

(B) The amounts forfeited are due to the performance or service criteria not being met in relation to the current financial year.

21. Lead Auditor's Independence Declaration

The lead auditor's independence declaration is set out on page 16 and forms part of the Directors' report for the year ended 30 June 2010.

Signed in accordance with a resolution of the directors:

Bruce McHarrie
Director
Perth
24th September 2010

HLB Mann Judd

Accountants | Business and Financial Advisers

AUDITOR'S INDEPENDENCE DECLARATION

As lead auditor for the audit of the financial report of Phylogica Limited for the year ended 30 June 2010, I declare that to the best of my knowledge and belief, there have been no contraventions of:

a) the auditor independence requirements of the Corporations Act 2001 in relation to the audit; and

b) any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Phylogica Limited.

Perth, Western Australia
24 September 2010

N G NEILL
Partner, HLB Mann Judd

HLB Mann Judd (WA Partnership) ABN 22 193 232 714
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Email: hlb@hlbwa.com.au. Website: http://www.hlb.com.au

Phylogica Limited

Statement of Comprehensive Income
For the year ended 30 June 2010

	Note	Consolidated 2010 $	2009 $
Continuing Operations			
Commercial income	*5(ii)*	**433,120**	1,162
Government grant income	*5(i)*	**163,136**	1,273,780
Net interest income		**91,658**	104,420
Contract research costs		**(1,891,831)**	(1,700,902)
Personnel expenses	*6*	**(1,339,211)**	(1,279,484)
Depreciation, amortisation & impairment	*7*	**(66,941)**	(1,006,796)
Professional services		**(415,768)**	(330,719)
Travel and accommodation		**(228,940)**	(126,221)
Licenses		**(17,449)**	(20,561)
Intellectual property maintenance		**(293,539)**	(353,390)
Laboratory consumables		**(808,188)**	(770,306)
Occupancy costs		**(24,110)**	(67,916)
Other operating expenses		**(174,762)**	(213,987)
Loss before income tax expense		**(4,572,825)**	(4,490,920)
Income tax expense	*8*	**-**	-
Net loss for the period		**(4,572,825)**	(4,490,920)
Other comprehensive income for the period, net of tax		**-**	-
Total comprehensive loss for the period		**(4,572,825)**	(4,490,920)
Total comprehensive loss for the period attributable to the members of Phylogica Limited	*17(iii)*	**(4,572,825)**	(4,490,920)
		Cents	Cents
Basic earnings per share	*18*	**(2.02)**	(2.75)
Diluted earnings per share	*18*	**(2.02)**	(2.75)

This statement of comprehensive income is to be read in conjunction with the notes to the financial statements set out on pages 21 to 38.

Phylogica Limited

Statement of Financial Position
As at 30 June 2010

	Note	Consolidated 2010 $	2009 $
Current assets			
Cash and cash equivalents		**1,281,044**	3,072,905
Trade and other receivables	*9*	**124,417**	341,576
Total current assets		**1,405,461**	3,414,481
Non-current assets			
Property, plant and equipment	*10*	**164,579**	72,740
Total non-current assets		**164,579**	72,740
Total assets		**1,570,040**	3,487,221
Current liabilities			
Trade and other payables	*11*	**603,991**	439,012
Interest-bearing liabilities	*12*	**1,237,691**	-
Employee benefits	*16*	**95,303**	51,701
Deferred government grants		**44,727**	44,014
Total current liabilities		**1,981,712**	534,727
Non-current liabilities			
Employee benefits	*16*	**25,408**	13,457
Interest bearing liabilities	*12*	**-**	1,027,793
Total non-current liabilities		**25,408**	1,041,250
Total liabilities		**2,007,120**	1,575,977
Net assets/ (liabilities)	*2(d)*	**(437,080)**	1,911,244
Equity			
Issued capital	*17(i)*	**21,973,323**	20,093,323
Reserves	*17(ii)*	**1,015,122**	670,621
Accumulated losses	*17(iii)*	**(23,425,525)**	(18,852,700)
Total equity/ (deficiency)		**(437,080)**	1,911,244

This statement of financial position is to be read in conjunction with the notes to the financial statements set out on pages 21 to 38.

Statement of Cash Flows
For the year ended 30 June 2010

	Note	Consolidated 2010 $	2009 $
Cash flows from operating activities			
Commercial income received		**433,120**	1,162
Government grants received		**204,947**	1,153,324
Cash paid to suppliers and employees		**(4,480,722)**	(5,130,926)
Cash generated from operations		**(3,842,655)**	(3,976,440)
Interest received		**90,893**	97,333
income taxes refunded		**123,078**	-
Net cash used in operating activities	*19*	**(3,628,684)**	(3,879,107)
Cash flows from investing activities			
Acquisition of property, plant and equipment	*10*	**(158,780)**	(5,418)
Proceeds from sale of property, plant and equipment		**15,603**	-
Net cash used in investing activities		**(143,177)**	(5,418)
Cash flows from financing activities			
Cash acquired on acquisition of subsidiary	*20*	**-**	80,107
Proceeds from the issue of convertible notes		**100,000**	1,240,000
Proceeds from the issue of share capital	*17*	**2,000,000**	2,600,000
Payment of transaction costs	*17*	**(120,000)**	(194,750)
Net cash from financing activities		**1,980,000**	3,725,357
Net (decrease) in cash and cash equivalents		**(1,791,861)**	(159,168)
Cash and cash equivalents at 1 July		**3,072,905**	3,232,073
Cash and cash equivalents at 30 June		**1,281,044**	3,072,905

This statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 21 to 38.

Statement of Changes in Equity
For the year ended 30 June 2010

	Note	Consolidated			
		Issued Capital	Accumulated Losses	Reserves	Total
		$	$	$	$
Balance at 1 July 2008		16,675,573	(14,361,780)	380,845	2,694,638
Loss attributable to members of the consolidated entity		-	(4,490,920)	-	(4,490,920)
Other comprehensive income		-	-	-	-
Total comprehensive income/(loss)		-	(4,490,920)	-	(4,490,920)
Shares issued during the year	*17(i)*	3,612,500	-	-	3,612,500
Share capital transaction costs	*17(i)*	(194,750)	-	-	(194,750)
Share-based payments	*17(ii)*	-	-	77,569	77,569
Convertible notes equity component	*17(ii)*	-	-	212,207	212,207
Balance at 30 June 2009		20,093,323	(18,852,700)	670,621	1,911,244
Balance at 1 July 2009		**20,093,323**	**(18,852,700)**	**670,621**	**1,911,244**
Loss attributable to members of the consolidated entity		**-**	**(4,572,825)**	**-**	**(4,572,825)**
Other comprehensive income		**-**	**-**	**-**	
Total comprehensive income/(loss)		**-**	**(4,572,825)**	**-**	**(4,572,825)**
Shares issued during the year	*17(i)*	**2,000,000**	**-**	**-**	**2,000,000**
Share capital transaction costs	*17(i)*	**(120,000)**	**-**	**-**	**(120,000)**
Share-based payments	*17(ii)*	**-**	**-**	**454,399**	**454,399**
Convertible notes equity component	*17(ii)*	**-**	**-**	**(109,898)**	**(109,898)**
Balance at 30 June 2010		**21,973,323**	**(23,425,525)**	**1,015,122**	**(437,080)**

This statement of changes in equity is to be read in conjunction with the notes to the financial statements set out on pages 21 to 38.

1. Reporting Entity

Phylogica is a Company domiciled in Australia. The financial report of the Consolidated Entity comprising the Company and its wholly owned subsidary for the financial year ended 30 June 2010 was authorised for issue by the directors on 24th September 2010. The Company is primarily involved in the discovery and optimisation of peptide-based drugs to treat inflammatory diseases.

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) which includes Australian equivalents to International Financial Reporting Standards (AIFRS) adopted by the Australian Accounting Standards Board (AASB), and the Corporations Act 2001. Compliance with AIRFS ensures that the financial report, comprising the financial statements and notes thereto complies with International Financial Reporting Standards (IFRSs).

(b) Basis of measurement

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

(c) Use of estimates and judgements

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

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

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

- Note 5(i) – government grant income, where the grant income for the succeeding quarter is shown on the statement of financial position as unearned income at balance date and relies upon satisfactory progress towards R&D milestones for the income to be earned. Amount at 30 June 2010 is $44,727 to be earned (2009: $30,137 refund owed to Phylogica).
- Note 17(i) – share based payments which include projections of future values, amount expensed for 2010 is $454,399 (2009: $77,569).
- Note 16 – employee benefits, where the rate of pay may change between balance date and payment and where long service leave utilisation may change.

(d) Going Concern

The financial report has been prepared on a going concern basis which assumes the settlement of liabilities and the realisation of assets in the normal course of business. For the year ended 30 June 2010 the Company has incurred a loss of $4,572,825 (2009: loss of $4,490,920) and at year end the Company had a working capital deficency of $576,251 (2009: surplus $2,879,754) including a cash and cash equivalents balance of $1,281,044 (2009: $3,072,905). Cash used in operating activities in 2010 was $3,628,684 (2009: $3,879,107). The Company had a net asset deficiency of $437,080 at 30 June 2010 caused by the accounting standards requirement that convertible notes be included as debt of $1,237,691 (see note 12).

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

- The convertible notes will only be repaid if that is the best outcome for the Company, otherwise they will convert to equity.
- There is capacity for the Company to reduce its operating cost structure;
- Cash flow forecasts for the next twelve months demonstrate the ability of the Company to continue as a going concern on the basis that expected revenue is received and/ or further capital is raised.

2. Basis of Preparation (Cont.)

- The Company has announced an agreement with MedImmune whereby a total of US$1.5 million will be received during the 2011 financial year.
- A fully underwritten rights issue commenced on 31 August 2010, to raise $2.4 million before costs.
- To the extent that further equity is required the Directors are confident that a sufficient capital raising can be completed.

3. Significant accounting policies

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

(a) Foreign currency

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

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

(b) Property, plant and equipment

(i) Recognition and measurement

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

(ii) Leased assets

Leases in terms of which the 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 note 3 (o).

(iii) Depreciation

Depreciation is charged to the statement of comprehensive income 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, depreciation method and useful lives if not insignificant, are reassessed annually.

(c) Research and development

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

(d) Trade and other receivables

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

(e) Cash and cash equivalents

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

3. Significant accounting policies (Cont.)

(f) Impairment

(i) Financial assets

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

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

(ii) Non- Financial Assets

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

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

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

(iii) Calculation of recoverable amount

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

(iv) Reversals of impairment

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

(f) 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.

(g) Transaction costs

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

3. Significant accounting policies (Cont.)

(h) 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.

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.

(i) Provisions

A provision is recognised in the statement of financial position 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.

(j) Trade and other payables

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

(k) Revenue

Goods sold and services rendered

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

(l) Commercial income

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

(m) Finance income and expense

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

3. Significant accounting policies (Cont.)

(n) Government Grants

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

(o) Expenses

Operating lease payments

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

(p) Financial instruments

(i) Non-derivative financial instruments

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

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

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

Cash and cash equivalents comprise cash balances and call deposits.

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

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

(ii) Share capital

Ordinary shares

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

(q) Income tax

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

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

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

3. Significant accounting policies (Cont.)

(r) 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 statement of comprehensive income and statement of financial position.

(s) Goods and services tax

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

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

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

(t) New standards and interpretations not yet adopted

In the year ended 30 June 2010, the Group has reviewed all of the new and revised Standards and Interpretations issued by the AASB that are relevant to its operations and effective for the current annual reporting period.

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

4. Financial risk management

Overview

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

- credit risk
- liquidity risk
- market risk.

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

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

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

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

Credit risk

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

4. Financial risk management (Cont.)

Trade and other receivables

The Company has no material credit risk at 30 June 2010 or 2009.

Cash investments

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

Liquidity risk

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

Market risk

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

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

Currency risk

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

Interest rate risk

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

Capital management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board's target is for employees and directors of the Company to hold between five and ten percent of the Company's ordinary shares. At present employees hold just under three percent of fully diluted issued capital, assuming that all outstanding share options vest and / or are exercised.

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

The Company is not subject to externally imposed capital requirements.

5. Income

(i) Government grant income

The Company has been awarded 2 government grants and these are recognised as revenue in the statement of comprehensive income in the same period as which the related expenses are incurred. $124,847 was recognised in the year ended 30 June 2010 (2009: $1,219,428). The larger grant ended at 30 June 2009. Future income under the remaining grant will be received only if the Company continues to meet the conditions of the grant agreement and the government body continues to support grants of the nature received. $38,289 was also received through the Export Market Development Grant Scheme (2009: $54,352) 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 full time equivalent research salaries and milestone payments. $433,120 was received from contract payments during the year (2009: $1,162).

6. Personnel expenses

	Consolidated 2010	Consolidated 2009
	$	$
Wages and salaries	**790,386**	1,104,177
Other associated staff costs	**14,558**	40,766
Contributions to defined contribution superannuation funds	**49,187**	106,326
Increase in annual leave accrual	**30,681**	(49,354)
Share based compensation- Note 17	**454,399**	77,569
	1,339,211	1,279,484

7. Depreciation & impairment

	2010	2009
Depreciation of equipment	**66,941**	114,030
Impairment of intangible assets	**-**	892,766
	66,941	1,006,796

8. Income Tax

(i) Income tax benefit

The prima facie tax on the operating loss is reconciled to the income tax provided in the accounts as follows:

	2010	2009
Prima facie tax benefit on operating loss before income tax at 30%	**(1,371,848)**	(1,347,276)
Tax effect of permanent differences	**201,159**	(382,577)
Current period tax losses and temporary differences not brought to account	**1,573,007**	1,729,853
Income tax benefit attributable to operating loss before income tax	**-**	-

(ii) Unrecognised deferred tax asset

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

	2010	2009
Deductible temporary differences	**12,345**	64,862
Tax losses	**7,995,554**	6,414,799
	8,007,899	6,479,661

Tax losses do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it cannot yet be considered probable that future taxable profit will be available against which the Company can utilise the benefits therefrom.

9. Trade and other receivables

	Consolidated 2010	Consolidated 2009
	$	$
GST receivable	**78,883**	128,744
Sundry debtors	**-**	15,603
Income tax refund	**-**	123,078
Government grant refund	**-**	74,151
Accrued Interest	**765**	-
Other receivables	**44,769**	-
	124,417	341,576

10. Plant and equipment

	2010	2009
Office and research equipment at cost	**383,377**	224,597
Accumulated depreciation	**(218,798)**	(151,857)
	164,579	72,740
Reconciliation		
Carrying amount at the beginning of the year	**72,740**	195,537
Acquisitions	**158,780**	5,148
Disposals	**-**	(13,915)
Depreciation	**(66,941)**	(114,030)
	164,579	72,740

11. Trade and other payables

	Consolidated 2010	Consolidated 2009
	$	$
Trade payables	**561,261**	329,574
Accrued expenses	**26,567**	18,000
Other	**16,163**	91,438
	603,991	439,012

12. Interest bearing liabilities

	2010	2009
Current		
Convertible note face value	**1,340,000**	-
Transferred to equity reserve	**(102,309)**	-
Interest bearing liability	**1,237,691**	-
Non-Current		
Convertible note face value	-	1,240,000
Transferred to equity reserve	-	(212,207)
Interest bearing liability	-	1,027,793

The convertible notes were issued at nil interest and mature on 30 April 2011. The notes have been discounted at a rate of 10% pa to calculate fair value at each balance date. The notes are redeemable by the Company by payment of $1,675,000, are convertible by noteholders before the maturity date at $0.05 per share or convert at maturity at $0.04 per share. Conversion at maturity would result in the issue of 33,500,000 shares or 10.6% of the issued capital after the September 2010 rights issue.

13. 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 statement of comprehensive income and statement of financial position.

14. Events subsequent to balance date

On 13 July 2010, Non-Executive director Mr Anthony Barton resigned as a director of Phylogica Limited.

On 18 August 2010, Phylogica Limited announced that is has entered into an agreement with MedImmune to evaluate Phylogica's proprietary Phylomer® peptide library for novel antimicrobial peptides. The signing of this agreement results in an upfront payment of US$750,000 to Phylogica and a further US$750,000 in committed research funding for an inital 12 month term. In addition to this Phylogica is eligible to receive development, regulatory and commercial milestone payments, in addition to royalties on potential worldwide sales.

On 30 August 2010, Phylogica lodged a prospectus for a renounceable rights issue to shareholders on the basis of one (1) New Share and one (1) New Option for every five (5) shares held at the record date, issued at an issue price of 5 cents per New Share. The New Options will have an exercise price of 15 cents and will expire on 31 August 2011. The rights issue has been fully underwritten. This rights issue will raise approximately $2,357,518, before issue costs, for working capital purposes and result in approximately 47,150,353 New Shares and 47,150,353 New Options being issued. The closing date for acceptances of this offer has been set as 24 September 2010.

15. Contingent liabilities and contingent assets

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

16. Employee benefits

	Consolidated	
	2010	**2009**
	$	**$**
Current		
Liability for annual leave	**82,382**	51,701
Superannuation payable	**12,921**	-
	95,303	51,701
Non-Current		
Liability for Long Service Leave	**25,408**	13,457
	25,408	13,457
Number of employees at year end	**5**	5

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

Consolidated:	**Long Service Leave**	**Annual Leave**
	$	**$**
Balance as 1 July 2009	13,457	51,701
Payments made	-	(24,244)
Charges raised or written back	11,951	54,925
Balance as 30 June 2010	25,408	82,382

(i) Share-based payments

In 2005 the Company established an employee share option programme (ESOP) that entitles key management personnel and senior employees to purchase shares in the Company.

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

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

(ii) Fair value of share options and assumptions

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

Granted during 2010:

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

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

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

16. Employee benefits (Cont.)

Granted during 2009:

Number of options	Grant Date	Expiry Date	Fair Value per Option	Exercise Price	Price of shares on grant date	Risk Free Interest Rate (%)	Estimated Volatility (%)	Number vested at 30 June 2009
400,000	26-Nov-08	31-July-11	$0.016	$0.250	$0.062	3.3	100	200,000
5,300,000	31-Mar-09	31-Mar-12	$0.023	$0.075	$0.051	3.4	100	2,650,000

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

1. 2,850,000 options vested immediately upon grant.
2. 2,650,000 options will vest on 31 March 2010.
3. The remaining 200,000 options vest in two equal tranches on 31/07/09 and 31/07/10.

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

No employee options were exercised during the year.

The weighted average life of the options granted during the year was 20.69 months.

17. Issued capital and accumulated losses

	Consolidated 2010 $	Consolidated 2009 $
(i) Issued and paid up capital		
235,751,764 (2009: 215,751,764) ordinary shares fully paid.	**21,973,323**	20,093,323

Movements in issued capital during the year:

Ordinary Shares	Consolidated 2010 Shares	Consolidated 2010 $	Consolidated 2009 Shares	Consolidated 2009 $
Opening balance	**215,751,764**	**20,093,323**	143,501,764	16,675,573
Shares issued during the year:				
Shares issued to acquire Dynamic Microbials	-	-	20,250,000	1,012,500
Shares issued at $0.05	-	-	52,000,000	2,600,000
Shares issued at $0.10	**20,000,000**	**2,000,000**	-	-
Share issue costs	-	**(120,000)**	-	(194,750)
Closing balance	**235,751,764**	**21,973,323**	215,751,764	20,093,323

Terms and Conditions

Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings.

In the event of winding up of the 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.

	Consolidated 2010 $	Consolidated 2009 $
(ii) Reserves		
Opening balance	**670,621**	380,845
Share based payments for the period	**454,399**	77,569
Equity component of convertible note	**(109,898)**	212,207
Balance at the end of the year	**1,015,122**	670,621
(iii) Accumulated losses		
Opening balance	**(18,852,700)**	(14,361,780)
Loss for the period	**(4,572,825)**	(4,490,920)
Balance at the end of the year	**(23,425,525)**	(18,852,700)

17. Issued capital and accumulated losses (Cont.)

(iv) Options

Options on issue at end of the year:

	Weighted Av. Exercise Price 2010	Number of Options 2010	Weighted Av. Exercise Price 2009	Number of Options 2009
(a) Options exercisable at $0.25 on or before 30 June 2010:				
Balance at beginning of year	**$0.25**	**6,650,000**	$0.25	6,650,000
Issued during the year	-	-	-	-
Lapsed	**$0.25**	**(6,650,000)**	-	-
Balance at end of year	-	-	$0.25	6,650,000
(b) Options exercisable at $0.30 on or before 31 July 2010:				
Balance at beginning of year	**$0.30**	**534,000**	$0.30	784,000
Issued during the year	-	-	-	-
Lapsed	**$0.30**	**(420,000)**	$0.30	(250,000)
Balance at end of year	**$0.30**	**114,000**	$0.30	534,000
(c) Options exercisable at $0.25 on or before 31 July 2011:				
Balance at beginning of year	**$0.25**	**400,000**	-	-
Issued during the year	-	-	$0.25	400,000
Lapsed	-	-	-	-
Balance at end of year	**$0.25**	**400,000**	$0.25	400,000
(d) Options exercisable at $0.075 on or before 31 March 2012:				
Balance at beginning of year	**$0.075**	**5,300,000**	-	-
Issued during the year	**$0.075**	**7,306,164**	$0.075	5,300,000
Forfeited during the year	**$0.075**	**(250,000)**	-	-
Balance at end of year	**$0.075**	**12,356,164**	$0.075	5,300,000
(e) Options exercisable at $0.10 on or before 31 March 2012:				
Balance at beginning of year	-	-	-	-
Issued during the year	**$0.10**	**2,500,000**	-	-
Balance at end of year	**$0.10**	**2,500,000**	-	-

(f) Fair value:

The options outstanding at 30 June 2010 have exercise prices of either $0.075, $0.10, $0.25 or $0.30 and a weighted average contractual life of 1.72 years. No options were exercised during the year ended 30 June 2010.

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

Fair value of share options and assumptions	**Key Management Personnel 2010**	**Key Management Personnel 2009**		**Senior Employees / Contractors 2009**	**Senior Employees 2008**	
Grant date	30/09/09	31/03/09	26/11/08	31/03/09	23/11/07	1/09/06
Fair value at grant date	$0.074	$0.023	$0.016	$0.023	$0.079	0.36
Share price	$0.11	$0.051	$0.062	$0.051	$0.29	$0.45
Exercise price	$0.075	$0.075	$0.25	$0.075	$0.30	$0.30
Expected volatility (weighted average)	100%	100%	100%	100%	30%	30%
Option life (expected weighted average)	2.50 yrs	3.00 yrs	2.67 yrs	3.00 yrs	3 yrs	3.3 yrs
Expected dividends	-	-	-	-	-	-
Risk free interest rate (based on government bonds)	4.83%	3.38%	3.30%	3.38%	6.39%	5.71

17. Issued capital and accumulated losses (Cont.)

	Consolidated 2010 $	Consolidated 2009 $
(g) Employee Expense:		
Share options granted- all equity settled:		
In 2009	-	77,569
In 2010	**454,399**	-
Total recognised as employee expense	**454,399**	77,569

18. Earnings per share

(i) Loss attributable to ordinary shareholders

	2010	2009
Loss for the period:		
Basic earnings	**(4,572,825)**	(4,490,920)
Diluted earnings*	**(4,572,825)**	(4,490,920)

(ii) Weighted average number of ordinary shares

	2010	2009
Weighted average number of shares used for basic earnings per share	**226,107,928**	163,073,682

*As the Company incurred a loss for the year ended 30 June 2010, the options on issue have an antidilutive effect, therefore the diluted earnings per share is equal to the basic earnings per share.

19. Note to the statement of cash flows

	2010	2009
Reconciliation of loss for the year to net cash used in operating activities:		
Loss for the year	**(4,572,825)**	(4,490,920)
Depreciation, amortisation & impairment	**66,941**	1,006,796
Share based payment expense	**454,399**	77,569
Increase/(decrease) in provisions for employee entitlements	**55,553**	(253,223)
Increase/(decrease) in payables and deferred income	**165,692**	(192,075)
(Increase)/decrease in receivables & prepayments	**201,556**	(27,254)
Net cash used in operating activities	**(3,628,684)**	(3,879,107)

20. Acquisition of subsidiary

The net assets acquired in the business combination during the year ended June 2009, and the goodwill arising, are as follows:

Net assets acquired:	Acquiree's carrying amount before business combination	Fair value adjustments	Fair value
Cash and cash equivalents	80,107	-	80,107
Trade and other receivables	134,593	-	134,593
Intangible assets	1,674,836	(782,069)	892,767
Property, plant and equipment	-	-	-
Deferred tax liabilities	-	-	-
Trade and other payables	(94,967)	-	(94,967)
Contingent liabilities	-	-	-
	1,794,569	(782,069)	1,012,500
Goodwill on consolidation			-
Total consideration			1,012,500

The cash outflow on acquisition is as follows:	
Net cash acquired with subsidiary	80,107
Cash paid	-
Net cash inflow	80,107

The consideration paid was the issue of 20,250,000 Phylogica shares fully paid at a deemed issue price of $0.05 per share, a total value of $1,012,500 for the 62.2% of Dynamic Microbials which Phylogica did not previously own. Prior to acquisition, Phylogica owned 13,666,667 shares of the 36,166,667 Dynamic Microbials shares on issue.

21. Financial instruments

(i) Interest rate risk

Profile:

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

	Consolidated 2010 $	Consolidated 2009 $
Variable rate instruments:		
Financial assets	**1,281,044**	3,072,905

Fair value sensitivity analysis for fixed rate instruments:

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

Cash flow sensitivity analysis for variable rate instruments:

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables remain constant. The analysis is performed on the same basis for 2009.

	Consolidated 2010		Consolidated 2009	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
Variable rate instruments	**12,810**	(12,810)	**30,729**	(30,729)

(ii) Fair value

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

(iii) Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. The 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.
No receivables are post due or considered impaired in 2010 or 2009.

(iv) Foreign exchange risk

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

(v) Capital management

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

(vi) Liquidity risk

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

	Carrying Amount $	Contractual Cash Flows $	6 months or less $
Trade and other payables:			
at 30 June 2010	603,991	(603,991)	(603,991)
at 30 June 2009	439,012	(439,012)	(439,012)

22. Commitments

	Consolidated 2010 $	2009 $
Future operating lease commitments not provided for in the financial statements and payable:		
Within one year	**60,000**	120,000
Within two to three years	**-**	60,000
	60,000	180,000

23. Related parties

(i) Key management personnel compensation

As permitted by the Corporations Regulations 2M.3.03, disclosures of remuneration policies, service contracts, details of remuneration and other equity instruments are included in the Directors Report on pages 1 to 15. 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
Mr H Karelis
Mr B McHarrie
Dr D Wilson (Non-executive until 21/12/08
Mr A Barton (Appointed 22/05/09) (Resigned 13/07/09)

Executive Directors
Dr P Watt
Dr D Wilson
Executives
Dr R Hopkins (Chief Operating Officer)
Mr G MacMillan (Company Secretary)

	Consolidated 2010 $	2009 $
The key management personnel compensation included in 'personnel expenses' (see note 6) are as follows:		
Short-term employee benefits	**640,397**	844,869
Post-employment benefits	**38,700**	60,619
Long term employee benefits	**32,286**	13,457
Share based payments	**247,919**	15,118
Total compensation	**959,302**	934,063

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 directors' interests existing at year-end.

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

A number of these entities transacted with the 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 arm's length basis.

(ii) Key management personnel transactions

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

Key management persons	Transaction	Note	2010 $	2009 $
Mr B McHarrie	Contract research services	(a)	**2,046,675**	1,856,912

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

Amounts payable to key management personnel at reporting date arising from these contract R&D services were as set out on the following page:

23. Related parties (Cont.)

	Consolidated 2010 $	Consolidated 2009 $
Current payables		
Trade and other payables	**187,724**	198,047
	187,724	198,047

(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 at 1 July 09	Granted as compensation	Exercised	Other changes	Held at 30 June 10	Vested during the year	Vested & exercisable at 30 June 10
Dr D Wilson	300,000	618,337	-	-	918,337	718,337	818,337
Mr B McHarrie	-	368,700	-	-	368,700	368,700	368,700
Mr H Karelis	-	368,700	-	-	368,700	368,700	368,700
Dr P Watt **	2,000,000	3,000,000	-	(2,000,000)	3,000,000	3,000,000	3,000,000
Executives							
Dr R Hopkins	1,050,000	-	-	(300,000)	750,000	375,000	750,000

Directors	Held at 1 July 08	Granted as compensation	Exercised	Other changes	Held at 30 June 09	Vested during the year	Vested & exercisable at 30 June 09
Dr D Wilson	-	300,000	-	-	300,000	100,000	100,000
Dr P Watt **	2,000,000	-	-	-	2,000,000	-	2,000,000
Dr M Pierce	-	100,000	-	-	100,000	100,000	100,000
Executives							
Dr R Hopkins	300,000	750,000	-	-	1,050,000	375,000	675,000

** Options held by key management personnel related parties.

No options held by key management personnel are vested but not exercisable at 30 June 2010 and 2009.

(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:

2010	Held at 1 July	Purchases	Options exercised	Sales	Held at 30 June
Directors					
Mr H Karelis	29,166,667	-	-	-	29,166,667
Mr B McHarrie	1,920,479	-	-	-	1,920,479
Mr A Barton (4)	28,160,323	250,000	-	-	28,410,323
Mr N Woolf (7)	na	-	-	-	-
Dr D Wilson	-	-	-	-	-
Dr P Watt	4,777,031	190,000	-	-	4,967,031
Executives					
Dr R Hopkins	1,397,749	261,454	-	-	1,659,203
Mr G MacMillan (6)	8,102,908	-	-	-	8,102,908

2009	Held at 1 July	Purchases	Options exercised	Sales	Held at 30 June
Directors					
Mr J von Roy (5)	687,241	-	-	-	687,241
Mr H Karelis	29,166,667	-	-	-	29,166,667
Mr B McHarrie	1,920,479	-	-	-	1,920,479
Mr A Barton (4)	na	na	na	na	28,160,323
Dr D Wilson	-	-	-	-	-
Dr P Watt	4,707,031	70,000	-	-	4,777,031
Executives					
Dr R Hopkins	na	na	na	na	1,397,749
Dr G Pullen (3)	125,543	-	-	-	125,543
Mr G Boden (2)	422,917	-	-	-	422,917
Mr G MacMillan (6)	na	na	na	na	8,102,908

23. Related parties (Cont.)

1. Dr Pierce was appointed a director on 20 February 2007 and resigned on 4 December 2008
2. Mr Boden was appointed as secretary on 17 August 2007and resigned on 29 May 2009.
3. Dr G Pullen resigned as an executive on 8 April 2009.
4. Mr A Barton was appointed a director on 22 May 2009 and resigned on 13 July 2010.
5. Mr J von Roy resigned as a director on 31 May 2009.
6. Mr G MacMillan was appointed as secretary on 29 May 2009.
7. Mr N Woolf was appointed as a director on 22 April 2010.
8. Australian Heritage Group Pty Ltd, a company associated with Mr A Barton and Mr G MacMillan received $120,000 for services provided in relation to the issue of 20,000,000 shares at $0.10 to raise $2,000,000 for the Company.
9. In April 2009, either directly or through an associated company, the following directors contributed capital to the company through the purchase of convertible notes.

Dr P Watt	$20,000
Dr D Wilson	$10,000
Mr J von Roy	$10,000
Mr H Karelis	$1,000,000

The convertible notes were issued at nil interest and mature on 30 April 2011. The notes are redeemable by the Company by payment of $1.25 for each $1.00 of notes, are convertible by noteholders before the maturity date at $0.05 per share or convert at maturity at $0.04 per share.

(v) Subsidaries

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

Name	Country of Incorporation	Equity Interest (%)		Investment ($)	
		2010	2009	2010	2009
Dynamic Microbials Limited	Australia	100	100	1,012,500	1,012,500

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

24. Parent Entity Disclosures

(i) Finanical position

	Consolidated 2010 $	Consolidated 2009 $
Assets		
Current assets	**1,405,461**	3,280,911
Non-current assets	**164,579**	202,793
Total assets	**1,570,040**	3,483,704
Liabilities		
Current liabilities	**744,021**	534,727
Non-current liabilities	**1,263,099**	1,041,250
Total liabilities	**2,007,120**	1,575,977
Equity		
Issued capital	**21,973,323**	20,093,323
Accumulated losses	**(23,425,525)**	(18,856,217)
Reserves:		
Share-based payments	**912,813**	458,414
Equity component of convertible note	**102,309**	212,207
Total equity	**(437,080)**	1,907,727

24. Parent Entity Disclosures (Cont.)

(ii) Financial performance

	Year Ended 30 June 2010 $	Year Ended 30 June 2009 $
Profit / (Loss) for the year	**(4,569,308)**	(4,494,437)
Other comprehensive income	**-**	-
Total comprehensive loss	**(4,569,308)**	(4,494,437)

25. Auditor's remuneration

	2010	2009
	$	$
Auditors of the Company:	**HLB Mann Judd**	HLB Mann Judd
Audit services		
Audit and review of financial reports	**25,750**	22,750
Other regulatory audit services	**6,600**	3,000
	32,350	25,750
Non audit services	**-**	-
	32,350	25,750

Directors' declaration

1 In the opinion of the directors of Phylogica Limited (the Company):

(a) the financial statements and notes and the audited remuneration disclosures that are contained in the Remuneration Report in the Directors' Report, set out on pages 8 to 15, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Consolidated Entity as at 30 June 2010 and of its performance, as represented by the results of operations and its cash flows, for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and

(iii) the financial report also complies with International Financial Reporting Standards as disclosed in note 2 (a); and

(b) The audited remuneration disclosures of the Remuneration Report in the Directors' Report (page 8 to 15) 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 2010 pursuant to Section 295A of the Corporations Act 2001.

Dated at Perth this 24th day of September, 2010

Signed in accordance with a resolution of the directors:

Bruce McHarrie
Director

HLB Mann Judd

Accountants | Business and Financial Advisers

INDEPENDENT AUDITOR'S REPORT

To the members of
PHYLOGICA LIMITED

Report on the Financial Report
We have audited the accompanying financial report of Phylogica Limited ("the company"), which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year as set out on pages 17 to 39.

Directors' Responsibility for the Financial 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 controls 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 Accounting Standard AASB 101: *Presentation of Financial Statements*, that the consolidated financial statements comply with International Financial Reporting Standards.

Auditor's Responsibility
Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. 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.

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

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

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

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HLB Mann Judd

Accountants | Business and Financial Advisers

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

Auditor's Opinion
In our opinion:

(a) the financial report of Phylogica Limited is in accordance with the Corporations Act 2001, including:
   (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 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*; and

(b) the consolidated financial statements also comply with International Financial Reporting Standards as disclosed in Note 2(a).

Report on the Remuneration Report
We have audited the Remuneration Report included in pages 8 to 15 of the directors' report for the year ended 30 June 2010.The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Auditor's Opinion
In our opinion the Remuneration Report of Phylogica Limited for the year ended 30 June 2010 complies with section 300A of the *Corporations Act 2001*.

HLB Mann Judd

HLB MANN JUDD
Chartered Accountants

Perth, Western Australia
24 September 2010

N G NEILL
Partner

Corporate Governance Statement

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

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

Principle 1 – Lay solid foundations for management and oversight

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

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

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

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

The Board of Directors

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

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

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

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

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

Composition of the Board

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

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

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

Independent professional advice

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

Remuneration arrangements

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

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

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

External audit

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

Audit committee

The Company has established a separately constituted audit committee.

Identification and management of risk

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

Ethical standards

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

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

The Remuneration Committee reviews the remuneration policies applicable to all Directors and Executive Officers on an as needed basis and makes recommendations on remuneration packages and terms of employment to the Board. Remuneration packages, which consist of base salary, fringe benefits, incentive schemes (including performance related bonuses), superannuation, and entitlements upon retirement or termination, are reviewed with due regard to performance and other relevant factors.

Principle 2 – Structure the Board to add value

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

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

The Board has five Directors comprising one executive chairman, one executive director and one independent non executive director.

Recommendation 2.2: The chair should be an independent director.

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

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

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

Recommendation 2.4: The Board should establish a nomination committee.

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

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

The Remuneration Committee has developed a formal process for performance evaluation of the Board. The Remuneration Committee reviews the remuneration policies applicable to all Directors and Executive Officers on an as needed basis and makes recommendations on remuneration packages and terms of employment to the Board. Remuneration packages, which consist of base salary, fringe benefits, incentive schemes (including performance related bonuses), superannuation, and entitlements upon retirement or termination, are reviewed with due regard to performance and other relevant factors.

Principle 3 – Promote ethical and responsible decision-making

Companies should actively promote ethical and responsible decision-making.

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

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

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

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

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

Recommendation 3.2: Companies should establish a policy concerning trading in company securities by directors, senior executives and employees, and disclose the policy or a summary of that policy.

The Policy on Directors and Senior Executives dealing in Securities objective is to:

- minimise the risk of Directors and Senior Executives of the Company contravening the laws against insider trading;
- ensure the Company is able to meet its reporting obligations under the ASX Listing Rules; and
- increase transparency with respect to trading in securities of the Company by Directors and Senior Executives.

The Chairman will generally not allow Directors and Senior Executives to deal in securities of the Company as a matter of course in the following periods:

- within the month prior to the release of annual or half yearly results;

- within the month prior to the issue of a prospectus; and
- where price sensitive information has not been disclosed because of an ASX Listing Rule exception.

Directors and Senior Executives should wait at least 2 business days after the release of the relevant information before dealing in securities so that the market has had time to absorb the information.

In specific circumstances however, such as financial hardship, the Chairman may waive the prohibition on a Director or Senior Executive dealing in securities at any of the above times on the condition that the Director or Senior Executive can demonstrate to him that they are not in possession of any price sensitive information that is not generally available to the public.

Principle 4 – Safeguard integrity in financial reporting

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

Recommendation 4.1: The Board should establish an audit committee.

The board has established an Audit Committee consisting of Harry Karleis and Bruce McHarrie (Chairman).

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

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

The Company's current Audit Committee only consists of 2 board members who are non-independent directors. The Chairperson is a non-independent chair.

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

The audit committee charter is available on the Company website.

Principle 5 – Make timely and balanced disclosure

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

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

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

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

Principle 6 – Respect the rights of shareholders

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

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

The Company is committed to the promotion of investor confidence by ensuring that trade in its securities takes place in an efficient, competitive and informed market. The Board Charter recognises the importance of forthright communication as a key plank in building shareholder value and that to prosper and achieve growth the Company must (among other things) earn the trust of employees, customers, suppliers, communities and security holders by being forthright in its communications and consistent in its fulfilment of obligations.

Principle 7 – Recognise and manage risk

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

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

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

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

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

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

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

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

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

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

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

Principle 8 – Remunerate fairly and responsibly

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

Recommendation 8.1: The Board should establish a remuneration committee.

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

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

Executive Directors remuneration packages may comprise of:

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

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

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

Departure from Best Practice Recommendations

From 1 July 2009 to 30 June 2010, the Company complied with each of the Eight Essential Corporate Governance Principles and Best Practice Recommendations published by the ASX Corporate Governance Council, other than in relation to the table below.

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

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

1. Listed Securities

The security holder information set out below was applicable as at 16 September 2010.

(i) Distribution of Security Numbers

Category (size of holding)	Ordinary Shares Shareholders	Ordinary Shares Shares
1 – 1,000	70	22,130
1,001 – 5,000	144	488,171
5,001 – 10,000	187	1,645,722
10,001 – 100,000	548	22,806,915
100,001 and over	247	210,788,826
Total	**1,196**	**235,751,764**

There are 297 shareholders holding less than a marketable parcel at a price of $0.051, totalling 1,116,023 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 Ltd	29,166,667	12.37
Telethon Institute for Child Health Research	20,605,501	8.74
Laissez Faire Et Cie P/L	7,912,292	3.36
Monslit P/L	7,600,000	3.22
Mainview Holdings P/L	7,419,810	3.15
Gateway Capital Ltd	6,992,500	2.97
Australian Heritage Group P/L	5,002,500	2.12
Paul Michael Watt	4,044,123	1.72
Fitel Nominees Ltd	3,615,000	1.53
L&E Fisher Nominees P/L	2,500,000	1.06
L&E Fisher Nominees P/L	2,400,000	1.02
Henley Park Estate P/L	2,250,000	0.95
HSBC Custody Nominees Australia Ltd	2,245,001	0.95
David Burton Gibson	2,236,405	0.95
Mal Washer Nominees P/L	2,030,071	0.86
Ellar Inv P/L	2,000,000	0.85
Michael R+RL Beech	1,950,000	0.83
Anthony P&CH Barton	1,947,513	0.83
GDM Services Pty Ltd	1,900,000	0.81
Bruce Fielding McHarrie	1,838,238	0.78
Total	**115,855,621**	**49.16**

(iv) Substantial Shareholders

The names of the substantial shareholders listed in the Company's share register as at 16 September 2010 were:

Name	Number of Ordinary Shares	% of Issued Capital
Biotech Capital Pty Ltd	29,166,667	12.4
Anthony Barton & associates	28,410,323	12.1
Telethon Institute of Child Health Research	20,605,501	8.7
Total	**78,182,491**	**33.2**

(v) On market buy back

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

2. Unquoted Option holder Information

The information on unquoted option holders set out below was applicable as at 16 September 2010.

(i) Distribution of unquoted option holder numbers

Category (size of holding)	No of option holders	No of options
100,001 and over	22	15,256,164
Total		**15,256,164**

(ii) Voting Rights

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

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

	No of options	%
Aymon Pacific Pty Ltd	5,000,000	32.8
Total	**5,000,000**	**32.8**