

# Phosphagenics Limited

ABN 32 056 482 403

Annual Financial Report  
for the year ended 31 December 2010

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# Directors' Report

Your directors submit their report for the year ended 31 December 2010.

## DIRECTORS

The names and details of the Company's directors in office during the financial year and until the date of this report are as follows. Directors were in office for this entire period unless otherwise stated.

### NAMES, QUALIFICATIONS, EXPERIENCE AND SPECIAL RESPONSIBILITIES

#### Currently in Office

**JONATHAN LANCELOT ADDISON (AGED 58 YEARS) BEC (TAS), ASIC, CFTP (SNR)  
INDEPENDENT DIRECTOR SINCE NOVEMBER 2002, CHAIRMAN SINCE MAY 2010  
LAST RE-ELECTED MAY 2008**

Mr Addison has over 30 years in the investment management industry, including wide experience in superannuation, and insurance. Currently, in addition to holding a number of Board positions he is an Investment Advisor to the Meat Industry Employee Superannuation Fund (MIESF). Previously he was the Fund Manager/CEO, of the Fund.

MIESF, a self-administered industry superannuation fund established in 1981 which operates nationally, currently holds 21,800,000 shares in Phosphagenics Limited. Prior to his appointment to MIESF, Mr Addison was a Director and Asset Consultant within the corporate finance section of PricewaterhouseCoopers and in this role was responsible for establishing an investment consulting practice with clients ranging from superannuation funds to insurance funds and funds managers. Prior to that, Mr Addison held a number of investment management and consulting positions in both the public and private sectors.

In recent years Mr Addison has spoken at a number of economics and investment related conferences both in Australia and overseas.

Mr Addison also holds Non-Executive Directorships with, African Enterprise International, (In October 2010 he was elected International Chairman), African Enterprise (Australia) Limited, African Enterprises New Zealand Limited, Hawksbridge Limited, Global Masters Fund Limited, TPCG Limited and Athelney Trust plc. Mr Addison stepped down as the Chairman of the Company's Audit, Compliance and Corporate Governance Committee in May 2010 as he is now Chairman of the Board.

**HARRY ROSEN (AGED 63 YEARS) BA , LLB  
EXECUTIVE DIRECTOR APPOINTED TO THE BOARD IN JUNE 1999  
APPOINTED CHIEF EXECUTIVE OFFICER DECEMBER 2005  
LAST RE-ELECTED MAY 2004\***

Mr Rosen is one of the founders of Betatene Limited and Denehurst Limited, two formerly ASX listed companies which commercialised significant research and development. Betatene is the world's largest producer of natural beta carotene. After the purchase of Betatene Limited by Henkel Corporation, Mr Rosen served as Vice President, Corporate Development. As a Vice President of Henkel Corporation, he worked for a number of years in the U.S. in the nutrition and health care industries.

Mr Rosen has consulted to many technology companies assisting them with the commercialisation of new technologies. He has had significant experience in the areas of seed capital raising, stock exchange listings, taxation and corporate law. Mr Rosen graduated from the Australian National University (BA-Psychology) and Melbourne University (LLB).

\* As Chief Executive Officer Mr Rosen is not required to retire by rotation.

## Directors' Report (continued)

**DR ESRA OGRU (AGED 35 YEARS) BSC (HONS) PHD**  
**EXECUTIVE DIRECTOR SINCE OCTOBER 2005**  
**JOINT CHIEF EXECUTIVE OFFICER SINCE MAY 2010**  
**LAST RE-ELECTED MAY 2009**

Dr Ogru is responsible for the management of the operations in Australia and internationally. She achieves this through leadership of a team of experienced pharmaceutical scientists and chemists and strategic collaborations.

In this role, Dr Ogru has developed commercial opportunities for both the Company's nutraceutical division and pharmaceutical technologies, such as transdermal drug delivery and drug enhancement platforms for cancer, heart disease and chronic pain management.

Dr Ogru has many years experience in both the academic and commercial aspects of the industry and has publications in peer-reviewed journals. Prior to joining Phosphagenics in 2001, Dr Ogru carried out significant research on obesity and diabetes. Additionally, she has considerable experience in the management and coordination of pre-clinical and clinical development of pharmaceutical products.

**DON CLARKE (AGED 57 YEARS) LLB (HONS)**  
**INDEPENDENT DIRECTOR APPOINTED AUGUST 2010**

Mr Don Clarke has been a partner of law firm Minter Ellison since 1988. He serves in the Melbourne Private Equity & Capital Markets group, predominantly advising ASX listed companies across a range of industries with emphasis on technology and manufacturing.

Mr Clarke is also the Deputy Chairman of Webjet Limited and a Director of Circadian Technologies Limited. He previously served on the Board of Calzada Limited (formerly Metabolic Pharmaceuticals Limited).

Mr Clarke was appointed as the Chairman of the Company's Audit, Compliance and Corporate Governance Committee in August 2010.

**STUART JAMES (AGED 62 YEARS) BA (HONS)**  
**INDEPENDENT DIRECTOR APPOINTED AUGUST 2010**

Mr Stuart James has held a number of high profile executive positions during his career and has extensive experience in the oil, health, pharmaceutical and financial services sectors. Following a 25 year career with Shell, both in Australia and internationally, Mr James' past roles have included Managing Director of Australian Financial Services for Colonial Group and Managing Director of Colonial State Bank (formerly the State Bank of NSW).

Mr James' most recent executive role was as CEO of the Mayne Group, including Mayne Health and Mayne Pharma. He is a Member of the Supervisory Board of Wolters Kluwer NV and a Member of the Advisory Board of Gresham Private Equity Ltd. Mr James is Chairman of Pulse Health Ltd, Progen Pharmaceuticals Ltd, Prime Financial Group Ltd and a Non-Executive Director of Greencross Ltd.

Mr James is a member of the Company's Audit, Compliance and Corporate Governance Committee.

## Directors' Report (continued)

**DR SANDRA WEBB (AGED 64 YEARS) BPHARM, PHD, DIP LAW  
INDEPENDENT DIRECTOR APPOINTED AUGUST 2010**

Dr Sandra Webb rejoins Phosphagenics, having served with the company as Pharmaceutical Development Advisor from February 2005 to June 2006. Dr Webb is a Director of Ground Zero Pharmaceuticals Pty Limited. She previously served on the Boards of AusBiotech Limited, Amrad Corporation Limited and Quintiles Pty Limited.

An experienced biopharmaceutical professional, Dr Webb has a strong track record of achievements in the commercial world of drug development. As founding Managing Director of Quintiles Australia, she successfully grew the company as the leading commercial research organisation in Australia. Under her stewardship Quintiles Australia was the most profitable subsidiary of the worldwide Quintiles Transnational Inc.

Dr Webb is a member of the Company's Audit, Compliance and Corporate Governance Committee.

**FORMER DIRECTORS:**

**ASSOCIATE PROFESSOR ANDREW LANCELOT VIZARD (AGED 52 YEARS) BVSc (HONS) MVPM  
INDEPENDENT DIRECTOR FROM JULY 1999 TO MAY 2010  
CHAIRMAN FROM OCTOBER 2000 TO MAY 2010  
LAST RE-ELECTED MAY 2007**

With a background in research and agricultural consultancy, Professor Vizard is the Senior Consultant with and former Director of the Mackinnon Project at the University of Melbourne. This enterprise is recognised as a leader in delivering practical advice to farmers and agribusiness on a wide range of agricultural and economic issues. Professor Vizard is the author of over fifty scientific papers.

Professor Vizard is an experienced company director, having served on the board of numerous statutory, scientific and commercial organisations. He is currently a Non-Executive Director of Ridley Corporation Ltd and Animal Health Australia Ltd, a Trustee of the Australian Wool Education Trust and a member of the Management Advisory Committee for Melbourne Water.

Professor Vizard was a member of the Company's Audit, Compliance and Corporate Governance Committee.

**PROFESSOR JOHN MILLS (AGED 70 YEARS) MD, FACP, FRACP  
INDEPENDENT DIRECTOR FROM MARCH 2004 TO AUGUST 2010  
LAST RE-ELECTED MAY 2010**

Professor Mills has a long and distinguished career in medical research, clinical medicine and biomedical business. In addition to his position as a Non-Executive Director of Phosphagenics, he is Executive Chairman of Cavid AB, Co-Founder and Director of R&D at TissuePath Pty Ltd, and a founding Non-Executive Director of GBS Venture Partners Pty Ltd. He was previously a Non-Executive Director (1995-2003) and Chairman (2001-2) of AMRAD Corporation. He is also a Non-Executive Director of the Prostate Cancer Foundation of Australia and Chair of the PCFA Research Committee. He holds professional appointments at Monash University, the University of California, San Francisco and RMIT, and is a consulting physician at The Alfred and Austin Hospitals in Melbourne.

Professor Mills has published over two hundred scientific articles and has served as a consultant to the pharmaceutical industry and governments, the World Health Organisation and the United Nations.

Professor Mills was appointed Chairman of the Company's Audit, Compliance and Corporate Governance Committee in May 2010 until he retired from the board in August 2010.

## Directors' Report (continued)

**MICHAEL RICHARD DWYER ASHTON (AGED 65 YEARS) BPHARM, MBA  
INDEPENDENT DIRECTOR FROM JULY 2008 TO AUGUST 2010  
LAST RE-ELECTED MAY 2009**

Mr Ashton has more than 30 years' experience in the international pharmaceutical industry having held senior management positions with Merck Inc. and Pfizer Inc., and executive board positions with Faulding Inc. and SkyePharma Plc.

Mr Ashton was CEO and Director of SkyePharma Plc., he was responsible for the re-organisation of SkyePharma AG as a public enterprise (1997–1998). In 1998 he took over responsibility of the operations of the SkyePharma Plc. group and re-organised the international structure in Europe, the U.S. and the world wide Business Development Group.

Earlier Mr Ashton was Chairman, President and CEO of Faulding Inc., the U.S. subsidiary he opened for FH Faulding, Australia's largest pharmaceutical company, and CEO of Purepac Inc. During that time, he supervised the start-up of David Bull in the U.S. and Canada and oversaw restructuring of Purepac Inc., into a leader of the U.S. generic pharmaceutical industry.

In addition, Mr Ashton served with Pfizer International for 14 years in various roles, which included Director of Pharmaceutical Business Development for Europe/Canada, Vice President of Pharmaceutical Development for Africa/Middle East, Pharmaceutical Business Director of Nigeria and Group Product Manager for the International Division in New York.

Mr Ashton previously applied his pharmacist background to various management positions during six years at Merck Sharp and Dohme in Sydney and the U.S. Mr Ashton is a member of the Boards of Hikma Pharmaceuticals Plc, Proximagen Neuroscience Plc and Transition Therapeutics Inc.

Mr Ashton holds a Bachelor of Pharmacy degree from Sydney University and a Masters in Business Administration from Rutgers University, New Jersey, U.S

## Directors' Report (continued)

### DIRECTORSHIPS OF OTHER LISTED COMPANIES

Directorships of other listed companies held by Directors in the three years immediately before the end of the financial year are as follows:

| NAME                | COMPANY  | PERIOD OF DIRECTORSHIP                 |
|---------------------|--|--|
| Prof. Andrew Vizard | Ridley Corporation Limited                               | Since 29 January 2001                  |
| Jonathan Addison    | Global Masters Fund Limited                              | Since 19 April 2005                    |
| Don Clarke          | Circadian Technologies Limited                           | Since 1 September 2005                 |
|                     | Webjet Limited   | Since 10 January 2008                  |
|                     | Calzada Limited (formerly Metabolic Pharmaceuticals Ltd) | From 12 April 2007 to 23 November 2009 |
| Stuart James        | Wolters Kluwer NV  | Since 26 April 2006                    |
|                     | Pulse Health Limited                                     | Since 7 November 2007                  |
|                     | Prime Financial Group Limited                            | Since 16 May 2006                      |
|                     | Progen Limited   | Since 1 July 2009                      |
|                     | Greencross Limited                                       | Since 30 October 2009                  |

### COMPANY SECRETARY

Mourice Garbutt FCIS, Honorary Justice of the Peace in Victoria

Mr Garbutt, through his professional corporate secretarial and compliance service company, provides secretarial, clerical and corporate governance support to client companies in Australia many of which are listed on the ASX Limited. Fees are charged on normal commercial terms.

### PRINCIPAL ACTIVITIES

The principle activities of the Company are the production, sale and licensing of products for the nutraceutical and pharmaceutical industries.

### OPERATING AND FINANCIAL REVIEW

At the end of December 2010, the company held \$2.7 million in cash and cash equivalents. Closing cash was 75% below the amount held at December 2009 of \$10.9 million. During March 2011, Phosphagenics raised gross \$7.55 million through the placement of 83.90 million shares at 9 cents per share to institutions, professional and sophisticated investors. The funds will be primarily used to advance the clinical development and manufacturing of the Company's core development product – the world's first oxycodone pain patch, and to fund product rollouts of its new cosmetic range, including its new anti-cellulite cream.

Revenues for the year of \$5.1 million increased by 365% from \$1.1 million in 2009, due mainly to a one-time payment to Phosphagenics of approximately \$1.09m (US\$1 million) and the issuance to Phosphagenics of 1.44 million shares in ProPhase Labs common stock which based on market price at the contract signing date was valued at approximately \$3.185 million. These shares are recognised as an available-for-sale investment at 31 December 2010. Product sales decreased year on year by 37%, mainly due to the decrease of Vital ET sales to ISP.

The operating loss before impairment of acquired intangible assets after income tax was \$5.9 million, a decrease from \$8.5 million in 2009. The Company booked impairment charges relating to acquired patent assets of \$7.66 million in 2010. During the course of the financial year, a number of acquired patents were partially or fully abandoned, and as a result the carrying value of these particular patents has been written off in full. For further details refer to the attached Financial Statements and notes.

## Directors' Report (continued)

A number of R&D milestones were achieved in 2010 including:

### *Insulin*

Completion of a transdermal insulin patch demonstrating that a proprietary TPM/insulin matrix patch can safely deliver insulin to regulate basal glucose regulation.

### *Diclofenac*

Completion of a Phase 1 diclofenac study demonstrating the proprietary TPM/diclofenac formulation was safe and well tolerated in humans. A TPM/Diclofenac matrix patch system has also been developed and in vivo studies have demonstrated that the novel patch system can deliver sustained therapeutic amounts of Diclofenac into the blood.

### *Oxycodone*

Completion of preclinical studies for the proprietary TPM/oxycodone transdermal matrix patch system. The results of the preclinical studies demonstrated that by incorporating TPM/oxycodone into innovative patch systems developed by Phosphagenics, the delivery of oxycodone was significantly increased when compared to Phosphagenics TPM/oxycodone gel alone. Several doses of the matrix patch system have been developed and tested in-house.

Phosphagenics completed a Phase 1B clinical study of the proprietary oxycodone transdermal matrix and reservoir patch systems. The results of the trial established that after a single dose the matrix patch delivered oxycodone into the blood stream in a reproducible, consistent and sustained manner.

Phosphagenics is now working with the global company – 3M (USA) to optimise and carry out large scale GMP development of the TPM/Oxycodone matrix patch system.

### *TPM/AOD cosmetic formulation*

Phosphagenics has completed all the necessary formulation and development work for TPM/AOD formulation. The product is now being tested in small focus group trials to assess certain efficacy parameters.

### *Commercial Agreements*

Phosphagenics signed an agreement with CSL to evaluate the TPM delivery technology.

Phosphagenics entered into an exclusive agreement with Métier Tribeca LLC, (“Métier”) to enable Métier to launch a premier line of cosmetic products utilising the TPM delivery technology, under its brand name Le Métier de Beauté.

Phosphagenics signed a collaborative research and option agreement with Calzada Limited (formerly Metabolic Pharmaceuticals Limited). Under the terms of the agreement, Phosphagenics may elect to license Calzada’s patented compound, AOD9604, for use as a cosmeceutical product marketed as a cellulite and subcutaneous fat reduction treatment. The license, should Phosphagenics elect to exercise the option, will be a worldwide exclusive license.

Phosphagenics signed an agreement with Therapeutics Inc (TI), a US based company, to evaluate the TPM technology in combination with steroids.

Phosphagenics signed an agreement with Novartis animal health to evaluate the TPM/Insulin system in domestic cats and dogs.

Phosphagenics now has 3 products in various stages of clinical development:

- transdermal insulin delivery formulation
- topical and patch diclofenac formulations
- oxycodone patch system

## Directors' Report (continued)

### Looking Forward

Clinical trials have clearly shown TPM technology can be used to safely deliver active agents into the blood stream, or the dermis, without causing irritation or erythema.

Phosphagenics announced the completion of several successful Phase 1 trials for its proprietary oxycodone/TPM (Targeted Penetration Matrix) transdermal patch system which delivered oxycodone in therapeutic doses in a consistent and sustained manner. This trial was conducted over 10 days.

In parallel to applying its proprietary delivery technology for use in pharmaceuticals, which have the potential to generate high value products, but which are subject to stringent regulatory requirements and long product development timelines, Phosphagenics is leveraging the research and development already undertaken to apply the TPM delivery technology to cosmetic and personal care products. The TPM delivery technology is well suited to products in this growing market, as products can be brought to market relatively quickly and with relatively low expenditure. Phosphagenics aims to generate cash from the sale of cosmeceutical products, which can be used to support research to develop the more costly, but higher value generating, pharmaceutical products.

In 2011 Phosphagenics will continue to develop and launch its own brand of personal care products (Elixia) into the Australian and South East Asian markets through pharmacies, department stores and infomercials. Phosphagenics will continue to expand the cosmetics business globally through the relationship with Le Métier de Beauté in the USA.

### FUTURE DEVELOPMENTS

Disclosure of information regarding likely developments in the operations of the consolidated entity in future financial years and the expected results of those operations is likely to result in unreasonable prejudice to the consolidated entity. Accordingly, this information has not been disclosed in this report.

### ENVIRONMENTAL REGULATIONS

The Company is registered with relevant authorities to use certain compounds in the manufacture of goods. All waste chemicals are disposed of using accredited service providers with notification to the relevant authorities.

### DIVIDENDS

The Directors have not recommended the payment of any dividends and no dividends were declared, paid or reinvested in the year to 31 December 2010.

### SHARE OPTIONS

Share options convertible to ordinary shares on issue at 31 December 2010

| Issuing entity    | Australian stock exchange listed | shares under option No. | Class of shares | Exercise price \$ | Expiry date  |
|-------------------|----------------------------------|-------------------------|-----------------|-------------------|--------------|
| Phosphagenics Ltd | unquoted                         | 500,000                 | Ordinary        | \$0.24            | 11 Mar 2011  |
| Phosphagenics Ltd | unquoted                         | 1,600,000               | Ordinary        | \$0.24            | 22 May 2011  |
| Phosphagenics Ltd | unquoted                         | 100,000                 | Ordinary        | \$0.36            | 28 Aug 2011  |
| Phosphagenics Ltd | unquoted                         | 1,300,000               | Ordinary        | \$0.26            | 06 June 2012 |
| Phosphagenics Ltd | unquoted                         | 5,000,000               | Ordinary        | \$0.14            | 31 Mar 2013  |
| Phosphagenics Ltd | unquoted                         | 1,900,000               | Ordinary        | \$0.15            | 17 Aug 2013  |
| Phosphagenics Ltd | unquoted                         | 2,400,000               | Ordinary        | \$0.15            | 17 June 2014 |
| Phosphagenics Ltd | unquoted                         | 2,650,000               | Ordinary        | \$0.13            | 30 June 2018 |
| <b>Total</b>      |                                  | <b>15,450,000</b>       |                 |                   |              |

## Directors' Report (continued)

The holders of share options do not have voting rights or ability to participate in any share or rights issue. Since the end of the financial year no options have been exercised.

### ROUNDING OF AMOUNTS

The amounts contained in this report and in the financial report have been rounded to the nearest \$1,000 (where rounding is applicable and where noted (\$'000)), under the option available to the company under ASIC Class Order 98/0100. The company is an entity to which the Class Order applies.

### INDEMNIFICATION OF OFFICERS AND AUDITORS

During the financial year, the Company paid a premium in respect of a contract insuring its Directors and Officers against a liability, other than a wilful breach of duty, of a nature that is required to be disclosed under section 300(8) of the *Corporations Act 2001*. In accordance with section 300(9) of the *Corporations Act 2001*, further details have not been disclosed due to confidentiality provisions contained in the insurance contract.

### DIRECTORS' MEETINGS

The number of meetings of directors (including meetings of committees of directors) held during the year and the number of meetings attended by each director were as follows:

| Directors                      | Board of Directors |          | Share Allotment committee |          | Audit, Compliance and Corporate Governance committee |          |
|--------------------------------|--------------------|----------|---------------------------|----------|--|----------|
|                                | Held               | Attended | Held                      | Attended | Held   | Attended |
| <b>Non-executive directors</b> |                    |          |                           |          |  |          |
| Vizard, A L <sup>1</sup>       | 6                  | 6        | -                         | -        | 2  | 2        |
| Addison, J L                   | 11                 | 11       | -                         | -        | 5  | 5        |
| Mills, J <sup>2</sup>          | 8                  | 8        | -                         | -        | 3  | 3        |
| Ashton, M R D <sup>2</sup>     | 8                  | 8        | -                         | -        | -  | -        |
| Clarke, D <sup>3</sup>         | 4                  | 4        | -                         | -        | 2  | 2        |
| James, S <sup>3</sup>          | 4                  | 4        | -                         | -        | 2  | 2        |
| Webb, S <sup>3</sup>           | 4                  | 4        | -                         | -        | 2  | 2        |
| <b>Executive directors</b>     |                    |          |                           |          |  |          |
| Rosen, H <sup>4</sup>          | 11                 | 10       | -                         | -        | -  | -        |
| Ogru, E                        | 11                 | 10       | -                         | -        | -  | -        |

1. Mr A.L. Vizard retired on 31<sup>st</sup> May 2010.
2. Professor J. Mills and Mr M.R.D. Ashton retired on 24<sup>th</sup> August 2010.
3. Mr D. Clarke, Mr S. James and Dr S. Webb were appointed to the board on 24<sup>th</sup> August 2010.
4. Mr H. Rosen was granted leave of absence whilst overseas.

## Directors' Report (continued)

### Committee Membership

For all committees, any two Directors constitutes a quorum. All Directors are eligible to sit on the share allotment committee. The audit, compliance and corporate governance committee comprises of Independent Directors; D Clarke (chairman), J L Addison, S James and S Webb. Mr Clarke was appointed chairman in August 2010 upon the retirement of Professor Mills.

### Directors Shareholdings

During the reporting period no shares were issued by the Company to directors, and the share entitlements of D. Clarke and S. Webb were existing shares already held on their appointment to the board of directors. Entitlements during this period, as reported to the ASX Limited, include share and option transactions and are as follows:

| Directors                      | 2010<br>Number of ordinary shares | 2010<br>Number of options over<br>ordinary shares |
|--------------------------------|-----------------------------------|---|
| <b>Non-executive directors</b> |                                   |   |
| Vizard, A L                    | -                                 | -   |
| Addison, J L                   | 19,000                            | -   |
| Mills, J                       | -                                 | -   |
| Ashton, M R D                  | -                                 | -   |
| Clarke, D                      | 30,000                            | -   |
| James, S                       | -                                 | -   |
| Webb, S                        | 110,000                           | -   |
| <b>Executive directors</b>     |                                   |   |
| Rosen, H                       | 64,226,436                        | -   |
| Ogru, E                        | 5,711,610                         | -   |
| <b>Total</b>                   | <b>70,097,046</b>                 | -   |

## Directors' Report (continued)

### REMUNERATION REPORT (AUDITED)

This remuneration report for the year ended 31 December 2010 outlines the remuneration arrangements of the Company and the Group in accordance with the requirements of the *Corporations Act 2001* (the Act) and its regulations. This information has been audited as required by section 308(3C) of the Act.

For the purposes of this report, key management personnel (KMP) of the Group are defined as those persons having authority and responsibility for planning, directing and controlling the major activities of the Company and the Group, directly or indirectly, including any director (whether executive or otherwise) of the parent company.

| Details of Key Management Personnel | Position   |
|-------------------------------------|--|
| <b>Non-executive directors</b>      |  |
| Vizard, A L                         | Chairman and Independent Director (retired 31 May 2010)      |
| Addison, J L <sup>1</sup>           | Chairman and Independent Director                            |
| Mills, J                            | Independent Director (retired 24 August 2010)                |
| Ashton, M R D                       | Independent Director (retired 24 August 2010)                |
| Clarke, D                           | Independent Director (appointed 24 August 2010)              |
| James, S                            | Independent Director (appointed 24 August 2010)              |
| Webb, S                             | Independent Director (appointed 24 August 2010)              |
| <b>Executive directors</b>          |  |
| Rosen, H                            | President and Chief Executive Officer                        |
| Ogru, E <sup>2</sup>                | Joint Chief Executive Officer                                |
| <b>Key management personnel</b>     |  |
| Banti, F                            | President Phosphagenics Inc, Senior Vice President Australia |
| Hodges, A                           | Chief Financial Officer (resigned 29 July 2010)              |
| Gavin, P                            | Vice President - R&D   |
| Arnott, A                           | Chief Financial Officer (appointed 1 September 2010)         |
| Butala, D                           | Vice President – Bioanalytical & CMC                         |
| Harrison, K                         | IP Manager   |
| Kyriakou, K                         | General Manager – Personal Care                              |
| Libinaki, R                         | Vice President - Nutraceuticals                              |

<sup>1</sup> Mr Addison was appointed as Chairman effective 31 May 2010.

<sup>2</sup> Dr Ogru was promoted to her new position effective 23 April 2010.

### Remuneration Committee

The remuneration committee, part of the audit, compliance and corporate governance committee, is responsible for determining and reviewing remuneration arrangements for the directors and executives. The remuneration committee assesses the appropriateness of the nature and amount of remuneration of executives on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality, high performing director and executive team.

### Remuneration philosophy and structure

The performance of the Company depends upon the quality of its directors and executives. Attempts to prosper include attracting, motivating and retaining highly skilled directors and executives. The broad remuneration philosophy is to ensure a remuneration package properly reflects the person's duties and responsibilities and that remuneration is competitive in attracting, retaining and motivating people of the highest quality.

In accordance with best practice corporate governance, the structure of non-executive director and executive remuneration is separate and distinct.

## Directors' Report (continued)

### Non executive director remuneration

#### *Objective*

The board seeks to set aggregate remuneration at a level that provides the Company with the ability to attract and retain directors of the highest calibre, whilst incurring a cost that is acceptable to shareholders.

#### *Structure*

The constitution and the ASX listing rules specify that the aggregate remuneration of non-executive directors shall be determined from time to time by a general meeting. The latest determination was at the annual general meeting held on 29 January 2004 when shareholders approved an aggregate remuneration of \$300,000 per year.

The amount of aggregate remuneration sought to be approved by shareholders and the fee structure is reviewed annually. The board considers advice from external consultants as well as the fees paid to non-executive directors of comparable companies when undertaking the annual review process. A review was conducted in late 2009 resulting in no change to remuneration of non-executive directors.

Each non-executive director receives a base fee of \$38,000 for being a director of the Group. The non-executive directors do not receive retirement benefits, nor do they participate in any incentive programs. The remuneration of non-executive directors for the period ending 31 December 2010 and 31 December 2009 is detailed in the tables within this report.

### Executive remuneration

#### *Objective*

The Group aims to reward executives with a level and mix of remuneration commensurate with their position and responsibilities so as to align the interests of executives with those of shareholders to retain executives at the Company to ensure that total remuneration is competitive by market standards.

#### *Structure*

In determining the level and make-up of executive remuneration, the board engages external consultants as needed to provide independent advice. The process consists of a review of company and individual performance, relevant comparative remuneration in the market and internally, and where appropriate, external advice on policies and practices.

Remuneration packages contain the following key elements:

- Fixed remuneration (base salary, superannuation and non-monetary benefits).
- Variable remuneration long term incentive (options issued under the Employee Share Option Plan (ESOP))

Executive directors' remuneration was reviewed in late 2009 resulting in a 5% increase and commencing in January 2010.

### Fixed remuneration

#### *Objective*

Fixed remuneration is reviewed annually by the board of directors. The process consists of a review of company and individual performance, relevant comparative remuneration externally and internally and, where appropriate, external advice on policies and practices. As noted above, the committee has access to external advice independent of management.

#### *Structure*

Executives are given the opportunity to receive their fixed (primary) remuneration in a variety of forms including cash and fringe benefits such as motor vehicles. It is intended that the manner of payment chosen will be optimal for the recipient without creating undue cost for the Group. Apart from termination benefits which accrue under statute such as unpaid annual leave, long service leave and superannuation benefits, there are no post employment retirement benefits.

## Directors' Report (continued)

### Variable remuneration long term incentive plan

#### *Objective*

The objective of the long term incentive plan is to reward executives in a manner that aligns remuneration with the creation of shareholder wealth and to ensure that executives view their relationship with the Group as a long-term one.

As such the long term incentive plan is only offered to executives who are able to influence the generation of shareholder wealth and thus have an impact on the Group's performance.

#### *Structure*

The long term incentive plan grants to executives are delivered in the form of share options under the Employee Share Option Plan (ESOP). The share options will vest over differing periods depending on the offer conditions, with no opportunity to retest. Executives are able to exercise the share options after vesting and before the options lapse.

Where a participant ceases employment prior to the vesting of their share options, the share options are forfeited unless cessation of employment is due to retirement or death. In the event of a change of control of the Group, the performance period end date will be brought forward to the date of the change of control and awards will vest over this shortened period.

The Groups current remuneration policies provide some degree of linkage between an executive's variable long term incentive remuneration and the overall financial performance of the Group. However, given the position of the Group and its stage of development, the remuneration is aimed at retaining key individuals to ensure the success of current and future product development and successful commercialisation of products, which will in turn impact future profitability of the Group and shareholder wealth.

### Employment contracts

No executives have fixed term contracts with the Group. The company or the executive may terminate employment by providing four weeks written notice. On termination, any long term incentive plan (ESOP) options that have vested are available to be exercised. Any options that have not yet vested will be forfeited. The company may terminate employment at any time without notice if serious misconduct has occurred. Where termination with cause occurs the executive is only entitled to that portion of remuneration that is fixed, and only up to the date of termination. On termination with cause any unvested options will immediately be forfeited.

### Options granted during the year to key management personnel

No options were granted during the year to key management personnel.

### Remuneration of key management personnel

| Aggregates          | 2010             | 2009             |
|---------------------|------------------|------------------|
|                     | \$               | \$               |
| Short-Term Benefits | 1,482,034        | 1,083,557        |
| Post-Employment     | 108,968          | 89,581           |
| Share Based Payment | -                | 137,125          |
| <b>Totals</b>       | <b>1,591,002</b> | <b>1,310,263</b> |

## Directors' Report (continued)

## Remuneration of key management personnel (continued)

| 2010                            | Salary & Fees    | Short – Term Cash Bonus | Non monetary benefits | Superan-nuation | Post-Employment Retirement benefits | Cash Incentives | Long Service Leave | Share Based Options | Payment Shares | Total            | Performance Related |
|---------------------------------|------------------|-------------------------|-----------------------|-----------------|-------------------------------------|-----------------|--------------------|---------------------|----------------|------------------|---------------------|
|                                 | \$               | \$                      | \$                    | \$              | \$                                  | \$              | \$                 | \$                  | \$             | \$               | %                   |
| <b>Non-executive directors</b>  |                  |                         |                       |                 |                                     |                 |                    |                     |                |                  |                     |
| Vizard, A L                     | 29,052           | -                       | -                     | 2,615           | -                                   | -               | -                  | -                   | -              | 31,667           | -                   |
| Addison, J L                    | 34,862           | -                       | -                     | 3,138           | -                                   | -               | -                  | -                   | -              | 38,000           | -                   |
| Mills, J                        | 23,242           | -                       | -                     | 2,092           | -                                   | -               | -                  | -                   | -              | 25,334           | -                   |
| Ashton, M R D                   | 25,756           | -                       | -                     | -               | -                                   | -               | -                  | -                   | -              | 25,756           | -                   |
| Clarke, D                       | 11,527           | -                       | -                     | 1,037           | -                                   | -               | -                  | -                   | -              | 12,564           | -                   |
| James, S                        | 11,527           | -                       | -                     | 1,037           | -                                   | -               | -                  | -                   | -              | 12,564           | -                   |
| Webb, S                         | 11,527           | -                       | -                     | 1,037           | -                                   | -               | -                  | -                   | -              | 12,564           | -                   |
| <b>Executive directors</b>      |                  |                         |                       |                 |                                     |                 |                    |                     |                |                  |                     |
| Rosen, H                        | 284,909          | -                       | -                     | 22,706          | -                                   | -               | -                  | -                   | -              | 307,615          | -                   |
| Ogru, E                         | 222,701          | -                       | -                     | 19,506          | -                                   | -               | -                  | -                   | -              | 242,207          | -                   |
| <b>Key management personnel</b> |                  |                         |                       |                 |                                     |                 |                    |                     |                |                  |                     |
| Banti, F                        | 185,576          | -                       | -                     | -               | -                                   | -               | -                  | -                   | -              | 185,576          | -                   |
| Hodges, A                       | 95,547           | -                       | -                     | 8,599           | -                                   | -               | -                  | -                   | -              | 104,146          | -                   |
| Gavin, P                        | 125,229          | -                       | -                     | 11,271          | -                                   | -               | -                  | -                   | -              | 136,500          | -                   |
| Arnott, A                       | 21,360           | -                       | -                     | -               | -                                   | -               | -                  | -                   | -              | 21,360           | -                   |
| Butala, D                       | 136,500          | -                       | -                     | 12,285          | -                                   | -               | -                  | -                   | -              | 148,785          | -                   |
| Harrison, K                     | 79,511           | -                       | -                     | 7,156           | -                                   | -               | -                  | -                   | -              | 86,667           | -                   |
| Kyriakou, K                     | 110,000          | -                       | -                     | 9,900           | -                                   | -               | -                  | -                   | -              | 119,900          | -                   |
| Libinaki, R                     | 73,208           | -                       | -                     | 6,589           | -                                   | -               | -                  | -                   | -              | 79,797           | -                   |
| <b>Totals</b>                   | <b>1,482,034</b> | <b>-</b>                | <b>-</b>              | <b>108,968</b>  | <b>-</b>                            | <b>-</b>        | <b>-</b>           | <b>-</b>            | <b>-</b>       | <b>1,591,002</b> | <b>-</b>            |

## Directors' Report (continued)

## Remuneration of key management personnel (continued)

| 2009                            | Salary & Fees    | Short – Term Cash Bonus | Non monetary benefits | Superannuation | Post-Employment Retirement benefits | Cash Incentives | Long Service Leave | Share Based Payment Options | Payment Shares | Total            | Performance Related |
|---------------------------------|------------------|-------------------------|-----------------------|----------------|-------------------------------------|-----------------|--------------------|-----------------------------|----------------|------------------|---------------------|
|                                 | \$               | \$                      | \$                    | \$             | \$                                  | \$              | \$                 | \$                          | \$             | \$               | %                   |
| <b>Non-executive directors</b>  |                  |                         |                       |                |                                     |                 |                    |                             |                |                  |                     |
| Vizard, A L                     | 69,725           | -                       | -                     | 6,275          | -                                   | -               | -                  | -                           | -              | 76,000           | -                   |
| Addison, J L                    | 34,862           | -                       | -                     | 3,138          | -                                   | -               | -                  | -                           | -              | 38,000           | -                   |
| Mills, J                        | 34,862           | -                       | -                     | 3,138          | -                                   | -               | -                  | -                           | -              | 38,000           | -                   |
| Ashton, M R D                   | 18,841           | -                       | -                     | -              | -                                   | -               | -                  | -                           | -              | 18,841           | -                   |
| <b>Executive directors</b>      |                  |                         |                       |                |                                     |                 |                    |                             |                |                  |                     |
| Rosen, H                        | 252,294          | -                       | -                     | 22,706         | -                                   | -               | -                  | -                           | -              | 275,000          | -                   |
| Ogru, E                         | 206,422          | -                       | -                     | 18,578         | -                                   | -               | -                  | -                           | -              | 225,000          | -                   |
| <b>Key management personnel</b> |                  |                         |                       |                |                                     |                 |                    |                             |                |                  |                     |
| Banti, F                        | 211,409          | -                       | -                     | -              | -                                   | -               | -                  | 80,321                      | -              | 291,730          | -                   |
| Hodges, A                       | 138,508          | -                       | -                     | 25,249         | -                                   | -               | -                  | 28,402                      | -              | 192,159          | -                   |
| Gavin, P                        | 116,634          | -                       | -                     | 10,497         | -                                   | -               | -                  | 28,402                      | -              | 155,533          | -                   |
| <b>Totals</b>                   | <b>1,083,557</b> | <b>-</b>                | <b>-</b>              | <b>89,581</b>  | <b>-</b>                            | <b>-</b>        | <b>-</b>           | <b>137,125</b>              | <b>-</b>       | <b>1,310,263</b> | <b>-</b>            |

## Directors' Report (continued)

## Option holdings of key management personnel

| 2010                 | 01 Jan 10<br>Balance<br>No. | Granted as<br>remuneration<br>No. | Options<br>Exercised<br>No. | Net other<br>change<br>No. | 31 Dec 10<br>Balance<br>No. | Vested<br>No.    | Not<br>Vested<br>No. |
|----------------------|-----------------------------|-----------------------------------|-----------------------------|----------------------------|-----------------------------|------------------|----------------------|
| <b>Non Executive</b> |                             |                                   |                             |                            |                             |                  |                      |
| <b>Directors</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Vizard, A.L          | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Addison, J.L         | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Mills, J             | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Ashton, M R D        | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Clarke, D            | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| James, S             | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Webb, S              | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| <b>Executive</b>     |                             |                                   |                             |                            |                             |                  |                      |
| <b>Directors</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Rosen, H             | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Ogru, E              | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| <b>Key</b>           |                             |                                   |                             |                            |                             |                  |                      |
| <b>Management</b>    |                             |                                   |                             |                            |                             |                  |                      |
| <b>Personnel</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Banti, F             | 2,650,000                   | -                                 | -                           | -                          | 2,650,000                   | 2,650,000        | -                    |
| Hodges, A            | 600,000                     | -                                 | -                           | (600,000) <sup>1</sup>     | -                           | -                | -                    |
| Gavin, P             | 800,000                     | -                                 | -                           | -                          | 800,000                     | 800,000          | -                    |
| Arnott, A            | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Butala, D            | 250,000                     | -                                 | -                           | -                          | 250,000                     | 250,000          | -                    |
| Harrison, K          | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Kyriakou, K          | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Libinaki, R          | 650,000                     | -                                 | -                           | -                          | 650,000                     | 650,000          | -                    |
| <b>Totals</b>        | <b>4,950,000</b>            | <b>-</b>                          | <b>-</b>                    | <b>(600,000)</b>           | <b>4,350,000</b>            | <b>4,350,000</b> | <b>-</b>             |

1. A Hodges options lapsed upon his resignation on 29<sup>th</sup> July 2010.

| 2009                 | 01 Jan 09<br>Balance<br>No. | Granted as<br>remuneration<br>No. | Options<br>Exercised<br>No. | Net other<br>change<br>No. | 31 Dec 09<br>Balance<br>No. | Vested<br>No.    | Not<br>Vested<br>No. |
|----------------------|-----------------------------|-----------------------------------|-----------------------------|----------------------------|-----------------------------|------------------|----------------------|
| <b>Non Executive</b> |                             |                                   |                             |                            |                             |                  |                      |
| <b>Directors</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Vizard, A.L          | 1,200,000                   | -                                 | -                           | (1,200,000) <sup>1</sup>   | -                           | -                | -                    |
| Addison, J.L         | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Mills, J             | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Ashton, M R D        | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| <b>Executive</b>     |                             |                                   |                             |                            |                             |                  |                      |
| <b>Directors</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Rosen, H             | 5,050,000                   | -                                 | -                           | (5,050,000) <sup>1</sup>   | -                           | -                | -                    |
| Ogru, E              | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| <b>Key</b>           |                             |                                   |                             |                            |                             |                  |                      |
| <b>Management</b>    |                             |                                   |                             |                            |                             |                  |                      |
| <b>Personnel</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Banti, F             | 2,000,000                   | 650,000                           | -                           | -                          | 2,650,000                   | 2,150,000        | 500,000              |
| Hodges, A            | 300,000                     | 300,000                           | -                           | -                          | 600,000                     | 300,000          | 300,000              |
| Gavin, P             | 500,000                     | 300,000                           | -                           | -                          | 800,000                     | 500,000          | 300,000              |
| <b>Totals</b>        | <b>9,050,000</b>            | <b>1,250,000</b>                  | <b>-</b>                    | <b>(6,250,000)</b>         | <b>4,050,000</b>            | <b>2,950,000</b> | <b>1,100,000</b>     |

## Directors' Report (continued)

1. Option holdings for A.L Vizard and H Rosen expired on 7<sup>th</sup> June 2009.

All options granted to key management personnel have been issued in accordance with the provisions of the Employee Share Option Plan (ESOP).

### Shareholdings of Key Management Personnel

| 2010                            | 01 Jan 10<br>Balance<br>No. | Granted as<br>remuneration<br>No. | Received on<br>exercise of options<br>No. | Net other<br>change<br>No. | 31 Dec 10<br>Balance<br>No. |
|---------------------------------|-----------------------------|-----------------------------------|---|----------------------------|-----------------------------|
| <b>Non Executive</b>            |                             |                                   |   |                            |                             |
| <b>Directors</b>                |                             |                                   |   |                            |                             |
| Vizard, A.L                     | 177,758                     | -                                 | -   | (177,758)                  | -                           |
| Addison, J.L                    | 19,000                      | -                                 | -   | -                          | 19,000                      |
| Mills, J                        | 694,057                     | -                                 | -   | (694,057)                  | -                           |
| Ashton, M R D                   | 263,043                     | -                                 | -   | (263,043)                  | -                           |
| Clarke, D                       | -                           | -                                 | -   | 30,000                     | 30,000                      |
| James, S                        | -                           | -                                 | -   | -                          | -                           |
| Webb, S                         | -                           | -                                 | -   | 110,000                    | 110,000                     |
| <b>Executive Directors</b>      |                             |                                   |   |                            |                             |
| Rosen, H                        | 64,226,436                  | -                                 | -   | -                          | 64,226,436                  |
| Ogru, E                         | 5,711,610                   | -                                 | -   | -                          | 5,711,610                   |
| <b>Key Management Personnel</b> |                             |                                   |   |                            |                             |
| Banti, F                        | -                           | -                                 | -   | -                          | -                           |
| Hodges, A                       | 52,420                      | -                                 | -   | (52,420)                   | -                           |
| Gavin, P                        | 99,000                      | -                                 | -   | -                          | 99,000                      |
| Arnott, A                       | -                           | -                                 | -   | -                          | -                           |
| Butala, D                       | -                           | -                                 | -   | -                          | -                           |
| Harrison, K                     | -                           | -                                 | -   | -                          | -                           |
| Kyriakou, K                     | -                           | -                                 | -   | -                          | -                           |
| Libinaki, R                     | 344,451                     | -                                 | -   | -                          | 344,451                     |
| <b>Totals</b>                   | <b>71,587,775</b>           | <b>-</b>                          | <b>-</b>                                  | <b>(1,047,278)</b>         | <b>70,540,497</b>           |

## Directors' Report (continued)

| 2009                            | 01 Jan 09<br>Balance<br>No. | Granted as<br>remuneration<br>No. | Received on<br>exercise of options<br>No. | Net other<br>change<br>No. | 31 Dec 09<br>Balance<br>No. |
|---------------------------------|-----------------------------|-----------------------------------|---|----------------------------|-----------------------------|
| <b>Non Executive Directors</b>  |                             |                                   |   |                            |                             |
| Vizard, A.L                     | 123,411                     | -                                 | -   | 54,347 <sup>1</sup>        | 177,758                     |
| Addison, J.L                    | 19,000                      | -                                 | -   | -                          | 19,000                      |
| Mills, J                        | 476,667                     | -                                 | -   | 217,390 <sup>1</sup>       | 694,057                     |
| Ashton, M R D                   | 100,000                     | -                                 | -   | 163,043 <sup>1</sup>       | 263,043                     |
| <b>Executive Directors</b>      |                             |                                   |   |                            |                             |
| Rosen, H                        | 64,226,436                  | -                                 | -   | -                          | 64,226,436                  |
| Ogru, E                         | 5,711,610                   | -                                 | -   | -                          | 5,711,610                   |
| <b>Key Management Personnel</b> |                             |                                   |   |                            |                             |
| Banti, F                        | -                           | -                                 | -   | -                          | -                           |
| Hodges, A                       | 52,420                      | -                                 | -   | -                          | 52,420                      |
| Gavin, P                        | 99,000                      | -                                 | -   | -                          | 99,000                      |
| <b>Totals</b>                   | <b>70,808,544</b>           | <b>-</b>                          | <b>-</b>                                  | <b>434,780</b>             | <b>71,243,324</b>           |

<sup>1</sup>During the reporting period shares issued to A Vizard, J. Mills and M. Ashton resulted from their participation in the Share Purchase Plan.

## Directors' Report (continued)

### NON-AUDIT SERVICES

The Directors are satisfied that the provision of non-audit services, during the year, by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. Details of amounts paid or payable to the auditor for non-audit services provided during the year by the auditor are outlined in note 6 to the financial statements.

### AUDITOR'S INDEPENDENCE DECLARATION

The auditor's independence declaration is included on page 19 of the financial report.

### CHANGES IN STATE OF AFFAIRS

During the financial year there was no significant change in the state of affairs of the consolidated entity other than that referred to in the financial statements or notes thereto.

### SUBSEQUENT EVENTS

There has not been any matter or circumstance, other than that referred to in the financial statements or notes thereto, that has arisen since the end of the financial year, that has significantly affected, or may significantly affect, the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in future financial years.

Signed in accordance with a resolution of the Directors made pursuant to s.298(2) of the *Corporations Act 2001*.

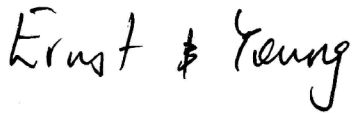


Jonathan Lancelot Addison  
Chairman

30 March 2011  
Melbourne

## Auditor's Independence Declaration to the Directors of Phosphagenics Limited

In relation to our audit of the financial report of Phosphagenics Limited for the financial year ended 31 December 2010, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

A handwritten signature in black ink that reads 'Ernst & Young' in a cursive style.

Ernst & Young

A handwritten signature in black ink that reads 'David Petersen' in a cursive style.

David Petersen  
Partner  
30 March 2011

# Corporate Governance Statement

## CORPORATE GOVERNANCE PRACTICES AND CONDUCT

The board of directors of Phosphagenics Limited is responsible for establishing the corporate governance framework of the Group having regard to the ASX Corporate Governance Council (CGC) published guidelines as well as its corporate governance principles and recommendations. The board guides and monitors the business and affairs of Phosphagenics Limited on behalf of the shareholders by whom they are elected and to whom they are accountable.

The table below summarises the Company's compliance with the CGS's recommendations.

| Principle | Recommendation   | Comply Yes/No | Reference/explanation | ASX Listing Rule/ Recommendation |
|-----------|--|---------------|-----------------------|----------------------------------|
| <b>1</b>  | <b>Lay solid foundations for management and oversight</b>  |               |                       |                                  |
| 1.1       | Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.  | Yes           | Page 22               | ASX LR 1.1                       |
| 1.2       | Companies should disclose the process for evaluating the performance of senior executives.   | Yes           | Page 24               | ASX LR 1.2                       |
| 1.3       | Companies should provide the information indicated in the guide to reporting on Principle 1.   | Yes           |                       | ASX LR 1.3                       |
| <b>2</b>  | <b>Structure the board to add value</b>  |               |                       |                                  |
| 2.1       | A majority of the board should be independent directors.   | Yes           | Page 22               | ASX LR 2.1                       |
| 2.2       | The chair should be an independent director.   | Yes           | Page 22               | ASX LR 2.2                       |
| 2.3       | The roles of chair and chief executive officer should not be exercised by the same individual.   | Yes           | Page 22               | ASX LR 2.3                       |
| 2.4       | The board should establish a nomination committee.   | No            | Page 23               | ASX LR 2.4                       |
| 2.5       | Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.  | Yes           | Page 11, 24           | ASX LR 2.5                       |
| 2.6       | Companies should provide the information indicated in the guide to reporting on Principle 2.   | Yes           |                       | ASX LR 2.6                       |
| <b>3</b>  | <b>Promote ethical and responsible decision-making</b>   |               |                       |                                  |
| 3.1       | Companies should establish a code of conduct and disclose the code or a summary of the code as to: <ul style="list-style-type: none"> <li>_ The practices necessary to maintain confidence in the company's integrity.</li> <li>_ The practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders.</li> <li>_ The responsibility and accountability of individuals for reporting and investigating reports of unethical practices.</li> </ul> | Yes           | Website               | ASX LR 3.1                       |
| 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.   | Yes           | Page 24               | ASX LR 3.2                       |
| 3.3       | Companies should provide the information indicated in the guide to reporting on Principle 3  | Yes           |                       | ASX LR 3.3                       |

| Principle | Recommendation  | Comply Yes/No | Reference/explanation | ASX Listing Rule/ Recommendation |
|-----------|---|---------------|-----------------------|----------------------------------|
| <b>4</b>  | <b>Safeguard integrity in financial reporting</b>   |               |                       |                                  |
| 4.1       | The board should establish an audit committee.  | Yes           | Page 24               | ASX LR 4.1                       |
| 4.2       | The audit committee should be structured so that it:<br>- Consists only of non-executive directors<br>- Has at least three members<br>- Consists of a majority of independent directors<br>- Is chaired by an independent chair, who is not chair of the board  | Yes           | Page 24               | ASX LR 4.2<br>ASX LR 12.7        |
| 4.3       | The audit committee should have a formal charter.   | Yes           | Page 24               | ASX LR 4.3                       |
| 4.4       | Companies should provide the information indicated in the Guide to reporting on Principle 4.  | Yes           |                       | ASX LR 4.4                       |
| <b>5</b>  | <b>Make timely and balanced disclosure</b>  |               |                       |                                  |
| 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.  | Yes           | Page 24               | ASX LR 5.1                       |
| 5.2       | Companies should provide the information indicated in the guide to reporting on Principle 5.  | Yes           |                       | ASX LR 5.2                       |
| <b>6</b>  | <b>Respect the rights of shareholders</b>   |               |                       |                                  |
| 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.  | Yes           | Page 26               | ASX LR 6.1                       |
| 6.2       | Companies should provide the information indicated in the guide to reporting on Principle 6.  | Yes           |                       | ASX LR 6.2                       |
| <b>7</b>  | <b>Recognise and manage risk</b>  |               |                       |                                  |
| 7.1       | Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.   | Yes           | Page 25               | ASX LR 7.1                       |
| 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  | Yes           | Page 24 & 25          | ASX LR 7.2                       |
| 7.3       | The board should disclose whether it has received assurance from the chief executive officer [or equivalent] and the chief financial 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. | Yes           | Page 26               | ASX LR 7.3                       |
| 7.4       | Companies should provide the information indicated in the guide to reporting on Principle 7.  | Yes           |                       | ASX LR 7.4                       |
| <b>8</b>  | <b>Remunerate fairly and responsibly</b>  |               |                       |                                  |
| 8.1       | The board should establish a remuneration committee.  | Yes           | Page 26               | ASX LR 8.1                       |
| 8.2       | Companies should clearly distinguish the structure of nonexecutive directors' remuneration from that of executive directors and senior executives.  | Yes           | Page 11 & 26          | ASX LR 8.2                       |
| 8.3       | Companies should provide the information indicated in the Guide to reporting on Principle 8.  | Yes           |                       | ASX LR 8.3                       |

## Corporate Governance Statement (continued)

The Companies corporate governance practices were in place throughout the year ended 31 December 2010.

### Board functions

The board seeks to identify the expectations of the shareholders, as well as other regulatory and ethical expectations and obligations. In addition, the board is responsible for identifying areas of significant business risk and ensuring arrangements are in place to adequately manage those risks. To ensure that the board is well equipped to discharge its responsibilities it has established guidelines for the nomination and selection of directors and for the operation of the board. The responsibility for the operation and administration of the Group is delegated, by the board, to the Chief Executive Officer and the executive management team. The board ensures that this team is appropriately qualified and experienced to discharge their responsibilities and has in place procedures to assess the performance of the Chief Executive Officer and the executive management team. Whilst at all times the board retains full responsibility for guiding and monitoring the Group, in discharging its stewardship it makes use of sub-committees. Specialist committees are able to focus on a particular responsibility and provide informed feedback to the board. To this end the board has established Share Allotment and Audit, Compliance and Corporate Governance Committees.

The Directors in office at the date of this statement, their skills, experience, expertise and period of directorship are detailed in the Directors' Report. In respect of the attendance at Board and Committee Meetings, shareholders are referred to the table of Meeting Attendance contained on page 8.

### Structure of the Board

The skills, experience and expertise relevant to the position of director held by each director in office at the date of the annual report are included in the directors' report. Directors of Phosphagenics Limited are considered to be independent when they are independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their unfettered and independent judgement.

In the context of director independence, "materiality" is considered from both the Group and individual director perspective. The determination of materiality requires consideration of both quantitative and qualitative elements. An item is presumed to be quantitatively immaterial if it is equal to or less than 5% of the appropriate base amount. It is presumed to be material (unless there is qualitative evidence to the contrary) if it is equal to or greater than 10% of the appropriate base amount. Qualitative factors considered include whether a relationship is strategically important, the competitive landscape, the nature of the relationship and the contractual or other arrangements governing it and other factors that point to the actual ability of the director in question to shape the direction of the Group's loyalty.

In accordance with the definition of independence above, and the materiality thresholds set, the following directors of Phosphagenics Limited are considered to have the following status:

| Name                           | Position and status               | Term in Office |
|--------------------------------|-----------------------------------|----------------|
| <b>Non-executive directors</b> |                                   |                |
| Addison, J L                   | Chairman and Independent Director | 8 years        |
| Clarke, D                      | Independent Director              | 0.5 years      |
| James, S                       | Independent Director              | 0.5 years      |
| Webb, S                        | Independent Director              | 0.5 years      |
| <b>Executive directors</b>     |                                   |                |
| Rosen, H                       | Chief Executive Officer           | 11 years       |
| Ogru, E                        | Joint Chief Executive Officer     | 5 years        |

The board recognises the Corporate Governance Council's recommendation that the Chair should be an independent director.

## Corporate Governance Statement (continued)

### *Composition of the Board*

The Company's Constitution provides for the appointment of a minimum of three Directors and up to a maximum of eight. At the date of this report, the Company has six Directors comprising two Executive and four Non-Executive Directors. The Chairman of the Board and the Chairman of the Board's Committees are Non-Executive Directors.

In November 2009 the Board of Directors undertook a review of the status of each Director and reached the opinion that each Director, apart from Mr Rosen and Dr Ogru, could be classified as a Non-Executive Director. In addition, this assessment has concluded Prof. A Vizard, Prof. J. Mills, Mr Addison and Mr Ashton qualified as Independent Directors.

In February 2011 the Board of Directors undertook a further review of the status of each Director and reached the opinion that each current Director, apart from Mr Rosen and Dr Ogru, could be classified as a Non-Executive Director. In addition, this assessment has concluded, Mr Addison, Mr Clarke, Mr James, and Ms Webb qualified as Independent Directors.

### **Board Responsibilities**

The responsibility for the operation and administration of the Company is delegated by the Board to the specifically identified outsourced service providers. The Board ensures that this team of service providers is appropriately qualified and experienced to discharge their responsibilities and has in place procedures to assess their performance.

The Board is responsible for ensuring that management's objectives and activities are aligned with the expectations and risks identified by the Board. The Board has a number of mechanisms in place to ensure this is achieved. In addition to the establishment of specific committees referred in this statement, these mechanisms include the following:

- Implementation of operating plans and budgets by management and Board monitoring of progress against budget – this includes the establishment and monitoring of key performance indicators (both financial and non-financial) for all significant business processes;
- Procedures to allow Directors, in the furtherance of their duties, to seek independent professional advice at the company's expense;
- The review and approval of acquisitions and disposals of businesses and assets, and the approval of contracts and financing arrangements within defined limits; and
- The appointment of an outsourced service provider, which is responsible for managing the Company's public image and communication with shareholders.

In conjunction with an ongoing review of the Board Charter, the Board will consider its responsibilities and delegated authorities to ensure they comply with best practice corporate governance.

### *Nomination and Membership*

Subject to the provisions of the Company's Constitution, Board composition and selection criteria for Directors are addressed by the full Board. Accordingly, a Nomination and Membership Committee has not been established.

The Constitution provides for events whereby Directors may be removed from the Board. Similarly shareholders have the ability to nominate, appoint and remove Directors. The Constitution also provides for the regular rotation of Directors, which ensures that Directors seek re-election by shareholders at least once every three years.

### *Independent Professional Advice*

Directors, in carrying out their duties as Directors or as members of Board Committees, may, after prior consultation with the Chairman, seek independent professional advice at the expense of the Company. If appropriate, such advice will be available to all Directors.

## Corporate Governance Statement (continued)

### *Timely and Balanced Disclosure*

The Board of Directors has established written policies and procedures designed to ensure compliance and at each meeting of the Board of Directors and specifically monitors the Company's activities and disclosures. On average there are between six and ten Board meetings a year. The Board of Directors has endorsed the principles of best corporate governance practice as set out by the Council.

### *Performance*

The performance of the board and key executives is reviewed periodically against both measurable and qualitative indicators. The performance criteria against which directors and executives are assessed are aligned with the financial and non-financial objectives of Phosphagenics Limited.

### **Trading Policy**

A Company Share Trading policy was adopted by the Board of Directors in May 2010 and amended by a resolution of directors in December 2010. Under the Company's Share Trading Policy, an executive or director must not trade in any securities of the Company at any time when they are in possession of unpublished, price-sensitive information in relation to those securities; during a blackout period or outside the Executive Trading Windows period without the permission of the Approving Officer. The Directors are permitted to deal in securities in which they have a relevant interest without restriction for any period other than the last day in each half or full year reporting period until six weeks after the release to the ASX of the announcements by the Company of its full year or half year results and six weeks after the date of the Company's annual general meeting. Directors are required to wait at least two business days after the release of any market sensitive announcement by the Company so that the market has had time to absorb the information.

As required by the ASX listing rules, the Company notifies the ASX of any transaction conducted by directors in the securities of the Company.

### **Board of Directors and its Committees**

The Board of Directors is responsible for the overall governance of the Company inclusive of its strategic development and the direction and the control of operations of the Company. Whilst the Board retains overall responsibility, it has established certain committees to assist in carrying out its responsibilities. Such committees include the audit, compliance and corporate governance committee and the share allotment committee.

### *Audit, Compliance and Corporate Governance Committee*

It is the board's responsibility to ensure that an effective internal control framework exists within the entity. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as the benchmarking of operational key performance indicators.

The board has delegated responsibility for establishing and maintaining a framework of internal control and ethical standards to the audit, compliance and corporate governance committee. The committee also provides the board with additional assurance regarding the reliability of financial information. A committee charter has been approved by the board.

The committee, as at the date of this statement, comprises four Non-Executive Independent Directors; Mr D Clarke (Chairman), Mr J Addison, Mr S James and Dr S Webb. The Company's Auditors are invited to attend meetings and to participate in committee discussions. The Group CFO and Company Secretary attends committee meetings.

## Corporate Governance Statement (continued)

The duties of the Committee include:

- The review of the Audit Programme and all matters relevant to the financial affairs of the Company's activities together with the production of Statutory Financial Reports inclusive of the Reports and Declarations by Directors.
- To review and advise on procedures in place to record the Company's activities and to ensure the safety of the Company's records and assets.
- To review Internal Control Procedures and the Auditor's Management letter.
- To review the half-yearly and yearly reports to the ASX Limited together with a review of the scope and quality of the annual statutory audit and the half-year audit review.
- To monitor Compliance with the provisions of the *Corporations Act 2001*, Australian Securities and Investment Commission guidelines and practice notes, ASX Listing Rules, taxation requirements and all regulatory bodies.
- Carry out the functions of the Remuneration Committee.
- Group Risk management

### *Share Allotment Committee*

Any two Directors will constitute a quorum for this committee, which deals with the allotment of new shares or grant or exercise of options.

### **Internal Control Framework and Ethical Standards**

The Board of Directors seeks to identify the expectations of shareholders as well as other regulatory and ethical expectations and obligations.

These matters are undertaken by the full Board together with the audit, compliance and corporate governance committee. In respect of the ethical standards, the full Board regularly discusses the maintenance by the Company of appropriate ethical standards in line with the Council's recommendations.

### **Risk**

The board acknowledges the Revised Supplementary Guidance to Principle 7 issued by the ASX in June 2008 and has continued its proactive approach to risk management. The identification and effective management of risk, including calculated risk-taking is viewed as an essential part of the company's approach to creating long-term shareholder value.

In recognition of this, the Board determines the company's risk profile and is responsible for overseeing and approving risk management strategy. The audit, compliance and corporate governance committee reviews policies, internal compliance and internal control.

The audit, compliance and corporate governance committee oversees the assessment of the effectiveness of risk management and internal compliance and control. The tasks of undertaking and assessing risk management and internal control effectiveness are delegated to management through the Chief Executive Officer and Chief Financial Officer, including responsibility for the day to day design and implementation of the company's risk management and internal control system.

Management reports to the audit, compliance and corporate governance committee on the company's key risks and the extent to which it believes these risks are being adequately managed. The reporting on risk by management is a standing agenda item at monthly Board meetings.

## Corporate Governance Statement (continued)

### *Business Risk*

The main areas of business risk, which are considered on an ongoing basis by the Board are;

- Failure to develop commercial products from the company's research and development
- Ability to raise capital or generate free cash flow to fund future research and development activities
- Failure to market the company's products
- General economic factors including those affecting interest and exchange rates
- Changes in Corporations and Taxation Law

### **CEO and CFO certification**

In accordance with section 295A of the *Corporations Act*, the Chief Executive Officer and Chief Financial Officer have provided a written statement to the board that:

- Their view provided on the Company's financial report is founded on a sound system of risk management and internal compliance and control which implements the financial policies adopted by the board
- The Company's risk management and internal compliance and control system is operating effectively in all material respects

The board agrees with the views of the ASX on this matter and notes that due to its nature, internal control assurance from the Chief Executive Officer and Chief Financial Officer can only be reasonable rather than absolute. This is due to such factors as the need for judgement, the use of testing on a sample basis, the inherent limitations in internal control and because much of the evidence available is persuasive rather than conclusive and therefore is not and cannot be designed to detect all weaknesses in control procedures. In response to this, internal control questions are required to be completed by the key management personnel in support of these written statements.

### **Remuneration**

The Board is responsible for determining and reviewing compensation arrangements for the directors themselves, the Chief Executive Officer and executive team. A Compensation (Remuneration) Committee has not been separately established, rather the function is performed by the Audit, Compliance and Corporate Governance Committee.

It is the Company's objective to provide maximum stakeholder benefit from the retention of a high quality Board and executive team by remunerating directors and key executives fairly and appropriately with reference to relevant employment market conditions. For a full discussion of the Company's remuneration philosophy and framework and the remuneration received by directors and executives in the current period please refer to the remuneration report, which is contained within the directors' report.

### **Shareholder communication policy**

Phosphagenics's objective is to promote effective communication with its shareholders at all times. Phosphagenics Limited is committed to:

- Ensuring that shareholders and the financial markets are provided with full and timely information about Phosphagenics's activities in a balanced and understandable way.
- Complying with continuous disclosure obligations contained in applicable the ASX listing rules and the *Corporations Act* in Australia.
- Communicating effectively with its shareholders and making it easier for shareholders to communicate with Phosphagenics Limited.

## Corporate Governance Statement (continued)

To promote effective communication with shareholders and encourage effective participation at general meetings, information is communicated to shareholders:

- Through the release of information to the market via the ASX
- Through the distribution of the annual report and Notices of Annual General Meeting
- Through shareholder meetings and investor relations presentations
- Through letters and other forms of communications directly to shareholders
- By posting relevant information on Phosphagenics website [www.phosphagenics.com](http://www.phosphagenics.com).

The Company's website [www.phosphagenics.com](http://www.phosphagenics.com) has a dedicated Investor Relations section for the purpose of publishing all important company information and relevant announcements made to the market. The Company has also established an e-mail directory for the direct distribution of announcements made to the ASX.

The external auditors are required to attend the Annual General Meeting and are available to answer any shareholder questions about the conduction of the audit and preparation of the audit report.

Annual Reports are provided to all share and option holders who have elected to receive the Report.

At the meetings of shareholders, Directors are subject to questioning by shareholders about the Directors' stewardship of the Company's affairs and it is shareholders who ultimately vote upon the financial statements and reports, the election of Directors, appointment of Auditors and any matters of Special Business.

Signed in accordance with a resolution of the Directors.



Jonathan Lancelot Addison  
Chairman

30 March 2011  
Melbourne

## Consolidated statement of comprehensive income

| <b>FOR THE YEAR ENDED<br/>31 DECEMBER 2010</b>  | <b>Note</b> | <b>2010<br/>\$'000</b> | <b>2009<br/>\$'000</b> |
|---|-------------|------------------------|------------------------|
| <b>Revenue</b>  |             |                        |                        |
| Sale of goods   |             | 419                    | 670                    |
| Licences  | 3a          | 4,386                  | -                      |
| Finance revenue   |             | 314                    | 430                    |
| <b>Total revenue</b>  |             | <u>5,119</u>           | <u>1,100</u>           |
| Cost of sales   |             | (44)                   | (228)                  |
| <b>Gross profit</b>   |             | <u>5,075</u>           | <u>872</u>             |
| Rental income   | 3b          | -                      | 113                    |
| Income from government grants   |             | 161                    | 304                    |
| Other income  | 3b          | 187                    | 197                    |
| Employee and Directors benefits expenses  |             | (3,491)                | (3,504)                |
| Occupancy and communications expenses   |             | (169)                  | (242)                  |
| Consulting and professional expenses  |             | (1,412)                | (961)                  |
| Administration expenses   |             | (868)                  | (516)                  |
| Research expenses   |             | (2,969)                | (3,450)                |
| Impairment of acquired intangible assets  |             | (7,660)                | -                      |
| Impairment of available-for-sale investment   |             | (1,449)                | -                      |
| Other expenses  | 3c          | (978)                  | (1,314)                |
| Loss before income tax  |             | <u>(13,573)</u>        | <u>(8,501)</u>         |
| Income tax benefit  | 4           | 2,298                  | -                      |
| Loss after income tax   |             | <u>(11,275)</u>        | <u>(8,501)</u>         |
| <b>Other Comprehensive Income</b>   |             |                        |                        |
| Foreign currency translation  | 15          | (20)                   | (18)                   |
| Income tax/(expense) on items of other comprehensive income   |             | -                      | -                      |
| <b>Other comprehensive income for the period, net of tax</b>  | 15          | <u>(20)</u>            | <u>(18)</u>            |
| <b>Total comprehensive income for the period</b>  |             | <u>(11,295)</u>        | <u>(8,519)</u>         |
| <b>Loss per share from continuing operations attributable to the ordinary equity holders of the parent:</b> |             |                        |                        |
| Basic loss per share  | 16          | (1.52 cents)           | (1.26 cents)           |
| Diluted loss per share  | 16          | (1.52 cents)           | (1.26 cents)           |

The above Statement of comprehensive income should be read in conjunction with the accompanying notes

## Consolidated statement of financial position

| AS AT 31 DECEMBER 2010               | Note | 2010<br>\$'000 | 2009<br>\$'000 |
|--------------------------------------|------|----------------|----------------|
| <b>ASSETS</b>                        |      |                |                |
| <b>CURRENT ASSETS</b>                |      |                |                |
| Cash and cash equivalents            | 21a  | 2,740          | 10,868         |
| Trade and other receivables          | 7    | 305            | 292            |
| Inventories                          | 8    | 522            | 58             |
| Other current assets                 |      | 157            | 329            |
| <b>TOTAL CURRENT ASSETS</b>          |      | <u>3,724</u>   | <u>11,547</u>  |
| <b>NON-CURRENT ASSETS</b>            |      |                |                |
| Plant and equipment                  | 9    | 1,298          | 1,445          |
| Intangible assets                    | 10   | 47,046         | 54,372         |
| Available-for-sale investment        | 11   | 1,700          | -              |
| <b>TOTAL NON-CURRENT ASSETS</b>      |      | <u>50,044</u>  | <u>55,817</u>  |
| <b>TOTAL ASSETS</b>                  |      | <u>53,768</u>  | <u>67,364</u>  |
| <b>LIABILITIES</b>                   |      |                |                |
| <b>CURRENT LIABILITIES</b>           |      |                |                |
| Trade and other payables             | 12   | 816            | 1,151          |
| Provisions                           | 13   | 115            | 96             |
| <b>TOTAL CURRENT LIABILITIES</b>     |      | <u>931</u>     | <u>1,247</u>   |
| <b>NON-CURRENT LIABILITIES</b>       |      |                |                |
| Deferred tax liability               | 4    | 13,830         | 16,128         |
| <b>TOTAL NON-CURRENT LIABILITIES</b> |      | <u>13,830</u>  | <u>16,128</u>  |
| <b>TOTAL LIABILITIES</b>             |      | <u>14,761</u>  | <u>17,375</u>  |
| <b>NET ASSETS</b>                    |      | <u>39,007</u>  | <u>49,989</u>  |
| <b>EQUITY</b>                        |      |                |                |
| Contributed Equity                   | 14   | 176,905        | 176,905        |
| Reserves                             | 15   | 29,126         | 28,833         |
| Accumulated losses                   |      | (167,024)      | (155,749)      |
| <b>TOTAL EQUITY</b>                  |      | <u>39,007</u>  | <u>49,989</u>  |

The above Statement of financial position should be read in conjunction with the accompanying notes

## Consolidated statement of cash flow

| <b>FOR THE YEAR ENDED<br/>31 DECEMBER 2010</b>        | <b>Note</b> | <b>2010<br/>\$'000</b> | <b>2009<br/>\$'000</b> |
|---|-------------|------------------------|------------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>           |             |                        |                        |
| Receipts from customers                               |             | 1,833                  | 726                    |
| Receipt of government grants                          |             | 161                    | 334                    |
| Payments to suppliers and employees                   |             | (10,334)               | (10,023)               |
| Net cash used in operating activities                 | 21(b)       | <u>(8,340)</u>         | <u>(8,963)</u>         |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>           |             |                        |                        |
| Interest received                                     |             | 342                    | 423                    |
| Purchase of plant and equipment                       |             | (131)                  | (76)                   |
| Net cash from investing activities                    |             | <u>211</u>             | <u>347</u>             |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>           |             |                        |                        |
| Proceeds from issues of shares                        | 14          | -                      | 6,589                  |
| Net cash from financing activities                    |             | <u>-</u>               | <u>6,589</u>           |
| Net decrease in cash and cash equivalents             |             | (8,129)                | (2,027)                |
| Cash and cash equivalents at the beginning of period  |             | 10,869                 | 12,896                 |
| <b>CASH AND CASH EQUIVALENTS AT THE END OF PERIOD</b> | 21(a)       | <u><u>2,740</u></u>    | <u><u>10,869</u></u>   |

The above Statement of cash flows should be read in conjunction with the accompanying notes

## Consolidated statement of changes in equity

|  | Contributed<br>Equity | Employee<br>Benefits<br>Reserve | Business<br>Combination &<br>Foreign Currency<br>Translation<br>Reserve | Accumulated<br>Losses | Total         |
|--|-----------------------|---------------------------------|---|-----------------------|---------------|
|  | \$'000                | \$'000                          | \$'000  | \$'000                | \$'000        |
| <b>Balance at<br/>1 January 2010</b>                             | 176,905               | 992                             | 27,841  | (155,749)             | 49,989        |
| Loss for the period  | -                     | -                               | -   | (11,275)              | (11,275)      |
| Other comprehensive income                                       | -                     | -                               | (20)  | -                     | (20)          |
| Total comprehensive income for<br>the period                     | -                     | -                               | (20)  | (11,275)              | (11,295)      |
| <b>Transactions with owners in<br/>their capacity as owners:</b> |                       |                                 |   |                       |               |
| Employee equity settlement<br>benefits                           | -                     | 110                             | -   | -                     | 110           |
| Share based payments   | -                     | 203                             | -   | -                     | 203           |
| <b>Balance at<br/>31 December 2010</b>                           | <b>176,905</b>        | <b>1,305</b>                    | <b>27,821</b>   | <b>(167,024)</b>      | <b>39,007</b> |
| <b>Balance at<br/>1 January 2009</b>                             | 170,316               | 626                             | 27,859  | (147,248)             | 51,553        |
| Loss for the period  | -                     | -                               | -   | (8,501)               | (8,501)       |
| Other comprehensive income                                       | -                     | -                               | (18)  | -                     | (18)          |
| Total comprehensive income for<br>the period                     | -                     | -                               | (18)  | (8,501)               | (8,519)       |
| <b>Transactions with owners in<br/>their capacity as owners:</b> |                       |                                 |   |                       |               |
| Issue of shares  | 7,014                 | -                               | -   | -                     | 7,014         |
| Transaction costs on share issue                                 | (425)                 | -                               | -   | -                     | (425)         |
| Employee equity settlement<br>benefits                           | -                     | 366                             | -   | -                     | 366           |
| <b>Balance at<br/>31 December 2009</b>                           | <b>176,905</b>        | <b>992</b>                      | <b>27,841</b>   | <b>(155,749)</b>      | <b>49,989</b> |

The above Statement of changes in equity should be read in conjunction with the accompanying notes.

# Notes to the consolidated financial statements

## YEAR ENDED 31 DECEMBER 2010

### 1. CORPORATE INFORMATION

The financial report of Phosphagenics Limited for the year ended 31 December 2010 was authorised for issue in accordance with a resolution of the Directors on 30<sup>th</sup> March 2011.

Phosphagenics Limited (the parent) is a company limited by shares incorporated in Australia whose shares are publicly traded on the Australian Stock Exchange (“ASX”).

The nature of the operations and principal activities of the Group are described in the directors' report.

The number of employees at 31 December 2010 is 29 (2009:30)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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#### **Basis of Preparation of the financial report**

The financial report is a general-purpose financial report, which has been prepared in accordance with the requirements of the *Corporations Act 2001* and Australian Accounting Standards. The financial report has also been prepared on a historical cost basis.

The financial report is presented in Australian dollars and all values are rounded to the nearest thousand dollars (\$'000) unless otherwise stated.

# Notes to the consolidated financial statements

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (a) Statement of Compliance

The financial report complies with Australian Accounting Standards as issued by the Australian Accounting Standards Board and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

### (b) New Accounting Standards and Interpretations

*(i) Changes in accounting policy and disclosures.*

The accounting policies adopted are consistent with those of the previous financial year except as follows: The Group has adopted the following new and amended Australian Accounting Standards and AASB Interpretations as of 1 January 2010:

- ▶ AASB 2009-5 *Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 5, 8, 101, 107, 117, 118, 136 & 139]* effective 1 January 2010
- ▶ AASB 2009-4 *Amendments to Australian Accounting Standards arising from the Annual Improvements Project* effective 1 July 2009
- ▶ AASB 2008-6 *Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 1 & AASB 5]* effective 1 July 2009

When the adoption of the Standard or Interpretation is deemed to have an impact on the financial statements or performance of the Group, its impact is described below:

#### ***Annual Improvements Project \****

In May 2009 and June 2010 the AASB issued omnibus of amendments to its Standards as part of the Annual Improvements Project, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions and application dates for each amendment. The adoption of the following amendments resulted in changes to accounting policies but did not have any impact on the financial position or performance of the Group:

*(ii) Accounting Standards and Interpretations issued but not yet effective.*

Australian Accounting Standards and Interpretations that have recently been issued or amended but are not yet effective and have not been adopted by the Group for the annual reporting period ending 31 December 2010, outlined in the table below:

| Reference    | Title   | Summary  | Application date of standard* | Impact on Group financial report   | Application date for Group* |
|--------------|---|--|-------------------------------|--|-----------------------------|
| AASB 9       | Financial Instruments   | <p>AASB 9 includes requirements for the classification and measurement of financial assets resulting from the first part of Phase 1 of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement (AASB 139 Financial Instruments: Recognition and Measurement).</p> <p>These requirements improve and simplify the approach for classification and measurement of financial assets compared with the requirements of AASB 139. The main changes from AASB 139 are described below.</p> <p>(a) Financial assets are classified based on (1) the objective of the entity's business model for managing the financial assets; (2) the characteristics of the contractual cash flows. This replaces the numerous categories of financial assets in AASB 139, each of which had its own classification criteria.</p> <p>(b) AASB 9 allows an irrevocable election on initial recognition to present gains and losses on investments in equity instruments that are not held for trading in other comprehensive income. Dividends in respect of these investments that are a return on investment can be recognised in profit or loss and there is no impairment or recycling on disposal of the instrument.</p> <p>(c) Financial assets can be designated and measured at fair value through profit or loss at initial recognition if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would arise from measuring assets or liabilities, or recognising the gains and losses on them, on different bases.</p> | 1 January 2013                | These amendments may have an impact on the Group, however the Group has not yet assessed the impact. | 1 January 2013              |
| AASB 2009-11 | Amendments to Australian Accounting Standards arising from AASB 9 [AASB 1, 3, 4, 5, 7, 101, 102, 108, 112, 118, 121, 127, 128, 131, 132, 136, 139, 1023 & 1038 and Interpretations 10 & 12] | <p>► These amendments arise from the issuance of AASB 9 <i>Financial Instruments</i> that sets out requirements for the classification and measurement of financial assets. The requirements in AASB 9 form part of the first phase of the International Accounting Standards Board's project to replace IAS 39 <i>Financial Instruments: Recognition and Measurement</i>.</p> <p>► <u>This Standard shall be applied when AASB 9 is applied</u></p>   | 1 January 2013                | These amendments may have an impact on the Group, however the Group has not yet assessed the impact. | 1 January 2013              |

| Reference          | Title   | Summary   | Application date of standard* | Impact on Group financial report   | Application date for Group* |
|--------------------|---|---|-------------------------------|--|-----------------------------|
| AASB 124 (Revised) | Related Party Disclosures (December 2009)   | <p>The revised AASB 124 simplifies the definition of a related party, clarifying its intended meaning and eliminating inconsistencies from the definition, including:</p> <ul style="list-style-type: none"> <li>(a) The definition now identifies a subsidiary and an associate with the same investor as related parties of each other</li> <li>(b) Entities significantly influenced by one person and entities significantly influenced by a close member of the family of that person are no longer related parties of each other</li> <li>(c) The definition now identifies that, whenever a person or entity has both joint control over a second entity and joint control or significant influence over a third party, the second and third entities are related to each other</li> </ul> <p>A partial exemption is also provided from the disclosure requirements for government-related entities. Entities that are related by virtue of being controlled by the same government can provide reduced related party disclosures.</p> | 1 January 2011                | These amendments may have an impact on the Group, however the Group has not yet assessed the impact.         | 1 January 2011              |
| AASB 2009-12       | Amendments to Australian Accounting Standards<br>[AASBs 5, 8, 108, 110, 112, 119, 133, 137, 139, 1023 & 1031 and Interpretations 2, 4, 16, 1039 & 1052] | <p>This amendment makes numerous editorial changes to a range of Australian Accounting Standards and Interpretations.</p> <p>In particular, it amends AASB 8 <i>Operating Segments</i> to require an entity to exercise judgement in assessing whether a government and entities known to be under the control of that government are considered a single customer for the purposes of certain operating segment disclosures. It also makes numerous editorial amendments to a range of Australian Accounting Standards and Interpretations, including amendments to reflect changes made to the text of IFRS by the IASB.</p>  | 1 January 2011                | Some of these amendments may have an impact on the Group, however the Group has not yet assessed the impact. | 1 January 2011              |

| Reference | Title   | Summary  | Application date of standard* | Impact on Group financial report  | Application date for Group* |
|-----------|---|--|-------------------------------|---|-----------------------------|
| AASB 1053 | Application of Tiers of Australian Accounting Standards | <p>This Standard establishes a differential financial reporting framework consisting of two Tiers of reporting requirements for preparing general purpose financial statements:</p> <p>(a) Tier 1: Australian Accounting Standards</p> <p>(b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements</p> <p>Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.</p> <p>The following entities apply Tier 1 requirements in preparing general purpose financial statements:</p> <p>(a) For-profit entities in the private sector that have public accountability (as defined in this Standard)</p> <p>(b) The Australian Government and State, Territory and Local Governments</p> <p>The following entities apply either Tier 2 or Tier 1 requirements in preparing general purpose financial statements:</p> <p>(a) For-profit private sector entities that do not have public accountability</p> <p>(b) All not-for-profit private sector entities</p> <p>(c) Public sector entities other than the Australian Government and State, Territory and Local Governments</p> | 1 July 2013                   | Phosphagenics Limited (the parent) is a company limited by shares and the shares are publicly traded on the Australian Stock Exchange therefore the Group has public accountability and will apply the Tier 1 requirements in preparing general purpose financial statements. | 1 January 2014              |

| Reference   | Title   | Summary  | Application date of standard* | Impact on Group financial report   | Application date for Group* |
|-------------|---|--|-------------------------------|--|-----------------------------|
| AASB 2010-4 | Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project [AASB 1, AASB 7, AASB 101, AASB 134 and Interpretation 13]                                 | <p>Emphasises the interaction between quantitative and qualitative AASB 7 disclosures and the nature and extent of risks associated with financial instruments.</p> <p>Clarifies that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements.</p> <p>Provides guidance to illustrate how to apply disclosure principles in AASB 134 for significant events and transactions</p> <p>Clarifies that when the fair value of award credits is measured based on the value of the awards for which they could be redeemed, the amount of discounts or incentives otherwise granted to customers not participating in the award credit scheme, is to be taken into account.</p> | 1 January 2011                | Some of these amendments may have an impact on the Group, however the Group has not yet assessed the impact. | 1 January 2011              |
| AASB 2010-5 | Amendments to Australian Accounting Standards<br><br>[AASB 1, 3, 4, 5, 101, 107, 112, 118, 119, 121, 132, 133, 134, 137, 139, 140, 1023 & 1038 and Interpretations 112, 115, 127, 132 & 1042] | <p>This Standard makes numerous editorial amendments to a range of Australian Accounting Standards and Interpretations, including amendments to reflect changes made to the text of IFRS by the IASB.</p> <p>These amendments have no major impact on the requirements of the amended pronouncements.</p>  | 1 January 2011                | These amendments may have an impact on the Group, however the Group has not yet assessed the impact.         | 1 January 2011              |

# Notes to the consolidated financial statements

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (c) Basis of consolidation

The consolidated financial statements comprise the financial statements of Phosphagenics Limited and its subsidiaries as at and for the period ended 31 December each year ('the Group').

Subsidiaries are all those entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether a group controls another entity.

The financial statements of subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

In preparing the consolidated financial statements, all intercompany balances and transactions, income and expenses and profit and losses resulting from intra-group transactions have been eliminated in full.

Investments in subsidiaries held by Phosphagenics Limited are accounted for at cost in the separate financial statements of the parent entity less any impairment charges.

### (d) Operating Segments – refer note 18

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance and for which discrete financial information is available. Management will also consider other factors in determining operating segments such as the existence of a line manager and the level of segment information presented to the board of directors.

Operating segments that meet the quantitative criteria as prescribed by AASB 8 are reported separately. However, an operating segment that does not meet the quantitative criteria is still reporting separately where information about the segment would be useful to users of the financial statements.

Information about other business activities and operating segments that are below the quantitative criteria are combined and disclosed in a separate category for "all other segments".

### (e) Significant accounting judgements, estimates and assumptions

The carrying amounts of certain assets and liabilities are often determined based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

#### *Impairment of intangibles with indefinite useful lives*

The Group determines whether intangible assets with indefinite useful lives, and intangible assets not yet available for use, are impaired at least on an annual basis. This requires an estimation of the recoverable amount of the cash-generating unit to which the goodwill is allocated. The assumptions used in this estimation of recoverable amount and the carrying amount of goodwill and intangibles with indefinite useful lives are discussed in note 10.

#### *Share-based payment transactions*

The Group measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by using the Binomial method taking into account the terms and conditions upon which the instruments were granted, as discussed in note 5. The accounting estimates and assumptions relating to equity-settled share-based payments would have no impact on the carrying amounts of assets and liabilities with the next annual reporting period but may impact expenses and equity.

# Notes to the consolidated financial statements

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *Development costs*

An intangible asset arising from development expenditure on an internal project is recognised only when Phosphagenics can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Any expenditure so capitalised is amortised over the period of expected future benefit from the related project on a straight line basis. The carrying value of capitalised developments costs not yet available for use is tested for impairment annually at 31 December.

### **(f) Cash and cash equivalents – refer note 20(a)**

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less, that are readily convertible to known amounts of cash and which are subject to an insignificant rate of change in value.

For the purposes of the Statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

### **(g) Provisions and employee benefits – refer note 12**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

When the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the reporting date. The discount rate used to determine the present value reflects the current market assessments of the time value of money and the risks specific to the liability. The increase in the provision resulting from the passage of time is recognised in finance costs.

### **Employee leave benefits**

#### *Wages, salaries and, annual leave.*

Liabilities for wages and salaries, including non-monetary benefits long service and annual leave expected to be settled within twelve months of the reporting date are recognised in respect of employees' services up to the reporting date. They are measured at the amounts expected to be paid when the liabilities are settled. Liabilities for non-accumulating sick leave are recognised when the leave is taken and are measured at the rates paid or payable.

#### *Long service leave*

The liability for long service leave is recognised and measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures, and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currencies that match, as closely as possible, the estimated future cash outflows.

# Notes to the consolidated financial statements

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### (h) Government grants

Government Grants are recognised in the statement of comprehensive income as grant revenue to offset the expenses they are intended to compensate.

### (i) Income Tax and other taxes – refer note 4

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities based on the current period's taxable income. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

Deferred income tax is provided on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

- except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets and unused tax losses can be utilised:

- except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Unrecognised deferred income tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Income taxes relating to items recognised directly in equity are recognised in equity and not in the statement of comprehensive income.

## Notes to the consolidated financial statements

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (j) Other taxes

Revenues, expenses and assets are recognised net of the amount of GST except:

- where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- 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 part of receivables or payables in the statement of financial position.

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

#### (k) Goodwill and intangibles – refer note 10

##### *Goodwill*

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to the cash-generating unit(s) that is expected to benefit from the synergies of the combination. Phosphagenics is viewed as a single cash-generation unit.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Phosphagenics performs its impairment testing as at 31 December each year using a value in use, discounted cash flow methodology.

Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Impairment losses recognised for goodwill are not subsequently reversed.

##### *Intangible assets acquired both separately and from a business combination*

Intangible assets acquired separately or in a business combination are initially measured at cost. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangible assets, excluding capitalised development costs, are not capitalised and expenditure is recognised in profit or loss in the year in which the expenditure was incurred.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful life and tested for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for prospectively by changing the amortisation period or method, as appropriate, which is a change in accounting estimate. The amortisation expense on intangible assets with finite lives is recognised in profit or loss in the expense category consistent with the function of the intangible asset.

## Notes to the consolidated financial statements

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed each reporting period to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate and is thus accounted for on a prospective basis.

#### *Research and Development costs*

Research costs are expensed as incurred. An intangible asset arising from development expenditure on an internal project is recognised only when Phosphagenics can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development. Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure so capitalised is amortised over the period of expected benefit from the related project.

The carrying value of an intangible asset arising from development expenditure is tested for impairment annually when the asset is not yet available for use, or more frequently when an indication of impairment arises during the reporting period.

A summary of the policies applied to the Group's intangible assets is as follows:

| Item                             | Intellectual Property   | Development Costs   |
|----------------------------------|---|---|
| Useful Life                      | Finite  | Finite  |
| Amortisation method used         | Amortised once significant revenues are generated over the remaining patent life on a straight-line basis | Amortised over the period of expected future benefit from the related project on a straight-line basis  |
| Internally generated or acquired | Acquired  | Internally generated  |
| Impairment testing               | Annually as at 31 December and more frequently when an indication of impairment exists                    | Annually as at 31 December for assets not yet available for use and more frequently when an indication of impairment exists. The amortisation method is reviewed at each financial year-end |

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the profit and loss when the asset is derecognised.

#### **(I) Impairment of non- financial assets other than goodwill**

Intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The Group conducts an annual review of asset values, which is used as a source of information to assess for any indicators of impairment. External factors, such as changes in expected future processes, technology and economic conditions, are also monitored to assess for indicators of impairment. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

## Notes to the consolidated financial statements

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that have previously been impaired are tested for possible reversal of the impairment whenever events or changes in circumstances indicate that the impairment may have reversed.

#### (m) Investments and other financial assets

Investments and other financial assets in the scope of AASB 139 *Financial Instruments: Recognition and Measurement* are categorised as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired or originated. Designation is re-evaluated at each reporting date, but there are restrictions on reclassifying to other categories.

When financial assets are recognised initially, they are measured at fair value, plus, in the case of assets not at fair value through profit or loss, directly attributable transaction costs.

##### (i) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets, principally equity securities, that are designated as available-for-sale or are not classified as any of the three preceding categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is recognised in profit or loss.

The fair value of investments that are actively traded in organised financial markets are determined by reference to quoted market bid prices at the close of business on the reporting date.

#### (n) Trade and other payables – refer note 12

Trade payables and other payables are carried at amortised costs and are not discounted due to their short term nature. They represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid and arise when the Group becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are not secured and are usually paid within 30 days of recognition.

#### (o) Share-based payment transactions – refer note 5

The Group provides benefits to its employees, including Key Management Personnel (KMP), in the form of share-based payments, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions). There is currently one plan in place to provide these benefits being the Employee Share Option Plan (ESOP), which provides benefits to key management personnel.

In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of Phosphagenics Limited (market conditions) if applicable. The cost of these equity-settled transactions with employees is measured by reference to the fair value of the equity instruments at the date at which they are granted. The fair value is determined by an external valuer using a binomial model, further details of which are given in note 5. The cost of equity-settled transactions is recognised together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled (the vesting period), ending on the date on which the relevant employees become fully entitled to the award (the vesting date).

At each subsequent reporting date until vesting, the cumulative charge to the statement of comprehensive income is the product of:

- (i) The grant date fair value of the award.
- (ii) The current best estimate of the number of awards that will vest, taking into account such factors as the likelihood of employee turnover during the vesting period.
- (iii) The expired portion of the vesting period.

# Notes to the consolidated financial statements

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The charge to the statement of comprehensive income for the period is the cumulative amount as calculated above less the amounts already charged in previous periods. There is a corresponding entry to equity.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new award are treated as if they were a modification of the original award, as described in the previous paragraph.

Options are considered anti-dilutive and therefore have not been included in the calculation of diluted earnings per share for 2009 and 2010, refer note 15.

### (p) Leases – refer note 16

Leases where the lessor retains substantial risks and reward of ownership are classified as operating leases. Operating lease payments are recognised as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

### (q) Inventories – refer note 8

Inventories including raw materials, work in progress and finished goods are valued at the lower of cost and net realisable value. Costs incurred in bringing each product to its present location and condition are accounted for as follows:

#### *Raw materials*

Purchase cost on a first-in, first-out basis. The cost of purchase comprises the purchase price including, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), transport, handling and other costs directly attributable to the acquisition of raw materials. Volume discounts and rebates are included in determining the cost of purchase.

#### *Finished goods and work-in-progress*

Cost of direct materials, labour and a proportion of variable and fixed manufacturing overheads based on normal operating capacity.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

### (r) Trade and other receivables – refer note 7

Trade receivables, which generally have thirty to sixty day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less an allowance for impairment.

Collectability of trade receivables is reviewed on an ongoing basis. Individual debts that are known to be uncollectible are written off when identified. An impairment provision is recognised when there is objective evidence that the Group will not be able to collect the receivable. Financial difficulties of the debtor, default payments or debts more than ninety days overdue are considered objective evidence of impairment. The amount of the impairment loss is the receivable carrying amount compared to the present value of estimated future cash flows, discounted at the original effective interest rate.

### (s) Plant and Equipment – refer note 9

Plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a diminishing value basis as follows:

Computer Equipment – 33% p.a.  
 Plant and equipment – 20% p.a.  
 Office Equipment - 20% p.a.

# Notes to the consolidated financial statements

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The assets' residual values, useful lives and amortisation methods are reviewed, and adjusted if appropriate, at each reporting period. When no future economic benefits are expected to arise from the continued use of an item of property, plant and equipment, it is derecognised. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the statement of comprehensive income in the year the item is derecognised.

### (t) Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

#### *Sale of goods*

Revenue from the sale of goods is recognised when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods and the costs in respect of the transaction can be reliably measured. Risks and rewards are considered passed to the buyer at the time of delivery of the goods to the customer.

#### *Royalties*

Royalty revenue is recognised on an accrual basis in accordance with the substance of the relevant agreement.

#### *Interest income*

Revenue is recognised as the interest accrues (using the effective interest method, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset) to the net carrying amount of the financial asset.

### (v) Contributed equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

### (w) Foreign currency translation

#### *Functional and presentation currency*

Both the functional and presentation currency of Phosphagenics Limited and its Australian subsidiaries is Australian dollars (\$). The United States subsidiaries functional currency is United States Dollars which is translated to the presentation currency.

#### *Transactions and balances*

Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the reporting date. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

#### *Translation of Group Companies functional currency to presentation currency*

The results of the United States subsidiary are translated into Australian Dollars as at the date of each transaction. Assets and liabilities are translated at exchange rates prevailing at reporting date. Exchange variations resulting from the translation are recognised in the foreign currency translation reserve in equity.

On consolidation, exchange differences arising from the translation of the net investment in the United States subsidiary are taken to the foreign currency translation reserve. If the United States subsidiary were sold, the proportionate share of exchange differences would be transferred out of equity and recognised in the statement of comprehensive income.

### (x) Earnings per share

Basic earnings per share is calculated as net loss attributable to members of the parent divided by the weighted average number of ordinary shares. Where the Group generates a loss attributable to members of the parent, basic and diluted earnings per share are the same as a loss attributable to members of the parent cannot be further diluted.

## Notes to the consolidated financial statements

### 3. OTHER REVENUE AND EXPENSES

|   | 2010<br>\$'000's | 2009<br>\$'000's |
|---|------------------|------------------|
| <b>(a) Licences</b>   |                  |                  |
| Licences – ProPhase Labs <sup>1</sup>   | 4,241            | -                |
| Licences – Other  | 145              | -                |
| <b>Total</b>  | <b>4,386</b>     | <b>-</b>         |
| <sup>1</sup> The licence revenue relates to a one-time payment to Phosphagenics of approximately \$1.09 million (US\$1 million) and the issuance to Phosphagenics of 1.44 million shares in ProPhase Labs common stock which based on market price at the contract signing date was valued at approximately \$3.149 million. These shares are recognised as an available-for-sale investment at 31 December 2010. |                  |                  |
| <b>(b) Other Income</b>   |                  |                  |
| Rental income   | -                | 113              |
| Other   | 187              | 197              |
| <b>Total</b>  | <b>187</b>       | <b>310</b>       |
| <b>(c) Other Expenses</b>   |                  |                  |
| Net foreign exchange gains/(losses)   | (91)             | (106)            |
| Depreciation  | (300)            | (365)            |
| Loss on disposal of plant & equipment   | -                | (39)             |
| Amortisation  | (66)             | (101)            |
| Operating lease rental expenses   | (342)            | (490)            |
| Travel  | (124)            | (183)            |
| Other   | (55)             | (30)             |
| <b>Total</b>  | <b>(978)</b>     | <b>(1,314)</b>   |

### 4. INCOME TAXES

|  | 2010<br>\$'000's | 2009<br>\$'000's |
|--|------------------|------------------|
| Major components of income tax expense are:  |                  |                  |
| <i>Current income tax</i>  | -                | -                |
| <i>Deferred income tax</i>   |                  |                  |
| Relating to origination and reversal of temporary differences  | (2,298)          | -                |
| Income tax expense recorded in the statement of comprehensive income   | <b>(2,298)</b>   | <b>-</b>         |
| The prima facie income tax expense/(benefit) on pre-tax accounting profit from operations reconciles to the income tax expense in the financial statements as follows: |                  |                  |
| Accounting (loss) before income tax  | (13,573)         | (8,501)          |
| Income tax expense calculated at 30% (2009: 30%)   | (4,072)          | (2,550)          |
| Non-deductible expenses  | 558              | 159              |
| Research & development deduction   | (223)            | (259)            |
| Unused tax losses and tax offsets not recognised as deferred tax assets  | 1,439            | 2,650            |
| Income tax benefit reported in income statement  | <b>(2,298)</b>   | <b>-</b>         |
| <b>Deferred tax liabilities comprise:</b>  |                  |                  |
| Intellectual property  | 13,830           | 16,128           |
|  | <b>13,830</b>    | <b>16,128</b>    |

## Notes to the consolidated financial statements

### 4. INCOME TAXES (continued)

#### Unrecognised deferred tax balances

The following items have not been brought to account as deferred tax assets:

|                                      |               |               |
|--------------------------------------|---------------|---------------|
| Tax losses not recognised            | 16,891        | 15,452        |
| Temporary differences not recognised | -             | -             |
| <b>Total</b>                         | <b>16,891</b> | <b>15,452</b> |

#### Tax consolidation

The company and its wholly-owned Australian resident entities have not formed a tax-consolidated group and are therefore taxed as separate entities.

### 5. SHARE BASED PAYMENTS

The Group provides benefits to service providers in the form of share-based payments. Employees render services in exchange rights over shares (equity-settled transactions). There is currently one plan in place to provide these benefits to employees, being the Employee Share Option Plan (ESOP). The ESOP is designed to align participants' interests with those of shareholders by increasing the value of the Company's shares. Share options carry no rights to dividends and no voting rights.

Options held by directors of the parent and its subsidiaries were acquired as part of the original subscriptions for shares in Phosphagenics Limited in 1999. Subsequently, all options granted to key management personnel have been issued in accordance with the provisions of the Employee Share Option Plan (ESOP).

#### Summary of options granted as share based payments

The following table illustrates the number (No.) and weighted average exercise prices (WAEP) of, and movements in, share options issued during the year.

| Item                                  | 2010<br>Options<br>No. | 2010<br>WAEP<br>\$ | 2009<br>Options<br>No. | 2009<br>WAEP<br>\$ |
|---------------------------------------|------------------------|--------------------|------------------------|--------------------|
| Outstanding at beginning of the year  | 12,350,000             | \$0.18             | 9,850,000              | \$0.19             |
| Granted during the year               | 15,000,000             | \$0.14             | 3,650,000              | \$0.15             |
| Forfeited during the year             | (900,000)              | \$0.15             | (1,150,000)            | \$0.18             |
| Exercised during the year             | -                      | -                  | -                      | -                  |
| Expired during the year               | (1,000,000)            | \$0.22             | -                      | -                  |
| <b>Outstanding at end of the year</b> | <b>25,450,000</b>      | <b>\$0.16</b>      | <b>12,350,000</b>      | <b>\$0.18</b>      |
| Exercisable at end of the year        | 15,450,000             | \$0.17             | 9,000,000              | \$0.22             |

When a participant in the employee share option plan ceases employment prior to the vesting of their share options, the share options are forfeited unless cessation of employment is due to retirement or death.

On 12 April 2010 15,000,000 options were granted to Southern Cross Equities Ltd, of which 5,000,000 vested at grant date.

## Notes to the consolidated financial statements

### 5. SHARE BASED PAYMENTS (continued)

The outstanding balance as at 31 December 2010 is represented by:

| Issuing entity    | Australian stock exchange listed | shares under option No. | Class of shares | Exercise price \$ | Expiry date  |
|-------------------|----------------------------------|-------------------------|-----------------|-------------------|--------------|
| Phosphagenics Ltd | unquoted                         | 500,000                 | Ordinary        | \$0.24            | 28 Mar 2011  |
| Phosphagenics Ltd | unquoted                         | 1,600,000               | Ordinary        | \$0.24            | 22 May 2011  |
| Phosphagenics Ltd | unquoted                         | 100,000                 | Ordinary        | \$0.36            | 28 Aug 2011  |
| Phosphagenics Ltd | unquoted                         | 1,300,000               | Ordinary        | \$0.26            | 06 June 2012 |
| Phosphagenics Ltd | unquoted                         | 15,000,000              | Ordinary        | \$0.14            | 31 Mar 2013  |
| Phosphagenics Ltd | unquoted                         | 1,900,000               | Ordinary        | \$0.15            | 17 Aug 2013  |
| Phosphagenics Ltd | unquoted                         | 2,400,000               | Ordinary        | \$0.15            | 17 June 2014 |
| Phosphagenics Ltd | unquoted                         | 2,650,000               | Ordinary        | \$0.13            | 30 June 2018 |
| <b>Total</b>      |                                  | <b>25,450,000</b>       |                 |                   |              |

#### Option pricing model

Share option fair values are calculated using a Binomial model. The options will be settled in ordinary shares of Phosphagenics Limited and vested options lapse if unexercised after the expiry date.

In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of Phosphagenics Limited.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled (the vesting period), ending on the date on which the relevant employees become fully entitled to the award (the vesting date).

A service period was determined as the most appropriate criteria to attach to the options given Phosphagenics is still developing its products for commercialisation. There are no other service or performance criteria attached to share based payment options.

| Model Inputs                                     | 2010 Other | 2009 ESOP | 2009 ESOP |
|--|------------|-----------|-----------|
| Dividend yield %                                 | 0.00%      | 0.00%     | 0.00%     |
| Expected volatility %                            | 61%        | 65%       | 65%       |
| Risk-free interest rate %                        | 5.30%      | 4.49%     | 4.49%     |
| Option life (years)                              | 3 years    | 8.5 years | 4.5 years |
| Option Exercise price \$                         | \$0.142    | \$0.137   | \$0.15    |
| Weighted Average Share price at measurement date | \$0.109    | \$0.126   | \$0.129   |

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur.

The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome.

## Notes to the consolidated financial statements

### 6. REMUNERATION OF AUDITORS

The auditor of Phosphagenics Ltd (the parent), and the Group is Ernst & Young.

| <b>Amounts received or due and receivable by Ernst &amp; Young</b> | <b>2010</b>    | <b>2009</b>   |
|--|----------------|---------------|
|  | \$             | \$            |
| Audit or review of the financial report                            | 83,845         | 77,500        |
| Other non audit services   | -              | 4,500         |
| Taxation services  | 33,716         | 17,500        |
| <b>Total</b>   | <b>117,561</b> | <b>99,500</b> |

### 7. TRADE AND OTHER RECEIVABLES

| <b>Current</b>                           | <b>2010</b> | <b>2009</b> |
|--|-------------|-------------|
|  | \$'000      | \$'000      |
| Trade receivables                        | 30          | 99          |
| Allowance for impairment loss            | -           | -           |
|  | 30          | 99          |
| Other                                    | 4           | 4           |
| Goods and services tax (GST) recoverable | 271         | 189         |
| <b>Total</b>                             | <b>305</b>  | <b>292</b>  |

Trade receivables are non interest bearing and are generally 45 day terms or as specified in contracts or agreements.

#### *Allowance for impairment loss*

A provision for impairment is recognised when there is objective evidence (such as the probability of insolvency or significant financial difficulty of the debtor) that the Group may not be able to collect all the amounts due under the original terms of the invoice. Impaired debts are derecognised when they are assessed as uncollectible. No debts were impaired at 31 December 2010.

| <b>Period</b>    | <b>Total</b> | <b>Neither past due or impaired</b> | <b>Past due but not impaired</b> |                   |                    |
|------------------|--------------|-------------------------------------|----------------------------------|-------------------|--------------------|
|                  |              |                                     | <b>30-60 days</b>                | <b>60-90 days</b> | <b>90-120 days</b> |
|                  | \$'000       | \$'000                              | \$'000                           | \$'000            | \$'000             |
| 31 December 2010 | 30           | -                                   | 27                               | 3                 | -                  |
| 31 December 2009 | 99           | 22                                  | 77                               | -                 | -                  |

Other balances within trade and other receivables do not contain impaired assets and are not past due. It is expected that these other balances will be received when due.

#### *Fair value and credit risk*

Due to the short term nature of these receivables, their carrying value is assumed to approximate their fair value. The maximum exposure to credit risk is the fair value of receivables.

### 8. INVENTORIES

|                        | <b>2010</b> | <b>2009</b> |
|------------------------|-------------|-------------|
|                        | \$'000      | \$'000      |
| <b>Raw materials:</b>  |             |             |
| At cost                | 283         | 58          |
| <b>Finished goods:</b> |             |             |
| At cost                | 239         | -           |
| <b>Total</b>           | <b>522</b>  | <b>58</b>   |

## Notes to the consolidated financial statements

### 9. PLANT AND EQUIPMENT

| 2010  | Plant and<br>equipment<br>at cost<br>\$'000 | Total<br>\$'000 |
|---|---|-----------------|
| <b>Year ended 31 December 2010</b>                                  |   |                 |
| At 1 January 2010 net of accumulated depreciation and impairment    | 1,445                                       | 1,445           |
| Additions   | 153   | 153             |
| Disposals   | -   | -               |
| Depreciation charge for the year                                    | (300)                                       | (300)           |
| At 31 December 2010, net of accumulated depreciation and impairment | <u>1,298</u>                                | <u>1,298</u>    |
| <b>At 31 December 2010</b>  |   |                 |
| Cost  | 2,566                                       | 2,566           |
| Accumulated depreciation and impairment                             | (1,268)                                     | (1,268)         |
| Net carrying value  | <u>1,298</u>                                | <u>1,298</u>    |

| 2009  | Plant and<br>equipment<br>at cost<br>\$'000 | Total<br>\$'000 |
|---|---|-----------------|
| <b>Year ended 31 December 2009</b>                                  |   |                 |
| At 1 January 2009 net of accumulated depreciation and impairment    | 1,761                                       | 1,761           |
| Additions   | 88  | 88              |
| Disposals   | (39)  | (39)            |
| Depreciation charge for the year                                    | (365)                                       | (365)           |
| At 31 December 2009, net of accumulated depreciation and impairment | <u>1,445</u>                                | <u>1,445</u>    |
| <b>At 31 December 2009</b>  |   |                 |
| Cost  | 2,414                                       | 2,414           |
| Accumulated depreciation and impairment                             | (969)                                       | (969)           |
| Net carrying value  | <u>1,445</u>                                | <u>1,445</u>    |

## Notes to the consolidated financial statements

### 10. INTANGIBLE ASSETS

| 2010  | Intellectual<br>Property<br>\$000 | Development<br>costs<br>\$000 | Total<br>\$000 |
|---|-----------------------------------|-------------------------------|----------------|
| <b>Balance at 1 January 2010 net of accumulated amortisation and impairment</b>   | 52,062                            | 2,310                         | 54,372         |
| Additions internally developed  | -                                 | 400                           | 400            |
| Provision for impairment  | (6,485)                           | (1,175)                       | (7,660)        |
| Amortisation  | -                                 | (66)                          | (66)           |
|   | <hr/>                             | <hr/>                         | <hr/>          |
| <b>Balance at 31 December 2010 net of accumulated amortisation and impairment</b> | <b>45,577</b>                     | <b>1,469</b>                  | <b>47,046</b>  |
|   | <hr/>                             | <hr/>                         | <hr/>          |
| <b>At 31 December 2010</b>  |                                   |                               |                |
| Cost (gross carrying amount)  | 121,362                           | 3,295                         | 124,657        |
| Accumulated amortisation and impairment   | (75,785)                          | (1,826)                       | (77,611)       |
| Net carrying amount   | <u>45,577</u>                     | <u>1,469</u>                  | <u>47,046</u>  |

| 2009  | Intellectual<br>Property<br>\$'000 | Development<br>costs<br>\$'000 | Total<br>\$'000 |
|---|------------------------------------|--------------------------------|-----------------|
| <b>Balance at 1 January 2009 net of accumulated amortisation and impairment</b>   | 52,062                             | 1,856                          | 53,918          |
| Additions   | -                                  | 555                            | 555             |
| Provision for impairment  | -                                  | -                              | -               |
| Amortisation  | -                                  | (101)                          | (101)           |
|   | <hr/>                              | <hr/>                          | <hr/>           |
| <b>Balance at 31 December 2009 net of accumulated amortisation and impairment</b> | <b>52,062</b>                      | <b>2,310</b>                   | <b>54,372</b>   |
|   | <hr/>                              | <hr/>                          | <hr/>           |
| <b>At 31 December 2009</b>  |                                    |                                |                 |
| Cost (Gross carrying amount)  | 121,362                            | 2,895                          | 124,257         |
| Accumulated amortisation and impairment   | (69,300)                           | (585)                          | (69,885)        |
| Net carrying amount   | <u>52,062</u>                      | <u>2,310</u>                   | <u>54,372</u>   |

#### Impairment Testing

Intangible assets with an indefinite useful life, or an intangible asset not yet available for use, are tested for impairment by comparing the asset carrying amount with its recoverable amount. Impairment indicators are used to help determine whether there is any indication that an asset may be impaired.

#### *Intellectual Property*

Intellectual property assets represent the fair value of patents acquired by the Company at 31 December 2004.

## Notes to the consolidated financial statements

### 10. INTANGIBLE ASSETS (continued)

Intangible assets are tested for impairment at least annually at 31 December, or earlier where an indicator of impairment arises. The recoverable amount has been determined by calculation of the value in use being the present value of future cash flows expected to be derived from intangible assets, excluding expansionary activities, finance costs and income tax.

An Independent valuer was engaged by the Company to calculate asset recoverable amounts. Asset recoverable amounts (value in use) are calculated using discounted cash flow methodology, and applying sensitivity analysis to various input assumptions.

Key assumptions of these valuations include:

- management opinion on future cash flows on a product by product basis
- different residual lifetime of acquired patents
- allocation of products' value to underlying patents
- probability adjustments (ranging from 0.225 to 1.00) to individual cash flows, reflecting various types of risks
- no terminal value

The pre-tax discount rate used was 20%, based on:

- the required rates of return on listed companies in a similar business
- the indicative rates of return required by suppliers of venture capital
- the Groups current level of financial gearing

Recoverable amounts were assessed from both a single cash generating unit as well as individual patent asset perspectives. Due to reprioritising development and commercialisation of particular patents, the Company's Directors have decided to apply a conservative approach to valuing the recoverable amounts of the specific acquired patents.

Consequently, the Directors have decided to decrease the carrying value of the acquired patent assets from the December 2009 value of \$53.7 million, to \$47.0 million. The decrease in asset value of \$7.66 million (2009: \$Nil) is recognised as an expense and has no cash impact on the Company.

#### *Development costs*

Development expenditure on an internal project is recognised as an intangible asset only when Phosphagenics can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the development and the ability to measure reliably the expenditure attributable to the intangible asset during its development.

Development expenditure is tested for impairment annually, when the asset is not yet available for use, or more frequently when an indication of impairment arises during the reporting period. At 31 December 2010 zero development costs were impaired and recognised as an expense (2009: Nil).

### 11. AVAILABLE-FOR-SALE INVESTMENT

|                                | 2010<br>\$'000's | 2009<br>\$'000's |
|--------------------------------|------------------|------------------|
| <b>Share – US listed</b>       |                  |                  |
| Fair value at acquisition date | 3,149            | -                |
| Impairment                     | (1,449)          | -                |
| <b>Shares – at fair value</b>  | <b>1,700</b>     | <b>-</b>         |

Available-for-sale investments consist of investments in ordinary shares, and therefore have no fixed maturity date or coupon rate. The US listed securities expose the Group to foreign exchange risk.

## Notes to the consolidated financial statements

### 11. AVAILABLE-FOR-SALE INVESTMENT (continued)

#### (a) Listed shares

The fair value of listed available-for-sale investments has been determined directly by reference to published price quotations in an active market.

### 12. CURRENT TRADE AND OTHER PAYABLES

|                                      | 2010<br>\$'000 | 2009<br>\$'000 |
|--------------------------------------|----------------|----------------|
| Trade payables                       | 548            | 989            |
| Accrued expenses                     | 92             | 83             |
| Goods and services tax (GST) payable | 2              | -              |
| Other                                | 174            | 79             |
| <b>Total</b>                         | <b>816</b>     | <b>1,151</b>   |

Due to the short-term nature of these payables, their carrying value is assumed to approximate their fair value.

No interest is charged on the trade payables and the consolidated entity has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

Other payables are non-trade payables and non-interest bearing. There were no related party payables at 31 December 2010.

### 13. CURRENT PROVISIONS

| CURRENT                     | 2010<br>\$'000 | 2009<br>\$'000 |
|-----------------------------|----------------|----------------|
| Annual leave benefits       | 98             | 86             |
| Long service leave benefits | 17             | 10             |
| <b>Total</b>                | <b>115</b>     | <b>96</b>      |

### 14. CONTRIBUTED EQUITY

| Fully paid ordinary shares   | 2010<br>No. '000's | 2010<br>\$'000 | 2009<br>No. '000's | 2009<br>\$'000 |
|------------------------------|--------------------|----------------|--------------------|----------------|
| Balance at beginning of year | 739,696            | 176,905        | 663,542            | 170,316        |
| Issue of shares              | -                  | -              | 76,087             | 7,000          |
| Exercise of options          | -                  | -              | 67                 | 14             |
| Capital raising costs        | -                  | -              | -                  | (425)          |
| Balance at end of year       | <b>739,696</b>     | <b>176,905</b> | <b>739,696</b>     | <b>176,905</b> |

Fully paid ordinary shares carry one vote per share and carry the right to dividends.

#### Share options

As at close of business on 31 December 2010 there were a total of 25,450,000 unexercised unquoted options issued as share based payments, of which 14,450,000 options are fully vested and can be exercised at any time up to the date of expiry.

Share options carry no rights to dividends and no voting rights. For further details of share based payments refer to note 5.

## Notes to the consolidated financial statements

### 15. RESERVES

|   | 2010<br>\$'000 | 2009<br>\$'000 |
|---|----------------|----------------|
| <b>Reserves</b>   |                |                |
| Business combination  | 27,812         | 27,812         |
| Employee equity-settled benefits  | 1,056          | 946            |
| Other equity-settled benefits   | 249            | 46             |
| Foreign Currency Translation Reserve  | 9              | 29             |
|   | <u>29,126</u>  | <u>28,833</u>  |
| <b>Business combination reserve</b>   |                |                |
| Balance at beginning of year  | 27,812         | 27,812         |
| Balance at end of year  | <u>27,812</u>  | <u>27,812</u>  |
| The business combinations reserve is used to record fair value adjustments relating to the business combination   |                |                |
| <b>Employee equity-settled benefits reserve</b>   |                |                |
| Balance at beginning of year  | 946            | 580            |
| Share based payment expense   | 110            | 366            |
| Balance at end of year  | <u>1,056</u>   | <u>946</u>     |
| The employee share option and share plan reserve is used to record the value of equity benefits provided to employees and Directors as part of their remuneration. For further details refer to note 5 in the Financial Statements. |                |                |
| <b>Other equity-settled benefits reserve</b>  |                |                |
| Balance at beginning of year  | 46             | 46             |
| Share based payments  | 203            | -              |
| Balance at end of year  | <u>249</u>     | <u>46</u>      |
| The other equity-settled benefits reserve is used to record the value of equity benefits provided to suppliers as part of their remuneration.   |                |                |
| <b>Foreign Currency Translation Reserve</b>   |                |                |
| Balance at beginning of year  | 29             | 47             |
| Foreign Currency Translation  | (20)           | (18)           |
| Balance at end of year  | <u>9</u>       | <u>29</u>      |

The foreign currency translation reserve is used to record the translation from Phosphagenics Inc.'s functional currency into Phosphagenics Ltd's reporting currency.

### 16. EARNINGS PER SHARE

#### Basic earnings per share

Basic earnings per share is calculated by dividing the net loss, from continuing operations attributable to ordinary equity holders of the parent for the year, by the weighted average number of ordinary shares outstanding during the year.

## Notes to the consolidated financial statements

### 16. EARNINGS PER SHARE (continued)

#### Diluted earnings per share

Diluted earnings per share is calculated by dividing the net loss attributable to ordinary shareholders by the weighted average number of ordinary shares on issue during the year (adjusted for the effects of dilutive options). There are

no instruments (e.g., share options) excluded from the calculation of diluted earnings per share that could potentially dilute basic earnings per share in the future because they are antidilutive for either of the periods presented.

There have been no transactions involving ordinary shares or potential ordinary shares that would significantly change the number of ordinary shares or potential ordinary shares outstanding between the reporting date and the date of completion of these financial statements.

| <b>Loss used in calculating earnings per share</b>  | <b>2010<br/>\$'000's</b>   | <b>2009<br/>\$'000's</b>   |
|---|----------------------------|----------------------------|
| Net Loss from continuing operations attributable to ordinary equity holders for the calculation of basic and diluted earnings per share | (11,275)                   | (8,501)                    |
| <b>Weighted average number of shares</b>  | <b>2010<br/>No. '000's</b> | <b>2009<br/>No. '000's</b> |
| Weighted average number of ordinary shares for the purposes of basic earnings per share   | 739,696                    | 681,716                    |
| Effect of dilution:   |                            |                            |
| Share options   | 22,352                     | 70,997                     |
| Weighted average number of ordinary shares adjusted for the effect of dilution  | 762,048                    | 752,713                    |

#### Information on the classification of securities

Options quoted on the ASX and options granted to employees and other service providers are considered to be potential ordinary shares and have been included in the determination of diluted earnings per share to the extent they are dilutive. These options have not been included in the determination of basic earnings per share.

### 17. COMMITMENTS FOR EXPENDITURE

#### Operating Leases

Non-cancellable operating leases relate to the rent of commercial property used for business operations.

| <b>Non-cancellable operating lease payments</b> | <b>2010<br/>\$'000's</b> | <b>2009<br/>\$'000's</b> |
|---|--------------------------|--------------------------|
| Within 1 year                                   | 226                      | 243                      |
| After 1 year but not more than 5 years          | -                        | 160                      |
| After more than 5 years                         | -                        | -                        |
| Total minimum lease payments                    | <u>226</u>               | <u>403</u>               |

# Notes to the consolidated financial statements

## 18. OPERATING SEGMENTS

### Identification of reportable segments

The group has identified its operating segments based on the internal reports that are reviewed and used by the Chief Executive Officer and his management team (the chief operating decision makers) in assessing the performance and in determining the allocation of resources.

The operating segments are identified by management based on the group's risks and returns that are affected predominantly by differences in the products and services provided. The reportable segments are based on aggregated operating segments determined according to the nature of the products and services provided, with each reportable segment representing a strategic business unit that offers different products and serves different markets.

### Types of products and services

#### Nutraceuticals

Nutraceuticals is the use of vitamins and nutritious products to improve human health. The nutraceutical business is developing active ingredients for the following market segments:

- Dietary Supplements - e.g. vitamin capsules & tablets. Phosphagenics is using its patented technology to orally deliver dietary supplements aimed at improving bioavailability and efficacy.
- Functional Foods and Beverages - e.g. nutritionally enhanced foods. Functional foods are an expanding nutraceutical market division, aimed at improving the nutritional benefits of everyday foods.
- Personal care products. Discovery research at Phosphagenics has shown that  $\alpha$ -tocopheryl phosphate (TP) is a natural molecule with increased activity over standard Vitamin E ( $\alpha$  tocopherol). TP has scientifically proven anti-inflammatory properties, it reduces redness, protects against UV induced photo damage, and also helps to heal and prevent acne. The structure of TP allows it to act as a penetration enhancer, increasing dermal absorption compared to tocopherol acetate and  $\alpha$ -tocopherol, allowing it to penetrate deeper into the skin for increased action. TP is also able to increase the penetration of molecules formulated in the same cream.

In April 2010 Phosphagenics launched its own brand of cosmetic products in Australia (Elixia®) sold exclusively through Pulse Pharmacies. Phosphagenics' nutraceutical business is a revenue-generating growth business. The route to market for Phosphagenics' nutraceutical products is through partnering with companies that have established distribution networks within the relevant market segments.

#### Pharmaceuticals

Phosphagenics' pharmaceutical segment is focused on:

- Drug delivery – enhancing the delivery of existing drugs orally or through the skin, utilising Phosphagenics' delivery technology TPM™
- Drug enhancement – augmenting the biological activity of existing drugs by adding a phosphate group to the chemical structure of the drug

The route to market for Phosphagenics' pharmaceutical products is through partnering with larger pharmaceutical companies at the appropriate stage in a product's development so as to maximise return on the Company's research and development investment.

The core competencies of the pharmaceutical business are generation of pharmaceutical intellectual property and translation of this knowledge base into commercially viable product candidates for the treatment of human conditions and disease.

Phosphagenics' strategy is to capitalise on its proprietary technology through joining its resources and development capabilities with co-development partners or licensees.

## Notes to the consolidated financial statements

### 18. OPERATING SEGMENTS (continued)

The objective of any development or marketing agreement entered into is to generate revenues from three sources:

- milestone payments and development fees during the pre-marketing phases of product development;
- royalties on product sales by partners; and
- manufacturing and supply of product to partners, predominantly of the phosphorylated delivery compound.

Phosphagenics choice of development products is based on market opportunity and the overall commercial viability of each individual drug candidate, including assessment of the current and expected competition for the product, the cost, timing and degree of difficulty to commercialise the product, the patent status of the drug compound and the market size of the product to be developed.

#### Accounting policies and inter-segment transactions

Accounting policies used by the Group in reporting segments are contained in note 1 to the accounts.

#### Major customers

The Group has a number of customers to which it provides products and services. The most significant client accounts for 58% (2009: 100%) of external revenue within the nutraceuticals operating segment. The next most significant client accounts for 27% (2009: Nil) of external revenue within the nutraceuticals operating segment.

#### Business segments

| 2010   | Nutraceuticals<br>\$'000's | Pharmaceuticals<br>\$'000's | Unallocated<br>\$'000's | Total Group<br>\$'000's |
|--|----------------------------|-----------------------------|-------------------------|-------------------------|
| <b>Revenue</b>                               |                            |                             |                         |                         |
| Sales and Royalties                          | 554                        | 4,251                       | -                       | 4,805                   |
| Grant Income                                 | -                          | 161                         | -                       | 161                     |
| <b>Total segment revenue</b>                 | <b>554</b>                 | <b>4,421</b>                | <b>-</b>                | <b>4,966</b>            |
| <b>Net operating profit/(loss) after tax</b> | <b>(5,821)</b>             | <b>(2,154)</b>              | <b>(3,300)</b>          | <b>(11,275)</b>         |
| Interest revenue                             | -                          | -                           | 314                     | 314                     |
| Depreciation and amortisation                | (280)                      | (66)                        | (20)                    | (366)                   |
| <b>Segment assets</b>                        | <b>799</b>                 | <b>1,055</b>                | <b>51,914</b>           | <b>53,768</b>           |
| Capital Expenditure                          | -                          | 132                         | 21                      | 153                     |
| <b>Segment liabilities</b>                   | <b>242</b>                 | <b>281</b>                  | <b>14,238</b>           | <b>14,761</b>           |
| <b>Cash flow information</b>                 |                            |                             |                         |                         |
| Net cash flow from Operating activities      | (1,297)                    | (3,495)                     | (3,548)                 | (8,340)                 |
| Net cash flow from investing activities      | -                          | (82)                        | 293                     | 211                     |
| Net cash flow from financing activities      | -                          | -                           | -                       | -                       |

## Notes to the consolidated financial statements

### 18. OPERATING SEGMENTS (continued)

| 2009                                    | Nutraceuticals<br>\$'000's | Pharmaceuticals<br>\$'000's | Unallocated<br>\$'000's | Total Group<br>\$'000's |
|---|----------------------------|-----------------------------|-------------------------|-------------------------|
| <b>Revenue</b>                          |                            |                             |                         |                         |
| Sales and Royalties                     | 670                        | -                           | -                       | 670                     |
| Grant Income                            | -                          | 304                         | -                       | 304                     |
| <b>Total segment revenue</b>            | <b>670</b>                 | <b>304</b>                  | <b>-</b>                | <b>974</b>              |
| <b>Net operating loss after tax</b>     | <b>(2,647)</b>             | <b>(2,976)</b>              | <b>(2,840)</b>          | <b>(8,463)</b>          |
| Interest revenue                        | -                          | -                           | 430                     | 430                     |
| Depreciation and amortisation           | (341)                      | (101)                       | (24)                    | (466)                   |
| Write off of assets                     | -                          | -                           | (38)                    | (38)                    |
| <b>Segment assets</b>                   | <b>799</b>                 | <b>923</b>                  | <b>65,642</b>           | <b>67,364</b>           |
| Capital expenditure                     | 7                          | 74                          | 7                       | 88                      |
| <b>Segment liabilities</b>              | <b>24</b>                  | <b>786</b>                  | <b>16,565</b>           | <b>17,375</b>           |
| <b>Cash flow information</b>            |                            |                             |                         |                         |
| Net cash flow from Operating activities | (2,395)                    | (2,287)                     | (4,281)                 | (8,963)                 |
| Net cash flow from investing activities | (7)                        | (62)                        | 416                     | 347                     |
| Net cash flow from financing activities | -                          | -                           | 6,589                   | 6,589                   |

#### i) Segment revenue reconciliation to the statement of comprehensive income

| Reconciliation of revenue                | 2010<br>\$'000 | 2009<br>\$'000 |
|--|----------------|----------------|
| Total segment revenue                    | 4,966          | 974            |
| Other revenue from continuing activities | 314            | 430            |
| Total revenue                            | 5,280          | 1,404          |

Revenue from external customers by geographical locations is detailed below. Revenue is attributed to geographic location based on the location of the customers. The company does not have external revenues from external customers that are attributable to any foreign country other than as shown.

| Revenue by geographical location | 2010<br>\$'000 | 2009<br>\$'000 |
|----------------------------------|----------------|----------------|
| Australia                        | 566            | 734            |
| United States                    | 4,714          | 670            |
| Total revenue                    | 5,280          | 1,404          |

#### ii) Segment net operating profit after tax reconciliation to the statement of comprehensive income

The executive management committee meets on a monthly basis to assess the performance of each segment by analysing the segment's net operating profit after tax. A segment's net operating profit after tax excludes non operating income and expense such as dividends received, fair value gains and losses, gains and losses on disposal of assets and impairment charges. Income tax expenses are calculated as 30% (2009:30%) of the segment's net operating profit.

## Notes to the consolidated financial statements

### 18. OPERATING SEGMENTS (continued)

| <b>Reconciliation of segment net operating profit after tax to net profit/loss before tax</b> | <b>2010<br/>\$'000</b> | <b>2009<br/>\$'000</b> |
|---|------------------------|------------------------|
| Segment net operating profit/(loss) after tax   | 1,431                  | (5,623)                |
| Other operating loss from continuing activities   | (15,004)               | (2,840)                |
| Net loss on disposal of plant and equipment   | -                      | (38)                   |
| Total net profit before tax per the statement of comprehensive income                         | <u>(13,573)</u>        | <u>(8,501)</u>         |

#### iii) Segment assets reconciliation to the statement of financial position

In assessing the segment performance on a monthly basis, the executive management committee analyses the segment as described above and its relation to the segment assets. Segment assets are those operating assets of the entity that the management committee views as directly attributing to the performance of the segment. These assets include plant and equipment, receivables, inventory and intangibles and exclude available-for-sale assets, derivative assets and deferred tax assets.

| <b>Reconciliation of segment operating assets to total assets</b> | <b>2010<br/>\$'000</b> | <b>2009<br/>\$'000</b> |
|---|------------------------|------------------------|
| Segment operating assets  | 1,854                  | 1,722                  |
| <i>Other operating assets from continuing activities</i>          |                        |                        |
| Intangibles   | 47,046                 | 54,372                 |
| Cash & cash equivalents   | 2,740                  | 10,868                 |
| All other operating assets from continuing activities             | 2,128                  | 402                    |
| Total assets per the statement of financial position              | <u>53,768</u>          | <u>67,364</u>          |

The analysis of the location of non-current assets other than financial instruments, deferred tax assets, pension assets is as follows

| <b>Non-current assets by geographical location</b> | <b>2010<br/>\$'000</b> | <b>2009<br/>\$'000</b> |
|--|------------------------|------------------------|
| Australia  | 48,344                 | 55,817                 |
| United States                                      | 1,700                  | -                      |
| Total assets                                       | <u>50,044</u>          | <u>55,817</u>          |

#### iv) Segment liabilities reconciliation to the statement of financial position

Segment liabilities include trade and other payables and debt. The Group has a centralised finance function that is responsible for raising debt and capital for the entire operations. Each entity or business uses this central function to invest excess cash or obtain funding for its operations.

| <b>Reconciliation of segment operating liabilities to total liabilities</b> | <b>2010<br/>\$'000</b> | <b>2009<br/>\$'000</b> |
|---|------------------------|------------------------|
| Segment operating liabilities   | 523                    | 810                    |
| Deferred tax liabilities  | 13,830                 | 16,128                 |
| Other operating liabilities from continuing activities                      | 408                    | 437                    |
| Total liabilities per the statement of financial position                   | <u>14,761</u>          | <u>17,375</u>          |

## Notes to the consolidated financial statements

### 19. RELATED PARTY DISCLOSURE

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

| Entity                        | Country of Incorporation | 2010 Equity Interest | 2009 Equity Interest | 2010 Investment \$'000 | 2009 Investment \$'000 |
|-------------------------------|--------------------------|----------------------|----------------------|------------------------|------------------------|
| Vital Health Sciences Pty Ltd | Australia                | 100%                 | 100%                 | 27,111                 | 27,111                 |
| Preform Technologies Pty Ltd  | Australia                | 100%                 | 100%                 | -                      | -                      |
| Adoil Pty Ltd                 | Australia                | 100%                 | 100%                 | -                      | -                      |
| Phosphagenics Inc.            | USA                      | 100%                 | 100%                 | -                      | -                      |

#### Other transactions with key management personnel

The loss from operations includes no items of revenue and expense that resulted from transactions other than remuneration or equity holdings, with specified directors or their personally-related entities. Professor Vizard provided consultancy services to the Group during the year on behalf of the board. These services were provided on normal commercial terms.

Don Clarke is a partner of law firm Minter Ellison. Minter Ellison provided professional services to the Group totalling \$2,970 (2009: Nil) during the year. These services were provided on normal commercial terms.

#### Option holdings of key management personnel

| 2010                            | 01 Jan 10 Balance No. | Granted as remuneration No. | Options Exercised No. | Net other change No.   | 31 Dec 10 Balance No. | Vested No.       | Not Vested No. |
|---------------------------------|-----------------------|-----------------------------|-----------------------|------------------------|-----------------------|------------------|----------------|
| <b>Non Executive Directors</b>  |                       |                             |                       |                        |                       |                  |                |
| Vizard, A.L                     | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Addison, J.L                    | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Mills, J                        | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Ashton, M R D                   | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Clarke, D                       | -                     | -                           | -                     | -                      | -                     | -                | -              |
| James, S                        | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Webb, S                         | -                     | -                           | -                     | -                      | -                     | -                | -              |
| <b>Executive Directors</b>      |                       |                             |                       |                        |                       |                  |                |
| Rosen, H                        | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Ogru, E                         | -                     | -                           | -                     | -                      | -                     | -                | -              |
| <b>Key Management Personnel</b> |                       |                             |                       |                        |                       |                  |                |
| Banti, F                        | 2,650,000             | -                           | -                     | -                      | 2,650,000             | 2,650,000        | -              |
| Hodges, A                       | 600,000               | -                           | -                     | (600,000) <sup>1</sup> | -                     | -                | -              |
| Gavin, P                        | 800,000               | -                           | -                     | -                      | 800,000               | 800,000          | -              |
| Arnott, A                       | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Butala, D                       | 250,000               | -                           | -                     | -                      | 250,000               | 250,000          | -              |
| Harrison, K                     | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Kyriakou, K                     | -                     | -                           | -                     | -                      | -                     | -                | -              |
| Libinaki, R                     | 650,000               | -                           | -                     | -                      | 650,000               | 650,000          | -              |
| <b>Totals</b>                   | <b>4,950,000</b>      | <b>-</b>                    | <b>-</b>              | <b>(600,000)</b>       | <b>4,350,000</b>      | <b>4,350,000</b> | <b>-</b>       |

1. A Hodges options lapsed upon his resignation on 29<sup>th</sup> July 2010.

# Notes to the consolidated financial statements

## 19. RELATED PARTY DISCLOSURE (continued)

| 2009                 | 01 Jan 09<br>Balance<br>No. | Granted as<br>remuneration<br>No. | Options<br>Exercised<br>No. | Net other<br>change<br>No. | 31 Dec 09<br>Balance<br>No. | Vested<br>No.    | Not<br>Vested<br>No. |
|----------------------|-----------------------------|-----------------------------------|-----------------------------|----------------------------|-----------------------------|------------------|----------------------|
| <b>Non Executive</b> |                             |                                   |                             |                            |                             |                  |                      |
| <b>Directors</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Vizard, A.L          | 1,200,000                   | -                                 | -                           | (1,200,000) <sup>1</sup>   | -                           | -                | -                    |
| Addison, J.L         | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Mills, J             | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| Ashton, M R D        | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| <b>Executive</b>     |                             |                                   |                             |                            |                             |                  |                      |
| <b>Directors</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Rosen, H             | 5,050,000                   | -                                 | -                           | (5,050,000) <sup>1</sup>   | -                           | -                | -                    |
| Ogru, E              | -                           | -                                 | -                           | -                          | -                           | -                | -                    |
| <b>Key</b>           |                             |                                   |                             |                            |                             |                  |                      |
| <b>Management</b>    |                             |                                   |                             |                            |                             |                  |                      |
| <b>Personnel</b>     |                             |                                   |                             |                            |                             |                  |                      |
| Banti, F             | 2,000,000                   | 650,000                           | -                           | -                          | 2,650,000                   | 2,150,000        | 500,000              |
| Hodges, A            | 300,000                     | 300,000                           | -                           | -                          | 600,000                     | 300,000          | 300,000              |
| Gavin, P             | 500,000                     | 300,000                           | -                           | -                          | 800,000                     | 500,000          | 300,000              |
| <b>Totals</b>        | <b>9,050,000</b>            | <b>1,250,000</b>                  | <b>-</b>                    | <b>(6,250,000)</b>         | <b>4,050,000</b>            | <b>2,950,000</b> | <b>1,100,000</b>     |

1. Option holdings for A.L Vizard and H Rosen expired on 7<sup>th</sup> June 2009.

All options granted to key management personnel have been issued in accordance with the provisions of the Employee Share Option Plan (ESOP).

### Transactions with other related parties

During the year, Vital Health Sciences Pty Ltd borrowed \$2,677,000 (2009: \$5,428,761) and Phosphagenics Inc. \$516,488 (2009: \$544,432) from Phosphagenics Ltd (the parent entity). No part of these funds has been repaid. The loan is non trading and non current in nature.

Phosphagenics Inc has insufficient net assets to repay the inter company loan balance to Phosphagenics Ltd (the parent entity). At 31 December 2010 Phosphagenics Ltd recognised an impairment of \$1,269,191 (2009: \$743,000) against the inter company loan with Phosphagenics Inc.

No amounts were provided for doubtful debts relating to debts due from related parties at reporting date (2009: Nil).

## 20. SUBSEQUENT EVENTS

On 18 March 2011, Phosphagenics completed the placement of 83,897,222 shares at 9 cents per share to institutions, professional and sophisticated investors, raising gross funds of \$7,550,750. The funds will be primarily used to advance the Company's core development product - an oxycodone pain patch, and to fund product rollouts of its new cosmetic range.

During March 2011, the appointment of Southern Cross Equities (SCE) as the Company's corporate advisor ended by mutual consent. Accordingly, 10,000,000 unvested options granted to SCE in April 2010 lapsed. SCE continue to hold 5,000,000 fully vested and exercisable options.

Other than those announcements released to the ASX there are no significant events subsequent to reporting date.

## 21. NOTES TO THE CASH FLOW STATEMENT

### (a) Reconciliation of cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents includes cash on hand and in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash and cash equivalents at the end of the financial year, as shown in the statement of cash flows, is reconciled to the related items in the statement of financial position as follows:

## Notes to the consolidated financial statements

### 21. NOTES TO THE CASH FLOW STATEMENT (continued)

|                     | 2010<br>\$'000 | 2009<br>\$'000 |
|---------------------|----------------|----------------|
| Cash at Bank        | 2,565          | 2,198          |
| Short Term Deposits | 175            | 8,670          |
|                     | 2,740          | 10,868         |

#### (b) Reconciliation of net loss after tax to net cash flows from operations

|   | 2010<br>\$'000 | 2009<br>\$'000 |
|---|----------------|----------------|
| Net Loss after tax  | (11,275)       | (8,501)        |
| <i>Adjustments for:</i>   |                |                |
| Revenue from licence fees received as shares                    | (3,149)        | -              |
| Depreciation, disposal and amortisation of non-current assets   | 366            | 505            |
| Impairment of available-for-sale asset                          | 1,449          | -              |
| ESOP Expense  | 110            | 366            |
| Other share based payments                                      | 203            | -              |
| Capitalisation of development expenses                          | (400)          | (555)          |
| Impairment of acquired intangible assets                        | 7,660          | -              |
| Interest received   | (342)          | (430)          |
| <i>Changes in assets and liabilities:</i>                       |                |                |
| (Increase)/ decrease in trade receivables and other receivables | (13)           | (60)           |
| (Increase)/decrease in inventories                              | (464)          | 154            |
| (Increase)/decrease in other current assets                     | 172            | (159)          |
| (Decrease)/increase in deferred tax liability                   | (2,298)        | -              |
| (Decrease)/increase in trade payables and other payables        | (378)          | (281)          |
| (Decrease)/increase in provisions                               | 19             | (2)            |
| Net cash (used in) operating activities                         | (8,340)        | (8,963)        |

### 22. FINANCIAL INSTRUMENTS

#### (a) Financial risk management objectives and policies

The Group's principal financial instruments comprise of cash and short-term deposits. Various financial instruments such as trade receivables and trade payables arise directly from operations. The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates.

The Group does not enter into, or trade, financial instruments including derivative financial instruments, for speculative purposes and manages its exposure to key financial risks, including interest rate and currency risk in accordance with the principals of prudent financial management. The objective of this is to support the delivery of the Group's financial targets whilst protecting future financial security.

Primary responsibility for identification and control of financial risks rests with the Audit Committee under the authority of the Board. The Board reviews and agrees policies for managing each of the risks including foreign exchange risk, interest rate risk and future cash flow forecast projections.

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in note 2 to the financial statements.

## Notes to the consolidated financial statements

### 22. FINANCIAL INSTRUMENTS (continued)

#### (b) Risk exposures and responses

##### *Interest rate risk*

The consolidated entity is only exposed to interest rate risk relating to cash at bank as it has no borrowings. At reporting date the Group has the following financial assets (no financial liabilities at 31 December 2010 or 31 December 2009) exposed to Australian Variable Interest Rates;

|                           | 2010<br>\$'000 | 2009<br>\$'000 |
|---------------------------|----------------|----------------|
| <b>Financial Assets</b>   |                |                |
| Cash and cash equivalents | 2,740          | 10,868         |

The following sensitivity analysis is based on the interest rate risk exposures in existence at 31 December 2010. If interest rates had moved, as illustrated in the table below, with all other variables held constant, post tax loss and equity would have been affected as follows;

|                         | Post Tax Loss<br>Higher/(Lower)                     |                | Equity<br>Higher/(Lower) |                |
|-------------------------|---|----------------|--------------------------|----------------|
|                         | 2010<br>\$'000                                      | 2009<br>\$'000 | 2010<br>\$'000           | 2009<br>\$'000 |
|                         | <b>Judgements of reasonably possible movements:</b> |                |                          |                |
| + 1% (100 basis points) | 27  | 109            | -                        | -              |
| -.5% (50 basis points)  | (14)  | (54)           | -                        | -              |

The movements in profit are due to higher/lower interest income from variable rate term deposits and cash balances. There is no equity movement as there are no financial assets or financial liabilities which are designated as cash flow hedges. The sensitivity is lower in 2010 in comparison to 2009 due to the lower cash and cash equivalents balance.

##### *Foreign Currency Risk*

The Group has transactional currency exposures principally due to its operations in the United States. Such exposure arises from sales or purchases by an operating unit in currencies, principally US dollars, other than the Groups presentation currency.

Approximately 90% of sales and royalties (2009: 48%) are denominated in currencies other than the presentation currency of the Group (Australian dollars), whilst 96% (2009: 94%) of costs are denominated in the Groups presentation currency. At 31 December 2010 the Group had the following exposure to US dollar foreign currency not designated in cash flow hedges:

|                              | 2010<br>\$'000 | 2009<br>\$'000 |
|------------------------------|----------------|----------------|
| <b>Financial Assets</b>      |                |                |
| Cash and cash equivalents    | 17             | 25             |
| Trade and other receivables  | -              | -              |
|                              | 17             | 25             |
| <b>Financial Liabilities</b> |                |                |
| Trade and other payables     | (10)           | -              |
|                              | -              | -              |
| <b>Net Exposure</b>          | 7              | 25             |

## Notes to the consolidated financial statements

### 22. FINANCIAL INSTRUMENTS (continued)

#### (b) Risk exposures and responses

At 31 December 2010, had the Australian Dollar moved, as illustrated in the table below, with all other variables held constant, post tax profit and equity would have been affected as follows;

|   | Post Tax Loss  |        | Equity         |        |
|---|----------------|--------|----------------|--------|
|   | Higher/(Lower) |        | Higher/(Lower) |        |
|   | 2010           | 2009   | 2010           | 2009   |
|   | \$'000         | \$'000 | \$'000         | \$'000 |
| <b>Judgements of reasonably possible movements:</b> |                |        |                |        |
| <b>Consolidated</b>                                 |                |        |                |        |
| AUD/USD +10%  | (2)            | (2)    | -              | -      |
| AUD/USD -5%   | 1              | 1      | -              | -      |

#### *Credit risk management*

Credit risk arises from the financial assets of the Group comprising cash and cash equivalents and trade and other receivables. Credit risk refers to the risk the counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties and obtaining sufficient collateral where appropriate, as a means of mitigating the risk of financial loss from defaults.

Group exposure to, and the credit ratings of, counterparties are continuously monitored and the aggregate value of transactions concluded are with approved counterparties. The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The credit risk on liquid funds and financial instruments is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies. The Group measures credit risk on a fair value basis.

The carrying value of financial assets recorded in the financial statements, net of any allowances for losses, represents the Groups maximum exposure to credit risk. Maturity analysis of financial assets and liabilities based on management's expectations as follows;

| Year Ended                   |              |          |          |          |              |
|------------------------------|--------------|----------|----------|----------|--------------|
| 31 December 2010             | ≤ 6          | 6-12     | 1-5      | >5       | Total        |
|                              | Months       | Months   | Years    | Years    |              |
|                              | \$'000       | \$'000   | \$'000   | \$'000   | \$'000       |
| <b>Financial Assets</b>      |              |          |          |          |              |
| Cash and cash equivalents    | 2,740        | -        | -        | -        | 2,740        |
| Trade and other receivables  | 305          | -        | -        | -        | 305          |
|                              | 3,045        | -        | -        | -        | 3,045        |
| <b>Financial Liabilities</b> |              |          |          |          |              |
| Trade and other payables     | (816)        | -        | -        | -        | (816)        |
|                              | (816)        | -        | -        | -        | (816)        |
| <b>Net Exposure</b>          | <b>2,229</b> | <b>-</b> | <b>-</b> | <b>-</b> | <b>2,229</b> |

## Notes to the consolidated financial statements

### 22. FINANCIAL INSTRUMENTS (continued)

#### (b) Risk exposures and responses

##### *Liquidity risk management*

Liquidity risk arises from the financial liabilities of the group and the group's subsequent ability to meet their obligations to repay their financial liabilities as and when they fall due. The Group continuously monitors cash flows and matches the maturity profiles of financial assets and liabilities.

| Year Ended<br>31 December 2010 | ≤ 6<br>Months<br>\$'000 | 6-12<br>Months<br>\$'000 | 1-5<br>Years<br>\$'000 | >5<br>Years<br>\$'000 | Total<br>\$'000 |
|--------------------------------|-------------------------|--------------------------|------------------------|-----------------------|-----------------|
| <b>Liquid financial assets</b> |                         |                          |                        |                       |                 |
| Cash and cash equivalents      | 2,740                   | -                        | -                      | -                     | 2,740           |
| Trade and other receivables    | 305                     | -                        | -                      | -                     | 305             |
|                                | <u>3,045</u>            | <u>-</u>                 | <u>-</u>               | <u>-</u>              | <u>3,045</u>    |
| <b>Financial liabilities</b>   |                         |                          |                        |                       |                 |
| Trade and other payables       | (816)                   | -                        | -                      | -                     | (816)           |
|                                | <u>(816)</u>            | <u>-</u>                 | <u>-</u>               | <u>-</u>              | <u>(816)</u>    |
| <b>Net inflow/(outflow)</b>    | <b>2,229</b>            | <b>-</b>                 | <b>-</b>               | <b>-</b>              | <b>2,229</b>    |

| Year Ended<br>31 December 2009 | ≤ 6<br>Months<br>\$'000 | 6-12<br>Months<br>\$'000 | 1-5<br>Years<br>\$'000 | >5<br>Years<br>\$'000 | Total<br>\$'000 |
|--------------------------------|-------------------------|--------------------------|------------------------|-----------------------|-----------------|
| <b>Liquid financial assets</b> |                         |                          |                        |                       |                 |
| Cash and cash equivalents      | 2,434                   | 5,723                    | 2,711                  | -                     | 10,868          |
| Trade and other receivables    | 292                     | -                        | -                      | -                     | 292             |
|                                | <u>2,726</u>            | <u>5,723</u>             | <u>2,711</u>           | <u>-</u>              | <u>11,160</u>   |
| <b>Financial liabilities</b>   |                         |                          |                        |                       |                 |
| Trade and other payables       | (1,151)                 | -                        | -                      | -                     | (1,151)         |
|                                | <u>(1,151)</u>          | <u>-</u>                 | <u>-</u>               | <u>-</u>              | <u>(1,151)</u>  |
| <b>Net inflow/(outflow)</b>    | <b>1,575</b>            | <b>5,723</b>             | <b>2,711</b>           | <b>-</b>              | <b>10,009</b>   |

##### *Fair Value*

Due to the short term nature of the financial instruments, their carrying value is assumed to approximate their fair value. The Group uses quoted market price in estimating the fair value of the available for sale investments, which is considered a level 1 in fair value hierarchy. There are currently no financial instruments with fair value estimated based on a level 2 or level 3 in the hierarchy.

Quoted market price represents the fair value determined based on quoted prices on active markets as at the reporting date without any deduction for transaction costs. The fair value of the available-for-sale financial investments are based on quoted market prices.

##### *Capital Management*

Management's objective is to ensure the entity continues as a going concern with the ability to fund future research and development requirements and commercialise the Groups products. Management also aim to maintain a capital structure that ensures the lowest cost of capital available and deliver optimal long term returns to shareholders.

## Notes to the consolidated financial statements

### 23. INFORMATION RELATING TO PHOSPHAGENICS LIMITED ('the parent entity')

|   | 2010<br>\$'000     | 2009<br>\$'000     |
|---|--------------------|--------------------|
| Current assets  | 3,031              | 11,108             |
| Total assets  | 50,989             | 62,170             |
| Current liabilities   | 734                | 424                |
| Total liabilities   | 734                | 424                |
| Contributed equity  | 176,905            | 176,905            |
| Accumulated losses  | (128,179)          | (116,151)          |
| Employee equity benefits reserve  | 1,056              | 946                |
| Other equity-settled benefits reserve   | 249                | 46                 |
| Total shareholder's equity  | <u>50,031</u>      | <u>61,746</u>      |
| Loss of the parent entity   | (11,801)           | (3,036)            |
| Total comprehensive income of the parent entity   | <u>(11,801)</u>    | <u>(3,036)</u>     |
| Guarantees entered into by the parent entity in relation to the debts of its subsidiaries         | -                  | -                  |
| Contingent liabilities of the parent entity   | -                  | -                  |
| Contractual commitments by the parent equity for the acquisition of property, plant or equipment. | (226) <sup>1</sup> | (403) <sup>1</sup> |

1. Non-cancellable operating leases relating to the rent of commercial property used for business operations.

## Directors' Declaration

In accordance with a resolution of the directors of Phosphagenics Limited, I state that:

1. In the opinion of the directors:
  - (a) The financial statements and notes of Phosphagenics Limited for the financial year ended 31 December 2010 are in accordance with the *Corporations Act 2001*, including:
    - (i) Giving a true and fair view of its financial position as at 31 December 2010 and performance
    - (ii) Complying with Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*
  - (b) The financial statements and notes also comply with International Financial Reporting Standards as disclosed in note 2(a)
  - (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. This declaration has been made after receiving the declarations required to be made to the Directors in accordance with section 295A of the *Corporations Act 2001* for the financial year ended 31 December 2010.

On behalf of the Board



Jonathan Lancelot Addison  
Chairman

30 March 2011

Melbourne

## Independent auditor's report to the members of Phosphagenics Limited

### Report on the financial report

We have audited the accompanying financial report of Phosphagenics Limited, which comprises the consolidated statement of financial position as at 31 December 2010, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, 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.

#### *Directors' responsibility for the financial report*

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 2a, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the 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. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about 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 judgment, 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 controls relevant to the entity'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 entity's internal controls. 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.

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

#### *Independence*

In conducting our audit we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration.

## Opinion

In our opinion:


- a. the financial report of Phosphagenics 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 31 December 2010 and of its performance for the year ended on that date; and
  - ii complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- b. the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 2a.

## Report on the remuneration report

We have audited the Remuneration Report included in pages 11 to 18 of the directors' report for the year ended 31 December 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.

## Opinion

In our opinion, the Remuneration Report of Phosphagenics Limited for the year ended 31 December 2010, complies with section 300A of the *Corporations Act 2001*.

A handwritten signature in black ink that reads 'Ernst & Young'.

Ernst & Young

A handwritten signature in black ink that reads 'David Petersen'.

David Petersen  
Partner  
Melbourne  
30 March 2011