AVEXA LIMITED ABN 53 108 150 750

The directors present their report on Avexa Limited (the 'Company') for the half-year ended 31 December 2005 and the review report thereon.

**Directors**

The directors of the Company at any time during or since the end of the half-year are:

| Name, qualification and independence status | Experience and special responsibilities |
|---|---|
| Dr H Niall<br>Independent Non-Executive Director and Chairman | Independent non-executive director and Chairman since 7 September 2004. Member of the Avexa Audit Committee. |
| Dr J J Chick<br>Executive Director | Chief Executive Officer from 7 September 2004 |
| Dr E Malta<br>Independent Non-Executive Director | Independent non-executive director and member of the Avexa Audit Committee appointed on 1 November 2005. |
| Mr S Cooper<br>Independent Non-Executive Director | Independent non-executive director and member of the Avexa Audit Committee from 18 November 2005; appointed Chair of that committee on 20 December 2005. |

Ms H A Cameron was an independent non-executive director and Chair of the Avexa Audit Committee until her resignation on 20 December 2005.

**Review of operations**

The principal activity of the Company during the course of the financial half-year was the development and commercialisation of anti-infective pharmaceutical programs and projects.

During the half year the Company initiated a Phase IIb clinical trial with AVX754, its lead HIV/AIDS drug candidate. Encouraging feedback was received in the period on the development plan for AVX754 from the US Food and Drug Administration (FDA) and the European agencies, and in October 2005 Avexa also met with an international panel of independent world renowned experts in the clinical management of HIV. Their feed-back indicated that the company would be well placed to move further along the drug development pathway with AVX754 once the Phase IIb trial was completed. To prepare for the Phase III trials the Company intends to undertake a number of activities over the next six months so that the development of AVX754 can be progressed as rapidly and cost effectively as possible.

With regard to Avexa's antibiotic program an animal proof of concept study to overcome multidrug-resistance has commenced. The imperative for this proof of concept study has been increased due to significant antibacterial findings by a number of independent groups who have collaborated on the testing of the lead compounds.

In an effective effort to increase Avexa's access to novel chemical entities that have the potential to become new drugs, the Company entered into a collaboration with CSIRO, one of the world's most diverse scientific global research organisations. Both companies are working together towards the discovery of new drugs for the treatment of serious human viral diseases. Subsequent to the reporting date, the Company also announced a collaboration with British company MNLPharma in the area of HIV integrase to access their library of novel plant derived compounds.

The Company has recorded a loss before amortisation of $4.4 million for the six months to 31 December 2005. The Company is writing down its intellectual property over 2 years, and this resulted in an amortisation charge of $3 million for the period, creating an overall loss of $7.4 million. Avexa's cash consumption was below budget at $4.1 million thereby preserving cash to a closing cash balance of $11.6 million at 31 December 2005.

Avexa's portfolio at 31 December 2005 comprised the following projects.

**AVX754 (apricitabine)**

In January 2005 Avexa licensed AVX754 from Shire. Apricitabine has been designated as the International Non-proprietary Name (INN) of AVX754. Apricitabine is a nucleoside reverse transcriptase inhibitor (NRTI) and has a mechanism of action similar to the marketed NRTIs that make up the backbone of therapy for HIV-infection.

Apricitabine is a cytidine analogue that has successfully completed four Phase I studies in healthy volunteers and a Phase IIa study in 63 HIV-infected patients. It has received approval for an Investigational New Drug (IND) filing, a US Government review process that enables companies to advance a potential drug into clinical trials, and has received fast-track approval from the FDA.

Laboratory tests show that apricitabine is effective against various strains of HIV which are resistant to commonly used HIV drugs on the market. In particular apricitabine has excellent activity against strains resistant to 3TC, FTC and AZT, three of the most commonly prescribed antiretroviral drugs. This, together with its clean adverse effect profile, is a most important aspect of apricitabine.

In July of 2005 Avexa initiated a Phase IIb trial to demonstrate that apricitabine is the best drug in its class for the treatment of patients with these resistant strains of HIV. The Phase IIb trial will aim to enrol around 60 patients who are currently failing therapy for their HIV infection. These patients harbour the HIV strain M184V, which is a drug-resistant mutated strain that results from the treatment of patients with Epivir ®, Combivir ® or Trizivir ® (currently marketed by GlaxoSmithKline (GSK)) or Emtriva ® and Truvada ® (currently marketed by Gilead Sciences). These drugs are the most commonly used first line therapies for HIV, and a successful Phase IIb trial will position apricitabine as the leading therapy for patients that are failing the first line therapy for HIV.

**HIV**

The combined pressures of clinical adverse effects of marketed medicines for HIV and the selection of HIV-1 strains resistant to current antiviral therapies are ongoing problems which limit the clinical goal of lifetime treatment of HIV-induced disease. This drives an urgent need to discover and develop new antiretrovirals that can potentially overcome these two issues.

Despite the identification of numerous inhibitors over the past decade, HIV integrase as a target has yet to be fully commercially exploited. However, Avexa scientists have established an extensive expertise in studying the HIV integrase. Avexa has identified several novel inhibitors of HIV integrase from high throughput screening of selected compound libraries together with sophisticated cellular assays and molecular modelling including crystallography. These inhibitors have been actively optimised by Avexa's team of in-house medicinal chemists to yield a series of novel and active compounds.

A small number of these compounds have been designated as lead compounds and are presently being optimised in Avexa's in-house laboratories using comprehensive cellular assays and molecular modelling techniques to guide the selection of a candidate molecule for formal preclinical testing.

To date there is no integrase inhibitor on the market, however Merck have demonstrated HIV integrase to be a valid clinical target by obtaining positive Phase II results for their latest anti-integrase candidate, MK-0518. Recently Gilead Sciences in-licensed Japanese Tobacco's Phase I integrase inhibitor for US $105 million in upfront and milestones plus royalties and has initiated a Phase I/II clinical trial on this compound.

**VRI**

Relatively quickly after the introduction of virtually every class of antibiotics in the past 50 years, resistance has emerged that has imposed significant clinical limitations on the use of these antibiotics. There is a strong feeling among key clinical opinion leaders that the need for novel antibiotics with activity against drug-resistant pathogens (specifically antibiotics active against drug-resistant gram-negative pathogens) is acute.

The incidence of vancomycin- and other antibiotic-resistant bacteria is increasing, and there is currently no simple antibiotic treatment for vancomycin-resistant infections, creating a significant unmet medical need that is likely to continue to expand in the future.

Using structural and genetic information about the cell wall of vancomycin-resistant bacteria the project has designed compounds in collaboration with the University of Wollongong, NSW, which bind to the modified cell wall in these bacteria and inhibit their ability to grow. This novel approach has also required the development of a number of new chemical methods to synthesise these particular types of compounds.

A small number of these compounds have been designated as lead compounds and their potencies have been validated in a series of independent assays at international microbiology laboratories. The compounds are presently being intensively studied in models which indicate their optimal clinical indication. Based on the outcomes of these models a candidate molecule will be selected for formal preclinical testing.

**Other projects**

Avexa's collaboration with the CSIRO continues to progress well. The two organisations are initially working together to look for new treatments of HIV; however the potential exists to expand this into other anti-viral targets such as Hepatitis. Avexa retains an interest in developing new drugs for the treatment of Hepatitis and continues to seek a suitable formulation for its Hepatitis B project, however has focused a majority of its resources on its lead program AVX754 currently in Phase IIb and decided to reduce the emphasis on the AVX491 project until such time as the formulation issue is resolved and there is a clear and risk-mitigated path forward.

**Post Balance Date Events**

There has not arisen since the end of the half-year, any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Company, the results of those operations, or the state of affairs of the Company, in future financial years.

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

The lead auditor's independence declaration forms part of the Directors' Report for the half-year ended 31 December 2005 and is set out on page 4 of this report.

**Rounding off**

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report and directors' report have been rounded off to the nearest thousand dollars, unless otherwise stated.

Dated at Melbourne this 13th day of February 2006.

Signed in accordance with a resolution of the directors.

Dr H Niall (Chairman)

**Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001 to the Directors of Avexa Limited**

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2005, there have been:

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

(ii) No contraventions of any applicable code of professional conduct in relation to the review.

KPMG

B W Szentirmay

Melbourne

13 February 2006

**Condensed interim income statement and statement of recognised income and expense**

| for the half-year ended 31 December 2005 | Note | **31 December 2005 $'000** | 31 December 2004 $'000 |
|---|---|---|---|
| Licence fee and royalty revenue | | **-** | - |
| Other revenues from ordinary activities | 2 | **343** | 263 |
| **Revenue** | | **343** | 263 |
| Contract research and development costs | | **(1,713)** | (835) |
| Raw materials and consumables used | | **(227)** | (95) |
| Personnel expenses excluding share-based payment expense | | **(1,252)** | (669) |
| Share-based payment expense | | **(59)** | (31) |
| Occupancy | | **(181)** | (102) |
| Depreciation expenses | | **(27)** | (3) |
| Amortisation of intellectual property | | **(3,000)** | (3,000) |
| Asset management | | **(133)** | (153) |
| Legal and professional services | | **(638)** | (200) |
| Travel | | **(159)** | (78) |
| Insurance | | **(71)** | (82) |
| Other expenses from ordinary activities | | **(291)** | (128) |
| Set up and establishment expenses | | **-** | (64) |
| **Loss before income tax expense** | | **(7,408)** | (5,177) |
| Income tax expense | | **-** | - |
| **Loss for the period attributable to members of Avexa Limited** | 3 | **(7,408)** | (5,177) |
| Income / (expense) recognised directly in equity | | **-** | - |
| **Total recognised income and expense for the period attributable to the members of Avexa Limited** | | **(7,408)** | (5,177) |
| | | **Cents** | Cents |
| Basic earnings per share | | **(5.3)** | (6.4) |
| Diluted earnings per share | | **(5.3)** | (6.4) |

*The Statement of Income is to be read in conjunction with the notes to the half-year financial statements set out on pages 8 to 18.*

| **Condensed interim balance sheet** as at 31 December 2005 | Note | **31 December 2005 $'000** | 30 June 2005 $'000 |
|---|---|---|---|
| **Current assets** | | | |
| Cash and cash equivalents | | **11,637** | 15,727 |
| Trade and other receivables | | **33** | 64 |
| Other | | **142** | 81 |
| Total current assets | | **11,812** | 15,872 |
| **Non-current assets** | | | |
| Property, plant and equipment | | **233** | 121 |
| Intangible assets | | **3,000** | 6,000 |
| Total non-current assets | | **3,233** | 6,121 |
| **Total assets** | | **15,045** | 21,993 |
| **Current liabilities** | | | |
| Trade and other payables | | **1,065** | 687 |
| Employee benefits | | **192** | 154 |
| Total current liabilities | | **1,257** | 841 |
| **Non-current liabilities** | | | |
| Employee benefits | | **25** | 40 |
| Total non-current liabilities | | **25** | 40 |
| **Total liabilities** | | **1,282** | 881 |
| **Net assets** | | **13,763** | 21,112 |
| **Issued capital** | | | |
| Contributed equity | 3 | **34,648** | 34,648 |
| Accumulated losses | 3 | **(20,885)** | (13,536) |
| **Total equity attributable to members of Avexa Limited** | | **13,763** | 21,112 |

*The Balance Sheet is to be read in conjunction with the notes to the half-year financial statements set out on pages 8 to 18.*

**Condensed interim statement of cash flows**

| for the half-year ended 31 December 2005 | **31 December 2005 $'000** | 31 December 2004 $'000 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash receipts in the course of operations | **305** | 77 |
| Cash payments in the course of operations | **(4,602)** | (2,333) |
| Interest received | **343** | 263 |
| Borrowing costs paid | **-** | - |
| Income taxes paid | **-** | - |
| Net cash from operating activities | **(3,954)** | (1,993) |
| **Cash flows from investing activities** | | |
| Payments for property, plant and equipment | **(136)** | (23) |
| Net cash from investing activities | **(136)** | (23) |
| **Cash flows from financing activities** | | |
| Proceeds from issue of shares (Note 3) | **-** | 12,000 |
| Consideration received for taking on employee entitlements | **-** | 86 |
| Net cash from financing activities | **-** | 12,086 |
| **Net (decrease)/ increase in cash and cash equivalents held** | **(4,090)** | 10,070 |
| Cash and cash equivalents at the beginning of the financial period | **15,727** | - |
| Cash and cash equivalents at the end of the financial period | **11,637** | 10,070 |

*The Statement of Cash Flows is to be read in conjunction with the notes to the half-year financial statements set out on pages 8 to 18.*

## 1 Significant accounting policies

Avexa Limited (the 'Company') is a company domiciled in Australia. The condensed interim financial report of the Company for the six months ended 31 December 2005 was authorised for issuance on 10 February 2006.

### (a) Statement of compliance

The condensed interim financial report is a general purpose financial report which has been prepared in accordance with the requirements of the Australian Accounting Standards, Urgent Issues Group ('UIG') Interpretations adopted by the Australian Accounting Standards Board ('AASB') and the Corporations Act 2001.

International Financial Reporting Standards ('IFRS') form the basis of Australian Accounting Standards adopted by the AASB, being Australian equivalents to IFRS ('AIFRS'). The interim financial report of the Company also complies with IFRS and interpretations adopted by the International Accounting Standards Board.

This is the Company's first AIFRS condensed interim financial report for part of the period covered by the first AIFRS annual financial report and AASB 1 *First Time Adoption of Australian Equivalents to International Financial Reporting Standards*. The condensed interim financial report does not include all of the information required for a full financial report.

The interim financial report is to be read in conjunction with the most recent annual financial report however, the basis of preparation of this report is different to that of the most recent annual financial report due to the first time adoption of AIFRS. This report must also be read in conjunction with any public announcements by Avexa Limited during the half-year in accordance with continuous disclosure obligations arising under the Corporations Act 2001.

An explanation of how the transition to AIFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in Note 11. This note includes reconciliations of equity and profit or loss for comparative periods reported under Australian Generally Accepted Accounting Principles ('previous AGAAP') to those reported for those periods under AIFRS.

### (b) Basis of preparation

The financial report is presented in Australian dollars.

The financial report is prepared on the historical cost basis.

The financial report has been prepared on a going concern basis, which assumes the settlement of liabilities and realisation of assets in the normal course of business. At 31 December 2005, the Company had $11.6 million of funds available to undertake and conclude all budgeted activities for the 2006 financial year in accordance with the Company's long term strategy. This strategy includes obtaining additional funding in the 2006 financial year in order to progress all existing projects, in particular Phase III of the AVX754 project, and to provide sufficient working capital for the Company beyond the 2006 financial year until such time as self-sustaining revenue streams are realised. Should additional funding not be procured, the Company will consider the impact on budgeted funding allocations and will prioritise spending in order to minimise the impact on the Company's working capital requirements. The ability of the Company to continue as a going concern beyond the 2006 financial year is dependent upon successful project outcomes and procurement of funds and the ability of the Company to manage expenditure within the budgeted range.

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report have been rounded off to the nearest thousand dollars, unless otherwise stated.

The preparation of an interim financial report in conformity with AASB 134 *Interim Financial Reporting* requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

### (b) Basis of preparation (continued)

These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

This condensed interim financial report has been prepared on the basis of AIFRS in issue that are effective or available for early adoption at the Company's first AIFRS reporting date, 30 June 2006. Based on these AIFRS, the Board of Directors has made assumptions about the accounting policies expected to be adopted ('accounting policies') when the first AIFRS annual financial report is prepared for the year ended 30 June 2006.

The Australian Accounting Standards and UIG Interpretations that will be effective or available for voluntary early adoption in the annual financial report for the year ended 30 June 2006 are still subject to change and therefore cannot be determined with certainty. Accordingly, the accounting policies for that annual period that are relevant to this interim financial information will be determined only when the first annual AIFRS financial report is prepared at 30 June 2006.

The preparation of the condensed interim financial report in accordance with AASB 134 resulted in changes to the accounting policies as compared with the most recent annual financial report prepared under previous AGAAP. The accounting policies set out below have been consistently applied to all periods presented in this interim financial report. They have also been applied in preparing an opening AIFRS balance sheet as at 1 July 2004 for the purposes of transition to Australian Accounting Standards – AIFRS, as required by AASB 1. The impact of the transition from previous AGAAP to AIFRS is explained in Note 11.

### (c) Revenue recognition

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

*Interest revenue*
Interest revenue is recognised as it accrues, taking into account the effective yield on the financial asset.

### (d) 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 Australian Taxation Office ('ATO') is included as a current asset or liability in the condensed interim balance sheet.

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

### (e) 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 income statement.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign 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.

**(f) Income Tax**

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

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

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

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying value of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

**(g) Receivables**

The collectability of receivables is assessed at reporting date and specific provision is made for any doubtful accounts. Trade receivables to be settled within contractual terms and conditions are carried at amounts due.

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

**(h) Property, plant and equipment**

(i) Owned assets

The Company holds no property. Items of plant and equipment are stated at costs less accumulated depreciation (see below) and impairment losses.

(ii) Leased assets

Leases in terms of which the Company assumes substantially all of 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.

(iii) Depreciation

Depreciation is charged to the income statement on a straight line basis over the estimated useful lives of each part of an item of plant and equipment. The estimated useful lives in the current and comparative periods are as follows:

- plant and equipment 2 – 5 years

The residual value, if not insignificant, is reassessed annually.

**(i) Intangible assets**

**Intellectual property**
The intangible asset of intellectual property acquired by the Company is stated at cost less accumulated amortisation less impairment losses.

**Amortisation**
Amortisation of acquired intellectual property is charged to the income statement on a straight line basis over the estimated useful life of the intangible asset, currently assessed as being a two year period which commenced on 1 July 2004.

**(j) Cash and cash equivalents**

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

**(k) Impairment**

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

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

Recoverable amount of assets is determined as the greater of their fair value less costs to sell and value in use. Value in use is assessed using discounted cash flow analysis.

On the basis that the non-current assets of the Company are utilised to facilitate the development and commercialisation of scientific projects to generate sustainable royalty and other revenue streams in the long term, a review of the Company's non-current assets at reporting date did not reveal any indication of impairment.

**(l) Payables**

Trade and other payables are stated at cost.

Liabilities are recognised for amounts to be paid in the future for goods or services received. Trade accounts payable are normally settled within 60 days. For payables expected to be settled within one year, the notional amount is deemed to reflect the fair value whereas all other payables are discounted to their fair value.

**(m) 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 the projected unit credit method and is discounted to its present value. The discount rate is the yield at the balance sheet date on government bonds that have maturity dates approximating the terms of the Company's obligations.

Periods of service with each employee's immediate former employer have been recognised by the Company as at the date of commencement of employment for those employees starting with the Company on 1 July 2004.

(ii) Share-based payment transactions

The Avexa Employee Share Option Plan allows employees to acquire shares in the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the vesting period during which the employees become unconditionally entitled to the options. The fair value of the options granted is calculated using a binomial model taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense in the income statement is adjusted to reflect the actual number of share options that vest.

### (m) Employee benefits (continued)

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

Liabilities for wages, salaries, annual leave and performance incentives represent present obligations resulting from employees' services provided up to balance sheet date, calculated at undiscounted amounts based on remuneration wage and salary rates that the Company expects to pay as at balance date including related on-costs, such as workcover insurance and payroll tax.

(iv) Superannuation

Obligations for contributions to defined contribution pension plans are recognised as an expense in the income statement as incurred.

### (n) Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, the provision is 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.

### (o) Expenses

(i) Operating lease payments

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

(ii) Research and development

Research expenditure undertaken with the prospect of gaining new scientific or technical knowledge or understanding is expensed as incurred. The Company does not currently undertake development activities as defined in AASB 138 *Intangible Assets* and therefore has not capitalised development expenditure.

### (p) Segment reporting

A segment is a distinguishable component of a company engaged in providing products or services within a particular business sector or geographical environment. The Company operates within a single business segment comprising anti-infective research and development and in a single geographical segment being that of Australia.

### (q) Earnings per share

Basic earnings per share ('EPS') is calculated by dividing the net income attributable to members of the Company for the reporting period, after exclusion of any costs of servicing equity (other than ordinary shares), by the weighted average number of ordinary shares of the Company, adjusted for any bonus issue.

Diluted EPS is calculated by dividing the basic EPS earnings, adjusted for the after tax effect of financing costs associated with dilutive potential ordinary shares and the effect on revenues and expenses of conversion to ordinary shares associated with dilutive potential ordinary shares, by the weighted average number of ordinary shares and dilutive potential ordinary shares adjusted for any bonus issue.

### (r) Derivative financial instruments for hedging of foreign exchange

The Company may elect to use derivative financial instruments on occasion to hedge its exposure to foreign exchange risks arising from operational and financial activities. In accordance with Company policy, the Company does not hold or issue derivative financial instruments for trading purposes.

### (r) Derivative financial instruments for hedging of foreign exchange (continued)

Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends upon the nature of the item being hedged.

The Company did not enter into any derivative financial arrangements in the current or prior period.

| | **31 December 2005 $'000** | 31 December 2004 $'000 |
|---|---|---|
| **2 Other Revenues from ordinary activities** | | |
| From operating activities | | |
| - Interest income | **343** | 263 |
| Total other revenues | **343** | 263 |

## 3 Issued capital and accumulated losses

### (i) Issued and paid up capital

| | **31 December 2005 $'000** | 31 December 2004 $'000 |
|---|---|---|
| 137,916,452 ordinary shares, fully paid | **34,648** | 24,000 |

The following movements in ordinary shares were recorded during the half-year ended 31 December 2005.

| | **2005 Number of shares** | 2004 Number of shares | **2005 $'000** | 2004 $'000 |
|---|---|---|---|---|
| Balance brought forward as at 1 July 2005 | **137,916,452** | 2 | **34,648** | - |
| Consideration for the acquisition of intellectual property (refer # below) | - | 40,156,000 | - | 12,000 |
| Issue of shares for cash consideration | - | 40,156,000 | - | 12,000 |
| Cancellation of initial opening capital | - | (2) | - | - |
| Balance carried forward as at 31 December 2005 | **137,916,452** | 80,312,000 | **34,648** | 24,000 |

# The intellectual property acquired at a cost of $12,000,000 is being amortised on a straight line basis over a period of 24 months commencing in July 2004.

There were no dividends paid or proposed during the period ended 31 December 2005 or in the previous interim period. Holders of ordinary shares are entitled to one vote per share at shareholders' meetings and to receive any dividends as may be declared. In the event of winding up of the Company, ordinary shareholders rank after all creditors and are fully entitled to any proceeds of liquidation.

### (ii) Accumulated losses

| | **31 December 2005 $'000** | 31 December 2004 $'000 |
|---|---|---|
| Loss for period | **(7,408)** | (5,177) |
| Equity component of share-based payments | **59** | 31 |
| Movement in accumulated losses for the period | **(7,349)** | (5,146) |

## 3 Issued capital and accumulated losses (continued)

### (iii) Options

There were 1,810,000 options to acquire ordinary shares issued during the half-year ended 31 December 2005 under and in accordance with the Avexa Employee Share Option Plan ('ESOP'). A summary of key terms and conditions is provided in the following table. All of these options remain on issue as at the date of this report and have a common expiry date of 30 June 2010.

| Issues in the current period | 600,000 to CEO | 500,000 to CEO | 180,000 to staff | 480,000 to SMT # | 50,000 to one employee |
|---|---|---|---|---|---|
| Exercise price | $0.40 | $0.19 | $0.19 | $0.19 | $0.40 |
| Vesting | 40% on issue; 20% on each of 5 October 2006, 2007 and 2008. | 50% on each of 1 July 2006 and 1 July 2007 | 75% on 26 September 2006; 25% on 26 September 2007. | 50% on each of 26 September 2006 and 26 September 2007. | 75% on 26 September 2006; 25% on 26 September 2007. |

\# References to the SMT are to the Senior Management Team. References to staff are to employees other than the CEO and SMT.

At 1 July 2005 there were 1,500,000 options on issue to employees with an exercise price of $0.40 and an expiry date of 30 June 2009. Of these options, 100,000 lapsed during the half year ended 31 December 2005. A further 4,000,000 options were held by Shire Biochem Inc and continue to be held as at 31 December 2005. Details of the terms and conditions of the latter options are provided in Note 10.

No options were exercised during the period such that at 31 December 2005, there was a total of 7,210,000 options over unissued shares on issue.

## 4 Segment information

The Company comprises a single business segment comprising anti-infective research and development and in a single geographical segment being that of Australia. Therefore the segment details are fully reflected in the results and balances reported in the condensed interim income and balance sheet statements.

## 5 Events subsequent to balance date

Subsequent to the condensed interim balance sheet date and up to the date of this report, there has not arisen any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Company, the results of those operations, or the state of affairs of the Company in future financial years.

## 6 Contingent liabilities and contingent assets

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

## 7 Related parties

Key management personnel receive compensation in the form of short term employee benefits, post employment benefits and equity compensation benefits (see Note 10). Key management personnel received total compensation of $509,181 for the six months ended 31 December 2005 (six months ended 31 December 2004: $405,850). Total remuneration is included within 'Personnel expenses' and 'Share-based payment expense' in the Income Statement.

## 8 Financial instruments

The Company did not enter into any foreign currency hedging arrangements or other derivative financial instruments during the financial period.

The fair values of all financial assets and liabilities at balance date and the prior reporting period balance date approximate the carrying amounts as recorded in the balance sheet. For receivables and payables with a remaining life of less than one year, the notional amount is deemed to reflect the fair value.

## 9 Earnings per share

### (i) Earnings reconciliation

| | **31 December 2005** | 31 December 2004 |
|---|---|---|
| | **$'000** | $'000 |
| Net profit / (loss): | | |
| Basic earnings | **(7,408)** | (5,177) |
| Diluted earnings | **(7,408)** | (5,177) |

| **(ii) Weighted average number of shares used as the denominator** | **Number** | Number |
|---|---|---|
| Number for basic earnings per share: | | |
| Ordinary shares | **137,916,452** | 80,312,000 |
| Number for diluted earnings per share: | | |
| Ordinary shares | **137,916,452** | 80,312,000 |
| Effect of share options on issue # | **2,352,459** | - |
| | **140,268,911** | 80,312,000 |

\# The exercise price of the 4,000,000 options issued to Shire Biochem Inc. shall be equal to the volume weighted average price of each share over the period commencing 30 business days before and ending 30 business days after the ASX trading day on which the results of the Company's Phase IIb study in respect of the compound AVX754 are announced. The exercise period for these options commences on 17 January 2008 and expires on the earlier of 17 January 2012 or the termination of the Shire Licence Agreement. At the present time, neither the exercise price nor consequently the dilutive factor is therefore capable of reliable measurement. The options have therefore been treated as non-dilutive in nature and excluded from the calculation of diluted earnings per share.

All options other than those held by Shire Biochem Inc. have exercise prices of either $0.19 or $0.40 and have been treated as dilutive in nature for the purposes of calculating diluted earnings per share.

## 10 Employee benefits

### (i) As at 31 December 2005

Details of total employee benefits as at balance sheet date are provided in the following table.

| | **$'000** | $'000 |
|---|---|---|
| Liability for incentive performance payments | **47** | 23 |
| Liability for long service leave | **76** | 31 |
| Liability for annual leave | **94** | 72 |
| Total employee benefits | **217** | 126 |

## 10 Employee benefits (continued)

### (ii) Share-based payments

The Company has an Employee Share Option Plan ('ESOP') which entitles employees to participate in periodic offers of options to acquire ordinary shares in the Company. The terms and conditions of the ESOP and issues made during the year ended 30 June 2005 are disclosed in the 2005 Avexa Annual Report.

During the six months ended 31 December 2005, grants of options have been made under the ESOP as disclosed in Note 3(iii).

The fair values of services received in return for share options granted to employees is measured by reference to the fair value of the options granted. The estimate of fair value of the services received is measured based on a binomial model. The contractual five year life of the option is used as an input to this model and a zero dividend rate has been assumed for each valuation.

The expected volatility is based on the historic volatility from the 23 September 2004 date of listing of the Company on the ASX through to the issue date. There are no market or non-market performance conditions associated with the options.

| Number and recipient(s)of options | Grant date | Expiry date | Fair value per option | Exercise price | Price of shares on value date | Risk free interest rate | Estimated volatility |
|---|---|---|---|---|---|---|---|
| 600,000 to CEO | 5 Oct 2005 | 30 June 2010 | $0.108 | $0.40 | $0.21 | 5.38% | 76.78% |
| 500,000 to CEO | 5 Oct 2005 | 30 June 2010 | $0.140 | $0.19 | $0.21 | 5.38% | 76.78% |
| 180,000 to staff | 26 Sept 2005 | 25 Sept 2010 | $0.117 | $0.19 | $0.18 | 5.25% | 76.78% |
| 480,000 to SMT | 26 Sept 2005 | 25 Sept 2010 | $0.117 | $0.19 | $0.18 | 5.25% | 76.78% |
| 50,000 (i) | 26 Sept 2005 | 25 Sept 2010 | $0.090 | $0.40 | $0.18 | 5.25% | 76.78% |

(i) Since issuing the 50,000 options at an exercise price of $0.40 as a catch up offer to one employee, the Company has adopted a policy of setting the exercise price at a 20% premium to the volume weighted average share price for the first five days of the financial year in which options are issued.

During the six months ended 31 December 2005 the Company recognised an expense of $59,000 related to the fair value of options issued by the Company.

## 11 Explanation of transition to AIFRS

As stated in Note 1(a), this is the Company's first condensed interim financial report for part of the period covered by the first IFRS annual financial statements for the Company prepared in accordance with Australian Accounting Standards – AIFRS.

The accounting policies in Note 1 have been applied in preparing the condensed Company interim financial statements for the six months ended 31 December 2005, the comparative information for the six months ended 31 December 2004 and the preparation of an opening AIFRS balance sheet as at 1 July 2004, the Company's date of transition.

In preparing its opening AIFRS balance sheet, comparative information for the six months ended 31 December 2004 and financial statements for the year ended 30 June 2005, the Company has adjusted amounts previously reported in financial statements prepared in accordance with its old basis of accounting (previous AGAAP). An explanation of how the transition from previous AGAAP to AIFRS has affected the Company's financial position, financial performance and cash flows is set out in the following table and the notes that accompany the table.

### (i) Financial position

In the following table, net assets are unaffected by the transition and therefore the constituent asset and liability figures under previous AGAAP as at 1 July 2004 and 31 December 2004 remain the same as previously reported and therefore have been excluded from the table.

## 11 Explanation of transition to AIFRS (continued)

### (ii) Financial performance

The only expense or revenue item in the income statement that has been affected by the transition is the 'Share-based payment expense' item, which has been increased to reflect the fair value of equity-settled share-based payments by $31,000 for the six months ended 31 December 2004 and by $61,000 for the full financial year ended 30 June 2005. On the basis that no revenue item or any other expense items are affected by the transition, an abridged version of the income statement is therefore reflected in the table.

### (iii) Cash flows

There are no adjustments required between the statement of cash flows prepared under AIFRS and previous AGAAP.

NOTES TO THE CONDENSED INTERIM FINANCIAL STATEMENTS for the half-year ended 31 December 2005

AVEXA LIMITED ABN 53 108 150 750

| | | | | Previous AGAAP | Effect of transition to AIFRS | AIFRS | Previous AGAAP | Effect of transition to AIFRS | AIFRS |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Six months ended 31 December 2004 in $'000 | | | Year ended 30 June 2005 in $'000 | | |
| **Impact of AIFRS transition on income statement:** | | | | | | | | | |
| Revenues from ordinary activities | | | | 263 | | 263 | 669 | - | 669 |
| Expenses other than employee expenses | | | | (4,740) | - | (4,740) | (12,723) | - | (12,723) |
| Employee expenses | | | | (669) | (31) | (700) | (1,482) | (61) | (1,543) |
| **Loss before tax** | | | | (5,146) | (31) | (5,177) | (13,536) | (61) | (13,597) |
| Income tax expense | | | | - | - | - | - | - | - |
| **Loss after tax** | | | | (5,146) | (31) | (5,177) | (13,536) | (61) | (13,597) |
| | **Previous AGAAP** | **Effect of transition to AIFRS** | **AIFRS** | **Previous AGAAP** | **Effect of transition to AIFRS** | **AIFRS** | **Previous AGAAP** | **Effect of transition to AIFRS** | **AIFRS** |
| | **1 July 2004 balances in $'000** | | | **31 December 2004 balances in $'000** | | | **30 June 2005 balances in $'000** | | |
| **Impact of AIFRS transition on balance sheet** | | | | | | | | | |
| **Equity** | | | | | | | | | |
| Issued capital | - | - | - | 24,000 | - | 24,000 | 34,648 | - | 34,648 |
| Accumulated losses | - | - | - | (5,146) | - | (5,146) | (13,536) | - | (13,536) |
| **Total equity** | - | - | - | 18,854 | - | 18,854 | 21,112 | - | 21,112 |

**Directors' declaration**

In the opinion of the directors of Avexa Limited ('the Company'):

(a) the financial statements and notes 1 to 11 as set out on pages 5 to 18, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Company as at 31 December 2005 and of its performance, as represented by the results of its operations and its cash flows for the half-year ended on that date; and

(ii) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Dated at Melbourne this 13th day of February 2006.

Signed in accordance with a resolution of the directors.

Dr H Niall
(Chairman)

**Independent review report to the members of Avexa Limited**

## Scope

### The financial report and directors' responsibility

The financial report comprises the condensed interim income statement and statement of recognised income and expense, balance sheet, statement of cash flows, accompanying notes 1 to 11 to the financial statements, and the directors' declaration set out on pages 5 to 19 for Avexa Limited ('the Company'), for the half-year ended 31 December 2005.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for preparing the relevant reconciling information regarding adjustments required under the Australian Accounting Standard AASB 1 *First Time Adoption of Australian equivalents to International Financial Reporting Standards.*

### Review approach

We conducted an independent review in order for the Company to lodge the financial report with the Australian Securities and Investments Commission. Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements.

We performed procedures in order to state whether on the basis of the procedures described anything has come to our attention that would indicate the financial report does not present fairly, in accordance with the Corporations Act 2001, Australian Accounting Standard AASB 134 *Interim Financial Reporting* and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our statement on the basis of the review procedures performed, which were limited primarily to:

- enquiries of company personnel; and
- analytical procedures applied to the financial data.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

The procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

A review cannot guarantee that all material misstatements have been detected.

**Statement**

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Avexa Limited is not in accordance with:

(a) the Corporations Act 2001, including:

i) giving a true and fair view of the Company's financial position as at 31 December 2005 and of its performance for the half-year ended on that date; and

ii) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and

(b) other mandatory financial reporting requirements in Australia.

KPMG

B W Szentirmay
Partner

Melbourne, Victoria

13 February, 2006