PHYLOGICA

BREAKTHROUGH PEPTIDE THERAPEUTICS

ABN 98 098 391 961

Annual Financial Statements

30 June 2017

Phylogica Limited

Corporate Information

Directors
Ms Stephanie Unwin
Chief Executive Officer / Executive Chair

Dr Robert Hayes
Executive Director / Chief Scientific Officer

Dr Rick Kendall
Non-Executive Director

Dr Bernard Hockings
Non-Executive Director

Dr Paul Watt
Non-Executive Director

Dr Rohan Hockings
Alternate Non-Executive Director (B Hockings)

Contents

Company Secretary
Mr Kevin Hart

Share Registry
Security Transfer Registrars Pty Ltd
PO Box 535
Applecross
Western Australia 6953
770 Canning Highway
Applecross
Western Australia 6153
Telephone: 08 9315 2333
Facsimile: 08 9315 2233
Email: registrar@securitytransfer.com.au

Auditors
HLB Mann Judd
Level 4
130 Stirling Street
Perth
Western Australia 6000

Website
www.phylogica.com

Incorporated in Western Australia, October 2001

Registered Office
Suite 8, 7 The Esplanade
Mt Pleasant
Western Australia 6153
Telephone: 08 9316 9100
Facsimile: 08 9315 5475

Postal Address
Suite 8, 7 The Esplanade
Mt Pleasant
Western Australia 6153

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

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

Frankfurt Exchange
Code: PH7 ordinary shares

The directors present their report on the consolidated group, comprising Phylogica Limited (referred to in these financial statements as "the Group" or "Phylogica") and its wholly owned subsidiary, together with the financial report for the year ended 30 June 2017 and the audit report thereon.

1. Directors

The Directors of the Company at any time during or since the end of the year are:

Executive Directors

Ms Stephanie Unwin **Age: 46**
LLB, B Econ, GAICD
Chief Executive Officer / Executive Chair

Appointed as a Director on 18 January 2016. Transitioned from Non-Executive Director to Non-Executive Chair on 8 April 2016. Transitioned to Chief Executive Officer, and Executive Chair on 17 June 2017. Current term ends June 2019.

Ms Unwin was previously the Executive General Manager, Commercial at Synergy - a role she held since March 2014 which encompasses Strategy and Innovation; Corporate Development; Transformation and Continuous Improvement; Modelling and Analytics; Corporate Affairs; Policy and the Chief Engineer. Stephanie held the role of General Manager Strategy and Business Development with Verve Energy from 2012 prior to its merger with Synergy on 1 January 2014.

Stephanie's background is in corporate law, and she previously worked with ASIC, Herbert Smith Freehills, Pullinger Readhead Stewart and Maxim Litigation Consultants before joining Verve Energy as its General Counsel and Company Secretary.

Stephanie is a former non-executive director of ASX/TSX listed entity Alacer Gold Corp (December 2001 to August 2013) and ASX listed entity Integra Mining Limited (November 2011 to January 2013). She is currently a director of Vinalco Energy Pty Ltd, Greenough River Solar Farm and Mumbida Wind Farm.

Ms Unwin has held no other Australian public company directorships in the last three years.

Dr Robert Hayes **Age: 58**
PhD
Executive Director

Appointed as a Director on 18 April 2017, Transitioned to Chief Scientific Officer on 17 June 2017. Current term ends June 2019.

Dr Hayes was previously Head of Biologics at multinational biopharmaceutical company Amgen (NASDAQ:AMGN), responsible for the leadership, strategic direction and operational management of the company's biologics preclinical discovery and biotherapeutics pipeline. This included bioreagent generation, large molecule lead identification, biologics optimization, and the transition to upstream process development and manufacturing.

Prior to Amgen, Dr Hayes spent seven years as Vice President & Venture Leader of a biotech company within Janssen R&D that focused on developing and exploiting small alternative scaffold proteins. He was also a Senior Director of Protein Engineering at Johnson and Johnson, one of the worlds' largest healthcare companies, for over three years.

With over 20 years' experience in biotech start-ups and large pharmaceutical companies, Dr Hayes has a proven track record in building teams around new scientific ideas and technologies. He also has significant experience in forming partnerships between biotech companies and university partners to advance the development and application of novel therapeutic platforms.

Dr Hayes holds a Ph.D. from the Imperial College London, where he was the Royal College of Science Scholar and a Royal Society University Research Fellow. He also completed postdoctoral research at Imperial and University California at Berkeley.

Non-executive Directors

Dr Paul Watt **Age: 52**
BSc(Hons), PhD
Non-Executive Director

Appointed as a Director on 12 September 2016.

Adjunct Professor Watt is the founder of Phylogica and is the principal inventor of Phylogica's drug discovery technologies. Prior to his appointment as a Non-Executive Director, Professor Watt held the position of Chief Scientific Officer of Phylogica, where he continues to provide strategic scientific services to the company as its Chief Scientific Advisor, bringing more than 15 years of experience in the biotechnology industry.

Professor Watt has published 57 peer reviewed papers, and has filed 25 patent applications many of which are granted in the US and Europe. Specialising in drug discovery biotechnology and molecular biology, he has attracted over A$10 million in research funding from Australia and the United States to develop the technology underpinning Phylogica.

Previously Professor Watt founded InfaMed Ltd, which became by Avita Medical Ltd, and commercialised an FDA-approved /CE-marked paediatric drug delivery device that he invented, which was marketed internationally. He was appointed Adjunct Professor at the School of Paediatrics and Child Health at the University of Western Australia and is now Director of Research Services and Innovation at the Telethon Kids Institute, and head of its Drug Discovery Unit where Phylogica's discovery research is carried out under contract.

Professor Watt carried out postdoctoral research in yeast genetics at Harvard and Oxford Universities, where he discovered and characterised proteins involved in maintaining genome stability and cancer. He has a doctorate in Molecular Biology from Oxford University and BSc (Hons) from the University of Western Australia.

Dr Bernard Hockings Age: 69
R.F.D., MD (WA), M.B.B.S (WA), F.R.A.C.P., F.C.S.A.N.Z, GAICD
Non-Executive Director

Appointed as a Director on 23 January 2014.

Dr Hockings retired as an Interventional Cardiologist in Private Practice in Western Australia in July 2016. He is a Clinical Associate Professor in Medicine at the University of Western Australia. Previously he was Director of the Coronary Care Unit at Royal Perth Hospital, Chair of the Medical Advisory Committee at the Mount Hospital and Director of Health Reserves (WA) for the Royal Australian Air Force.

Dr Hockings has a lifelong interest in medical research. His Doctoral Thesis involved Vasodilator Therapy in the treatment of heart failure. He has been closely involved with clinical teaching throughout his career. Dr Hockings is now a major shareholder in Phylogica.

Dr B Hockings has held no other Australian public company directorships in the last three years.

Dr Rohan Hockings Age: 34
M.B.B.S (Hons.), J.D., G.D.L.P
Alternate Non-Executive Director

Appointed as an Alternate Director for Dr Bernard Hockings on 15 August 2016.

Dr Hockings is a founding principal of a private equity fund active in the acquisition of health care assets within Australia. His previous roles include strategy and operational advisory positions with a global management consulting firm, equity capital markets experience as a solicitor with a national law firm and a number of appointments as a medical practitioner. Dr. Hockings has a special interest in both venture capital and private equity within the healthcare industry and has been a shareholder in Phylogica for more than 5 years.

Dr R Hockings has held no other Australian public company directorships in the last three years.

Dr Rick Kendall Age: 63
PhD

Appointed as a Director on 18 April 2017. Current term ends November 2017.

Based in California, Dr Kendall is currently Vice President Research at Kite Pharma, responsible for the company's research pipeline and developing CAR-T technology.

Previously, Dr Kendall was Executive Director of Oncology Research at Amgen, where he directed a group of 90+ scientists, and was responsible for the development of the Amgen cancer franchise strategy aligning research with other functions including Chemistry, Protein Sciences, Medical Translational Sciences, Development and

Commercial. Results included 17 clinical candidate molecules made up of 9 small molecules and 8 protein therapeutics. Dr Kendall holds an associate adjunct professor position in the Department of Molecular, Cellular and Developmental Biology, at the University of California at Santa Barbara.

Dr Kendall has consulted to Phylogica previously on the development of the company's assets including the iMyc oncology program and Functional Penetrating Phylomer (FPP) intracellular drug delivery technology.

FORMER DIRECTORS

Dr Doug Wilson **Age: 80**
MB, ChB, FRACP, FRCPA
Non-Executive Director

Appointed as a Director on 10 December 2007. Transitioned from Non-Executive Chair to Non-Executive Director on 8 October 2015. Resigned 25 November 2016.

Dr Wilson is a New Zealand medical graduate with post graduate experience in London at St Thomas Hospital Medical School, and at Walter and Eliza Hall Institute Melbourne.

Dr Wilson joined the international pharmaceutical industry and became Senior Vice president for Boehringer Ingelheim for Medicine and Regulatory Affairs in the USA, responsible for all dealings with FDA. He moved to Ingelheim and had the same responsibilities world-wide. Dr Wilson headed the company's International Labelling Committee, deputy head of the International Medical Committee which oversaw all drugs in clinical development globally. During his tenure he saw ten drugs approved in the USA.

Dr Wilson is now a consultant and is on the board of a number of other companies and consults widely on biotech and pharmaceutical issues.

Dr Wilson serves as the non-executive chair on the board of ASX listed company, Adherium Limited. Dr Wilson has held no other Australian public company directorships in the last three years.

Mr Jeremy Curnock Cook **Age: 67**
MA
Non-Executive Director

Appointed as a Director on 29 February 2012. Resigned 18 April 2017.

He was formerly the head of the life science private equity team at Rothschild Asset Management in the UK and an active investor in the Australian life science sector. At Rothschild, Mr Curnock Cook was responsible for the launch of the first dedicated biotechnology fund for the Australian market.

Over his 40-year career, Mr Curnock Cook has specialised in creating value in emerging biotech enterprises, through active participation with management. He has served on over 40 Boards in various roles, including Chair of private and public biotechnology companies listed on NASDAQ, LSE, TSX and ASX.

Mr Curnock Cook received his MA in Natural Sciences from Trinity College in Dublin, Ireland.

Mr Curnock Cook serves as a non-executive director on the board of ASX listed companies, Avita Medical Ltd and Adherium Limited. Mr Curnock Cook has held no other Australian public company directorships in the last three years.

Former Executive

Dr Richard Hopkins **Age: 49**
BSc (Hons), PhD
Chief Executive Officer

Appointed as a Director on 19 July 2013. Resigned 18 July 2016.

Dr Hopkins was a founder of Phylogica. His most recent research is focussed on engineering peptide leads for drug development. He has published over 20 peer reviewed papers and is a co-inventor on over 10 patent applications, several of which have been issued in the US and Europe.

Previously, Dr Hopkins carried out postdoctoral research in yeast genetics at the Telethon Institute for Child Health Research, Perth, Western Australia. His research focussed on the development of a novel class of peptides, trademarked by Phylogica as Phylomers® and the methods to integrate them into various high throughput screening platforms such as yeast-two-hybrid and phage display.

Dr Hopkins has a BSc (Hons) and completed a PhD in Molecular Parasitiology.

Dr Hopkins is current Director and CEO of Pharmaust Ltd, an ASX-listed company and is the Chair of Ausbiotech (WA Branch)

2. Company Secretary

Mr Kevin Hart **Age: 55**
BComm
FCA
Company Secretary/Chief Financial Officer – Appointed 24 July 2017

Kevin holds a Bachelor of Commerce Degree and is a Chartered Accountant. He is a Partner at Endeavour Corporate Pty Ltd, an advisory firm that specialises in the provision of company secretarial services to ASX listed entities. Kevin has over 26 years of professional experience with various public companies, mostly in the exploration and mining industry.

FORMER COMPANY SECRETARIES

Mr Graeme Boden **Age: 68**
BEc (Hons)
Company Secretary/Chief Financial Officer – Resigned 24 July 2017

Ms Natasha Forde **Age: 29**
Joint Company Secretary – Resigned 31 March 2017

3. Directors' Meetings

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

Director	Directors' Meetings		Audit Committee		Risk Committee		Remuneration Committee	
	A	B	A	B	A	B	A	B
S Unwin	10	10	2	2	-	-	-	-
P Watt	9	9	-	-	-	-	-	-
R Hayes	3	2	-	-	-	-	-	-
R Kendall	3	2	-	-	-	-	-	-
B Hockings	10	9	2	1	-	-	-	-
R Hockings (Alt BH)	9	6	-	-	-	-	-	-
D Wilson*	3	2	2	1	-	-	-	-
J Curnock Cook*	8	6	2	1	-	-	-	-
R Hopkins*	-	-	-	-	-	-	-	-

A = Number of meetings held while in office

B = Meetings attended

** Resigned during the financial year.*

4. Principal Activities

The principal activity of the Company during the financial year was drug discovery research and development, whether in its own right or in partnership with international pharmaceutical companies, utilising the Company's Phylomer® peptide libraries and proprietary screening capabilities.

5. Operating Results and Financial Position

The consolidated operating loss after tax for the financial year ended on 30 June 2017 was $1,950,837 (2016 loss: $3,978,672). Included in the result for the year is an amount of $2,760,258 commercial income (2016: Nil) being a milestone payment to extend the exclusivity period under the terms of a Research Collaboration and Licence agreement with Genentech a member of the Roche Group.

The accounting standards do not permit the capitalisation of development expenditure in circumstances where the company cannot demonstrate sustainable revenue generation derived from the results of the expenditure. Research expenditure must be expensed under accounting standards. The expenditure incurred in relation to obtaining and maintaining patent protection is allowed to be capitalised under the standards but the Company has adopted a policy of expensing such expenditure as it is incurred.

Since incorporation, Phylogica has raised $57.2 million in capital, reduced to $53.2 million after netting capital raising fees. From this amount the following expenditures have been undertaken (all amounts $ million):

Research & Development:	Prior to 2015	2016	2017	Total
Contract Research	20.83	3.47	3.44	27.74
Personnel (allocation)	7.24	0.45	-	7.70
Laboratory Consumables	5.14	0.66	0.99	6.79
	33.21	4.58	4.43	42.23
IP Maintenance	3.41	0.28	0.21	3.91
	36.62	4.86	4.64	46.14

The cash position of the Company at 30 June 2017 was $9.9 million (30 June 2016: $7.1 million).

6. Review of Activities

6.1 Corporate

During the year Stephanie Unwin was appointed Chief Executive Officer, providing significant senior executive and commercial experience to the strategic direction of Phylogica. Dr Robert Hayes was appointed Chief Scientific Officer, bringing extensive experience in biotechnology research and drug development to the commercialisation of Phylogica candidates. Dr Rick Kendall was appointed Non-Executive Director, offering valuable experience in pharmaceutical research and oncology drug development.

In June 2017 the company successfully raised $5m (before costs) to enhance the pre-clinical validation of Phylogica intracellular delivery technology and proprietary drug cargoes.

6.2 Operations

Strong progress was made during the 2017 financial year with significant progress being made in the Company's drug development program.

Significant highlights in the Company's cancer drug discovery program during the year included:

- The identification of new Phylomer FPPs with improved ability to deliver a range of biologics inside cells, expansion of the potency of Phylomer FPPs, and extension of in vivo half-life of our FPP cargo conjugates. The Company has completed several in vivo studies that demonstrate that we can significantly extend the half-lives of Phylomer FPPs using protein engineering. Encouragingly these engineered Phylomer FPPs are not all trapped in one tissue or location in the animal model, such as the liver or the kidney, but are more evenly distributed throughout the body. All of these constitute key milestones in the development of a robust delivery technology that will allow us to deliver biologics targeted towards intracellular therapeutic targets.

- Further progress with iMyc lead optimisation to improve their potency, identification of biomarker signature to track on-target effect of iMyc leads, and confirmation of potent activity of iMycs across a wide range of blood cancer cell lines.

- Drafting of a new patent application by the Company's patent attorneys to capture IP around variants of two of our lead Phylomer FPP families. This filing will allow Phylogica to publicise details around its exciting findings in high impact publications that are currently being prepared as well as at international conferences.

- Collaborations with Genentech and Professor Sir David Lane the Chief Scientist of A*Star, Singapore are both active and proceeding well. The Company has begun new screens for Genentech, which are already yielding encouraging results around the previously reported expansion of our antimicrobial collaboration.

6.3 Future Prospects

The next 12 months will see PYC deliver its *in vivo* (live animal model) data demonstrating the efficacy of our intracellular delivery platform in conjunction with our current lead in house cargo, iMyc and non-human toxicology data in late 2018. The Company will also work on validating a range of cargo types able to be delivered into the intracellular environment in commercial and academic collaborations, together with our own in-house work. The Company will also enhance its peptide libraries using genomes from additional microorganism families and identify new sequences to generate next generation IP further supporting the value in the platform and cell targeting cargoes.

7. Significant Changes in the State of Affairs

There were no significant changes in the state of affairs other than:

The wholly owned dormant subsidiary Dynamic Microbials Ltd was deregistered on 5 July 2017.

On 16 June 2017 the Company completed a placement of 125,000,000 shares at an issue price of $0.04 per share. The net proceeds raised under the offer, after expenses were $4,686,750.

8. Dividends

No dividends have been paid or declared by the Company since the end of the previous financial year.

9. Events Subsequent to Reporting Date

There are no matters or circumstances that have arisen since the end of the financial year that have significantly affected or may significantly affect the operations of the Group, the results of those operations or the state of affairs of the Group, in future financial years.

10. Directors' Interests

The relevant interest of each director in the shares and options over shares issued by Phylogica as notified by the directors to the Australian Securities Exchange in accordance with Section 205G(1) of the Corporations Act 2001, at the date of this report is as follows:

Director	Ordinary Shares	Options
S Unwin	3,333,333	6,666,667
P Watt	14,517,197	20,000,000
R Hayes	-	-
R Kendall	-	-
B Hockings	582,924,185	-
R Hockings	-	-

11. Indemnification and Insurance of Directors and Officers

11.1 Directors' and officers' indemnity

The Group has agreed to indemnify each Director and the Company Secretary (Officers) against all liabilities or loss (other than the Group or a related body corporate) that may arise from their position as Officers of the Group and its controlled entities, except where the liability arises out of conduct involving a lack of good faith, or indemnification is otherwise not permitted under the Corporations Act. The indemnity stipulates that the Group will meet the full amount of any such liabilities, including costs and expenses, and covers a period of seven years after ceasing to be an Officer of the Group.

The Group has also indemnified the current directors and certain members of its senior management for all liabilities and loss (other than the Group or a related body corporate) that may arise from their position, except where the liability arises out of conduct involving lack of good faith or indemnification is otherwise not permitted under the Corporations Act.

The Group has executed deeds of indemnity, access and insurance in favour of each Officer of the Group.

11.2 Directors' and officers' insurance

The Group has paid insurance premiums for one year of cover in respect of directors' and officers' liability insurance contracts, for Officers of the Group. The insurance cover is on standard industry terms and provides cover for loss and liability for wrongful acts in relation to the relevant person's role as an Officer, except that cover is not provided for loss in relation to Officers gaining any profit or advantage to which they were not legally entitled, or Officers committing any criminal, dishonest, fraudulent or malicious act or omission, or any knowing or wilful violation of any statute or regulation. Cover is also only provided for fines and penalties in limited circumstances and up to a small financial limit.

In accordance with usual commercial practice, the insurance contract prohibits disclosure of details of the nature of the liabilities covered by the insurance, the limit of indemnity and the amount of the premium paid under the contract.

12. Non-Audit Services

During the year, HLB Mann Judd, the Group's auditor, did not perform other services in addition to its statutory duties.

13. Options and Unissued Shares Under Convertible Securities

At the date of this report, ordinary shares of the Company under option totalled 43,697,917 exercisable at various dates on or before 30 November 2019 (2016: 33,593,750 options exercisable at various dates on or before 23 September 2017).

Number of options	Exercisable at $0.025 Expiring on 23 September 2017	Exercisable at $0.00 Expiring on 30 November 2019	Exercisable at $0.00 Expiring on 30 June 2018	Total
Issued	17,031,250	6,666,667	20,000,000	43,697,917
Vested	9,931,250	3,333,333	10,000,000	23,264,583

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

14. Environmental Regulation and Performance

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

15. Corporate Governance

The Company's corporate governance statement can be found at the following URL:

http://phylogica.com/media/articles/Investors---Corporate-Governance/Corporate-Governance-393/160829-PYC-Corporate-Governance-Statement.pdf

16. Remuneration Report - Audited

Remuneration is referred to as compensation throughout this report.

16.1 Principles of compensation

Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Company, including directors of the Company and other executives. Key management personnel includes all directors, the company secretaries and specific executives of the Company.

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

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

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

16.2 Fixed remuneration

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

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

16.3 Performance linked remuneration

Performance linked compensation includes short term incentives (STI), in the form of cash bonuses paid upon the achievement of predetermined Key Performance Indicators (KPI), and long-term incentives (LTI) provided as options under the Employee Share Option Plan. In the case of Executive Directors, the number and conditions of the options are approved by the shareholders in general meeting.

16.4 Short term incentive bonus (STI)

The Board has set KPIs in conjunction with each of the Executive Directors and senior management.

Short Term Incentives are usually in the form of cash bonuses calculated based on achievement of Key Performance Indicators (KPI's). The actual KPI's are agreed annually with the Board to ensure they remain relevant and appropriate to the Company and the Executives to ensure that they are linked to the strategic and operational plans of the Company.

16.5 2018 Financial Year Short Term Incentives

Managing Director – Ms S Unwin	• Where on the date that is 12 months from 17 June 2017 the 30 day VWAP is 150% of the year one base price (5 cents) the Company will pay $200,000 i.e. 40% of salary. • If 200% of the year one base price (5 cents) the Company will pay $400,000 (50% of salary). • If exceeds 150% but is less than 200% of the year one base share price (5 cents) the Company will pay between $200,000 (40% of salary) and $400,000 (80% of salary) based on a pro rata sliding scale.
Chief Scientific Officer – Dr R Hayes	• A payment of up to $300,000 (including superannuation) for agreed scientific and corporate milestones.

No bonuses were paid in relation to the 2016 and the 2017 financial years due to the Company's financial situation.

16.6 Long term incentives (LTI)

The Employee Share Option Plan (ESOP) was established during the 2006 financial year and is open to all employees and contractors. The ESOP was last renewed at the annual general meeting held 27 November 2014. Options are granted for no consideration and have a three-year term. One half of those options allocated will vest immediately and, unless agreed by the Directors, one half will vest on the subsequent anniversary of issue.

During the year, no options were granted under the ESOP (2016: nil). 19,856,250 Options vested on grant and 9,931,250 will vest when the Company's share price reaches 6 cents, as measured on a 5-day Volume Weighted Average basis.

During June 2011, the Board resolved to implement a Loan Funded Share Plan ("Plan") for Key Management Personnel. The Loan Funded Share Plan was approved by shareholders at the annual general meeting of held on 24 November 2011. Participants of the plan acquire ordinary shares at market value and the purchase price of the shares will be 100% funded by a loan provided by the Company.

In September 2016 Dr P Watt transitioned from a full-time role with Phylogica to a role with Telethon Kids Institute (TKI) whilst taking up a consulting position with Phylogica as Scientific Advisor and Founder as well as becoming a non-executive director. Dr R Hopkins ceased employment in October 2016. Upon cessation of their roles the Loan Funded shares were cancelled.

16.7 Short-term and long-term incentive structure

The Company has not established a causal relationship between compensation structure and shareholder returns. The directors consider that the Company's progress to date and external remuneration levels provide support for the premise that the compensation structure is appropriate, given the objectives set out earlier in this report.

16.8 Consequences of performance on shareholders' wealth

The Board has regard to a broad range of factors in considering the Company's performance and how best to generate shareholder value. These include financial factors, securing new drug discovery partnerships and others that relate to meeting the objectives of existing discovery alliances, scientific progress of the Company's in-house projects, grants awarded, staff development etc. The Board has some, but not absolute regard to the Company's result and cash consumption during the year. It does not utilise earnings per share as a performance measure nor does it contemplate consideration of any dividends in the short to medium term, given that efforts are being expended to build the business and generate self-sustaining revenue streams. The Company is of the view that any adverse movement in the Company's share price should not be taken into account in assessing the performance of employees, unless such a measure is agreed with the executive as a KPI.

16.9 Service agreements

At 30 June 2017, the senior executives of the Company who are full time employees, had conditions of employment as set out below.

Name	Stephanie Unwin[1]	Dr Robert Hayes[2]
Position	Chief Executive Officer	Chief Scientific Officer
Term Expiring	17 June 2019	17 June 2019
Salary	$500,000 pa	$550,000 Yr1, $600,000 Yr2
Options [3]	10,000,000	10,000,000
Termination Notice	If terminated by the Company the greater of twelve months notice on the remainder of the initial term. If terminated by the individual by giving two months notice.	If terminated by the Company six months notice and two months notice by the individual.

1) Ms Unwin was appointed as Chief Executive Officer on 17 June 2017.
2) Dr Robert Hayes was appointed Chief Scientific Officer on 17 June 2017
3) Unlisted Options as incentive on commencement of employment to be issued pending shareholder approval.

Dr Doug Wilson held the position of Non-Executive Chair to 8 October 2015, after which he became a Non-Executive Director and resigned 25 November 2016.

Company Secretarial services are provided by a contractor with no financial commitment by the Company other than a monthly fee, payable in arrears, for services rendered by employees of the service company, including the company secretary.

16.10 Non-executive directors

The aggregate remuneration of all non-executive directors was set at $300,000 per annum at the annual general meeting held on 27 November 2014. The base fee for a non-executive director has been $40,000 per annum since 1 July 2011. The Company makes contributions at the statutory minimum rate to superannuation funds nominated by directors, in addition to the base fee.

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

16.11 Equity instruments

16.11.1 Options

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

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

During the reporting period, the following options over ordinary shares in the Company were granted as compensation to key management personnel (2016: 10,000,000).

Key management person	Number of options outstanding at 30 June 2017	Grant date	Fair value per option at grant date ($)	Exercise price per option ($)	Expiry date	Number of options vested during 2017
CEO Stephanie Unwin	6,666,667	25 Nov 2016	$0.016	$ nil	30 Nov 2019	3,333,333 (exercised)
Executive Dr P Watt	20,000,000	25 Nov 2016	$0.016	$nil	30 Jun 2018	10,000,000

Director options outstanding as at 30 June 2016 were cancelled on termination of employment during the year.

(b) <u>Modification of terms of equity-settled share-based payment transactions</u>

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

(c) Exercise of options granted as compensation

During the reporting period, 3,333,333 options previously granted as compensation were exercised (2016: Nil).

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

Details of vesting profiles of the options granted as remuneration to executive directors of the Company and the named Company executive are detailed as follows:

Key management person	Options granted		Vested in year (%)	Forfeited in year (%)	Financial years in which grant vests	Value yet to vest	
	Number	Date				Minimum ($)	Maximum ($)
S Unwin	10,000,000	26 Nov 2016	3,333,333	-	(1)	85,332	85,332
Dr R Hopkins	6,500,000	27 Nov 2014	-	6,500,000		n/a	n/a
Dr P Watt	23,500,000	23 Sept 2014	10,000,000	3,500,000	(2)	96,000	96,000

(1) The unvested options vest 50% on 30 November 2017 and 50% on 30 November 2018.

(2) The unvested options will not vest until the Company's share price reaches 5 cents, as measured on 5-day Volume Weighted Average basis.

(e) Analysis of Movements in options

Other than the above there were no movements during the reporting period of options over ordinary shares in the Company held by Company directors and other Key Management Personnel.

16.11.2 Loan Funded Share Plan

During June 2011, the Board resolved to implement a Loan Funded Share Plan ("Plan") for Key Management Personnel. Offers of allocations under the plan were made to three key management personnel on 3 June 2011 and acceptances were received from all key management personnel.

The offers accepted were as follows:

a) Term of the loan: 7 years (3 June 2018) or cessation of employment, whichever is earlier.
b) Purchase price of shares funded by loan is 6.4 cents.
c) 33% of the shares vested on 3 June 2014, 33% on 3 June 2015 and 34% on 3 June 2016.

In September 2016 Dr P Watt transitioned from a full-time role with Phylogica to a role with Telethon Kids Institute (TKI) whilst taking up a consulting position with Phylogica as Scientific Advisor and Founder as well as becoming a non-executive director. Dr R Hopkins ceased employment in October 2016. Upon cessation of their roles the Loan Funded shares were cancelled.

16.12 Directors' and executive officers' remuneration

Details of the nature and amount of each major element of remuneration of each director and each of the executives of the Company (Key Management Personnel) are as set out on the following page.

Year ended 30 June 2017	Note	Short Term Benefits Salary & Fees $	Long Term Benefits Long Service Leave $	Post-Employment Benefits Superannuation $	Share-Based Payments Value of Options/ Loan Funded Shares $	Total $	Performance based as proportion of Remuneration %
Executive Directors							
Ms Stephanie Unwin	1	79,198	-	7,524	79,999	166,721	48
Dr Robert Hayes	2	504,149	-	-	-	504,149	-
Non-executive Directors							
Dr Bernard Hockings		43,800	-	-	-	43,800	-
Dr Rick Kendall		45,165	-	-	-	45,165	-
Dr Paul Watt	3	190,341	65,489	3,914	163,369	423,113	39
Former Non-Executive Directors							
Mr Jeremy Curnock Cook	4	35,040	-	-	-	35,040	-
Dr Doug Wilson	5	27,788				27,788	-
Former Executive Director							
Dr Richard Hopkins	6	141,035	49,336	5,863	3,300	199,534	2
Total Key Management Personnel		**1,066,516**	**114,825**	**17,301**	**246,668**	**1,445,310**	**17**
Company Secretaries:							
Mr Graeme Boden	7	109,570	-	-	563	110,133	-
Ms Natasha Forde	7	-	-	-	433	433	-
Total Company Secretaries		**109,570**	**-**	**-**	**996**	**110,566**	**-**

Note

1) Stephanie Unwin transitioned to Chief Executive Officer and Executive Chair on 17 June 2017.
2) Dr Robert Hayes was appointed Chief Scientific Officer on 17 June 2017.
3) Dr P Watt transitioned from a full-time role with Phylogica to a role with Telethon Kids Institute (TKI) whilst taking up a consulting position with Phylogica as Chief Scientific Advisor and becoming a non-executive director.
4) Mr Jeremy Curnock resigned on 18 April 2017
5) Mr Doug Wilson resigned on 25 November 2016.
6) Dr Richard Hopkins resigned on 18 July 2016
7) Payments made to Boden Corporate Services Pty Ltd (BCS) include time spent on Company activities, including accounting and administration by G Boden and other employees of BCS, including Ms N Forde who was appointed as a Joint Company Secretary on 26 March 2015.
8) The fair values of the options and loan funded shares are calculated at the date of grant using a Black-Scholes pricing model and allocated to each reporting period in accordance with the vesting profile of the options/ loan funded shares. The value recognised is the portion of the fair value of the options or loan funded shares allocated to the reporting period. In valuing the options and loan funded shares, market conditions have been taken into account.
9) The Company pays an insurance premium for company reimbursement and directors' and officers' liability insurance as a combined amount. The portion of the premium which relates to directors and officers has not been included as part of remuneration.

Year ended 30 June 2016	Note	Short Term Benefits Salary & Fees $	Long Term Benefits Long Service Leave $	Post-Employment Benefits Superannuation $	Share-Based Payments Value of Options/ Loan Funded Shares $	Total $	Performance based as proportion of Remuneration %
Non-Executive Directors							
Mr Bruce McHarrie	1	43,384	-	4,122	-	47,506	-
Mr Jeremy Curnock Cook		43,800	-	-	-	43,800	-
Dr Bernard Hockings		43,800	-	-	-	43,800	-
Dr Doug Wilson	2	70,150	-	-	-	70,150	-
Ms Stephanie Unwin	3	23,622	-	2,244	-	25,866	-
Executive Directors							
Dr Richard Hopkins		262,500	5,133	19,308	18,542	305,483	6
Management:							
Dr Paul Watt		220,500	4,446	19,308	24,891	269,145	9
Total Key Management Personnel		**707,756**	**9,579**	**44,982**	**43,433**	**805,750**	**5**
Company Secretaries:							
Mr Graeme Boden	4	96,871	-	-	235	97,106	-
Ms Natasha Forde	5	-	-	-	181	181	-
Total Company Secretaries		**96,871**	**-**	**-**	**416**	**97,287**	**-**

Note

1) Mr McHarrie transitioned from Non-Executive Director to Non-Executive Chair on 8 October 2015. Mr McHarrie resigned as a director on 8 April 2016.
2) Dr Wilson transitioned from Non-Executive Chair to Non-Executive Director on 8 October 2015.
3) Ms Unwin was appointed a Non-Executive Director on 18 January 2016. Ms Unwin transitioned to Non-Executive Chair on 8 April 2016.
4) Payments made to Boden Corporate Services Pty Ltd (BCS) include time spent on Company activities, including accounting and administration by G Boden and other employees of BCS, including Ms N Forde who was appointed as a Joint Company Secretary on 26 March 2015.
5) Payments for the services provided by Ms N Forde, both before and after appointment as a Secretary, are included in the remuneration shown against Mr G Boden.
6) The fair values of the options and loan funded shares are calculated at the date of grant using a Black-Scholes pricing model and allocated to each reporting period in accordance with the vesting profile of the options/ loan funded shares. The value recognised is the portion of the fair value of the options or loan funded shares allocated to the reporting period. In valuing the options and loan funded shares, market conditions have been taken into account.
7) The Company pays an insurance premium for company reimbursement and directors' and officers' liability insurance as a combined amount. The portion of the premium which relates to directors and officers has not been included as part of remuneration.

16.13 Analysis of bonuses included in remuneration

No bonuses were awarded in relation to the 2017 financial year as the key performance criterion of financial sustainability was not met.

16.14 Movements in share and options holdings

Movements in Key Management Personnel equity holdings during the period are set out below.

16.14.1 Options over equity instruments

The movement during the reporting period in the number of options over ordinary shares in the Group held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

Key Management Personnel	Balance 1 July 2016	Granted as Compensation	Sold	Other Changes	Balance 30 June 2017	Vested During the Year	Vested & Exercisable 30 June 2017
Directors							
Ms S Unwin(i)	-	10,000,000	-	(3,333,333)	6,666,667	3,333,333	-
Dr R Hayes	-	-	-	-	-	-	-
Dr B Hockings	-	-	-	-	-	-	-
Dr R Kendall							
Dr P Watt(ii)	3,500,000	20,000,000	-	(3,500,000)	-	10,000,000	10,000,000
Former Non-Executive Directors							
Dr J Curnock Cook	-	-	-	-	-	-	-
Dr D Wilson	-	-	-	-	-	-	-
Former Executive Directors							
Dr R Hopkins(ii)	6,500,000	-	-	(6,500,000)	-	-	-
Company Secretary / CFO							
Mr G Boden	406,250	-	-	-	406,250		

- **i.** Options exercised
- **ii.** Options expired unexercised

Key Management Personnel	Balance 1 July 2015	Granted as Compensation	Sold	Other changes(i)	Balance 30 June 2016	Vested During the Year	Vested & Exercisable 30 June 2016
Directors							
Dr D Wilson	584,795	-	-	(584,795)	-	-	-
Dr R Hopkins	7,004,262	-	-	(504,262)	6,500,000	-	3,700,000
Dr B Hockings(1)	77,844,256	-	(77,844,256)	-	-	-	-
Executives							
Dr P Watt	3,961,864	-	-	(461,864)	3,500,000	-	2,000,000
Company Secretary / CFO							
Mr G Boden	406,250	-	-	-	406,250	-	243,750

i. These options expired unexercised on the expiry date 30 June 2016.

16.14.2 Shareholdings

The movement during the reporting period in the number of ordinary shares in the Group held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows:

Key Management Personnel	Balance 1 July 2016	Purchases	Other Changes	Granted as Compensation	Sales	Balance 30 June 2017
Directors						
Ms S Unwin	-	-	3,333,333	-	-	3,333,333
Dr R Hayes	-	-	-	-	-	-
Dr B Hockings	601,946,632	13,977,553	-	-	(33,000,000)	582,924,185
Dr R Kendall	-	-	-	-	-	-
Dr P Watt	23,517,197	-	(9,000,000)	-	-	14,517,197
Former Non-Executive Directors						
Dr J Curnock Cook	-	-	-	-	-	-
Dr D Wilson (1)	1,711,989	-	-	-	-	1,711,989
Former Executive Directors						
Dr R Hopkins (1)	28,487,611	-	-	-	-	28,487,611
Company Secretary / CFO						
Mr G Boden	5,000,000	-	-	-	-	5,000,000

(1) Shares held at date of resignation.

Key Management Personnel	Balance 1 July 2015	Purchases	Other Changes	Granted As Compensation	Sales	Balance 30 June 2016
Directors						
Dr D Wilson	1,711,989	-	-	-	-	1,711,989
Mr B McHarrie (1)	3,304,576	-	-	-	-	3,304,576
Dr B Hockings	288,481,482	457,933,332	-	-	(144,468,182)	601,946,632
Dr R Hopkins	16,487,611	12,000,000	-	-	-	28,487,611
Executives						
Dr P Watt	21,480,660	5,236,537	-	-	(3,200,000)	23,517,197
Company Secretary / CFO						
Mr G Boden	2,500,000	2,500,000	-	-	-	5,000,000

Note

1) Mr McHarrie ceased to be a key management person on his resignation as a director on 8 April 2016. This holding is at the date of his resignation.

16.15 Key management personnel transactions

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

A number of these entities transacted with the Group or its subsidiaries in the reporting period. The terms and conditions of the transactions with management persons and their related parties were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-director related entities on an arm's length basis.

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

Key management persons	Transaction	Note	2017 $	2016 $
Mr G Boden	Corporate services	(a)	109,570	96,871

(a) Boden Corporate Services Pty Ltd, of which Mr Boden is a director, has provided services in company secretarial, accounting and administration roles for which services fees were billed based on normal market rates, and were due and payable under normal payment terms. These fees are included in the remuneration table above.

Amounts payable to key management personnel at reporting date arising from these contract services were as set below:

	2017 $	2016 $
Current payables:		
Trade and other payables	11,595	5,809
	11,595	5,809

17. Proceedings on behalf of the Company

No person has applied for leave of court to bring proceedings on behalf of the Company or intervene in any proceedings to which the Company is a party, for the purpose of taking responsibility on behalf of the Company for all or any part of those proceedings.

18. Auditor's Independence Declaration

The auditor's independence declaration is set out on page 18 and forms part of the Directors' report for the year ended 30 June 2017.

Signed in accordance with a resolution of the directors:

Stephanie Unwin
Chair
Perth
21st September 2017

Accountants | Business and Financial Advisers

AUDITOR'S INDEPENDENCE DECLARATION

As lead auditor for the audit of the consolidated financial report of Phylogica Limited for the year ended 30 June 2017, I declare that to the best of my knowledge and belief, there have been no contraventions of:

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

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

HLB Mann Judd

HLB Mann Judd
Chartered Accountants

M R Ohm
Partner

Perth, Western Australia
21 September 2017

HLB Mann Judd (WA Partnership) ABN 22 193 232 714
Level 4 130 Stirling Street Perth WA 6000 | PO Box 8124 Perth BC WA 6849 | Telephone +61 (08) 9227 7500 | Fax +61 (08) 9227 7533
Email: mailbox@hlbwa.com.au | Website: www.hlb.com.au

Consolidated Statement of Profit or Loss and Other Comprehensive Income
For the year ended 30 June 2017

	Note	2017 $	2016 $
Continuing Operations			
Commercial revenue	*5(ii)*	2,760,258	-
Net interest revenue		75,864	178,678
Other revenue		2,475	1,076
Contract research costs		(3,467,469)	(3,465,057)
Personnel expenses	*7*	(623,063)	(897,691)
Depreciation	*8*	(55,255)	(122,115)
Professional services		(1,037,561)	(315,810)
Travel and accommodation		(184,841)	(203,996)
Intellectual property maintenance		(211,366)	(282,065)
Laboratory consumables		(993,169)	(658,178)
Occupancy costs		(6,587)	(6,067)
Other operating expenses		(435,028)	(274,695)
Loss before income tax benefit		(4,175,742)	(6,045,920)
Income tax benefit	*9*	2,224,905	2,067,248
Net loss for the year		(1,950,837)	(3,978,672)
Other comprehensive income for the year, net of tax		-	-
Total comprehensive loss for the year		(1,950,837)	(3,978,672)
Total comprehensive loss for the year attributable to the members	*18(iii)*	**(1,950,837)**	**(3,978,672)**
		Cents	**Cents**
Basic loss per share	*19*	(0.10)	(0.21)
Diluted loss per share	*19*	(0.10)	(0.21)

This statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to the financial statements.

Consolidated Statement of Financial Position
As at 30 June 2017

	Note	2017 $	2016 $
Current assets			
Cash and cash equivalents		9,939,943	7,073,541
Trade and other receivables	*10*	192,206	125,657
Total current assets		10,132,149	7,199,198
Non-current assets			
Plant and equipment	*11*	216,109	66,568
Total non-current assets		216,109	66,568
Total assets		10,348,258	7,265,766
Current liabilities			
Trade and other payables	*13*	1,489,208	1,099,841
Employee benefits	*17*	-	335,682
Total current liabilities		1,489,208	1,435,523
Total liabilities		1,489,208	1,435,523
Net assets		**8,859,050**	**5,830,243**
Equity			
Issued capital	*18(i)*	53,209,076	48,456,076
Reserves	*18(ii)*	1,063,701	837,057
Accumulated losses	*18(iii)*	(45,413,727)	(43,462,890)
Total equity		**8,859,050**	**5,830,243**

This statement of financial position is to be read in conjunction with the notes to the financial statements.

Consolidated Statement of Cash Flows
For the year ended 30 June 2017

	Note	2017 $	2016 $
Cash flows from operating activities			
Commercial income received		2,760,258	-
Cash paid to suppliers and employees		(6,942,210)	(5,408,536)
Cash used in operations		(4,181,952)	(5,408,536)
R&D tax rebate		2,224,905	2,067,248
Interest received		73,911	174,559
Net cash used in operating activities	*20*	**(1,883,136)**	**(3,166,729)**
Cash flows from investing activities			
Proceeds from the sale of property, plant and equipment		1,073	1,402
Acquisition of property, plant and equipment		(4,535)	(26,781)
Net cash used in investing activities		**(3,462)**	**(25,379)**
Cash flows from financing activities			
Proceeds from the issue of share capital	*18(i)*	5,066,250	10,020,694
Payment of transaction costs	*18(i)*	(313,250)	(1,230,914)
Net cash from financing activities		**4,753,000**	**8,789,780**
Net increase/(decrease) in cash and cash equivalents		2,866,402	5,597,672
Cash and cash equivalents at the beginning of the year		7,073,541	1,475,869
Cash and cash equivalents at the end of the year		**9,939,943**	**7,073,541**

This statement of cash flows is to be read in conjunction with the notes to the financial statements.

Consolidated Statement of Changes in Equity
For the year ended 30 June 2017

	Note	Issued Capital $	Accumulated Losses $	Reserves $	Total $
Balance at 1 July 2015		39,666,296	(39,484,218)	779,956	962,034
Loss attributable to members of the consolidated entity		-	(3,978,672)	-	(3,978,672)
Other comprehensive income		-	-	-	-
Total comprehensive loss		-	(3,978,672)	-	(3,978,672)
Shares issued during the year	*18(i)*	10,020,694	-	-	10,020,694
Share capital transaction costs	*18(i)*	(1,230,914)	-	-	(1,230,914)
Share-based payments	*18(ii)*	-	-	57,101	57,101
Balance at 30 June 2016		**48,456,076**	**(43,462,890)**	**837,057**	**5,830,243**
Balance at 1 July 2016		**48,456,076**	**(43,462,890)**	**837,057**	**5,830,243**
Loss attributable to members of the consolidated entity		-	(1,950,837)	-	(1,950,837)
Other comprehensive income		-	-	-	-
Total comprehensive loss		-	(1,950,837)	-	(1,950,837)
Shares issued during the year	*18(i)*	5,066,250	-	-	5,066,250
Share capital transaction costs	*18(i)*	(313,250)	-	-	(313,250)
Share-based payments	*18(ii)*	-	-	226,644	226,644
Balance at 30 June 2017		**53,209,076**	**(45,413,727)**	**1,063,701**	**8,859,050**

This statement of changes in equity is to be read in conjunction with the notes to the financial statements.

1. Reporting Entity

Phylogica is a listed public company incorporated and operating in Australia. The financial report of the Group comprising the Company and its wholly owned subsidiary for the financial year ended 30 June 2017 was authorised for issue by the directors on 21st September 2017. The Company is primarily involved in the provision of peptide drug discovery services to the pharmaceutical industry.

2. Basis of Preparation

(a) Statement of Compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASB's) which includes Australian equivalents to International Financial Reporting Standards (AIFRS) adopted by the Australian Accounting Standards Board (AASB), and the Corporations Act 2001. Compliance with AIFRS ensures that the financial report, comprising the financial statements and notes thereto, complies with International Financial Reporting Standards (IFRS's).

(b) Basis of measurement

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

(c) Use of estimates and judgements

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

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

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

- Note 18(viii) – share based payments net expense for 2017 is $226,644 (2016: $57,101).
- Note 17 – employee benefits, where the rate of pay may change between balance date and payment and where long service leave utilisation may change.

(d) Going Concern

The financial report has been prepared on a going concern basis which assumes the settlement of liabilities and the realisation of assets in the normal course of business. For the year ended 30 June 2017 the Company has incurred a loss of $1,950,837 (2016: loss of $3,978,672) and at year end the Company had working capital of $8,642,942 (2016: $5,763,675) including a cash and cash equivalents balance of $9,939,943 (2016: $7,073,541). Cash used in operating activities in 2017 was $1,883,136 (2016: $3,166,729).

The Directors believe that it is appropriate to prepare the financial report on a going concern basis because the Company expects to receive an R&D rebate of approximately $2 million during the first half of the 2018 financial year, and with the opening cash balance, the Directors are of the view that this will be sufficient to cover expenditure for the period of 12 months from the date of approval of this financial report. Should it not be received, the company also has the option of selectively reducing expenditure where necessary.

2. Basis of Preparation *(Cont.)*

(e) Basis of consolidation

The consolidated financial statements incorporate the assets and liabilities of the subsidiary of Phylogica Limited ('company' or 'parent entity') as at 30 June 2017 and the results of its subsidiary for the year then ended. Phylogica Limited and its subsidiary are referred to in this financial report as the Group.

The financial statements of the subsidiary are prepared for the same reporting period as the parent entity, using consistent accounting policies. The subsidiary was dormant during the 2017 financial year.

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.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Control exists where the company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing when the Group controls another entity.

Unrealised gains or transactions between the Group and its associates are eliminated to the extent of the Group's interests in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

When the Group ceases to have control, joint control or significant influence, any retained interest in the entity is remeasured to its fair value with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint controlled entity or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

3. Significant accounting policies

(a) Foreign currency

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction.

(b) Property, plant and equipment

(i) Recognition and measurement

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

(ii) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. The Company has no finance leases. Leases other than finance leases are classified as operating leases and are accounted for as described in note 3(q).

(iii) Depreciation

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

Office and research equipment 2-13 years

The residual value, depreciation method and useful lives if significant, are reassessed annually.

3. Significant accounting policies *(Cont.)*

(c) Research and development

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

(d) Trade and other receivables

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

(e) Cash and cash equivalents

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

(f) Financial assets

Financial assets in the scope of AASB 139 Financial Instruments: Recognition and Measurement are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets after initial recognition and, when allowed and appropriate, re-evaluates this designation at each financial year-end. All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets under contracts that require delivery of the assets within the period established generally by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss:

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on investments held for trading are recognised in profit or loss.

(g) Impairment

(i) Financial assets

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

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

(ii) Non- Financial Assets

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

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

3. Significant accounting policies *(Cont.)*

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

(iii) Calculation of recoverable amount

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

(iv) Reversals of impairment

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

(h) Earnings per share

Basic earnings per share (EPS) is calculated by dividing the income or loss attributable to the members of the Company for reporting period, after exclusion of any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the half year, adjusted for any bonus elements.

Diluted EPS adjusts the figures used in the determination of basic EPS to take into account the after tax effect of interest recognised associated with the dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares adjusted for any bonus elements.

(i) Transaction costs

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

(j) Employee benefits

(i) Long-term service benefits

The Company's net obligation in respect of long-term service benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using expected future increases in wage and salary rates including related on-costs and expected settlement dates, and is discounted using the rates attached to the Commonwealth Government bonds at the reporting date which have maturity dates approximating to the terms of the Company's obligations.

(ii) Share based payment transactions

The grant date fair value of options granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become unconditionally entitled to the options. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest.

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

Liabilities for employee benefits for wages, salaries, annual leave and sick leave that are expected to be settled within 12 months of the reporting date represent present obligations resulting from employees' services provided to reporting date, are calculated at undiscounted amounts based on remuneration wage and salary rates that the Group expects to pay as at reporting date including related on-costs, such as workers compensation insurance and payroll tax.

No provision is made for non-vesting sick leave as the anticipated pattern of future sick leave taken indicates that accumulated non-vesting sick leave will never be paid.

3. Significant accounting policies *(Cont.)*

(iv) Defined contribution superannuation funds

Obligations for contributions to defined contribution superannuation funds are recognised as an expense in the statement of comprehensive income as incurred.

(k) Provisions

A provision is recognised in the statement of financial position when the Group has a present legal or constructive obligation as a result of a past event that can be measured reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, when appropriate, the risks specific to the liability.

(l) Trade and other payables

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

(m) Revenue

Goods sold and services rendered

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

(n) Commercial income

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

(o) Finance income and expense

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

(p) Government Grants

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

(q) Expenses

Operating lease payments

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

(r) Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables. Non-derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

3. Significant accounting policies *(Cont.)*

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

Cash and cash equivalents comprise cash balances and call deposits.

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

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

(ii) Share capital

Ordinary shares

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

(s) Income tax

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

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

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

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(t) Segment reporting

The Group comprises a single business segment comprising discovery and development of novel therapeutics and a single geographical location being Australia. The segment details are therefore fully reflected in the results and balances reported in the statement of comprehensive income and statement of financial position.

(u) Goods and services tax

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

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

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

(v) New standards and interpretations not yet adopted

In the year ended 30 June 2017, the Directors have reviewed all of the new and revised Standards and Interpretations issued by the AASB that are relevant to the Group's operations and effective for the current annual reporting period.

3. Significant accounting policies *(Cont.)*

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

The Directors have also reviewed all new Standards and Interpretations that have been issued but are not yet effective for the year ended 30 June 2017. As a result of this review the Directors have determined that there is no impact, material or otherwise, of the new and revised Standards and Interpretations on the Group's business and therefore, no change necessary to Group accounting policies.

4. Financial risk management

Overview

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

- credit risk
- liquidity risk
- market risk

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

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

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

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

Credit risk

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

Trade and other receivables

The Group had no material credit risk at 30 June 2017 or 2016.

Cash investments

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

Liquidity risk

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

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return. The Group does not presently use financial derivatives as a risk management tool.

4. Financial risk management *(Cont.)*

Currency risk

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

Interest rate risk

The Group does not have any borrowings. The Group invests temporarily idle funds for terms of up to three months at variable interest rates.

Capital management

The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Board's target is for employees and directors of the Group to hold between five and ten percent of the Group's ordinary shares as performance incentives. At present employees hold approximately 2% of fully diluted issued capital, assuming that all outstanding share options and loan funded shares vest and / or are exercised.

There were no changes in the Group's approach to capital management during the year. The Group is not subject to externally imposed capital requirements.

5. Revenue

(i) Government grant income

The Group previously had been awarded a government grant which was recognised as revenue in the statement of comprehensive income in the same period as which the related expenses are incurred. No grant income was recognised in the year ended 30 June 2017 (2016: Nil).

(ii) Commercial income

Commercial income is derived from contracts to fund research and is based upon a mixture of funding full time equivalent research salaries and milestone payments. $2,760,258 of commercial income was recognised during the year ended 30 June 2017 (2016: Nil). There were no outstanding performance obligations on the part of Phylogica with respect to this income.

6. Research and development expenditure

The accounting standards do not permit the capitalisation of development expenditure in circumstances where the company cannot demonstrate sustainable revenue generation derived from the results of the expenditure. Research expenditure must be expensed under accounting standards. The expenditure incurred in relation to obtaining and maintaining patent protection is allowed to be capitalised under the accounting standards but the Company has adopted a policy of expensing such expenditure as it is incurred.

Since incorporation, Phylogica has raised $57.2 million in capital, reduced to $53.2 million after netting capital raising fees. From this amount the following expenditures have been undertaken (all amounts $ million):

Research & Development:	Prior to 2015	2016	2017	Total
Contract Research	20.83	3.47	3.44	27.74
Personnel (allocation)	7.24	0.45	-	7.70
Laboratory Consumables	5.14	0.66	0.99	6.79
	33.21	4.58	4.43	42.23
IP Maintenance	3.41	0.28	0.21	3.91
	36.62	4.86	4.64	46.14

7. Personnel expenses

	2017 $	2016 $
Wages and salaries	393,502	772,211
Other associated staff costs	4,202	16,792
Contributions to defined contribution superannuation funds	22,965	50,677
Decrease in Long Service Leave accrual	(14,575)	-
Increase/(Decrease) in annual leave accrual	(9,675)	910
Share based compensation - note 18	226,644	57,101
	623,063	897,691

Refer Note 18 for reversal of share based payment expense on expiry of options and Loan Funded Shares.

8. Depreciation

	2017 $	2016 $
Depreciation of equipment	55,255	122,115

9. Income Tax

	2017 $	2016 $
(i) Income tax benefit		
The prima facie tax on the operating loss is reconciled to the income tax provided in the accounts as follows:		
Prima facie tax benefit on operating loss before income tax at 28.5%	1,190,086	1,813,776
Tax effect of permanent differences	224,826	81,662
Current period tax losses and temporary differences not brought to account	(1,414,912)	(1,895,438)
R&D income tax incentive received relating to prior year	2,224,905	2,067,248
Income tax benefit	2,224,905	2,067,248
(ii) Unrecognised deferred tax asset		
Deferred tax assets have not been recognised in respect of the following items:		
Deductible/(Assessable) temporary differences	110,633	(281)
R&D refundable tax offset receivable in relation to current year	2,007,225	2,587,500
Tax losses	10,021,137	9,910,786
	12,138,995	12,498,005

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

10. Trade and other receivables

	2017 $	2016 $
GST receivable	184,789	120,517
Accrued Interest	7,093	5,140
Other receivables	324	-
	192,206	125,657

11. Plant and equipment

	2017 $	2016 $
Office and research equipment at cost	1,513,615	1,320,079
Accumulated depreciation	(1,297,506)	(1,253,511)
	216,109	66,568
Reconciliation:		
Carrying amount at the beginning of the year	66,568	162,572
Acquisitions	204,796	26,993
Disposals	-	(882)
Depreciation	(55,255)	(122,115)
Carrying amount at the end of the year	216,109	66,568

12. Other financial assets

On 2 April 2015, Phylogica received 7,710 Class B shares in Phoremost Limited, a private company registered in the UK, and not quoted on any market.

The shares were received as consideration for the granting of a non-exclusive licence to Phoremost for the phenotypic screening on Phylomer libraries to discover small molecule drugs. The value of the Class B shares cannot be reliably estimated, and there is no liquid market.

13. Trade and other payables

	2017 $	2016 $
Trade payables (1)	1,446,153	1,056,757
Accrued expenses	17,000	24,300
Other	26,055	18,784
	1,489,208	1,099,841

(1) Trade payables are non-interest bearing and are normally settled on 30-day terms.

14. Segment information

The Company comprises a single business segment being the provision of drug discovery services to the international pharmaceutical industry utilising the Company's Phylomer® peptide libraries and proprietary screening capabilities; and a single geographical location being Australia. The segment details are therefore fully reflected in the results and balances reported in the statement of comprehensive income and statement of financial position.

15. Events subsequent to balance date

There are no matters or circumstances that have arisen since the end of the financial year that have significantly affected or may significantly affect the operations of the Group, the results of those operations or the state of affairs of the Group, in future financial years.

16. Contingent liabilities

Phylogica has a research services contract with the Telethon Kids Institute. If this contract were to be terminated Phylogica would be responsible to reimburse the Telethon Kids Institute for the payout of severance and annual leave for the staff terminated as a consequence of the terminated contract.

At 30 June 2017, it was estimated this cost would be $488,000 for 27 employees (2016: $462,000 for 24 employees).

17. Employee benefits

	2017 $	2016 $
Current:		
Liability for annual leave	-	210,676
Liability for long service leave	-	125,006
	-	335,682

	Long Service Leave $	Annual Leave $
Balance as 1 July 2016	125,006	210,676
Payments made	(125,006)	(210,676)
Balance as 30 June 2017	-	-

(i) Share-based payments

(a) ESOP

At the Annual General Meeting held November 2014, the Group renewed an employee share option programme (ESOP) that entitles key management personnel and senior employees to purchase shares in the Group.

No options were granted under the ESOP during the year ended 30 June 2017 (2016: Nil).

(b) Loan Funded Shares

A scheme under which shares may be issued by the Group to directors or employees for no cash consideration was approved by shareholders at the Annual General Meeting held on 24 November 2011.

Participants of the Plan are determined by the Board and can be directors or employees of the Company or a subsidiary. The Board considers length of service, seniority, responsibilities, potential contribution and any other relevant matters in determining eligibility of potential participants.

The issue price for the shares issued under the Plan is the share price on the day of the offer to the participant. A participant who is invited to subscribe for shares under the Plan will be invited to apply for a loan up to the amount payable in respect of the shares accepted by the participant.

These loans are to be made on the following terms:

- Interest free;
- Applied directly against the issue price of the shares to be acquired under the Plan;
- For a term to be determined by the Board;
- Repayable to the extent of the lesser of the issue price of the relevant shares issued, less any cash dividends applied against the outstanding principal; and the last market sale price of the shares on the date of repayment of the loan;
- The loan must be repaid in full prior to expiry of the loan;
- The Company will have a lien over the shares in respect of which a loan is outstanding;
- Shares issued under the Plan are not transferable while a loan amount in respect of those shares remains payable; and
- Shares issued under the Plan will not be quoted on a publicly traded stock market while a loan amount in respect of those shares remains payable.

A total of 15 million shares were issued under the Plan to key management personnel during previous financial years. Details of issues under the plan are as follows:

a) Term of the loan: 7 years (3 June 2018) or cessation of employment, whichever is earlier.
b) Purchase price of shares funded by loan is 6.4 cents.
c) 33% of the shares vested on 3 June 2014, 33% on 3 June 2015 and 34% on 3 June 2016.

17. Employee benefits *(Cont.)*

In September 2016 Dr P Watt transitioned from a full time role with Phylogica to a role with Telethon Kids Institute (TKI) whilst taking up a consulting position with Phylogica as Chief Scientific Advisor and becoming a non-executive director. Dr R Hopkins ceased employment in October 2016. Upon cessation of their roles the Loan Funded shares were cancelled.

(ii) Fair value and assumptions

(a) Options

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

During the year ended 30 June 2017, 30,000,000 options were granted to key management personnel after approval at the annual general meeting held 25 November 2016 (2016: Nil).

The fair value of the options is calculated at grant date using a Black–Scholes pricing model and allocated to each reporting period in accordance with the vesting profile of the options.

The value recognised is the portion of the fair value of the options allocated to the reporting period. The factors and assumptions used in determining the fair value on grant date of options issued during the financial year as follows:

Granted during 2017:

Number of Options	Grant Date	Expiry Date	Fair Value per Option	Exercise Price	Share Price on Grant Date	Risk Free Interest Rate (%)	Estimated Volatility (%)	Number Vested as at 30 June 2017
10,000,000	25/11/2016	30/11/2019	$0.016	Nil	$0.016	1.91	100	3,333,333
20,000,000	25/11/2016	30/06/2018	$0.016	Nil	$0.016	1.91	100	10,000,000

The expected volatility is based on the historic volatility (calculated based on the weighted average remaining life of the share options), adjusted for any expected changes to future volatility due to publicly available information.

No dividends have been assumed to be paid during the life of the options. 3,337,500 employee options were exercised during the year (2015: Nil) and 13,225,000 were forfeited upon termination of employment.

(b) Loan Funded Shares

All shares issued under the Plan with limited recourse loans are valued in a similar way to options and the fair value of shares issued under the Plan is determined as detailed below.

Fair value of shares issued under the plan during 2017 was Nil (2016: Nil).

The assessed fair value at grant date of shares issued under the plan during the year ended 30 June 2012 was 3.96 cents per share. The fair value at grant date is determined using a Black-Scholes pricing model that takes into account the exercise price, the term of the loan, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk-free interest rate for the term of the loan giving a total value of $831,600.

In accordance with accounting standards, the allocations amortised over the vesting periods led to the following expense and corresponding increase in the Share Based Payment Reserve:

	$
Financial years prior to 2016	555,895
2016 financial year	38,105
2017 financial year	-
	594,000

There were no Loan Funded Shares outstanding at 30 June 2017 and the amounts had fully vested and were not therefore reversed on forfeiture.

18. Capital and accumulated losses

(i) Issued, unissued and paid up capital

	2017 $	2016 $
2,120,122,067 (2016: 2,004,138,734) ordinary shares fully paid.	53,209,076	48,456,076

Movements in capital during the year:

Ordinary Shares	2017 Shares	2017 $	2016 Shares	2016 $
Balance at the beginning of the year	2,004,138,734	48,456,076	1,002,069,367	39,666,296
Shares issued during the year:				
- Issued at $0.04	125,000,000	5,000,000	-	-
- Issued at $0.25	2,650,000	66,250	-	-
- Issued for nil consideration	3,333,333	-	-	-
- Issued at $0.01	-	-	1,002,069,367	10,020,694
- Loan funded shares cancelled	(15,000,000)	-	-	-
- Share issue costs	-	(313,250)	-	(1,230,914)
Balance at the end of the year	2,120,122,067	53,209,076	2,004,138,734	48,456,076

Terms and Conditions:

Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings. In the event of winding up of the Group, ordinary shareholders rank after all other shareholders and creditors and are fully entitled to any proceeds of liquidation.

The shares have no par value.

(ii) Reserves

	2017 $	2016 $
Balance at the beginning of the year	837,057	779,956
Share based payments for the year	262,364	57,101
Expiry of options	(35,720)	-
Balance at the end of the year	1,063,701	837,057

Nature and purpose of reserves:

Share based payments reserve
This reserve is used to record the value of equity benefits provided to employees and directors as part of their remuneration. Refer to Note 17 and the Remuneration Report for further details of these plans.

(iii) Accumulated losses

	2017 $	2016 $
Balance at the beginning of the year	(43,462,890)	(39,484,218)
Loss for the year	(1,950,837)	(3,978,672)
Balance at the end of the year	(45,413,727)	(43,462,890)

(iv) Options

Options on issue during the year	Weighted Av. Exercise Price 2017	Number of Options 2017	Weighted Av. Exercise Price 2016	Number of Options 2016
(a) Options exercisable at $0.035 on or before 15 August 2015:				
Balance at beginning of year	-	-	$0.035	8,125,000
Lapsed	-	-	$0.035	(8,125,000)
Balance at end of year	-	-	-	-

18. Capital and accumulated losses *(Contd.)*

(b) Options exercisable at $0.09 on or before 30 June 2016:				
Balance at beginning of year	-	-	$0.09	164,657,280
Lapsed	-	-	$0.09	(164,657,280)
Balance at end of year	-	-	-	-
(c) Options exercisable at $0.025 on or before 23 September 2017:				
Balance at beginning of year	$0.025	33,593,750	$0.025	33,593,750
Exercised during the year	$0.025	(2,650,000)	-	-
Lapsed	$0.025	(13,225,000)	-	-
Balance at end of year	$0.025	17,718,750	$0.025	33,593,750
(d) Options exercisable at $0.00 on or before 30 November 2019:				
Balance at beginning of year	-	-	-	-
Issued during the year	$0.00	10,000,000	-	-
Exercised during the year	$0.00	(3,333,333)	-	-
Lapsed	-	-	-	-
Balance at end of year	$0.00	6,666,667	-	-
(e) Options exercisable at $0.00 on or before 30 June 2018:				
Balance at beginning of year	-	-	-	-
Issued during the year	$0.00	20,000,000	-	-
Lapsed	-	-	-	-
Balance at end of year	$0.00	20,000,000	-	-

(f) Fair value:

The options outstanding at 30 June 2017 have an exercise price of $0.025. 2,650,000 were exercised during the year ended 30 June 2017 (2016: Nil) and 13,225,000 were cancelled (2016:Nil). The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using the Black – Scholes option pricing formula.

(v) Loan Funded Shares

Loan funded shares on issue during the year	Weighted Av. Exercise Price 2017	Number of Shares 2017	Weighted Av. Exercise Price 2016	Number of Shares 2016
(a) LFS exercisable at $0.064 on or before 3 June 2018:				
Balance at beginning of year	$0.064	15,000,000	$0.064	15,000,000
Lapsed	-	(15,000,000)	-	-
Balance at end of year	-	-	$0.064	15,000,000

(b) Fair value of loan funded shares and assumptions:	**Key Management Personnel**
Grant date	24 November 2011
Fair value at grant date	$0.049
Share price	$0.060
Exercise price	$0.064
Expected volatility (weighted average)	100%
Option life (expected weighted average)	6.53 years
Risk free interest rate (based on government bonds)	5.15%

18. Capital and accumulated losses *(Contd.)*

(viii) Employee Expense

	2017 $	2016 $
Equity – settled share-based payments issued:		
In FY15	3,300	18,996
In FY12	(20,024)	38,105
In FY 17	243,368	-
Total recognised as employee expense	226,644	57,101

Following cessation of employment of R Hopkins and P Watts, the rights in relation to the employee loan funded shares were not exercised and the shares were consequently cancelled.

19. Earnings per share

(i) Loss attributable to ordinary shareholders

	2017 $	2016 $
Loss for the year:		
Basic earnings	(1,950,837)	(3,978,672)
Diluted earnings*	(1,950,837)	(3,978,672)

(ii) Weighted average number of ordinary shares

	Number	Number
Weighted average number of shares used for basic earnings per share	2,005,193,665	1,883,341,331

*As the Group incurred a loss for the year ended 30 June 2017, the options on issue have an antidilutive effect, therefore the diluted earnings per share is equal to the basic earnings per share.

20. Note to the statement of cash flows

	2017 $	2016 $
Reconciliation of loss for the year to net cash used in operating activities:		
Loss for the year	(1,950,837)	(3,978,672)
Depreciation, amortisation & impairment	55,255	122,115
Share based payment expense	226,644	57,101
Proceeds from the sale of fixed assets	(1,398)	(968)
Disposal of fixed assets	-	798
Increase/(decrease) in provisions for employee benefits	(335,712)	14,558
Increase/(decrease) in payables	189,136	624,891
(Increase)/decrease in receivables	(66,224)	(6,552)
Net cash used in operating activities	(1,883,136)	(3,166,729)

21. Commitments

	2017 $	2016 $
Payable within one year	66,250	55,000
Payable after one year but not more than five years	88,250	154,500
	154,500	209,500

Research Collaboration Commitment:

Phylogica is collaborating on one project (2016: two projects) with the University of Queensland. Under the collaboration, Phylogica has a cash contribution payable to the University of Queensland over three years.

During the year one third of the collaboration with the University of Queensland was completed.

22. Financial instruments

(i) Interest rate risk profile:

	2017 $	2016 $
At reporting date the interest rate profile of the Group's interest bearing financial instrument was:		
Variable rate instruments:		
- Financial assets	9,939,943	7,073,541

Fair value sensitivity analysis for fixed rate instruments:

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

Cash flow sensitivity analysis for variable rate instruments:

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables remain constant. The analysis is performed on the same basis for 2016.

	2017		2016	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
Variable rate instruments	99,399	(99,399)	70,735	(70,735)

(ii) Fair value

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

(iii) Credit risk

Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. The Group undertakes due diligence prior to entering into any collaboration, co-development or licensing agreement with a counterparty that exposes the Group to credit risk.

No receivables are past due or considered impaired in 2017 or 2016.

(iv) Foreign exchange risk

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

(v) Capital management

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

(vi) Liquidity risk

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

	Carrying Amount $	Contractual Cash Flows $	6 months or less $
Trade and other payables:			
at 30 June 2017	1,489,208	(1,489,208)	(1,476,649)
at 30 June 2016	1,099,841	(1,099,841)	(1,099,841)

23. Related parties

(i) Key management personnel compensation

Executive Directors	
Ms S Unwin	(Chief Executive Officer / Executive Chairman)
Dr R Hayes	(Chief Scientific Officer - Appointed 17 June 2017)
Non-executive Directors	
Dr R Kendall	(Non-executive Director - Appointed 18 April 2017)
Dr P Watt	(Scientific Advisor and Founder – Appointed 12 September 2016)
Dr B Hockings	(Non-executive Director)
Dr R Hockings	(Alternate Director to B Hockings) (Appointed 15 August 2016)
Former Non-executive Directors	
Mr J Curnock Cook	(Resigned 18 April 2017)
Dr D Wilson	(Resigned 25 November 2016)
Former Executive Director	
Dr R Hopkins	(Chief Executive Officer) (Resigned 18 July 2016)
Executives	
Mr Kevin Hart	(Chief Financial Officer & Company Secretary) (Appointed 24 July 2017)
Former Executives	
Mr G Boden	(Chief Financial Officer & Company Secretary) (Resigned 24 July 2017)

	2017 $	2016 $
The key management personnel compensation is as follows:		
- Short-term employee benefits	1,176,086	707,756
- Post-employment benefits	114,825	44,982
- Long term employee benefits	17,301	9,579
- Share based payments	247,664	43,433
Total compensation	1,555,876	805,750

(ii) Key management personnel transactions

Apart from details disclosed in this note, no director has entered into a material contract with the Group since the end of the previous financial year and there were no material contracts involving directors' interests existing at year-end.

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

A number of these entities transacted with the Group or its subsidiaries in the reporting period. The terms and conditions of the transactions with management persons and their related parties were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions to non-director related entities on an arm's length basis.

23. Related parties *(Contd.)*

(ii) Key management personnel transactions *(Contd.)*

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

Key management persons	Transaction	Note	2017 $	2016 $
Mr G Boden	Corporate services	(a)	109,571	96,871

(a) Boden Corporate Services Pty Ltd, of which Mr Boden is a director, has provided services in company secretarial, accounting and administration roles, for which services fees were billed based on normal market rates, and were due and payable under normal payment terms.

Amounts payable to key management personnel at reporting date arising from these contract services were as set below:

	2017 $	2016 $
Current payables:		
Trade and other payables	11,595	5,809
	11,595	5,809

(iii) Subsidiaries

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

Name	Country of Incorporation	Equity Interest (%)		Investment ($)	
		2017	2016	2017	2016
Dynamic Microbials Limited	Australia	100	100	1,012,500	1,012,500
Provision for non-recovery				(1,012,500)	(1,012,500)
Carrying value of investment				Nil	Nil

Phylogica Limited is the ultimate Australian parent entity and ultimate parent of the Group. Dynamic Microbials was de-registered on 5 July 2017.

24. Auditor's remuneration

	2017 $	2016 $
Audit services		
Audit and review of financial reports	34,500	33,500
	34,500	33,500
Non-audit services	-	-
	34,500	33,500

25. Parent Entity Disclosures

(i) Financial position

	2017 $	2016 $
Assets		
Current assets	10,132,149	7,199,198
Non-current assets	216,109	66,568
Total assets	10,348,258	7,265,766
Liabilities		
Current liabilities	1,489,208	1,435,523
Total liabilities	1,489,208	1,435,523

25. Parent Entity Disclosures *(Contd.)*

(i) Financial position (Contd.)

Equity		
Issued capital	53,209,076	48,456,076
Accumulated losses	(45,413,727)	(43,462,890)
Reserves - Share-based payments	1,063,701	837,057
Total equity	8,859,050	5,830,243

(ii) Financial performance

	Year Ended	
	30 June 2017 $	30 June 2016 $
Loss for the year	(1,950,837)	(3,978,672)
Other comprehensive income	-	-
Total comprehensive loss	(1,950,837)	(3,978,672)

Directors' Declaration

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

a. the financial statements and notes and the audited remuneration disclosures that are contained in the Remuneration Report in the Directors' Report, set out on pages 9 to 17, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Group as at 30 June 2017 and of its performance, as represented by the results of operations and its cash flows, for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001, professional reporting requirements and other mandatory requirements;

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

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

2 The directors have been given the declarations by the chief executive officer and chief financial officer for the financial year ended 30 June 2017 pursuant to Section 295A of the Corporations Act 2001.

Dated at Perth this 21st day of September 2017

Signed in accordance with a resolution of the directors:

Ms Stephanie Unwin
Chair

HLB Mann Judd

Accountants | Business and Financial Advisers

INDEPENDENT AUDITOR'S REPORT

To the members of Phylogica Limited

Report on the Audit of the Financial Report

Opinion

We have audited the financial report of Phylogica Limited ("the Company") and its controlled entities ("the Group"), which comprises the consolidated statement of financial position as at 30 June 2017, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

In our opinion, the accompanying financial report of the Group is in accordance with the *Corporations Act 2001*, including:

a) giving a true and fair view of the Group's financial position as at 30 June 2017 and of its financial performance for the year then ended; and

b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* ("the Code") that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

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

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial report of the current period. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	How our audit addressed the key audit matter
Revenue recognition – commercial income (Refer Note 5)	
A substantial amount of the Group's revenue relates to the milestone payment received from Genentech Inc. In December 2016, Phylogica announced that it would receive a $US2m milestone payment from Genentech to extend its exclusivity period for the Research Collaboration and License Agreement to discover antibiotics utilising Phylogica's Phylomer drug discovery platform, including the proprietary cell penetrating peptide discovery technology. We considered this to be a key audit matter due to its significance to the financial report and its importance to the users' understanding of the financial report as a whole.	Our procedures included but were not limited to the following: - We reviewed the agreement with Genentech and considered its key terms and conditions; - We considered the treatment of the milestone payment under relevant accounting standards; and - We ensured the correct amount of revenue had been recognised in the current period with reference to these key terms and accounting standard requirements.
Share based payment expense (Refer Note 17)	
The Group has a share-based payment expense of $226,644 for the year ended 30 June 2017. We considered this to be a key audit matter as the valuation of these share-based payments is subject to complex estimation techniques and significant judgement.	Our procedures included but were not limited to the following: - We assessed the reasonableness of the assumptions used in the valuation of the share based payments expense as well as testing the accuracy of the calculations themselves; - We considered the allocation of the share-based payment expense across vesting periods; - We reviewed the treatment of any market or non-market vesting conditions and ensured these had been treated correctly in accordance with AASB 2 'Share-based Payment'; and - We also agreed the terms of the share based payments to the relevant agreements to ensure that the valuations were based on the terms of those agreements.

Information other than the financial report and auditor's report thereon

The directors are responsible for the other information. The other information comprises the information included in the Group's annual report for the year ended 30 June 2017, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors 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 control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial

report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the financial report of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on the Remuneration Report

Opinion on the remuneration report

We have audited the remuneration report included in the directors' report for the year ended 30 June 2017.

In our opinion, the remuneration report of Phylogica Limited for the year ended 30 June 2017 complies with section 300A of the *Corporations Act 2001*.

Responsibilities

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.

HLB Mann Judd

HLB Mann Judd
Chartered Accountants

M R Ohm
Partner

Perth, Western Australia
21 September 2017