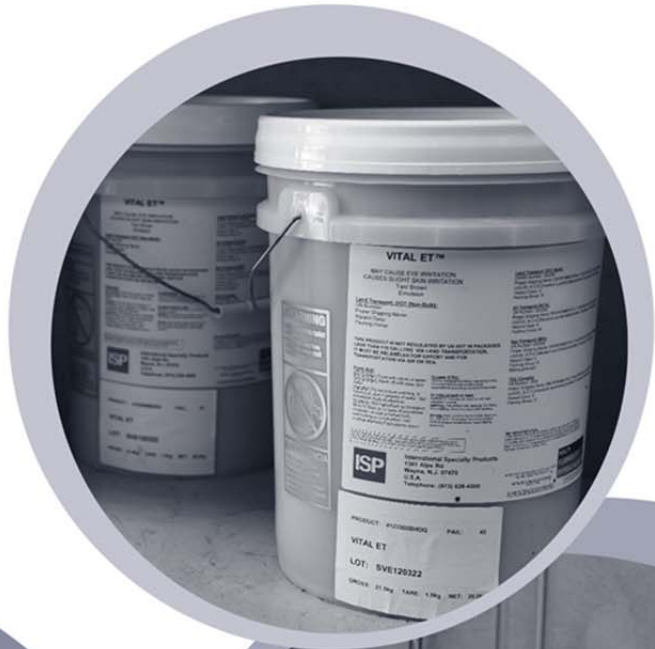


# Phosphagenics Limited

ABN 32 056 482 403

## Financial Report

FOR THE HALF YEAR ENDED 30 JUNE 2014



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# Directors' Report

Your directors have pleasure in submitting this report on Phosphagenics Limited and its controlled entities for the half-year ended 30 June 2014.

## DIRECTORS

The names and particulars of the directors of Phosphagenics Limited in office at any time during or since the end of the period.

### Currently in Office

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**LAWRENCE GOZLAN BSc (Hons)**

Independent non-executive director  
Chairman  
Chairman of remuneration and nomination committees  
Member of audit, compliance and corporate governance committee

Mr Gozlan has been a leading fund manager and analyst in the Australian biotech sector over the past decade. He is the Chief Investment Officer and founder of global investment fund Scientia Capital, which specialises in managing investments for domestic and international institutional investors in the life science sector. Prior to this Mr Gozlan was the biotech analyst for QIC, the largest Australian institutional investor in life sciences at the time.

In 2013 Mr Gozlan was appointed to the Board of AusBiotech Ltd, Australia's main life sciences industry body.

Other current directorships of listed entities:  
Oncosil Medical Limited, Prana Biotechnology Limited  
Former directorships of listed entities in last 3 years:  
Teleso Technologies Limited

Nil ordinary shares in Phosphagenics Limited

**HARRY ROSEN BA, LLB**

Executive Director  
Appointed Managing Director December 2005\*

Mr Rosen, as founding director of Phosphagenics Limited has, since 1999, been instrumental in the corporate and commercial development of the Company's portfolio of patents based upon the patented TPM<sup>®</sup> drug delivery system.

Previously, Mr Rosen was 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 USA 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.

\* As Managing Director Mr Rosen is not required to retire by rotation.

Other current directorships of listed entities: None  
Former directorships of listed entities in last 3 years: None

64,226,436 ordinary shares in Phosphagenics Limited  
2,000,000 performance rights in Phosphagenics Limited

**NATHAN DRONA MBA**

Independent non-executive director  
Chairman of audit, compliance and corporate governance committee  
Member of remuneration and nomination committees

Mr Drona joins the Board following a 15 year career in international investment banking, most recently as Managing Director of Challiss in New York and Sydney.

Mr Drona has a strong background in corporate finance and has executed over 25 global banking and M&A engagements in biotech, medical devices and healthcare, leading to the award of "Pharmaceutical Buy-Side M&A Advisor of the Year" by Frost & Sullivan in 2005.

Other current directorships of listed entities:  
Alchemia Ltd  
Former directorships of listed entities in last 3 years: None

Nil ordinary shares in Phosphagenics Limited

## Directors' Report continued

### **DR GEERT CAUWENBERGH PhD**

Independent non-executive director  
Member of remuneration, nomination and audit, compliance and corporate governance committees

Dr Cauwenbergh is very experienced in the life sciences sector, having started his career with Janssen Research Foundation in Belgium in 1979. He moved to the USA in 1994 to take up the role of Vice President Product Development for Johnson & Johnson. Subsequently he was appointed Global Vice President of R&D for Johnson & Johnson Consumer companies worldwide.

In 2001 Dr Cauwenbergh left Johnson & Johnson and founded Barrier Therapeutics, a company developing drugs to treat skin diseases. In 2008 Barrier Therapeutics was acquired by Stiefel Laboratories. At the time of acquisition the company's annual revenues had reached approximately US\$45 million.

Dr Cauwenbergh is currently President and CEO of NASDAQ listed company RXi Pharmaceuticals. In this role he has guided RXi Pharmaceuticals through its initial public offering and helped it successfully prepare and submit its first US FDA Investigational New Drug Application.

Other current directorships of listed entities:  
RXi Pharmaceuticals Inc, Moberg Pharma AB  
Former directorships of listed entities in last 3 years:  
Ablynx NV

Nil ordinary shares in Phosphagenics Limited

### **Former Directors:**

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### **JONATHAN LANCELOT ADDISON BSc, ASIC, CFTP (Snr)**

Independent non-executive director and Chairman until his resignation on 28 February 2014

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 with both listed and unlisted companies in Australia, Africa, New Zealand and the UK, he is an investment advisor to the Meat Industry Employee Superannuation Fund (MIESF).

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

Other current directorships of listed entities:  
Chairman Global Masters Funds Limited  
Former directorships of listed entities in last 3 years:  
None

### **DON CLARKE LLB (Hons)**

Independent non-executive director until his resignation on 28 February 2014

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

Mr Clarke was Chairman of the Company's Audit, Compliance and Corporate Governance Committee.

Other current directorships: Deputy Chairman of Webjet Limited  
Former directorships of listed entities in last 3 years:  
Circadian Technologies Limited

### **DR SANDRA WEBB BPharm, PhD, Dip Law**

Independent non-executive director until her resignation on 28 February 2014

Dr Webb is an experienced biopharmaceutical professional and has a strong record of achievements in the commercial world of drug development. She is a Director of Ground Zero Pharmaceuticals Pty Limited and Chair of the Advisory Board of Knightsbridge Lawyers & Patent Attorneys.

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

Other current directorships: None  
Former directorships of listed entities in last 3 years:  
None

### **STUART JAMES BA (Hons)**

Independent non-executive director until his resignation on 28 February 2014

Mr James held a number of high profile executive positions during his career and has extensive experience in the oil, health, pharmaceutical and financial services sectors.

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

Other current directorships: Chairman Pulse Health Limited, Chairman Greencross Ltd, Chairman Prime Financial Group Limited  
Former directorships of listed entities in last 3 years:  
Chairman Progen Limited

## Directors' Report continued

### PRINCIPAL ACTIVITIES

The principal activities of the Company are the production, sale and licensing of products incorporating its patented platform technology TPM<sup>®</sup> for the pharmaceutical, skin care and animal health industries.

### RESULTS

For the six months ended 30 June 2014, the Company returned a loss after tax of \$2.8 million (2013: \$6.1 million). Revenue and other income for the period totalled \$4.0 million (2013: \$3.4 million), including \$2.1 million from recoveries of misappropriations (2013: \$0.6 million) and \$1.1 million relating to the R&D tax incentive (2013: \$1.7 million).

Cash at 30 June 2014 totalled \$7.6 million (31 December 2013: \$8.8 million). As at 30 June 2014 Shareholders' Equity totalled \$38.1 million (31 December 2013: \$40.8 million).

For further details refer to the attached Financial Statements and notes.

### DIVIDENDS

The directors have not recommended the payment of any dividends and no dividends were declared, paid or reinvested in the period to 30 June 2014.

### OPERATING AND FINANCIAL REVIEW

#### **Opioid Pain Patch Program**

During the first half the year, the Company's prime focus remained fixed on advancing both the TPM<sup>®</sup>/Oxymorphone and TPM<sup>®</sup>/Oxycodone patches towards Phase 2 clinical studies.

Phosphagenics will conduct a small proof of concept Phase 2A study in Australia on the TPM<sup>®</sup>/Oxycodone patch for postherpetic neuralgia. Before doing so, there are a number of matters that need to be addressed, of which the most important and time-consuming one is the manufacture of the TPM<sup>®</sup>/Oxycodone patches to GMP (Good manufacturing practices). There aren't any facilities approved by the TGA in Australia to manufacture opioid patches to GMP. This necessitated the Company to select and conclude arrangements with a US patch manufacturer; undertake technology transfer; and have the manufacturer scale up our laboratory scale process. This process has now essentially been completed.

The program to prepare the TPM<sup>®</sup>/Oxymorphone patch for a US Phase 2 study is considerably more complicated. Before any party can undertake a human study in the US, it is required to apply for an IND (Investigational New Drug) from the US FDA. The requirements for a Phase 2 are substantially

more stringent than for a Phase 1 and therefore require significantly more preparation.

In order to obtain an IND for its planned US study, Phosphagenics has needed to undertake many tasks including:

- The technical transfer of its TPM<sup>®</sup>/Oxymorphone patch manufacturing process to a US patch manufacturer;
- Scaling up the process to manufacture GMP patches at larger scale for use in the Phase 2;
- Conducting a dermal toxicity study on the US manufactured patch in a non-rodent animal model;
- Conducting a stability study;
- Requesting a Pre IND meeting with the FDA;
- Preparing the IND Application;
- Conducting further PK characterisation human studies on the patch in Australia.

None of the tasks described above are unusual, with some having been completed.

The first of the two characterising studies, required for the US IND application, was recently completed. This trial involved 15 healthy volunteers in a three week study. Phosphagenics recently released the results of this trial to the market with the highlight being the reproducibility of the original results announced in October last year. Additionally, all 15 subjects involved in the trial achieved therapeutic plasma concentrations with the patch, making it 27 subjects in all to do so. The trial also examined the elimination rate of oxymorphone from the body. This showed an expected and steady clearance of the drug, an important safety feature of patches generally but one which had to be demonstrated before initiation of the Phase 2 trial.

#### **Diclofenac**

In January 2014 both Novartis India and Themis Medicare launched a diclofenac gel, incorporating Phosphagenics' TPM<sup>®</sup> platform technology, in the Indian market. Novartis branded its product as Voveran<sup>®</sup> TPM<sup>®</sup> Gel and Themis Medicare its product Instanac TPM<sup>®</sup> Gel, indicating the importance of the TPM<sup>®</sup> technology in their products. Both products highlighted the superior delivery properties of the TPM<sup>®</sup> drug delivery system compared to other diclofenac gels on their packaging.

Our licensee has advised us that the products have been very well received by medical practitioners. This is corroborated by tocopheryl phosphate reorders from the manufacturer, Themis Medicare. The successful launch bodes well for the product in other territories.

## Directors' Report continued

### **Personal Care**

#### **Vital ET<sup>®</sup>**

Based on orders held at the end of the first half from the Company's distributor, Ashland Inc., total sales of Vital ET<sup>®</sup> should exceed \$1 million in 2014.

These sales will be skewed to the second half of the year due to the long lead-time required to source raw material need to manufacture the product.

#### **Private Label**

During first half of the year Phosphagenics continued to progress its private label arrangements in South Korea and with the giant US nutritional company, GNC. The Korean Drug Company launched its product, BodyShaper AOP Cellulite Cream, using the Miss Korea Pageant as the forum for its launch.

#### **Licensing**

In May Le Métier de Beauté (LMBDB) was acquired by a private US investor. LMBDB retained the marketing expertise of its senior management team. The assignment of our license played a pivotal role in the acquisition and along with an injection of new funding, should lead to an increased use of Phosphagenics' TPM<sup>®</sup> technology. The outstanding royalty up to December 2013 of \$242,000, which was provided against in 2013, has now been recovered.

#### **BioElixia<sup>®</sup>**

Following a difficult year in 2013, the BioElixia<sup>®</sup> skin and body care brand has stabilised. In a turbulent and unpredictable retail space, retail sales of the brand at David Jones, Myer and Priceline remain modest but are comparable with last year.

To complement its popular BodyShaper range, BioElixia<sup>®</sup> will be launching a new product, the Multi-Purpose Rescue Balm, in August 2014. Early indications suggest that the product will be well received by both retailers and consumers.

#### **Animal Health**

Phosphagenics' Australian partners have consolidated their operations under a single corporate entity Integrated Animal Health (IAH). IAH has spent much of the first half of 2014 putting in place the structures and personnel to drive the Company forward. Recent reorders of TPM<sup>®</sup> indicates that the customer base is growing.

In May the Company announced the results of a study that tested the topically applied TPM<sup>®</sup>/Oxycodone patch on thoroughbred racehorses. The study was conducted in collaboration with IAH and examined the relief of topical pain in racehorses suffering from cannon (shin) bone soreness. While the study involved a small number of horses the results showed

complete pain relief in all horses within 24 hours with little systemic exposure of oxycodone.

As a consequence of a cut back in funding by the US Government generally in 2014, this has also impacted the USDA. No research has been conducted in regards to our collaboration with the USDA in the first half.

#### **Dermatology**

The Phase 2 TPM<sup>®</sup>/Tretinoin trial commenced last year and was completed recently. The study was designed to evaluate the effectiveness of TPM<sup>®</sup>/Tretinoin in the treatment of acne vulgaris compared to the market leader Retin A. Results should come through shortly and will be announced as soon as they are received.

### **LOOKING FORWARD**

Phosphagenics' clinical programs, especially for oxycodone and oxymorphone, will continue in the second half of 2014 and accelerate in 2015. Evaluation of the Phase 2 TPM<sup>®</sup>/Tretinoin trial will be made as soon as the results come to hand and we will plan future clinical programs accordingly.

A second TPM<sup>®</sup>/Oxymorphone trial to further characterise the patch will evaluate the consistency of the delivery profile between several potential patch application sites of the body (flank, chest, upper arm and upper back) as well as the rest period required before a patch can be reapplied to the same application site. Both parameters are important aspects of protocol design for the Phase 2 trial to be conducted in the US as well as forming part of the commercial product label.

As soon as the Company completes all the elements required for an IND Application, it will meet with the US FDA in a Pre IND meeting to ensure that the Agency agrees with the Phase 2 protocols, the product safety and product manufacturing. Once the IND application is approved it will commence its Phase 2 trial as soon as possible thereafter.

The TPM<sup>®</sup>/Oxycodone patch is earmarked for topical delivery. A Phase 2A trial will commence in the early part of the next quarter for pain caused by postherpetic neuralgia (PHN). This trial will be conducted in Australia and could take up to six months to complete with the main time constraint being recruitment. The trial itself will only take around four weeks.

## Directors' Report *continued*

The Company sells a complex form of TPM<sup>®</sup> through its global distributor, Ashland Inc. The product is trademarked under the name Vital ET<sup>®</sup>. The product is a multi-purpose Vitamin E derivative that has superior properties, to Vitamin E and is superior to the normal form of vitamin E. For the first time, based on orders currently held, it is expected that annual sales will exceed \$1 million, with most of those expected to occur in the second half of this year.

The BioElixia<sup>®</sup> brand is expected to show increased revenue in the second half of 2014. TVSN has indicated that they would likely resume promotion of BioElixia<sup>®</sup> on their network. In 2012 BioElixia<sup>®</sup> products were some of the most successful personal care products sold on TVSN, so resumption of this revenue source would be mutually beneficial.

For animal health our partners, IAH strategy of targeting nutritionists and dairy farmers has resulted in a good uptake of the products in the dairy industry and this will only continue in Australia and other parts of the world. In New Zealand we are assisting our partner in obtaining regulatory registrations to complement discussions that are taking place with some of the country's larger dairy companies. New Zealand's herd population is about 2-3 times larger than the Australia market and ownership is more concentrated.

The Company's recent capital raising has positioned the company well to fund all its medium term clinical programs. This together with the subsequent increase in market capitalisation has put Phosphagenics on the investment landscape of many institutions several of whom participated in the \$19.3 million placement.

### SIGNIFICANT CHANGES IN STATE OF AFFAIRS

During the period to 30 June 2014 there was no significant change in the state of affairs of the consolidated entity other than that referred to in the half-year report or notes thereto.

### SIGNIFICANT EVENTS AFTER BALANCE DATE

On 11 July 2014 the Company announced it had raised a total \$19.3 million of funds via share placement. An initial \$12.3 million was raised from placement in July with a further \$3.0 million via a share purchase plan finalised in August. The final share placement of \$4.0 million was approved by shareholders at a General Meeting on 25 August 2014 and is due for receipt by 29 August 2014. These equity raisings have been at an issue price of \$0.08 a share resulting in the issue of 241,500,000 new ordinary fully paid shares and increasing number of ordinary paid shares to 1,261,965,957 shares.

### LIKELY DEVELOPMENTS AND FUTURE RESULTS

Information regarding likely developments is included in the Looking Forward section of the Directors' Report.

### ROUNDING

The amounts contained in this report and in the financial report have been rounded to the nearest \$1,000 (unless stated otherwise) under the option available to the Company under ASIC Class Order 98/0100. The Company is an entity to which the Class Order applies.

### REGISTERED OFFICE

11 Duerdin Street, Clayton, Victoria 3168

Signed in accordance with a resolution of the Board of Directors:



Lawrence Gozlan  
Chairman and Independent Director

Melbourne  
27 August 2014



## Auditor's Independence Declaration

As lead auditor for the review of Phosphagenics Limited for the half-year ended 30 June 2014, I declare that to the best of my knowledge and belief, there have been:

- a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and
- b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Phosphagenics Limited and the entities it controlled during the period.

A handwritten signature in black ink, appearing to read 'A. Linschoten', is written in a cursive style.

Anton Linschoten  
Partner  
PricewaterhouseCoopers

Melbourne  
27 August 2014



# Consolidated Statement of Comprehensive Income

For the half-year ended 30 June 2014

	Notes	Consolidated	
		30 June 2014 \$'000	30 June 2013 \$'000
<b>Revenue</b>			
Sale of goods		478	476
Royalties		114	108
Finance revenue		120	345
<b>Total Revenue</b>		<b>712</b>	<b>929</b>
Cost of sales		(216)	(249)
<b>Gross Profit</b>		<b>496</b>	<b>680</b>
Income from government grants		1,069	1,809
Recoveries	4a	2,088	565
Other income		135	50
Employee and Directors benefits expenses		(2,449)	(2,480)
Research expenses		(943)	(1,797)
Consulting and professional expenses		(444)	(1,012)
Occupancy and communications expenses		(303)	(326)
Share of loss of associate		-	(21)
Marketing		(217)	(282)
Amortisation and depreciation		(1,923)	(1,945)
Costs under investigation	4b	-	(465)
Other expenses	4c	(294)	(848)
<b>Loss before income tax</b>		<b>(2,785)</b>	<b>(6,072)</b>
Income tax/(expense)		-	-
<b>Loss after income tax</b>		<b>(2,785)</b>	<b>(6,072)</b>
<b>Other Comprehensive Income</b>			
Foreign currency translation		-	(47)
Income tax/(expense) on items of other comprehensive income		-	-
<b>Other comprehensive loss for the period, net of tax</b>		<b>-</b>	<b>(47)</b>
<b>Total comprehensive loss for the period</b>		<b>(2,785)</b>	<b>(6,119)</b>

## Loss per share from continuing operations attributable to the ordinary equity holders of the parent:

Basic loss per share	(0.27 cents)	(0.59 cents)
Diluted loss per share	(0.27 cents)	(0.59 cents)

# Consolidated Statement of Financial Position

as at 30 June 2014

		<b>Consolidated</b>	
	Notes	30 June 2014 \$'000	31 December 2013 \$'000
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and cash equivalents	6	7,640	8,823
Trade and other receivables		3,141	4,421
Inventories	8	770	699
Other current assets		1,073	212
<b>Total Current Assets</b>		<b>12,624</b>	<b>14,155</b>
<b>Non-current assets</b>			
Intangible assets		26,056	27,877
Plant and equipment		837	926
<b>Total Non-Current Assets</b>		<b>26,893</b>	<b>28,803</b>
<b>TOTAL ASSETS</b>		<b>39,517</b>	<b>42,958</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables		810	1,688
Provisions		527	432
<b>Total Current Liabilities</b>		<b>1,337</b>	<b>2,120</b>
<b>Non-current liabilities</b>			
Provisions		80	67
<b>Total Non-Current Liabilities</b>		<b>80</b>	<b>67</b>
<b>TOTAL LIABILITIES</b>		<b>1,417</b>	<b>2,187</b>
<b>NET ASSETS</b>		<b>38,100</b>	<b>40,771</b>
<b>EQUITY</b>			
Contributed equity	10	209,895	209,895
Accumulated losses		(201,823)	(199,038)
Reserves		30,028	29,914
<b>TOTAL EQUITY</b>		<b>38,100</b>	<b>40,771</b>

## Consolidated Statement of Cash Flows

For the half-year ended 30 June 2014

	Notes	Consolidated	
		30 June 2014 \$'000	30 June 2013 \$'000
<b>Cash flows from operating activities</b>			
Receipts from customers and related parties		865	559
Receipts from recoveries		2,422	-
Receipts of government grants		1,982	3,376
Interest received		133	334
Payments to suppliers and employees		(6,572)	(7,089)
<b>Net cash (outflow) from operating activities</b>		<b>(1,170)</b>	<b>(2,820)</b>
<b>Cash flows from investing activities</b>			
Purchase of plant and equipment		(13)	(31)
<b>Net cash (outflow) from investing activities</b>		<b>(13)</b>	<b>(31)</b>
<b>Cash flows from financing activities</b>			
Proceeds from share issues		-	-
Costs of issue of shares	10	-	(2)
Proceeds from exercise of options	10	-	36
<b>Net cash inflow from financing activities</b>		<b>-</b>	<b>34</b>
Net (decrease) in cash and cash equivalents		(1,183)	(2,817)
Cash and cash equivalents at beginning of the period		8,823	16,912
<b>Cash and cash equivalents at the end of the period</b>	6	<b>7,640</b>	<b>14,095</b>

## Consolidated Statement of Changes in Equity

For the half-year ended 30 June 2014

	Contributed Equity \$'000	Reserves \$'000	Accumulated Losses \$'000	Total \$'000
<b>Balance at 1 January 2014</b>	209,895	29,914	(199,038)	40,771
Loss for the period	-	-	(2,785)	(2,785)
Other comprehensive income	-	-	-	-
Total comprehensive income for the half year	-	-	(2,785)	(2,785)
<b>Transactions with owners in their capacity as owners</b>				
Issue of shares	-	-	-	-
Transaction costs on share issue	-	-	-	-
Employee equity settlement benefits	-	114	-	114
<b>Balance at 30 June 2014</b>	<b>209,895</b>	<b>30,028</b>	<b>(201,823)</b>	<b>38,100</b>
<b>Balance at 1 January 2013</b>	209,861	29,724	(186,365)	53,220
Loss for the period	-	-	(6,072)	(6,072)
Other comprehensive income	-	(47)	-	(47)
Total comprehensive income for the half year	-	-	(6,072)	(6,119)
<b>Transactions with owners in their capacity as owners</b>				
Issue of shares	36	-	-	36
Transaction costs on share issue	(2)	-	-	(2)
Share based payments	-	54	-	54
<b>Balance at 30 June 2013</b>	<b>209,895</b>	<b>29,731</b>	<b>(192,640)</b>	<b>46,986</b>

# Notes to the Financial Statements

For the half-year ended 30 June 2014

## 1. CORPORATE INFORMATION

The half-year consolidated financial statements of Phosphagenics Limited for the six months ended 30 June 2014 were authorised for issue in accordance with a resolution of the directors on 27 August 2014.

Phosphagenics Limited is a limited company incorporated and domiciled in Australia whose shares are publicly traded. The principal activities of the company and its subsidiaries (the Group) are described in the Directors Report.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF PREPARATION

This general purpose financial report for the half year ended 30 June 2014 has been prepared in accordance with AASB 134 Interim Financial Reporting and the Corporations Act, 2001. The half-year financial report does not include all notes of the type normally included within the annual financial report and therefore cannot be expected to provide as full an understanding of the financial performance, financial position and financing and investing activities of the consolidated entity as the full financial report.

It is recommended that the half-year financial report be read in conjunction with the annual report for the year ended 31 December 2013 and be considered together with any public announcements made by Phosphagenics Limited during the half-year ended 30 June 2014 in accordance with the continuous disclosure obligations of the ASX Listing rules.

### CHANGES IN ACCOUNTING POLICY

The accounting policies and methods of computation are the same as those adopted in the most recent Annual Financial Report, unless otherwise stated, and this Half Year Financial Report has been prepared on the historical cost basis.

The following Australian Accounting Standards and Interpretations have application from 1 January 2014 and have been assessed as not relevant to the half-year financial report:

- AASB 1053 Application of Tiers of Australian Accounting Standards
- AASB 2011-4 Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements

- AASB 2013-3 Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities
- Interpretation 21 Levies

## 3. 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 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.

The Animal Health segment did not meet materiality levels and its results have been included within the Unallocated segment.

### TYPES OF PRODUCTS AND SERVICES

#### SKIN CARE

Skin Care is the use of TP in a range of products to improve the appearance of skin. 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. TPM is also able to increase the penetration of molecules formulated in the same cream.

Phosphagenics has commercialised a range of skin care products under the brand name BioElixia<sup>®</sup>, within two categories: high performance skin care and BodyShaper products. In Australia these products are sold on-line, through home shopping channel TVSN, at major department stores, David Jones and Myer, as well as Priceline and other pharmacy chains. The Company is conducting research into dermatological products and is currently in a Phase 2 clinical study for the reduction of acne

## Notes to the Financial Statements *continued*

### PAIN PORTFOLIO

Phosphagenics' pain portfolio is focused on enhancing the delivery of existing pain used for paid treatment. Its focus is primarily on delivering opioids, previously administered orally, through the skin utilising Phosphagenics' delivery technology TPM<sup>®</sup>.

The route to market for Phosphagenics' pain portfolio is by partnering with large pharmaceutical companies at the appropriate stage in a product's development to maximise return on the Company's research and development investment.

### ACCOUNTING POLICIES AND INTER-SEGMENT TRANSACTIONS

The accounting policies used by the Group in reporting segments internally is the same as those contained in note 2 to the accounts and in the prior period.

The following table presents revenue and profit information regarding operating segment performance for the half-year periods ended 30 June 2014 and 30 June 2013.

Half-year ended 30 June 2014	Skin Care \$'000's	Pain Portfolio \$'000's	Total all Segments \$'000s	Unallocated \$'000's	Total Group \$'000's
Sales and Royalties	480	95	575	17	592
<b>Total segment revenue</b>	<b>480</b>	<b>95</b>	<b>575</b>	<b>17</b>	<b>592</b>
Interest revenue	-	-	-	120	120
Income from government grants	-	-	-	1,069	1,069
Recoveries	-	-	-	2,088	2,088
Depreciation and amortisation	(57)	-	(57)	(1,866)	(1,923)
Employee and Directors benefit expense	-	-	-	(2,449)	(2,449)
Other operating expenses from continuing activities	(1,053)	(568)	(1,621)	(661)	(2,282)
<b>Net operating profit/(loss) after tax</b>	<b>(630)</b>	<b>(473)</b>	<b>(1,103)</b>	<b>(1,682)</b>	<b>(2,785)</b>
<b>Segment assets</b>	<b>1,342</b>	<b>274</b>	<b>1,616</b>	<b>37,901</b>	<b>39,517</b>

Half-year ended 30 June 2013	Skin Care \$'000's	Pain Portfolio \$'000's	Total all Segments \$'000s	Unallocated \$'000's	Total Group \$'000's
Sales and Royalties	581	-	581	3	584
<b>Total segment revenue</b>	<b>581</b>	<b>-</b>	<b>581</b>	<b>3</b>	<b>584</b>
Interest revenue	-	-	-	345	345
Income from government grants	-	-	-	1,809	1,809
Recoveries	-	-	-	565	565
Employee and Directors benefit expense	-	-	-	(2,480)	(2,480)
Depreciation and amortisation	(57)	-	(57)	(1,888)	(1,945)
Other operating expenses from continuing activities	(1,233)	(1,916)	(3,149)	(1,801)	(4,950)
<b>Net operating profit/(loss) after tax</b>	<b>(709)</b>	<b>(1,916)</b>	<b>(2,625)</b>	<b>(3,447)</b>	<b>(6,072)</b>
<b>Segment assets</b>	<b>1,748</b>	<b>-</b>	<b>1,748</b>	<b>41,210</b>	<b>42,958</b>

## Notes to the Financial Statements continued

### 4. REVENUES AND EXPENSES

	Consolidated	
	30 June 2014 \$'000	30 June 2013 \$'000
<b>a) Recoveries</b>		
Recoveries	2,088	565
<p>Recoveries from misappropriations are recognised when they are virtually certain, which is principally on receipt of cash. See further details at note 9.</p>		
<b>b) Costs under investigation</b>		
Cost under investigation	-	(465)
<p>Costs under investigation are attributable to misappropriations by the former CEO. These costs are non-recurring and have accordingly been separately disclosed.</p>		
<b>c) Other expenses</b>		
Travel and entertainment expenses	(161)	(127)
Net foreign exchange gains/(losses)	7	(22)
Insurance expenses	(107)	(99)
Doubtful debts	242	-
Inventory write down	(18)	(304)
Corporate expenses	(102)	(127)
Information technology expenses	(60)	(41)
Other	(95)	(128)
<b>Total other expenses</b>	<b>(294)</b>	<b>(848)</b>

Other expenses includes a writeback on a provision for doubtful debts relating to Le Métier de Beauté which was recovered.

### d) Seasonality of Operations

Phosphagenics Limited operations are not affected by seasonality.

### 5. DIVIDENDS PAID AND PROPOSED

There were no dividends declared or paid during the half year ended 30 June 2014 (2013: nil).

### 6. CASH AND CASH EQUIVALENTS

	Consolidated	
	30 June 2014 \$'000	31 December 2013 \$'000
<p>For the purposes of the half-year statement of cash flows, cash and cash equivalents are comprised of the following:</p>		
Cash at bank and in hand	1,434	1,637
Short-term deposits	6,206	7,186
<b>Total Cash and Cash Equivalents</b>	<b>7,640</b>	<b>8,823</b>

Short-term deposits are at terms less than three months.

## Notes to the Financial Statements continued

### 7. SHARE BASED PAYMENTS

The Group provides benefits to service providers in the form of share-based payments. Employees render services in exchange for rights over shares (equity-settled transactions). There are currently two schemes in place to provide these benefits to employees, being the Employee Share Option Plan (ESOP) and the Employee Conditional Rights Scheme (ECRS).

#### EMPLOYEE SHARE OPTION PLAN

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.

#### EMPLOYEE CONDITIONAL RIGHTS SCHEME

The ECRS allows eligible employees to be granted Performance Rights to acquire Shares at no cost. The purpose of the Scheme, and the performance conditions within, is to provide a long term incentive to staff as part of a focus to more closely link overall remuneration to the achievement of performance benchmarks, to encourage direct involvement and interest in the performance of the Company and to enable the acquisition of a long term equity interest in the Company by its staff. All employees, including executive and non-executive Directors, and any individual whom the Board determines to be an eligible participant for the purposes of the Scheme, are eligible to participate in the Scheme.

The Scheme is administered by the Board, with all objectives, determinations, approvals or opinions made or given by the Board in its absolute discretion.

Under the terms of the ECRS, the rights will vest if certain non-market or market conditions are fulfilled. One of the key overriding conditions of the Scheme is that if the 10 day Volume Weighted Average Price is not less than \$0.35 at any time prior to 31 December 2014, then 100% of the Performance Rights will vest.

Alternatively, vesting of the Rights is conditional on Phosphagenics achieving the following conditions:

Milestone 1 (16.5% of Rights awarded if achieved by 30 Jun 2012) - Completion of recruitment for the clinical trial of the Oxycodone patch, Submission of an IND for the Oxycodone patch, and gross revenues from global sales of all non-prescription products of the Company of not less than \$10 million.

Milestone 2 (16.5% of Rights awarded if any two of the following achieved by 31 Dec 2013) - Completion of the clinical trial of the oxycodone patch on time and on budget and the Board determines to continue the development and commercialisation of the patch, gross revenues from the commercialisation of the Company's TPM<sup>®</sup> technology for use in or in connection with dermatology products of not less than \$1 million, and gross revenues from global sales of all non-prescription products of the Company of not less than \$20 million.

Milestone 3 (34% of Rights awarded if any two of the following achieved by 31 Dec 2014) - Completion of all pivotal human clinical trials of the oxycodone patch, gross revenues from the commercialisation of the Company's TPM<sup>®</sup> technology for use in or in connection with the dermatology products of not less than \$2million, and gross revenues from global sales of all non-prescription products of the Company of not less than \$30 million.

Milestone 4 (34% of Rights awarded if either of the following achieved by 31 Dec 2015) - NDA (or equivalent) registration of the oxycodone patch or commercial agreement for the marketing and sale of the oxycodone patch, or gross revenues from global sales of all non-prescription products of the Company of not less than A\$40 million.

Fair values under both methods are calculated using a Binomial model. Options and Rights will be settled in ordinary shares of Phosphagenics Limited and vested options/rights 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 party becomes fully entitled to the award (the vesting date).



## Notes to the Financial Statements *continued*

During the six months ended 30 June 2014 nil share options were granted under the ESOP (2013: nil).

During the six months ended 30 June 2014, nil Rights were granted. During the 2013 comparative period nil Rights were granted under the ECRS.

During the six months ended 30 June 2014 3,000,000 options were granted (2013: nil) to three Independent Directors following approval at the AGM in May 2014.

The following table lists the inputs to the model used for the half-year ended 30 June 2014.

	<b>30 June 2014 Options</b>
Dividend yield (%)	0.00%
Expected volatility (%)	60%
Risk-free interest rate (%)	3.2%
Option life (years)	5 years
Exercise price (\$)	\$0.17

### 8. INVENTORIES

During the half-year ended 30 June 2014, there was a total write down for the period of \$18,249 (2013: \$303,570).

### 9. COMMITMENTS AND CONTINGENCIES

#### LEASE COMMITMENTS

At 30 June 2014 the Group has commitments of \$189,900 (2013: \$124,305) relating to non-cancellable operating leases over the warehouse and manufacturing facilities, which expire in 2014 and 2017. The lease on the registered office is on a month-to-month basis with the Company actively seeking new premises.

#### CONTINGENT ASSETS

On 30 October 2013 the Company entered into a Deed of Settlement with its former CEO, Dr Ogru, her husband, Vedat Isikgel, and her mother, Esin Ogru, for the misappropriated funds of \$6,331,396 plus interest and costs. As at reporting date \$2,628,083 had been repaid. Further recoveries may eventuate from the sale of one additional property, which carries a significant mortgage. The Company holds a caveat over the real property.

On 7 November 2013 the Company entered into a Deed of Settlement with an unnamed (due to confidentiality agreement) party, his wife and associated companies, for misappropriated funds of \$4,392,035 plus interest and costs. These amounts are joint and severally liable with Dr Ogru's debt.

As at reporting date \$1,150,858 had been repaid by these parties. Further recoveries may eventuate from the repayment from a portion of all parties' future total income.

On 18 December 2013 the Company, and its subsidiary Vital Health Sciences Pty Ltd, was awarded judgment in the Supreme Court of Victoria against its former employee Dr Gianello, his wife and an associated company. An amount of \$6,053,772 was awarded for damages, \$76,295 for interest and \$23,106 for costs. The damages awarded are joint and several with the debts of the two Deeds described above. On 6 February 2014 Dr Gianello and his wife filed for bankruptcy. Due to the uncertainty of proceedings no recoveries have been recognised. The Company is the largest creditor and is actively pursuing its claims.

## Notes to the Financial Statements *continued*

### 10. CONTRIBUTED EQUITY

	<b>Consolidated</b>	
	<b>(No. '000's)</b>	<b>(\$'000's)</b>
<b>Issued and paid up capital</b>		
Fully paid ordinary shares carry one vote per share and carry the right to receive dividends		
Movement in ordinary shares on issue:		
At 1 January 2014	1,020,465	209,895
Issue of shares	-	-
Exercise of options	-	-
Transaction costs on share issue	-	-
<b>At 30 June 2014</b>	<b>1,020,465</b>	<b>209,895</b>
At 1 January 2013	1,020,215	209,861
Issue of shares	-	-
Exercise of options	250	36
Transaction costs on share issue	-	(2)
<b>At 30 June 2013</b>	<b>1,020,465</b>	<b>209,895</b>

On 31 March 2013, 250,000 options with an exercise price of \$0.142 were exercised.

### 11. EVENTS AFTER THE BALANCE SHEET DATE

On 11 July 2014 the Company announced it had raised a total \$19.3 million of funds via share placement. An initial \$12.3 million was raised from placement in July with a further \$3 million via a share purchase plan finalised in August. The final share placement of \$4.0 million was approved by shareholders at a General Meeting on 25 August 2014 and is due for receipt by 29 August 2014. These equity raisings have been at an issue price of \$0.08 a share resulting in the issue of 241,500,000 new ordinary fully paid shares and increasing number of ordinary paid shares to 1,261,965,957 shares.

## Director's Declaration

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

In the opinion of the directors:

- (a) The financial statements and notes of Phosphagenics Limited for the half-year ended 30 June 2014 are in accordance with the *Corporations Act 2001*, including:
  - (i) Giving a true and fair view of the consolidated entity's financial position as at 30 June 2014 and the performance for the half-year ended on that date; and
  - (ii) Complying with Accounting Standards AASB 134: *Interim Financial Reporting* and *Corporations Regulations 2001*; and
- (b) There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

On behalf of the Board



Lawrence Gozlan  
Chairman and Independent Director

Melbourne  
27 August 2014



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

### ***Report on the Half-Year Financial Report***

We have reviewed the accompanying half-year financial report of Phosphagenics Limited (the Company), which comprises the consolidated statement of financial position as at 30 June 2014, the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, selected explanatory notes and the directors' declaration for Phosphagenics Limited (the consolidated entity). The consolidated entity comprises the company and the entities it controlled during that half-year.

### ***Directors' responsibility for the half-year financial report***

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement whether due to fraud or error.

### ***Auditor's responsibility***

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Australian Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 30 June 2014 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Phosphagenics Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### ***Independence***

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

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**PricewaterhouseCoopers, ABN 52 780 433 757**

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### *Conclusion*

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Phosphagenics Limited is not in accordance with the *Corporations Act 2001* including:

- a) giving a true and fair view of the consolidated entity's financial position as at 30 June 2014 and of its performance for the half-year ended on that date;
- b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

A handwritten signature in cursive script that reads 'PricewaterhouseCoopers'.

PricewaterhouseCoopers

A handwritten signature in cursive script that reads 'Anton Linschoten'.

Anton Linschoten  
Partner

Melbourne  
27 August 2014