

VIRALYTICS LTD

ABN 12 010 657 351

APPENDIX 4D

Half Year Report

For the 6 months ended 31 December 2017 (current period)
and the previous corresponding period 6 months ended 31 December 2016

Results for announcement to the market

	31 Dec 17	31 Dec 16	% movement	
	(\$,000)	(\$,000)		
Revenue from ordinary activities	231	287	Down	19%
(Loss) from ordinary activities after tax attributable to members	(9,291)	(7,133)	Up	30%
(Loss) for the period attributable to members	(9,291)	(7,133)	Up	30%
<hr/>				
	31 Dec 17	31 Dec 16		
Net tangible asset backing per ordinary security	12.5 cents	17.7 cents		
Basic (Loss) per share	(3.9 cents)	(3.0 cents)		

An explanation of the result of the current period and full financial details are set out in the attached Directors' Report and Financial Report.

It is not proposed that any dividends will be paid. No dividends were paid in the previous corresponding period.

Viralytics Limited

ABN 12 010 657 351

HALF-YEAR FINANCIAL REPORT

31 DECEMBER 2017

Corporate Information

Directors

Mr Paul Hopper	Chairman
Dr Leonard Post	Non-Executive Director
Mr Peter Turvey	Non-Executive Director
Dr Malcolm McColl	Managing Director and Chief Executive

Company Secretary

Ms Sarah Prince

Chief Financial Officer

Mr Robert Vickery

Principal Place of Business

Suite 305, Level 3
66 Hunter Street
Sydney NSW 2000

Ph: (02) 9988-4000
Fax: (02) 8068-6038
Email: investorrelations@viralytics.com
Web: www.viralytics.com

Auditors

Grant Thornton Audit Pty Ltd
Level 17, 383 Kent Street
Sydney NSW 2000

Registered Office

c/- Company Matters
Level 12, 680 George Street
Sydney, NSW 2000

Share Registry & Register

Link Market Services Limited
Level 12, 680 George Street
Sydney, NSW 2000
Ph: (02) 8280 7454

Directors' Report

The directors present their Report together with statements of the Group, being Viralytics Limited (the 'Company') and its controlled entities (the 'Group') for the half-year ended 31 December 2017.

DIRECTORS

The names of directors in office during the half year and until the date of this report are set out below. Directors were in office for this entire period unless otherwise stated.

Mr Paul Hopper	Chairman
Dr Leonard Post	Non-Executive Director
Mr Peter Turvey	Non-Executive Director
Dr Malcolm McColl	Managing Director and Chief Executive

RESULTS AND DIVIDENDS

The loss after tax of the Group for the half-year was \$9.3 million (comparative half-year: loss of \$7.1 million). The increase in loss was due largely to significantly increased operational expenditure including trial costs and manufacture of drug. Offsetting this was an increase in R&D tax incentive revenue of \$5.0 million attributable to recognising an estimate for the amount receivable for the period to December 2017 compared to nil in the prior year, as it was considered the Group is in a position to reliably estimate the R&D tax incentive for the first time.

No dividend was proposed or paid.

CASH MANAGEMENT AND FUNDING

The Group's cash on hand decreased in the 6 months to 31 December 2017 by \$12.2 million to \$22.0 million.

Operating cash outflow for the period was \$11.9 million compared to \$7.4 million in the prior corresponding period (6 months to 31 December 2016). Nothing was received from the Research and Development Tax Incentive refund (2016 - \$0m) but \$6.4 million was received in the first quarter of 2018. \$0.2 million interest was received (2016 - \$0.3 million). Payments to suppliers and employees was up by \$4.4 million compared to December 2016.

Directors' Report

REVIEW OF OPERATIONS

On 21 February 2018 the Company announced a Scheme Implementation Agreement with Merck Sharp and Dohme of Kenilworth NJ, United States (known as MSD outside the United States and Canada). Under the terms of the agreement it is proposed that Merck will acquire 100% of the Company by way of a Scheme of Arrangement for A\$1.75 cash per share.

Implementation of the Scheme will be subject to customary conditions, including Viralytics shareholder approval, court approval, regulatory approval, an independent expert concluding, and continuing to conclude, that the Scheme is in the best interests of shareholders, and no material adverse change or prescribed event occurring. The company is operating under the terms of the scheme at the date of this report. It is anticipated implementation of the transaction will be completed by the second quarter of 2018.

The company continues to progress three important combination studies in melanoma, lung and bladder cancer patients. A new trial in uveal melanoma (CLEVER) has been initiated with the first patient enrolment expected in February or March 2018. Data on the three ongoing studies was presented in November at the Annual Conference of the Society for Immunotherapy of Cancer (SITC).

In January 2018 the company completed a \$29.6 million share placement to Lepu Medical Group of China at a significant premium to the prevailing share price at that time.

CLINICAL TRIALS

Phase 1b MITCI Combination Clinical Trial

Results from the Phase 1b MITCI melanoma trial in combination with YERVOY^{®1} were most recently presented at the 32nd Annual Meeting of the Society for Immunotherapy of Cancer (SITC) in November. Those results showed that the combination was well tolerated and has activity in advanced melanoma patients whether or not they have been previously been treated with anti-PD-1 therapies such as KEYTRUDA^{®2}.

In the 14 patients who had not been previously treated with KEYTRUDA or other anti-PD-1 therapies, the response rate is 57 percent. In the 7 patients who had failed earlier single line anti-PD-1 treatment, responses have been seen in 2 of 7 patients promising results in a setting where there is a high unmet need for new therapies.

¹ YERVOY[®] is a trademark of Bristol-Myers Squibb

² KEYTRUDA[®] is a trademark of Merck and Co.

Directors' Report

Phase 1b CAPRA Combination Clinical Trial

Results from the Phase 1b CAPRA melanoma trial in combination with KEYTRUDA were most recently presented at the 32nd Annual Meeting of the Society for Immunotherapy of Cancer (SITC) in November. Those results included good tolerability and a preliminary Best Overall Response Rate (BORR) of 61 percent (14/23) and a disease control rate of 78 percent (18/23), with very promising durability of response in 7 of 11 patients with the most advanced Stage IV M1c disease.

Phase 1b KEYNOTE-200 Solid Tumour Cancer Clinical Trial

Preliminary results from the 90 patient CAPRA melanoma trial in combination with KEYTRUDA were presented at the 32nd Annual Meeting of the Society for Immunotherapy of Cancer (SITC) in November.

Of the 28 checkpoint naïve patients assessed at that time, 9 patients were not evaluable for target lesion response assessment by CT scan due to early disease progression or study discontinuation. For the remaining 19 evaluable patients, there was response (not all yet confirmed) in 3 of 6 NSCLC and 5 of 13 metastatic bladder cancer patients. 12 of these 19 patients currently remain on the study.

28 and 56 percent respectively of the advanced bladder and NSCLC cancer patients had received 2 or more prior therapies. To date, the combination therapy has been well tolerated with no dose-limiting toxicities. 7 of 64 patients (11%) have experienced treatment-related Grade 3 or higher adverse events. The trial has recruited strongly with full recruitment achieved in February 2018.

In addition, initial data from an assessment of the tumour microenvironment, following biopsy of tumour tissues before and after CAVATAK/pembrolizumab administration, demonstrate promising changes in the levels of the important biomarker PD-L1, including a significant increase to positive PDL-1 levels from a group of 5 patients who previously had negative or weak levels. In general, elevated levels of PD-L1 correlate with improved outcomes with anti-PD-1/PDL-1 checkpoint therapy in lung and bladder cancer.

Directors' Report

Pre-Clinical Studies

The results of a melanoma preclinical study of a novel immunotherapy combination consisting of CAVATAK, an anti-PD-1 monoclonal antibody (mAb), and an IDO inhibitor were discussed in a poster presentation at the SITC meeting in November suggesting a potential new clinical application for CAVATAK going forward.

The study data demonstrate a notable positive trend in both the reduction of the overall tumour burden as well as a survival benefit in mice treated with either the triple combination or the double combination of CAVATAK and an anti-PD-1, compared with mice receiving anti-PD-1 and IDO inhibition without CAVATAK. The triple combination was tested in an immune-competent mouse melanoma model and appears to be generally well tolerated. These results support the potential clinical evaluation of this novel immunotherapy combination.

INTELLECTUAL PROPERTY

Viralytics continues to develop and strengthen its intellectual property portfolio while maintaining a focus on cost and relevance to its strategic goals. New intellectual property is being developed, including patents covering CAVATAK combination settings, and existing patent claims continue to be pursued through various international jurisdictions.

SUBSEQUENT EVENTS

On 5 January 2018 Lepu Medical Group of China participated in an Equity Placement of 36,138,637 shares at a price of \$0.82 per share. Lepu Medical Group paid \$29,633,682 in consideration for the shares issued.

On 8 January 2018 the Group received \$6,437,137 from the Australian Taxation Office under the Research and Development Tax Incentive Programme relating to the financial year ending 30 June 2017.

On 10 January 2018 Malcolm McColl exercised 1,200,000 unlisted options, converting them to ordinary shares for a consideration of \$391,200 (\$0.326 per share).

On 21 February 2018 the Company announced a Scheme Implementation Agreement with Merck Sharp and Dohme of Kenilworth NJ, United States (known as MSD outside the United States and Canada). Under the terms of the agreement it is proposed that Merck will acquire 100% of the Company by way of a Scheme of Arrangement for A\$1.75 cash per share.

Implementation of the Scheme will be subject to customary conditions, including Viralytics shareholder approval, court approval, regulatory approval, an independent expert concluding, and continuing to conclude, that the Scheme is in the best interests of shareholders, and no material adverse change or prescribed event occurring. It is anticipated implementation of the transaction will be completed by the second quarter of 2018.

Directors' Report

AUDITOR'S INDEPENDENCE DECLARATION

A statement of independence has been provided by our auditors, Grant Thornton and is included at page 7.

This report is signed in accordance with a resolution of the Board of Directors.



Mr. Paul Hopper
Chairman
Sydney
Dated: 26 February 2018

Level 17, 383 Kent Street
Sydney NSW 2000

Correspondence to:
Locked Bag Q800
QVB Post Office
Sydney NSW 1230

T +61 2 8297 2400
F +61 2 9299 4445
E info.nsw@au.gt.com
W www.granthornton.com.au

Auditor's Independence Declaration to the Directors of Viralytics Limited

In accordance with the requirements of section 307C of the *Corporations Act 2001*, as lead auditor for the review of Viralytics Limited for the half-year ended 31 December 2017. 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.



Grant Thornton Audit Pty Ltd
Chartered Accountants



L M Worsley
Partner – Audit & Assurance

Sydney, 26 February 2018

Grant Thornton Audit Pty Ltd ACN 130 913 594
a subsidiary or related entity of Grant Thornton Australia Ltd ABN 41 127 556 389

'Grant Thornton' refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires. Grant Thornton Australia Ltd is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms. GTIL does not provide services to clients. GTIL and its member firms are not agents of, and do not obligate one another and are not liable for one another's acts or omissions. In the Australian context only, the use of the term 'Grant Thornton' may refer to Grant Thornton Australia Limited ABN 41 127 556 389 and its Australian subsidiaries and related entities. GTIL is not an Australian related entity to Grant Thornton Australia Limited.

Consolidated Statement of Profit or Loss and Other Comprehensive Income

for the half-year ended 31 December 2017

	Note	December 2017 \$	December 2016 \$
Revenue			
Interest Revenue		231,264	285,936
Total Revenue		231,264	285,936
Other Income			
R&D Tax Incentive	3	5,097,234	94,404
Unrealised foreign exchange gain		-	682,005
Total Other Income		5,097,234	776,409
Research and development costs:			
Clinical trials		(5,710,060)	(3,776,354)
Research and development		(1,409,127)	(1,339,610)
Drug product		(4,106,741)	(715,154)
Patents and related costs		(74,595)	(160,201)
Amortisation of intangibles		(195,156)	(195,156)
Depreciation expense		(37,357)	(21,819)
Employee costs		(995,115)	(675,560)
Option share based expense		(772,136)	(539,675)
Corporate compliance costs		(716,359)	(526,664)
Administration costs		(259,686)	(244,962)
Interest Expense		(19)	(4)
Foreign currency translation loss		(338,046)	-
Total Expenses		(14,614,397)	(8,195,159)
Loss from ordinary activities before income tax		(9,285,899)	(7,132,814)
Income tax expense		-	-
Loss from ordinary activities after income tax		(9,285,899)	(7,132,814)
Other comprehensive income			
Exchange Differences on translating foreign		(4,700)	-
Total Comprehensive Loss		(9,290,599)	(7,132,814)
Basic loss per share (cents per share)		(3.9)	(3.0)
Diluted loss per share (cents per share)		(3.9)	(3.0)

Consolidated Statement of Financial Position

as at 31 December 2017

		December 2017	June 2017
	Notes	\$	\$
ASSETS			
Current Assets			
Cash and cash equivalents		22,021,879	34,274,058
Trade and other receivables	3, 4	11,922,191	6,865,193
Total Current Assets		33,944,070	41,139,251
Non-Current Assets			
Plant and equipment	5	192,000	146,836
Investments	6	-	-
Intangible assets	7	1,057,996	1,253,152
Total Non-Current Assets		1,249,996	1,399,988
TOTAL ASSETS		35,194,066	42,539,239
LIABILITIES			
Current Liabilities			
Trade and other payables	8	4,038,709	2,949,129
Total Current Liabilities		4,038,709	2,949,129
Non-Current Liabilities			
Trade and other payables	8	16,986	-
Total Non-Current Liabilities		16,986	-
TOTAL LIABILITES		4,055,695	2,949,129
NET ASSETS		31,138,371	39,590,110
EQUITY			
Contributed equity	9	121,885,635	121,696,416
Reserves	10	2,386,204	3,222,263
Accumulated losses		(93,133,468)	(85,328,569)
TOTAL EQUITY		31,138,371	39,590,110

The accompanying notes form part of these financial statements.

Consolidated Statement of Changes in Equity

for the half-year ended 31 December 2017

	Share Capital	Retained Earnings	Reserves		Total
	Ordinary \$	(Accumula ted Losses) \$	Option Reserve \$	Foreign Currency Translation Reserve \$	\$
Balance at 1 July 2017	121,696,416	(85,328,569)	3,223,308	(1,045)	39,590,110
Loss after income tax expense for the year	-	(9,285,899)	-	-	(9,285,899)
Other comprehensive income for the year	-	-	-	(4,700)	(4,700)
Total comprehensive income for the year	-	(9,285,899)	-	(4,700)	(9,290,599)
Transactions with owners in their capacity as owners, and other transfers:					
Transaction costs	(3,676)	-	-	-	(3,676)
Ordinary Shares issued on Exercise of Options	70,400	-	-	-	70,400
Transfer to share capital for options exercised	35,060	-	(35,060)	-	-
Conversion of Performance Rights	87,435	-	(87,435)	-	-
Options Expired During the Period	-	1,481,000	(1,481,000)	-	-
Share option based compensation	-	-	772,136	-	772,136
Total transactions with owners and other transfers	189,219	1,481,000	(831,359)	-	838,860
Balance at 31 December 2017	121,885,635	(93,133,468)	2,391,949	(5,745)	31,138,371

The accompanying notes form part of these financial statements.

Consolidated Statement of Changes in Equity

for the half-year ended 31 December 2017

	Contributed Equity	Retained Earnings (Accumulated Losses)	Reserves	Total
	Ordinary		Share Based Payment Reserve	
	\$	\$	\$	\$
Balance at 1 July 2016	121,169,264	(73,035,059)	2,193,819	50,328,024
Loss for the Period	-	(7,132,814)	-	(7,132,814)
Other Comprehensive Income	-	-	-	-
Comprehensive income for the period	-	(7,132,814)	-	(7,132,814)
Cost of fund raising	(4,050)	-	-	(4,050)
Exercise of options	210,000	-	-	210,000
Share Rights Converted to Shares	56,050	-	(56,050)	-
Share option based compensation	-	-	539,675	539,675
Transfer to share capital for options exercised	82,800	-	(82,800)	-
Total transactions with owners and other transfers	344,800	-	400,825	745,625
Balance at 31 December 2016	121,514,064	(80,167,873)	2,594,644	43,940,835

The accompanying notes form part of these financial statements.

Consolidated Statement of Cash Flow

for the half-year ended 31 December 2017

	December 2017	December 2016
	\$	\$
Cash flows from Operating Activities		
Payments to suppliers and employees	(12,124,985)	(7,670,872)
Interest Received	232,300	292,793
Interest Paid	(19)	-
Net cash (used in) operating activities	(11,892,704)	(7,378,079)
Cash flows from Investing Activities		
Purchase of Plant and equipment	(82,522)	(55,563)
Net cash (used in) investing activities	(82,522)	(55,563)
Cash flows from Financing Activities		
Exercise of options	70,400	210,000
Costs of fund raising	(3,676)	(4,050)
Net cash provided by financing activities	66,724	205,950
Net increase/(decrease) in cash held	(11,908,502)	(7,227,692)
Net Foreign Exchange Difference	(343,677)	682,005
Cash at beginning of the financial period	34,274,058	46,121,485
Cash at the end of the financial period	22,021,879	39,575,798

The accompanying notes form part of these financial statements

Notes to the financial statements

for the half-year ended 31 December 2017

1. BASIS OF PREPARATION OF THE HALF-YEAR FINANCIAL REPORT

This half-year financial report is a general-purpose condensed interim financial report that has been prepared in accordance with Australian Accounting Standard AASB134; 'Interim Financial Reporting', other authoritative pronouncements of the Australian Accounting Standards Board and the *Corporations Act 2001*.

The half-year report does not include full disclosure of the type normally included in an annual financial report. The half-year financial report should be read in conjunction with the Annual Financial Report of Viralytics Limited (the Group) as at 30 June 2017. It is recommended that the half-year financial report be considered together with any public announcements made by the Group during the half-year ended 31 December 2017 in accordance with the continuous disclosure obligations arising under the Australian Securities Exchange Listing Rules and the *Corporations Act 2001*.

Except as described below, the accounting policies applied by the Group in this half-year financial report are the same as those applied by the Group in the financial report as at and for the year ended 30 June 2017.

Going Concern

The financial statements for the period ended 31 December 2017 are prepared on a going concern basis.

Notwithstanding that the Group has a history of losses, the Directors consider that it has sufficient capital to pursue its strategic plan and objectives in the next twelve months as laid out in the Directors Report. This is because the Group has cash assets of \$22 million at 31 December 2017 and on 5th January 2018 it raised a further \$29.6 million from a share placement. This cash will fund programmes beyond 12 months from the signing of this report. The cash holdings will provide sufficient funding to meet foreseeable expenditure commitments and pay debts as and when they fall due.

Estimates

When preparing the interim financial statements, management undertakes a number of judgements, estimates and assumptions about recognition and measurement of assets, liabilities, income and expenses. The actual results may differ from the judgements, estimates and assumptions made by management, and will seldom equal the estimated results.

The judgements, estimates and assumptions applied in the interim financial statements, including the key sources of estimation uncertainty were the same as those applied in the Group's last half yearly financial statements for the period ended 30 June 2017.

Notes to the financial statements

for the half-year ended 31 December 2017

2. OPERATING SEGMENTS

The entity's operating segment is based on the internal reports that are reviewed and used by the Board of Directors (being the Chief Operating Decision Makers ('CODM')) in assessing performance and determining the allocation of resources. The entity operates in one segment being Development of Oncolytic Therapeutics. The information reported to the CODM, on a monthly basis, is profit or loss before interest, tax, depreciation and amortisation and other one-off-items ('EBITDA') as well as cash flow.

	December 2017	December 2016
	\$	\$
3. R&D TAX INCENTIVE		
R&D Tax Incentive Income	5,097,234	94,404

R&D Tax Refund receivable at 31 December comprises \$6,437,137 in respect of the year ending 30 June 2017 which was received on 8 January 2018 and \$5,045,978 for the period July to December 2017 which is anticipated to be receivable as part of the Group's application for the year ending 30 June 2018. The latter amount is an estimate and is conditional on the 2018 application being successful. For December 2016 the receivable for the 6 month period to December was not recognised based on a judgement that there was uncertainty about the quantum of the amount being successfully claimed and therefore that the R&D tax refund was not able to be reliably estimated. The Group now considers it has sufficient R&D claim history and is now in a position to reliably estimate the R&D tax refund at the interim period at 31 December 2017.

	December 2017	June 2017
	\$	\$
4. TRADE AND OTHER RECEIVABLES		
GST Receivable	109,381	99,364
Prepayments	277,750	326,967
Interest Receivable	51,945	52,981
R&D Tax Refund	11,483,115	6,385,881
	11,922,191	6,865,193

Notes to the financial statements

for the half-year ended 31 December 2017

	December 2017	June 2017
	\$	\$
5. PLANT AND EQUIPMENT		
Plant and Equipment at cost	1,146,920	1,064,399
Accumulated depreciation	(954,920)	(917,563)
	192,000	146,836

Movements in Carrying Amounts

Movements in the carrying amounts at the beginning and end of the current and previous period:

Balance at beginning of period	146,836	78,668
Additions	82,521	119,912
Disposals	-	-
Depreciation expense	(37,357)	(51,744)
Balance at end of period	192,000	146,836

6. INVESTMENTS - EQUITY ACCOUNTED ASSOCIATES

InJet Digital Aerosols Limited	-	-
--------------------------------	---	---

InJet Digital Aerosols Ltd (IDAL) was an unlisted public company incorporated in Australia. Viralytics Ltd held a 44.5% interest in the issued capital of IDAL. On 5 October 2017 the company was de-registered. Accordingly the investment in Injet has been written off.

In prior periods the Group recognised the losses attributable to the Associate to the extent of the investment. A Presentation of Accounts and Statement lodged with ASIC by the External Liquidators on 23 June 2017 indicated total creditors of \$495,950. It further indicated that no dividend was likely to be paid to creditors. Consequently, the carrying value of the investment is nil (June 2017 – nil).

Notes to the financial statements

for the half-year ended 31 December 2017

	December 2017 \$	June 2017 \$
7. INTANGIBLE ASSETS		
Virotherapy Intellectual Property	8,605,532	8,605,532
Accumulated Amortisation	(7,547,536)	(7,352,380)
	1,057,996	1,253,152
Movement in Intangibles		
Balance at beginning of period	1,253,152	1,643,464
Amortisation expense for the period	(195,156)	(390,312)
Balance at end of period	1,057,996	1,253,152
8. TRADE AND OTHER PAYABLES		
Current		
Trade payables	2,509,278	1,810,951
Sundry payables and accrued expenses	1,257,042	941,473
Employee entitlements – annual leave	272,389	196,705
	4,038,709	2,949,129
Non-Current		
Employee entitlements	16,986	-
	16,986	-

Notes to the financial statements

for the half-year ended 31 December 2017

	December 2017	
	Number	\$
9. CONTRIBUTED EQUITY		
Ordinary Shares		
Issued and fully paid	240,924,252	121,885,635
Movements in ordinary shares on issue		
At 1 July 2017	240,623,752	121,696,416
Share Rights Converted to Shares	100,500	87,435
Exercise of Options proceeds	-	70,400
Options Converted to Shares	200,000	35,060
Transaction costs	-	(3,676)
At 31 December 2017	240,924,252	121,885,635
	December 2017 \$	June 2017 \$
10. RESERVES		
Share Based Payments Reserve	2,391,949	3,223,308
Foreign Currency Translation Reserve	(5,745)	(1,045)
	2,386,204	3,222,263

In total \$772,136 (Dec 2016: \$539,675) of employee remuneration expense has been included in profit or loss and credited to the share based payment reserve in respect of equity settled share based payment transactions. If all unlisted options were exercised in accordance with their terms of issue 15,383,667 shares would be issued (June 2017: 14,197,667) and Contributed Equity would increase by \$10.0 million (June 2017: \$8.6 million).

The share based payment reserve records items recognised as an expense on payment of share based consideration. The option valuations were calculated using the Black-Scholes option pricing model. Historical volatility has been the basis for determining expected share price volatility as it is assumed that this is indicative of future movements. For purposes of the valuation the assumed life of the options was based on the historical exercise patterns, which may not eventuate in the future.

Notes to the financial statements

for the half-year ended 31 December 2017

10. RESERVES continued

No special features inherent to the options granted were incorporated into measurement of fair value. 9,000,000 options offered in September 2015 and 4,500,000 options issued in December 2017 contained vesting conditions contingent on achievement of performance targets based on share price, clinical trial progress or corporate transaction activity. A probability discount has *not* been applied to the measurement of fair value of those options. This is because some of the options issued had terms in which the vesting conditions are met if *either* market based or non-market based conditions are met.

Of the 2015 options the first of the two tranches issued vested on account of the market based conditions being met. The second tranche expired as none of the conditions were achieved within the prescribed timeframe. Of the 2017 options the first of the two tranches issued vested in January 2018 on account of a non-market based conditions being met. The second tranche has not yet vested.

The Group has taken the view for the remaining tranche of the 2017 issued options that they are more likely to vest due to one of the non-market conditions (clinical trial progress or corporate transaction activity) rather than the single market based condition (share price). The result is a higher valuation than would otherwise be the case if the performance conditions were considered in the valuation.

The following terms and conditions apply to unlisted options issued:

- Options issued entitle the holder to acquire an unissued ordinary share in the Group;
- Options are unlisted and not transferable;
- Options not exercised in the prescribed period will lapse;
- Each option has no voting or dividend right;

All options issued were issued free of charge.

Notes to the financial statements

for the half-year ended 31 December 2017

	December 2017 Number	June 2017 Number
10. RESERVES continued		
Options		
Unlisted options	15,383,667	14,197,667
Movements in Options:		
Balance at the beginning of the period	14,197,667	13,145,000
Options issued	5,886,000	1,686,000
Options exercised	(200,000)	(633,333)
Options expired	(4,500,000)	-
Balance at end of period	15,383,667	14,197,667
Share Rights		
Unlisted Share Rights	131,500	100,500
Movements in Share Rights:		
Balance at the beginning of the period	100,500	100,000
Share Rights issued	131,500	100,500
Share Rights Converted to Shares	(100,500)	(95,000)
Share Rights Lapsed	-	(5,000)
Balance at end of period	131,500	100,500

Notes to the financial statements

for the half-year ended 31 December 2017

	December 2017 cents	December 2016 cents
11. EARNINGS PER SHARE		
Basic earnings (loss) cents per share	(3.9)	(3.0)
Diluted earnings (loss) cents per share	(3.9)	(3.0)
Income and share information used in the calculations of basic and diluted earnings per share:		
	\$	\$
Net (Loss) used to calculate basic EPS	(9,285,899)	(7,132,814)
	Number	Number
Weighted average number of ordinary shares on issue used to calculate basic earnings per share	240,750,132	240,207,158
Effect of dilutive securities	-	-
Adjusted weighted average number of Ordinary shares and potential ordinary shares used to calculate diluted earnings per share	240,750,132	240,207,158

As at the balance date, there are 15,383,667 share options on issue. These potential ordinary shares have not been taken into account when calculating the diluted loss per share due to their anti-dilutive nature.

11. CONTINGENT LIABILITIES

As at 31 December 2017 Directors do not consider there to be any contingent liabilities.

12. SUBSEQUENT EVENTS

On 5 January 2018 Lepu Medical Group of China participated in an Equity Placement of 36,138,637 shares at a price of \$0.82 per share. Lepu Medical Group paid \$29,633,682 in consideration for the shares issued.

On 8 January 2018 the Group received \$6,437,137 from the Australian Taxation Office under the Research and Development Tax Incentive Programme relating to the financial year ending 30 June 2017.

On 10 January 2018 Malcolm McColl exercised 1,200,000 unlisted options, converting them to ordinary shares for a consideration of \$391,200 (\$0.326 per share).

Notes to the financial statements

for the half-year ended 31 December 2017

12. SUBSEQUENT EVENTS continued

On 21 February 2018 the Company announced a Scheme Implementation Agreement with Merck Sharp and Dohme of Kenilworth NJ, United States (known as MSD outside the United States and Canada). Under the terms of the agreement it is proposed that Merck will acquire 100% of the Company by way of a Scheme of Arrangement for A\$1.75 cash per share.

Implementation of the Scheme will be subject to customary conditions, including Viralytics shareholder approval, court approval, regulatory approval, an independent expert concluding, and continuing to conclude, that the Scheme is in the best interests of shareholders, and no material adverse change or prescribed event occurring. It is anticipated implementation of the transaction will be completed by the second quarter of 2018.

Directors' Declaration

The directors' of the Group declare that:

- (1) the financial statements and notes, as set out on pages 8 to 21 are in accordance with the *Corporations Act 2001* including:
 - (a) complying with the Australian Accounting Standard AASB 134: Interim Financial Reporting, and
 - (b) giving a true and fair view of the Group's financial position as at 31 December 2017 and its performance for the half-year ended on that date.
- (2) in the directors' opinion there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Board of Directors.



Mr Paul Hopper
Chairman

Sydney
Date: 26 February 2018

Level 17, 383 Kent Street
Sydney NSW 2000

Correspondence to:
Locked Bag Q800
QVB Post Office
Sydney NSW 1230

T +61 2 8297 2400
F +61 2 9299 4445
E info.nsw@au.gt.com
W www.grantthornton.com.au

Independent Auditor's Review Report to the Members of Viralytics Limited

Report on the Half-Year Financial Report

Conclusion

We have reviewed the accompanying half-year financial report of Viralytics Limited (the 'Company') and its subsidiaries (the Group), which comprises the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, a description of accounting policies, other selected explanatory notes, and the directors' declaration.

Based on our review, which is not an audit, nothing has come to our attention that causes us to believe that the half-year financial report of Viralytics Limited does not give a true and fair view of the financial position of the Group as at 31 December 2017, and of its financial performance and its cash flows for the half-year ended on that date, in accordance with the *Corporations Act 2001*, including complying with Accounting Standard AASB 134 *Interim Financial reporting*.

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 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 gives a true and fair view and 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 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 half-year financial report is not in accordance with the

Grant Thornton Audit Pty Ltd ACN 130 913 594
a subsidiary or related entity of Grant Thornton Australia Ltd ABN 41 127 556 389

'Grant Thornton' refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires. Grant Thornton Australia Ltd is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms. GTIL does not provide services to clients. GTIL and its member firms are not agents of, and do not obligate one another and are not liable for one another's acts or omissions. In the Australian context only, the use of the term 'Grant Thornton' may refer to Grant Thornton Australia Limited ABN 41 127 556 389 and its Australian subsidiaries and related entities. GTIL is not an Australian related entity to Grant Thornton Australia Limited.

Corporations Act 2001 including giving a true and fair view of the Group's financial position as at 31 December 2017 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 Viralytics 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*.



Grant Thornton Audit Pty Ltd
Chartered Accountants



L M Worsley
Partner - Audit & Assurance

Sydney, 26 February 2018