



Financial Report for the year 30 June 2012

Directors' Report and Audited Financial Statements

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Director's Report

The Board of Directors of Mesoblast Group has resolved to submit the following annual financial report of the Group for the financial year ended 30 June 2012. In order to comply with the provisions of the *Corporations Act 2001*, the directors report the following information.

Directors

Directors of the Company in office at any time during or since the end of the year (unless specified) were:

Name	Position
Brian Jamieson	Non-executive Chairman
Kevin Buchi*	Non-executive Director (resigned on 9 May 2012)
Dr Ben-Zion Weiner*	Non-executive Director (elected on 9 May 2012)
Donal O'Dwyer	Non-executive Director
Michael Spooner	Non-executive Director
Silviu Itescu	Executive Director

*Dr Ben-Zion Weiner replaced Kevin Buchi as Teva Pharmaceutical Industries Ltd representative on the Board.

Details of directors qualifications, experience and special responsibilities, together with meetings attended, can be found on pages 12 to 15 of this report.

Principal Activities & Strategy

Review of Operations

Mesoblast's proprietary Mesenchymal Precursor Cell (MPC) technology platform continues to deliver a broad and diverse product pipeline. Our strong financial position means that we can independently develop new products for inflammatory and immunologic conditions, for diabetes and its complications, and for orthopedic applications, while our cardiovascular and neurologic product pipeline is being developed in partnership with Teva Pharmaceutical Industries Ltd (Teva).

In the 2012 fiscal year, we invested considerable resources and effort into broadening our product pipeline, and are particularly excited about the advances we are making in addressing systemic diseases of inflammation and immunity such as diabetes and rheumatoid arthritis. These are clinical areas where our adult stem cell technology appears to have unique mechanisms of action, and where we anticipate further corporate strategic activity. Finally, we have put much effort into our manufacturing alliance with Lonza to facilitate commercial scale-up, reduce costs, and provide capacity for commercial supply of product ahead of regulatory approvals and commercial rollout.

The remainder of 2012 should see Mesoblast continuing to achieve its stated milestones and reporting exciting progress in relation to a number of our programs.

Financial Snapshot

The full year ended 30 June 2012 saw the Company with a significant cash position of \$206.7 million, compared with \$263.2 million in the financial year ended 2011.

Mesoblast recorded total revenue and other income of \$38.3 million and a loss before tax of \$48.7 million in the 2012 financial year, compared with revenue and other income of \$120.9 million and a profit before tax of \$92.2 million in the 2011 financial year. The 2011 results included \$101.6 million of net accounting revaluation gains which were a one-off event relating to the 2010 Angioblast Inc transaction.

The financial year 2012 includes a full year of revenue (\$27.7 million) recognized as a result of the development and commercialization deal entered into with Cephalon (now Teva) in December 2010 compared with only six months for 2011 (\$14.6 million).

Mesoblast maintains strong research capabilities in Australia, the United States and Singapore. Certain projects are outsourced to best of breed worldwide, leveraging their infrastructure, know-how and other funding sources. The Company has also continued to expand recruitment of talented and experienced staff for its Australian, United States and Singapore operations, building on its high-level of clinical, regulatory, technical and manufacturing core competencies.

Clinical Highlights of Our Diversified Product Portfolio

During the past year Mesoblast has made much progress in diversifying its clinical product offerings. Today, the Company has evolved in terms of the clinical diseases and markets it is targeting, and is broadly developing clinical products for disorders related to (a) inflammation and

immunology, (b) diabetes and its complications, (c) orthopedic diseases of the spine, and (d) cardiovascular diseases in partnership with Teva.

Clinical Development of Intravenous Products for Metabolic Diseases and Inflammatory/Immunologic Conditions

Mesoblast is developing a high value intravenous product franchise targeting a wide range of systemic diseases by administration of an intravenous formulation of allogeneic, or off-the-shelf, MPCs. The intravenous formulation is currently in Phase 2 clinical trials for the treatment of early Type 2 diabetes. The Company plans to evaluate the intravenous MPC formulation for the treatment of renal, liver and cardiac complications of diabetes, to begin Phase 2 trials for the treatment of rheumatoid arthritis within six months, and to begin clinical trials for treatment of pulmonary conditions next year.

Type 2 Diabetes

Results from a randomized, placebo-controlled study performed in 17 non-human primates with dietary-induced Type 2 diabetes showed that a single intravenous injection of Mesoblast's MPCs resulted in significant lowering of blood sugar levels for up to six months. This was accompanied by significant reductions in circulating C-reactive protein (C-RP), an established major predictor of heart attacks and death in patients with Type 2 diabetes.

These results built on an earlier study which showed that a single dose of human MPCs injected into mice with diabetes resulted in restoration in the damaged pancreas of the balance between insulin-producing beta cells, which reduce blood glucose, and glucagon-producing alpha cells, which increase blood glucose. Together, the results of these preclinical studies suggest that Mesoblast's MPCs might be an effective treatment for improved glucose control in diabetic patients, and may also be able to reduce end-organ complications of diabetes including those affecting the kidneys, heart and eyes.

Based on these promising preclinical data, Mesoblast received clearance from the United States Food and Drug Administration (FDA) to initiate a Phase 2 clinical trial using intravenous delivery of Mesoblast's MPC technology in 60 patients suffering from Type 2 diabetes. The randomized, placebo-controlled trial is underway at multiple trial sites in the United States, with additional sites to be initiated in Europe, Asia and Australia.

The trial is comparing the effects of a single intravenous injection of one of three escalating doses of allogeneic MPCs (0.3, 1.0 or 2.0 million MPC/kg) with placebo in poorly-controlled patients with Type 2 diabetes. Patients will be evaluated over 12 weeks for effectiveness of the treatment in terms of blood glucose control and changes in various hormones that may be abnormal in patients with Type 2 diabetes. In addition, the trial will monitor

treatment-related changes in C-reactive protein (C-RP), to see if MPC treatment can be cardioprotective by reducing inflammatory markers associated with heart attacks and death in patients with Type 2 diabetes.

Rheumatoid Arthritis

Rheumatoid arthritis (RA) represents the second indication in a growing list of major market segments that will be targeted by Mesoblast's intravenous product formulation. The prevalence of RA is estimated to be 0.8% worldwide. In the United States, RA affects 1.3 million people, is responsible for 250,000 hospitalizations, and 9 million physician visits each year.

RA is an autoimmune disease driven and perpetuated by pro-inflammatory cytokines such as TNF-alpha, IL-6, and IL-17. Treatments targeting any of these pathways alone are only moderately effective in RA, need to be administered chronically, and may cause unacceptable infectious adverse events. According to Global Data, the RA therapeutics market was valued at \$10.3 billion globally in 2010, and has doubled over a four-year period after growing at a Compound Annual Growth Rate (CAGR) of 12.3%.

Preclinical trials in sheep indicated that the Company's immunomodulatory MPCs may have a mechanism of action that is unique from other biological therapies by shutting down multiple cytokine pathways simultaneously. A single intravenous injection of allogeneic MPCs in sheep with collagen-induced arthritis concomitantly affected T cells, monocytes/macrophages, and synoviocytes to simultaneously shut down TNF-alpha, IL-6, and IL-17 cytokine pathways, and improve joint pathology. This suggests that Mesoblast's MPCs have the potential to become a first line treatment with a superior and sustained benefit on reducing inflammation and destruction of joints in people suffering from severe RA.

Subject to regulatory clearances, the Company intends to commence two trials in the fourth quarter of 2012, evaluating the effects of MPCs in patients who suffer from early or advanced stages of RA.

Clinical Development of Cardiovascular Products, Strategic Alliance with Teva

Congestive Heart Failure and Acute Myocardial Infarction

Mesoblast's adult stem cell-based cardiovascular products are being developed for several conditions including congestive heart failure (CHF) and acute myocardial infarction (heart attacks).

After 30 months follow up of the 60-patients enrolled in the Phase 2 clinical trial for heart failure, Mesoblast and Teva have met with both the FDA and the European Medicines Association (EMA) in relation to a proposed Phase 3 clinical trial protocol to evaluate

the effectiveness of a single MPC dose to prevent hospitalization and death in CHF patients. We are in detailed discussions with Teva to define the best trial design.

In the Phase 2 trial, the 15 patients treated with the single intra-cardiac injection procedure of one of the MPC doses, were not hospitalized for decompensated heart failure or cardiac death over a mean follow-up period approaching three years. If these outcomes are reproduced in further trials, in conjunction with demonstrable product safety, the results may support United States and European regulatory approvals of the MPC formulation for use in patients with advanced congestive heart failure.

Additional cardiovascular indications are being investigated, including intracoronary injection of MPCs for prevention of heart failure after an acute myocardial infarction (heart attacks). An ongoing placebo-controlled Phase 2 trial in 225 patients, AMICI (**A**llogeneic **M**esenchymal precursor cell **I**nfusion in myo**C**ardial **I**nfarction), is actively recruiting in Europe under Europe's voluntary harmonization procedure, and in Australia under the guidance of the Therapeutic Goods Administration (TGA). In addition to 10 sites in Australia and New Zealand, multiple European centers are participating including in Denmark, the United Kingdom, The Netherlands, Poland, Czech Republic, Austria and Sweden. The primary endpoint of the study will be safety and efficacy at six months in heart attack patients who will receive either MPCs at one of two doses or placebo.

Clinical Development of Orthopedic Products for Spinal Disease Markets

Up to 15 per cent of people in industrialized countries have chronic low back pain lasting more than six months. For those with progressive, severe and debilitating pain due to degenerating intervertebral discs, the only current option is major back surgery involving spinal fusion, artificial disc replacement, or other surgical procedures. Mesoblast is developing two products for this patient population, one for patients with end-stage disease to induce bony fusion between two vertebrae without the need for a second procedure to harvest autograft bone, and a second for earlier stage disease to avoid surgery and its complications.

Spinal Fusion Product

Over 500,000 spinal fusion procedures are performed annually in the United States alone. Surgeons are seeking a safe product that can induce new bone formation without the need for a second procedure requiring harvesting of autograft bone from the hip. Following extensive preclinical studies, Mesoblast is completing a lumbar spinal fusion Phase 2 clinical trial comparing two doses of allogeneic MPCs with autograft bone. The trial has completed enrolment, and data are expected towards the end of this year. If the Phase 2 results were to show positive effects

of MPCs on pain reduction and radiographic fusion that are equivalent to autograft, this product may be ready to proceed to Phase 3.

Intervertebral Disc Repair product

Using a simple intervertebral disc injection of allogeneic MPCs that takes around 15 minutes in an outpatient setting, Mesoblast is developing a non-surgical adult stem cell treatment for patients with chronic low back pain due to degenerating intervertebral discs. The Phase 2 clinical trial design, endpoints and dose ranges are based on Mesoblast's successful preclinical study using allogeneic sheep MPCs for non-surgical restoration of damaged intervertebral discs. In the preclinical study, a single non-surgical injection of Mesoblast's allogeneic MPCs into damaged intervertebral discs resulted in significant regeneration of disc anatomy, increase in proteoglycan content, and increase in disc height, for at least six months.

Mesoblast's double-blind, placebo-controlled Phase 2 clinical trial is being conducted at 15 sites across the United States, and will randomize a total of 100 patients with intervertebral disc disease to receive a non-surgical, percutaneous injection into the intervertebral disc of either low or high dose MPCs with hyaluronic acid carrier, hyaluronic acid carrier alone or saline alone. The trial aims to extend Mesoblast's preclinical results, and show that a single MPC injection can reduce low back pain and improve function over six months, improve disc anatomy, and eliminate the need for a surgical procedure. The Company expects enrollment to be completed by the end of the third quarter.

Clinical Development of Other Products

Eye Diseases

Mesoblast is developing a stem cell therapeutic product for treating various vascular diseases of the eye, including wet Age-related Macular Degeneration (AMD) and diabetic macular edema. Wet AMD causes sudden and severe central vision loss and accounts for approximately 90 per cent of all blindness in the elderly.

The Phase 2 trial for combining Mesoblast's MPC cells with an anti-VEGF agent is being conducted at the Singapore National Eye Centre, and is being expanded to include one of Australia's major eye diseases hospitals.

Bone Marrow Transplantation

Mesoblast's clinical approach to expansion of hematopoietic stem cells could broaden the use of bone marrow transplantation to those in need of the procedure but who currently cannot find a donor, without the need for full matching. If the Phase 3 results confirm the Phase 2 data generated from 36 patients, the procedure could reduce time to engraftment, improve survival, and significantly decrease the cost of care for this patient population.

Manufacturing

The Company has put much effort into our product manufacturing strategy to facilitate commercial scale-up, reduce costs, and provide capacity for commercial supply of product.

Mesoblast has a strategic stem cell manufacturing alliance with Lonza, one of the world's leading manufacturers of biologic products. Access to Lonza's global manufacturing capabilities provides Mesoblast with significant commercial advantages and is in line with our growth strategy to deliver the highest quality and most effective cell therapy products worldwide.

To capitalize on Lonza's state-of-the-art cell therapy facilities in Singapore, in addition to its facilities in the United States and Europe, Mesoblast has established operations in Singapore where it will recruit personnel for research, manufacturing, and commercial activities.

The Year Ahead

Mesoblast's solid cash position enables continued parallel development of multiple clinical products. We have positioned ourselves as an innovative developer of products for inflammatory and immunologic conditions, for diabetes and its complications, for orthopedic spine conditions, and, together with Teva for cardiovascular conditions. We are well poised to efficiently execute on our current clinical and corporate goals.

Financial Summary

Operating results

Net loss before tax for the 2012 year is \$48.7m compared to a profit of \$92.2m for 2011, as reported in the table below:

	30 June 2012 \$	30 June 2011 \$	Movement \$
(Loss)/profit before income tax	(48,722,818)	92,241,504	(140,964,322)
Income tax expense	(22,422,496)	(1,634,914)	(20,787,582)
(Loss)/profit after income tax	(71,145,314)	90,606,590	(161,751,904)

The net increase in loss of \$141.0m before tax is primarily due to a one-off accounting gain of \$101.6m recognized in the prior period as a result of the acquisition of Mesoblast Inc (previously called Angioblast Systems Inc). Further discussion of the result is set out in following sections of the directors' report.

Tax expense for the current year is approximately 35% (U.S. federal tax rate) of the revenue received from Teva after applying tax losses carried forward. The tax expense related to this revenue would be recognized on the same basis as the recognition of the revenue for accounting purposes, to the extent that the Group is expected to have future taxable income. As there is no certainty Mesoblast Inc. will have tax payable in the foreseeable future, the tax expense has been recorded in full in the current year. Should Mesoblast Inc. have taxable profits in the future this expense may be reinstated as an asset at that time.

Revenue from continuing operations

Revenue from continuing operations for the 2012 year totals \$38.2m (2011: \$19.3m), an increase of \$18.9m as shown in the table below:

	30 June 2012 \$	30 June 2011 \$	Movement \$
Revenue from continuing operations			
Commercialization revenue	27,682,896	14,609,186	13,073,710
Interest revenue	10,471,695	4,648,636	5,823,059
	38,154,591	19,257,822	18,896,769

2012 includes a full year of revenue (\$27.7m) recognized from the upfront payment received from Cephalon Inc (which was acquired by Teva Pharmaceutical Industries Ltd) upon signing the development and commercialization agreement in December 2010,. In 2011 by comparison, only 7 months (\$14.6m) was recognised, resulting in additional revenue of \$13.1m for the 2012 year. This revenue continues to be recognized over the development life of the indications subject to the agreement. This timeframe is reviewed every six months and adjusted accordingly to reflect latest applicable timelines.

The Group has earned an additional \$5.8m in interest in 2012 when compared to 2011 due to the increased cash reserves held by the Group over the course of the year.

Other income

	30 June 2012 \$	30 June 2011 \$	Movement \$
Other Income			
Gain on revaluation of investment to fair value	–	86,737,561	(86,737,561)
Share of losses of equity accounted associates written back on acquisition	–	14,873,899	(14,873,899)
Total other income recorded on the acquisition of a previously held associate	–	101,611,460	(101,611,460)
Government grant revenue	125,311	–	125,311
	125,311	101,611,460	(101,486,149)

Other income for the prior period includes a \$101.6m one-off revaluation gain (as noted above) of the Group's investment in its associate. This gain was recognized on consolidation in accordance with applicable International Financial Reporting Standards as a result of acquiring the outstanding shares of Mesoblast Inc.

Expenditure

Total expenses from continuing operations in 2012 total \$87.0m (2011: \$28.6m), increasing from prior year by \$58.4m as noted in the table below:

	30 June 2012	30 June 2011	Movement
	\$	\$	\$
Expenses from continuing operations			
Research and development	36,936,864	11,947,774	24,989,090
Manufacturing commercialization	22,015,041	3,366,774	18,648,267
Management and administration	28,050,526	11,792,973	16,257,553
Interest expense	289	14,912	(14,623)
Share of losses of equity accounted associates	–	1,505,345	(1,505,345)
	87,002,720	28,627,778	58,374,942

Research & development expenses have increased in 2012 as a result of the Group's increased investment in clinical, regulatory and new product development. The increase of \$25.0m is specifically attributable to the following items of expenditure: clinical and preclinical trial expenses (increase \$11.5m), labor (increase \$7.1m) and share based payments (increase \$5.6m). The increase in share based payments expense is a reflection of the black scholes valuation of each option awarded in 2012, which is required to be expensed over the vesting period in accordance with accounting standards. The 2012 options and loan funded shares valuation has increased as a result of the increased underlying share price.

In line with the Group's policy and to comply with accounting standards, all costs associated with research and development are fully expensed in the period in which they are incurred as the directors do not consider the Group can demonstrate all the factors required by accounting standards to be able to capitalize development expenditure at this time.

The Group has invested an additional \$18.6m in manufacturing activities during 2012 compared with the prior year. These activities include increased production to support our clinical programs and process development initiatives aimed at improving manufacturing capabilities and efficiencies.

Management and administration costs have increased by \$16.3m, reflecting a full 12 months of business activity together with significantly increased operations of the consolidated Group. In comparison, the consolidated Group recorded only 7 months activity for the period to June 2011. The total increase can be specifically attributed to increased expenses for labor (increase \$7.3m), share based payments (increase \$3.2m), legal and professional fees (increase \$1.4m), general overheads (\$2.5m), and net foreign exchanges losses (\$1.8m).

Earnings per share

	2012	2011
	Cents	Cents
Basic (losses)/profit per share	(25.15)	41.79
Diluted (losses)/profit per share	(25.15)	39.78

Statement of cash flows

During the current year, the Group's cash reserves (before allowing for the effect of foreign exchange on cash balances) decreased by \$61.9m (2011: increase \$239.0m). This change is broadly explained by the prior year cash inflows of USD130m for the commercialization payment received together with \$121.8m of cash received from ordinary share issues to institutional and sophisticated investors (net of brokerage) which was not repeated in 2012. This is highlighted in the table below:

	30 June 2012 \$	30 June 2011 \$	Movement \$
Cash flows from operations – (outflow)/inflow	(72,116,783)	108,228,873	(180,345,656)
Cash flows from investing activities – (outflow)/inflow	5,332,418	4,714,718	617,700
Cash flows from financing activities – (outflow)/inflow	4,882,638	126,093,410	(121,210,772)
Net cash flows (outflow)/inflow	(61,901,727)	239,037,001	(300,938,728)

Included in net cash outflows from operating activities for the year are payments to suppliers and employees of \$65.2m (2011:\$22.5m), the increase reflecting the increased number of clinical programs and manufacturing activities of the Group. As noted above, 2011 includes US\$130m received from Cephalon (Teva) as an operational cash flow.

Operating cash outflows include US\$7m for estimated U.S. taxes for the tax year ended 31 December 2011. A U.S. tax refund of US\$3.4m is expected to be received for this same tax year.

During the 2012 year, the Group raised \$4.9m (2011: \$4.3m) from the exercise of employee share options. As noted above, 2011 includes cash received (net of brokerage) of \$121.8m from equity raisings from institutional and sophisticated investors (including Teva).

Balance sheet

The Group's cash position at 30 June 2012 was \$206.7m (2011:\$263.2m). The decrease in cash reserves of \$56.5m is explained in the statement of cash flows section above, but generally relates to the further progression of clinical trials and manufacturing processes as the Group nears commercialization.

The Group's policy is to invest its cash in 'A' rated (or better) term deposits, spread across the large four Australian banking institutions. Cash amounts for short term operational use are held in at call accounts. Currently the Group holds the majority of its cash in AUD, taking advantage of the AUD deposit rates. The Group has forward currency exchange contracts in place to purchase USD required to meet future USD expenditure on US based trials.

The Group's strategy is to outsource manufacturing, continuing research and clinical trials to specialist, best of breed partner organizations. Consequently, the Group has not incurred any major capital expenditure for the period. As noted above, all costs associated with research and development, are fully expensed in the period they were incurred and consequently no capital items relating to research and development are reported on the balance sheet.

Dividends

No dividends were paid or declared during the course of the financial year and no dividends are recommended in respect to the financial year ended 30 June 2012 (2011: nil).

Share Options

Shares under option

Unissued ordinary shares of Mesoblast Limited under option at the date of this directors' report are as follows:

Issue Date	Exercise price of options AUD	Expiry date of options	Number of shares under option
7/07/2008	1.00	30/06/2013	826,000
19/01/2009	0.96	18/01/2014	80,000
30/11/2009	1.73	30/11/2014	300,000
30/11/2009	1.58	30/11/2014	1,010,000
26/02/2010	2.00	26/02/2015	72,000
22/09/2010	2.64	21/09/2015	485,000
29/11/2010	3.48	29/11/2015	2,365,600
22/12/2011	7.99	30/06/2016	2,730,000
24/02/2012	8.48	23/02/2017	270,000
7/12/2010	3.78	7/12/2012	277,390
	USD		
7/12/2010	0.046	7/07/2015	287,903
7/12/2010	0.444	25/04/2017	127,956
7/12/2010	0.444	2/05/2017	127,956
7/12/2010	0.474	7/12/2014	255,913
7/12/2010	0.305	26/10/2018	345,999
7/12/2010	0.340	7/12/2014	255,913
7/12/2010	0.340	26/10/2019	703,761
			<u>10,521,391</u>

No option holder has any right under the options to participate in any other share issues of the Group. Further details of the options series can be found in Note 24 to the financial statements.

Included in these options are options granted as remuneration to officers who are among the five highest remunerated officers of the company and the group (other than Directors), but are not key management persons and hence are not disclosed in the remuneration report:

Name of Officer	Issue Date	Exercise price of options	Number of shares under option
Jenni Pilcher	22/12/2011	7.99*	150,000*
Michael Schuster	22/12/2011	7.99	200,000
Donna Skerrett	22/12/2011	7.99	200,000
Michael Warman	22/12/2011	7.99	150,000
Darin Weber	22/12/2011	7.99	200,000

*Loan funded shares rather than options. Exercise price shown is the price to purchase the share.

Shares issued on exercise of options

Detail of shares or interests issued as a result of the exercise of options during or since the end of the financial year are:

Grant Date	Number of shares issued	Issue price of shares	Amount unpaid per share
7/07/2008	620,000	1.00	–
30/11/2009	340,000	1.58	–
26/02/2010	3,000	2.00	–
27/07/2007	850,000	2.13	–
29/11/2010	364,400	3.48	–
22/09/2010	40,000	2.64	–
7/12/2010	180,000	0.444	–
7/12/2010	32,094	0.305	–
7/12/2010	95,862	0.305	–
7/12/2010	277,389	1.20	–
7/12/2010	277,389	3.44	–
7/12/2010	39,892	0.424	–
7/12/2010	159,822	–	–
	3,279,848		

Significant Changes In the State of Affairs

There were no significant changes in the state of affairs of the Group during the financial year.

Matters Subsequent to the End of the Financial Year

There are no events that have arisen after 30 June 2012 and prior to the signing of this financial report that would likely have a material impact on the financial results presented.

Business Strategies and Prospects for Future Years

Our corporate strategy aims to maximally leverage our resources in order to develop within a parallel timeframe multiple products derived from our unique and patented adult stem cell technology platform. This strategy capitalizes on our own technical, clinical, and regulatory expertise, is supported by sufficient cash reserves, and is facilitated by commercial synergies accessed through strategic partnerships. In addition, our commercial leadership position is substantially underpinned by an integrated manufacturing strategy, and by ongoing protection of our intellectual property.

Environmental Regulations

The Board considers that adequate systems are in place to manage the Group's obligations and is not aware of any breach of environmental requirements as they relate to the Group.

Indemnification of Officers

During the financial year, the Group paid premiums in respect of a contract insuring the directors and company secretary of the Group, and all executive officers of the Group. The liabilities insured are to the extent permitted by the *Corporations Act 2001*. Further disclosure required under section 300(9) of the *Corporations Act 2001* is prohibited under the terms of the insurance contract.

Proceedings on Behalf of the Group

The *Corporations Act 2001* allows specified persons to bring, or intervene in, proceedings on behalf of the Group. No proceedings have been brought or intervened in on behalf of the Group with leave of the Court under section 237 of the *Corporations Act 2001*.

Non-Audit Services

The Group may decide to employ the auditor on assignments additional to their statutory audit duties where the auditor's expertise and experience are relevant and considered to be important.

The board of directors has considered the position and is satisfied that the provision of the non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The directors are satisfied that the provision of the non-audit services as set out below, did not compromise the auditor independence requirements of the *Corporations Act 2001* because the services are not deemed to undermine the general principles relating to auditor independence as set out in APES 110 *Code of Ethics for Professional Accountants*.

During the year the following fees were paid or payable for non-audit services provided by the auditor of the parent entity, its related practices and non-related audit firms:

	30 June 2012	30 June 2011
	\$	\$
Taxation services		
Employee share option plan tax advice	2,200	–
Employee long-term incentive structuring advice	–	47,500
Total taxation services	2,200	47,500

Auditor's Independence Declaration

A copy of the auditor's independence declaration under Section 307C in relation to the audit for the year ended 30 June 2012 is included on page 22 of the annual report.

Information on Directors

Brian Jamieson FCA

Non-executive Chairman

Experience and expertise

Mr Jamieson was Chief Executive of Minter Ellison Melbourne and a partner of the Minter Ellison Revenue Group from 2002-2005. He retired as Chief Executive of Minter Ellison Melbourne on 31 December 2005. Prior to joining Minter Ellison, Mr Jamieson was Executive Officer at KPMG Australia from 1998-2000, Managing Partner of KPMG Melbourne and Southern Regions from 1993-1998 and Chairman of KPMG Melbourne from 2001-2002. He was also a KPMG Board Member in Australia, and a member of the USA Management Committee. Mr Jamieson has over 30 years of experience in providing advice and audit services to a diverse range of public and large private companies. He is a fellow of the Institute of Chartered Accountants in Australia.

Other current directorships

Non-executive chairman of Sigma Pharmaceuticals Limited (since 2005)

Non-executive director of the Tatts Group Limited (since 2005)

Non-executive director OZ Minerals Limited (since 2004)

Non-executive director of Tigers Realm Coal Limited (since 2011)

Director and Treasurer of the Bionics Institute (since 2002)

Director and Treasurer of The Sir Robert Menzies Foundation (since 2004)

Former directorships in the last 3 years

None.

Special responsibilities

Chairman of the Board

Member of the Audit & Risk Committee

Member of the Remuneration Committee

Interests in shares and options

Ordinary shares in Mesoblast Limited: 310,000

Share options in Mesoblast Limited: 300,000

Donal O'Dwyer BE, MBA

Non-executive Director

Experience and expertise

Mr O'Dwyer has over 20 years' experience as a senior executive in the global cardiovascular and medical devices industries. From 1996 to 2003, Mr O'Dwyer worked for Cordis Cardiology, the cardiology division of Johnson & Johnson's Cordis Corporation, initially as its president (Europe) and from 2000 as its worldwide president. In his role, Mr O'Dwyer led Cordis through the launch of the revolutionary Cypher drug eluting coronary stent technology, and saw the company take over number one market share of coronary stents worldwide. Prior to joining Cordis, Mr O'Dwyer worked for 12 years with Baxter Healthcare, rising from plant manager in Ireland to president of the Cardiovascular Group, Europe, now Edwards Lifesciences. Mr O'Dwyer is a qualified civil engineer and has an MBA.

Other current directorships

Non-executive director of Cochlear Limited (since 2005)

Non-executive director of Atcor Medical Holdings Limited (since 2004)

Chairman of Board of Atcor Medical Pty Ltd (since 2004)

Non-executive director of Sunshine Heart Inc. (since 2004)

Chairman of board of Endoluminal Sciences Pty Ltd (since 2005)

Former directorships in the last 3 years

Non-executive director of Mesoblast Inc. (from 2004 to 2011)

Special responsibilities

Chairman of the Remuneration Committee

Member of the Audit & Risk Committee

Interests in shares and options

Ordinary shares in Mesoblast Limited: 305,000

Share options in Mesoblast Limited: 799,737

Michael Spooner BCoM, ACA, MAICD

Non-executive Director

Experience and expertise

Mr Spooner is a well-known and respected business leader. He has an extensive network of relationships with investment firms and business communities across the globe, having spent the majority of the past 25 years living and working internationally. Mr Spooner consults to a number of listed and unlisted companies based in Australia and the US. In 2009 Mr Spooner was appointed Chairman of BiVACOR a total artificial heart company. Most recently, Mr Spooner was a non-executive director of Peplin Inc., a dermatology focused skin cancer company from 2004 until the company was sold in 2009 for over \$300m. He was also a non-executive director of Hawaii Biotech Inc. a specialty developer of vaccines from 2010 to 2011. Previously, Mr Spooner was the Chairman of Mesoblast Limited from its initial listing in 2004 until 2007 and Managing Director & CEO of Ventracor Limited where he led the transformation of a small Australian listed life sciences company into the second highest performing stock on the S&P/ASX 200 index. He was a Principal Partner and Director of Consulting Services with PricewaterhouseCoopers (Coopers & Lybrand) in Hong Kong for several years.

Other current directorships

Chairman of BiVACOR Pty Ltd (since 2009)

Former directorships in the last 3 years

Non-executive director of Hawaii Biotech Inc (from 2010 to 2011)

Non-executive director of Advanced Surgical Design (from 2010 to 2011)

Non-executive director of Peplin Inc (from 2004 to 2009)

Managing Director & CEO of Ventracor Limited (from 2001 to 2003)

Director of Hunter Immunology Limited (from 2007 to 2008)

Special responsibilities

Chairman of the Audit & Risk Committee

Member of the Remuneration Committee

Interests in shares and options

Ordinary shares in Mesoblast Limited: 1,081,335

No share option holdings

Ben-Zion Weiner BSc, MSc, PhD

Non-executive Director

Experience and expertise

Dr Weiner is Special Adviser to the CEO of Teva Pharmaceutical Industries Ltd. He has been Teva's head of global research and development for over three decades, most recently as Chief R&D Officer and a member of the Teva Executive Committee. In this role, he has directly overseen all pharmaceutical R&D and innovative branded product pipeline development. Dr Weiner has been responsible for the development of hundreds of generic products for the United States, European and other markets. In parallel, he has been responsible for the development and regulatory approval of Teva's innovative product portfolio. Dr Weiner has twice been the recipient of the Rothschild prize for innovation, including for the commercialization of Copaxone in the treatment of multiple sclerosis.

Other current directorships

Director of Gefen Biomed Investments Ltd (since 2010)

Board Member of XTL Biopharmaceuticals Limited (since 2012)

Former directorships in the last 3 years

None.

Special responsibilities

The nominated representative for the Teva Pharmaceutical Industries Ltd board seat.

Interests in shares and options

No share holdings

No share option holdings

Information on Directors (continued)

Silviu Itescu MBBS (Hons), FRACP, FACP, FACR
Executive Director

Experience and expertise

Professor Itescu has established an outstanding international reputation as a physician scientist in the fields of stem cell biology, autoimmune diseases, organ transplantation, and heart failure. He is currently an active faculty member of the University of Melbourne and Monash University and was previously a faculty member of Columbia University in New York. Professor Itescu has consulted for various international pharmaceutical companies, has been an adviser to biotechnology and health care investor groups, and has served on the Board of Directors of a number of publicly-listed life sciences companies.

Other current directorships

Director of Mesoblast Inc. (since 2001)

Former directorships in the last 3 years

None.

Special responsibilities

Chief executive

Interests in shares and options

Ordinary shares in Mesoblast Limited: 68,244,642

No share option holdings

J. Kevin Buchi BE, MBA

Non-executive Director until resigning on 9 May 2012

Experience and expertise

Mr Buchi was promoted to Chief Executive Officer of global biopharmaceutical company, Cephalon Inc, in 2010, after serving the Company in other capacities for almost 20 years. Most recently, Mr Buchi served as Chief Operating Officer and managed the Company's global sales and marketing functions, as well as product manufacturing, business development and investor relations. From 1996 to 2009, he served as Chief Financial Officer and, from 2004, head of business development for the Company. Mr Buchi has played an instrumental role in the global growth of Cephalon through acquisitions and sound financial management. At various times in his career since joining Cephalon in 1991 as controller, Mr Buchi has had oversight of corporate finance, accounting, information systems, facilities, human resources and administration. On 14 October 2011 Cephalon Inc. was acquired by Teva Pharmaceutical Industries Ltd. Mr Buchi graduated from Cornell University with a Bachelor of Arts degree in chemistry. He was a synthetic organic chemist for the Eastman Kodak Company before going on to obtain a master's degree in management from the J.L. Kellogg Graduate School of Management at Northwestern University. He worked for a large public accounting firm before beginning his career in the pharmaceutical industry with E.I. du Pont de Nemours and Company in 1983.

Special responsibilities

The nominated representative for the Teva Pharmaceutical Industries Ltd board seat.

Interests in shares and options

No share holdings

No share option holdings

Company Secretary

The company secretary is Mrs Jenni Pilcher CA, BBS. Since qualifying as a Chartered Accountant with Price Waterhouse, Mrs Pilcher has worked in corporate and business financial roles for high profile international companies in pharmaceuticals, FMCG (fast moving consumer goods) and services. Before joining Mesoblast as Financial Controller in 2007, she spent six years with ASX 200 Company, Spotless Group, progressing through a variety of financial roles. Previously Mrs Pilcher worked in the finance teams at Cadbury Schweppes plc and international pharmaceutical group Medeva plc, both based in the United Kingdom. She was appointed Chief Financial Officer of Mesoblast in November 2007 and Company Secretary in January 2012.

Meetings of Directors

The number of meetings of the Group's directors (including committee meetings of directors) held during the year ended 30 June 2012 and the numbers of meetings attended by each director were:

Director	Board of directors		Audit & Risk committee		Remuneration committee	
	A	B	A	B	A	B
Brian Jamieson	8	8	5	5	3	3
Donal O'Dwyer	8	8	5	5	3	3
Michael Spooner	8	8	5	5	3	3
Kevin Buchi (resigned 9 May 2012)	5	6	4	5	**	**
Dr Ben-Zion Weiner (appointed 9 May 2012)	0	1	**	**	**	**
Silviu Itescu	8	8	**	**	**	**

A = Number of meetings attended.

B = Number of meetings held during the time the director held office or was a member of the committee.

**Not a member of the relevant committee

Remuneration Report

The directors of the Company present the following remuneration report, which forms part of the directors' report and has been prepared in accordance with s300A of the *Corporations Act 2001*. The remuneration report has been audited as required by s308 (3C) of the *Corporations Act 2001*. The remuneration report sets out remuneration information for the Company's key management personnel.

The remuneration report is set out under the following main headings:

1. Remuneration committee
2. Non-executive director remuneration policy
3. Executive remuneration policy and framework
4. Use of remuneration consultants
5. Voting and comments made at the Company's 2011 Annual General Meeting (AGM)
6. Company performance and remuneration
7. Key management personnel remuneration
8. Service agreements
9. Share-based compensation

1. Remuneration committee

The remuneration committee is a committee of the Board, and is primarily responsible for making recommendations to the Board on:

- Non-executive director fees
- Remuneration levels of executive directors and other key management personnel
- The executive remuneration framework
- The award of short-term and long-term incentives
- Share ownership plans

The committee's objective is to ensure remuneration policies are fair and competitive and in line with similar industry benchmarks whilst aligned with the objectives of the Company. The remuneration committee seeks independent advice from remuneration consultants as and when it deems necessary (see below).

2. Non-executive director remuneration policy

Non-executive director fees were recently set with reference to external advice and market rates for similar size companies.

In addition to directors' fees, directors are entitled to participate in the Company's share ownership plan to the extent the participation is approved by shareholders at the Company's annual general meetings. The most recent allocation of share options made to a Director was on his election to the board of directors and was approved by shareholders in November 2009. There have been no recommendations or allocations of options to Directors since that time nor are there any foreseeable recommendations.

During the current year a cash bonus of \$125,000 was paid to each of three non-executive directors as recognition for the outstanding performance and growth of the Company for the year ended 30 June 2011, a year which produced a major re-rating of the Company on the stock market. This bonus was also paid in recognition of directors' fees being lower than market rates during previous years, when the Company was in its growth phase and the objective was to conserve cash.

Directors' fees

The directors' fees are determined within an aggregate directors' fee pool limit which is periodically recommended for approval by shareholders. The pool currently available is \$1,000,000 per annum which was approved by shareholders at the extraordinary general meeting held on 9 February 2011.

The current base fees were last reviewed and approved effective 1 July 2011:

Position	Effective 1 July 2012			From 1 July 2011 to 30 June 2012		
	Board \$	Audit Committee \$	Remuneration Committee \$	Board \$	Audit Committee \$	Remuneration Committee \$
Chair	220,000	20,000	15,000	220,000	20,000	15,000
Member	100,000	10,000	7,500	100,000	10,000	7,500
Company Secretary	–	–	–	40,000*	–	–

* Company secretary position was transitioned to an in-house role on 1 January 2012 at which time a separate fee for company secretarial services ceased.

3. Executive remuneration policy and framework

The Board ensures that executive remuneration complies with the following good reward governance practices:

- Competitiveness and reasonableness
- Acceptability to shareholders
- Performance linkage
- Transparency

The Company has structured an executive remuneration framework that is market competitive and complimentary to the reward strategy of the organization.

The Company's remuneration framework is aligned to shareholders interests and in particular aligned to the commercialization of the Group's intellectual property and in achieving its milestones in a highly ethical and professional manner.

The executive remuneration framework provides a mix of fixed and variable pay, and performance incentive rewards.

Base pay

Executives are offered a competitive base pay that comprises the fixed component of pay and rewards. The base pay for executives is reviewed annually to ensure the executives' pay is competitive with the market. An executive's pay is also reviewed on promotion.

There is no guaranteed base pay increases included in any executive contracts.

Benefits

Australian resident employees are entitled to retirement benefits which are paid in accordance with the super guarantee legislation. U.S. resident employees are entitled to certain health, dental and vision insurance cover.

Short-term performance incentives

Bonuses are payable to executives based upon the attainment of agreed corporate and individual key performance indicators, which are reviewed annually and approved by the Board of Directors.

Long-term performance incentives

All options and loan funded shares are issued with an exercise price, or price to purchase a share, which includes a premium to the actual share price on grant date. In addition to the exercise premium, certain options are granted with performance milestones (refer page 56). For those options which do not have specific performance milestones attached, they will vest over time, on the condition that the holder continues to provide services to the Company. Options and loan funded shares typically expire five years after grant date.

Long-term incentives for senior management are currently awarded annually, and comprise approximately 40% of their total annual remuneration package at the time of the award. The CEO, as the founder of the Company, to date has not participated in the long-term incentive program.

4. Use of remuneration consultants

During the financial year the Mesoblast remuneration committee engaged Deloitte to review and provide recommendations on the appropriateness of the long-term incentive (share based) plans. As a result of this review, Deloitte recommended the adoption of a loan funded share plan for its Australian resident employees. This plan was adopted and has replaced the current Employee Share Option Plan for Australian resident employees only. Deloitte was paid \$33,785 for these services, which included drafting of necessary documentation to allow the implementation of the plan.

The remuneration committee also engaged Mercer remuneration consultants to review its current remuneration policies and amounts for its senior executives. Under the terms of the engagement Mercer provided remuneration recommendations as defined in section 9B of the *Corporations Act 2001* and was paid \$31,500 for these services.

The following arrangements were made to ensure that the remuneration recommendations received from both Deloitte and Mercer were free from undue influence:

- Deloitte and Mercer were engaged by, and reported directly to, the chair of the remuneration committee. The agreement for the provision of remuneration consulting services was executed by the chair of the remuneration committee under delegate authority on behalf of the board.
- The report containing remuneration recommendations, and LFSP drafting, was provided to the chair of the remuneration committee in both instances; and
- Both Mercer and Deloitte were permitted to speak to the CFO of the company in order to seek and clarification or information relevant to providing their recommendations, however they were not permitted to provide any member of management or staff with a copy of their report.

As a consequence, the board is satisfied that the recommendations were made free from undue influence from any members of the key management personnel.

5. Voting and comments made at the Company's 2011 Annual General Meeting (AGM)

Mesoblast Ltd received 98% of the proxy votes in favour of adopting the 2011 remuneration report, and the same resolution was passed on a show of hands at the meeting. The Company did not receive any feedback at the AGM on its remuneration practices.

6. Company performance and remuneration

	2008	2009	2010	2011	2012
Share price (ASX:MSB) – closing at 30 June	\$0.91	\$0.83	\$1.85	\$8.65	\$6.19
Market capitalization at 30 June	\$108.5m	\$113.0m	\$286.3m	\$2,425m	\$1,770m
– increase/(decrease) – %		4%	153%	747%	(27%)
Short-term incentives – % of target paid to CEO	0%	100%	100%	100%	65%
Short-term incentives – % of base salary paid to CEO	0%	40%	40%	42%	65%

The Company's remuneration policies seek to reward staff members for their contribution to achieving significant clinical and regulatory milestones, together with the achievement of operational and commercial objectives. These milestones and objectives build sustainable and long-term shareholder value.

For the years 2009 and prior, the Company was in early stage of development and cash was a key focus for the business. Consequently base pay and STIs were at the low end of market rates, and remuneration packages were substituted with non-cash long term incentives. In addition, during the global financial crisis all bonuses and base pay increases were put on hold due to the level of uncertainty at that time.

In December 2010, the Company entered into the development and commercialization agreement with Cephalon Inc. (acquired by Teva Pharmaceutical Industries Limited – 'Teva'), which lead to a significant cash injection of approximately \$270m, being \$139m by way of an equity investment of 19.99% at \$4.35 per share, plus US\$130m payment for upfront milestones. In addition to this initial cash injection, there are future milestones payable upon achieving certain regulatory approvals, and a profit sharing agreement on future sales. This partnership with Teva saw a significant rerating of the Company in the market and entry into the ASX 200 group of companies. A significant expansion in the operational activities of the Company followed, which in turn lead to strategic key appointments and the resetting of remuneration packages for

the CEO and the senior management group to align remuneration with other similar size companies within the industry. Bonuses were also paid to reward the team for this extraordinary achievement.

As expected with the biotechnology industry and pre-revenue generating companies, the Company's share price is volatile and more susceptible to market conditions and sentiment than revenue generating companies. 2011 saw a rapid increase in the Company's stock price in recognition of the partnership with Teva. This was followed by the share price stabilizing during 2012.

The Company continues to set goals annually which are aligned to increasing shareholder wealth and return. STIs will continue to be paid on achievement of those goals and related Company success.

7. Key management personnel remuneration

Key management personnel includes all non-executive directors (as disclosed on page 60) and executive directors being the CEO, who together have the authority and responsibility for planning, directing and controlling the activities of the Group.

Details of the remuneration of the Company's key management personnel are set out below:

2012 Name	Short-term employee benefits			Post-employment benefits	Share-based payments	Other	Total
	Salary & fees	Cash Bonus ⁽ⁱ⁾	Non-monetary benefits	Super-annuation	Options & rights	Termination benefits	
	\$	\$	\$	\$	\$	\$	\$
Executive director							
Silviu Itescu (CEO)	920,833**	585,000*	–	15,775	–	–	1,521,608
Non-executive directors							
Brian Jamieson	220,000	125,000	–	15,775	11,801	–	372,576
Donal O'Dwyer	125,000	125,000	–	13,319	–	–	263,319
Michael Spooner	127,500	125,000	–	13,505	–	–	266,005
Kevin Buchi (from 1 July 2011 to 9 May 2012)	85,753	–	–	–	–	–	85,753
Ben-Zion Weiner (from 9 May 2012 to 30 June 2012)	14,361*	–	–	–	–	–	14,361
Total 2012	1,493,447	960,000	–	58,374	11,801	–	2,523,622
Executive director							
Silviu Itescu	498,436	400,000***	–	15,199	–	–	913,635
Non-executive directors							
Brian Jamieson	110,917	–	–	9,083	87,057	–	207,057
Byron McAllister (from 1 July to 29 November 2010)	25,000	–	–	–	–	–	25,000
Donal O'Dwyer	55,046	–	–	4,954	–	–	60,000
Michael Spooner	55,046	–	–	4,954	–	–	60,000
Kevin Buchi (from 30 December 2010 to 30 June 2011)	30,000	–	–	–	–	–	30,000
Total 2011	774,445	400,000	–	34,190	87,057	–	1,295,692

*Accrued but not paid as at 30 June 2012;

** Includes \$20,833 paid relating to services provided for the preceding financial year.

*** Includes \$100,000 payment for achievement of KPIs relating to the previous financial year.

(i) CEO % of bonus forfeited during the year as a result of performance targets not being met is 35%. Non-executive directors bonuses paid = 100% of entitlement and 0% were forfeited.

Performance based remuneration is comprised of bonuses.

The relative proportions of remuneration that are linked to performance and those that are fixed are as follows:

Name	Fixed remuneration		At risk – STI		At risk – LTI	
	2012 %	2011 %	2012 %	2011 %	2012 %	2011 %
Silviu Itescu – target	50	70	50	30	0	0
Silviu Itescu – paid (or due for payment)	61	70	39	30	0	0

8. Service agreements

The non-executive directors and the company secretary are engaged through a letter of appointment. Non-executive directors are appointed by shareholders on the basis that one third of all non-executive directors retire annually and are eligible for re-election at the Annual General Meeting.

Remuneration and other terms of employment for the CEO, and senior management, are formalized in an employment agreement. Provisions of the employment agreement for the CEO relating to remuneration are set out below:

Name	Term	Termination Benefits
Silviu Itescu	Three years, commencing 1 April 2011	12 months' salary

9. Share-based compensation

Options granted to purchase fully paid shares of the Group

There were no options granted during the year to key management personnel (2011:nil).

Modifications to terms and conditions of options granted

There has been no modification to any terms and conditions of options during the current and previous financial years.

Options held by key management personnel that were exercised during the year

2012

There were no options held by key management personnel that were exercised during the current year.

2011	Exercise Price \$	Exercise Date	No. of ordinary shares issued on exercise of options during the year	Value per share at exercise date \$
Donal O'Dwyer*	USD0.47	20/12/2010	639,784	3.62

*Exercised upon the acquisition of Mesoblast Inc. and sold as part of a facility on 20 December 2010. The value per share is the weighted average value of those options that were exercised and sold on the same day as part of this facility

Value of options held by key management personnel that vested and/or lapsed during the year

	2012		2011	
	No. of options vested during the year	No. of options lapsed during the year	No. of options vested during the year	No. of options lapsed during the year
Brian Jamieson	–	–	225,000	–
Donal O'Dwyer*	–	–	1,439,511	–
			1,664,511	

*Options vested on acquisition of Mesoblast Inc, and converted to Mesoblast options.

Value of options yet to vest after the end of the current financial year

	Year of Grant	Vested during the year %	Forfeited during the year %	Subsequent financial years in which options may vest
Brian Jamieson	2010	–	–	2013

This report is made in accordance with a resolution of the directors.



Mr Brian Jamieson
Chairman

22 August 2012, Melbourne



Auditor's Independence Declaration

As lead auditor for the audit of Mesoblast Limited for the year ended 30 June 2012, I declare that to the best of my knowledge and belief, there have been:

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

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

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

Anton Linschoten
Partner
PricewaterhouseCoopers

Melbourne
22 August 2012

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Consolidated Income Statement for the year ended 30 June 2012

	Note	30 June 2012 \$	30 June 2011 \$
Revenue from continuing operations	2(a)	38,154,591	19,257,822
Other income	2(b)	125,311	101,611,460
		38,279,902	120,869,282
Expenses from continuing operations	2(c)		
Research and development		(36,936,864)	(11,947,774)
Manufacturing commercialization		(22,015,041)	(3,366,774)
Management and administration		(28,050,526)	(11,792,973)
Interest expense		(289)	(14,912)
Share of losses of equity accounted associates		–	(1,505,345)
		(87,002,720)	(28,627,778)
(Loss)/profit before income tax		(48,722,818)	92,241,504
Income tax expense	4	(22,422,496)	(1,634,914)
(Loss)/profit attributable to the owners of Mesoblast Limited		(71,145,314)	90,606,590
(Losses)/profits per share from continuing operations attributable to the ordinary equity holders of the Group:			
		Cents	Cents
Basic – (losses)/earnings per share	6	(25.15)	41.79
Diluted – (losses)/earnings per share	6	(25.15)	39.78

The above consolidated income statement should be read in conjunction with the accompanying notes.

Consolidated Statement of Comprehensive Income for the year ended 30 June 2012

	Note	30 June 2012 \$	30 June 2011 \$
(Loss)/profit for the year		(71,145,314)	90,606,590
Other comprehensive income			
Exchange differences on translation of share of losses of foreign associates		–	1,704,870
Foreign exchange balance written back on acquisition of a previously held associate		–	(2,124,874)
Exchange differences on translation of foreign operations	18	14,905,068	(21,915,730)
Other comprehensive (loss)/income for the period, net of tax		14,905,068	(22,335,734)
Total comprehensive (loss)/income is attributable to the owners of Mesoblast Limited		(56,240,246)	68,270,856

The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.

Consolidated Statement of Changes in Equity for the year ended 30 June 2012

	Note	Issued Capital \$	Share Option Reserve \$	Foreign Currency Translation Reserve \$	Retained Earnings \$	Total \$
Balance at 1 July 2010		87,949,316	5,175,760	420,004	(55,625,820)	37,919,260
Profit/(loss) for the year		–	–	–	90,606,590	90,606,590
Other comprehensive income		3,519,335	(3,519,335)	(22,335,734)	–	(22,335,734)
Total comprehensive profit/(loss) for the period		3,519,335	(3,519,335)	(22,335,734)	90,606,590	68,270,856
Transactions with owners in their capacity as owners:						
Contributions of equity net of transaction costs		126,093,410	–	–	–	126,093,410
Equity issued on acquisition of Mesoblast Inc ^ .		235,361,526	33,091,753	–	–	268,453,279
	17	361,454,936	33,091,753	–	–	394,546,689
Share options (at fair market value) issued on acquisition of Mesoblast Inc. exercised and converted to equity		24,191,394	(24,191,394)	–	–	–
Tax effect of options deductible for tax		–	11,806,925	–	–	11,806,925
Fair value of share-based payments		–	3,300,443	–	–	3,300,443
		385,646,330	24,007,727	–	–	409,654,057
Balance at 30 June 2011		477,114,981	25,664,152	(21,915,730)	34,980,770	515,844,173
(Loss)/profit for the year		–	–	–	(71,145,314)	(71,145,314)
Other comprehensive income		–	485,856	14,419,212	–	14,905,068
Total comprehensive (loss)/profit for the period		–	485,856	14,419,212	(71,145,314)	(56,240,246)
Transactions with owners in their capacity as owners:						
Contributions of equity net of transaction costs		5,765,958	–	–	–	5,765,958
	17	5,765,958	–	–	–	5,765,958
Tax effect of options deductible for tax		–	1,360,275	–	–	1,360,275
Transfer exercised options		2,123,227	(2,123,227)	–	–	–
Fair value of share-based payments		–	12,117,623	–	–	12,117,623
		2,123,227	11,354,671	–	–	13,477,898
Balance at 30 June 2012		485,004,166	37,504,679	(7,496,518)	(36,164,544)	478,847,783

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

^ In the Mesoblast 2011 Annual Report Mesoblast Inc. was referred to as Angioblast Systems Inc. Subsequently Angioblast Systems Inc. has changed its name to Mesoblast Inc.

Consolidated Balance Sheet as at 30 June 2012

	Note	30 June 2012 \$	30 June 2011 \$
Assets			
Current Assets			
Cash and cash equivalents	7	206,748,798	263,227,585
Trade and other receivables	8	10,668,742	2,100,945
Prepayments		318,580	165,536
Total Current Assets		217,736,120	265,494,066
Non-Current Assets			
Property, plant and equipment	9	1,998,430	609,849
Deferred tax asset	10	3,502,429	21,820,392
Intangible assets	11	497,218,571	475,326,200
Total Non-Current Assets		502,719,430	497,756,441
Total Assets		720,455,550	763,250,507
Liabilities			
Current Liabilities			
Trade and other payables	12	11,969,147	3,665,407
Deferred revenue	13	28,209,500	27,129,937
Derivative financial instruments	14	1,406,762	–
Provisions	16	2,908,900	–
Total Current Liabilities		44,494,309	30,795,344
Non-Current Liabilities			
Deferred revenue	13	56,361,109	81,334,137
Deferred tax liability	15	132,911,392	127,817,393
Provisions	16	7,840,957	7,459,460
Total Non-Current Liabilities		197,113,458	216,610,990
Total Liabilities		241,607,767	247,406,334
Net Assets		478,847,783	515,844,173
Equity			
Issued capital	17	485,004,166	477,114,981
Reserves	18	30,008,161	3,748,422
Retained earnings/(accumulated losses)		(36,164,544)	34,980,770
Total Equity		478,847,783	515,844,173

The above consolidated balance sheet should be read in conjunction with the accompanying notes.

Consolidated Statement of Cash Flows for the year ended 30 June 2012

	Note	30 June 2012 \$	30 June 2011 \$
Cash Flows from Operating Activities			
Payments to suppliers and employees (inclusive of goods and services tax)		(65,204,459)	(22,488,270)
Commercial milestones received		–	130,708,000
Government grants and other income received		125,311	9,143
Income taxes paid		(7,037,635)	–
Net cash (outflows)/inflows in operating activities	19 (b)	(72,116,783)	108,228,873
Cash Flows from Investing Activities			
Interest paid		(289)	(98)
Interest received		9,308,114	2,790,056
Payments for financial derivatives		(1,273,792)	–
Cash acquired on acquisition of subsidiary		–	3,448,299
Payments for intellectual property and licences		(722,000)	–
Investment in fixed assets		(1,983,283)	(461,549)
Proceeds from sale of fixed assets		3,668	–
Loan advanced to associate company		–	(1,061,990)
Net cash inflows in investing activities		5,332,418	4,714,718
Cash Flows from Financing Activities			
Proceeds from issue of shares		4,882,638	126,863,724
Payments for share issue costs		–	(770,314)
Net cash inflows by financing activities		4,882,638	126,093,410
Net (decrease)/increase in cash and cash equivalents		(61,901,727)	239,037,001
Cash and cash equivalents at beginning of year		263,227,585	32,049,327
FX gains/(losses) on the translation of foreign bank accounts		5,422,940	(7,858,743)
Cash and cash equivalents at end of year	19 (a)	206,748,798	263,227,585

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the Financial Statements for the year ended 30 June 2012

Introduction

The financial report covers Mesoblast Limited ('Mesoblast'), a company limited by shares whose shares are publicly traded on the Australian stock exchange (ASX). Mesoblast is incorporated and domiciled in Australia and has its registered office and principal place of business as follows:

Registered office and Principal place of business

Level 39
55 Collins Street
Melbourne

The principal activity of the economic entity during the financial year was the commercialization of unique intellectual property associated with the isolation, culture and scale-up of adult stem cells referred to as Mesenchymal Precursor Cells (MPCs).

The financial statements were authorized for issue by the directors on 22 August 2012. The directors have the power to amend and reissue the financial statements.

Notes to the Financial Statements for the year ended 30 June 2012

1. Significant Accounting Policies

Statement of compliance

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. The financial statements are for the consolidated entity consisting of Mesoblast Limited and its subsidiaries.

Basis of preparation

These general purpose financial statements have been prepared in accordance with Australian Accounting Standards and Interpretations issued by the Australian Accounting Standards Board and the *Corporations Act 2001*. Mesoblast Limited is a for-profit entity for the purpose of preparing the financial statements.

i. Compliance with IFRS

The consolidated financial statements of the Mesoblast Limited Group also comply with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

ii. New and amended standards adopted by the Group

None of the new standards and amendments to standards that are mandatory for the first time for the financial year beginning 1 July 2011 affected any of the amounts recognized in the current period or any prior period and are not likely to affect future periods.

iii. Early adoption of standards

The Group has not elected to apply any pronouncements before their operative date in the annual reporting period beginning 1 July 2011.

iv. Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and liabilities (including derivative instruments) at fair value through profit or loss, certain classes of property, plant and equipment and investment property.

Critical accounting estimates

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are:

i. Income taxes

The Group is subject to income taxes in Australia and the United States of America. Significant judgment is required in determining the worldwide provision for income taxes. There are certain transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The Group estimates its tax liabilities based on the Group's understanding of the tax law. Where the final outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

The Group has recognized deferred tax assets to the extent that it is probable that the asset will be utilized either through the application of carry back rules or the utilization of taxable temporary differences (deferred tax liabilities) relating to the same taxation authority and the same subsidiary against which the unused tax losses can be utilized.

ii. Revenue recognition

The total upfront cash received under the development and commercialization agreement is USD 130,000,000. The Group has recognized revenue of \$27,682,896 in the current year (2011: \$14,609,186) for this payment on the basis that the revenue will be earned through-out the life of the development of those products pertaining to that payment. The development lives of those products are estimates which are reviewed on a half yearly basis as a minimum. There was no change to the estimated development life of the product on the review undertaken on 30 June 2012.

iii. Estimated impairment of goodwill

The Group tests annually whether goodwill has suffered any impairment in accordance with its accounting policy stated in notes 1(k) and 1(p).

The following significant accounting policies have been adopted in the preparation and presentation of the financial report:

(a) Principles of consolidation

i. Subsidiaries

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Mesoblast Limited ('company' or 'parent entity') as at 30 June 2012 and the results of all subsidiaries for the year then ended. Mesoblast Limited and its subsidiaries together are referred to in this financial report as the Group or the consolidated entity.

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The acquisition method of accounting is used to account for business combinations by the Group.

Intercompany transactions, balances and unrealized gains on transactions between Group companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Non-controlling interests in the results and equity of subsidiaries are shown separately in the consolidated income statement, statement of comprehensive income, statement of changes in equity and balance sheet respectively.

ii. Employee share trust

The Group has formed a trust to administer the Group's employee share scheme. This trust is consolidated, as the substance of the relationship is that the trust is controlled by the Group.

iii. Associates

Associates are all entities over which the Group has significant influence but not control or joint control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting, after initially being recognized at cost. The Group's investment in associates includes goodwill identified on acquisition (refer to note 20).

The Group's share of its associates' post-acquisition profits or losses is recognized in profit or loss, and its share of post-acquisition other comprehensive income is recognized in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Dividends receivable from associates are recognized as a reduction in the carrying amount of the investment.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured long-term receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized 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.

(b) Segment reporting

The Group predominately operates in one segment being the research and development of MPCs.

(c) Foreign currency translation

Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Australian dollars, which is Mesoblast Limited's functional and presentation currency.

Translations and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the transaction at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit and loss, except when they are deferred in equity as qualifying cash flow hedges and qualifying net investment hedges or attributable to part of the net investment in a foreign operation.

Non monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Translation differences on assets and liabilities carried at fair value are reported as part of the fair value gain or loss. For example, translation differences on non monetary assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss and translation differences on non monetary assets such as equities classified as available for sale financial assets are recognized in other comprehensive income.

Group companies

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for the balance sheets presented are translated at the closing rate at the date of that balance sheets;
- income and expenses for the statements of comprehensive income are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognized in other comprehensive income.

Notes to the Financial Statements for the year ended 30 June 2012

1. Significant Accounting Policies (continued)

On consolidation, exchange differences arising from the translation of any net investment in foreign entities, and of borrowings and other financial instruments designated as hedges of such investments, are recognized in other comprehensive income. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, the associated exchange differences are reclassified to profit or loss, as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entities and translated at the closing rate.

(d) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Amounts disclosed as revenue are net of returns, trade allowances, rebates and amounts collected on behalf of third parties.

The Group recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue is recognized for the major business activities as follows:

Commercialization revenue

Commercialization revenue refers to upfront and milestone payments received under development and commercialization agreements. Upfront milestone payments which are typically received upon (or near) the signing of these agreements are recognized as revenue over the key collaboration period pertaining to the agreement. Milestone payments are recognized on an accruals basis when the development milestone has been reached.

Interest revenue

Interest revenue is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

(e) Government grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to cost reimbursements are deferred and recognized in the statement of comprehensive income over the period necessary to match them on a systematic basis with the costs that they are intended to compensate.

Government grants whose primary condition is for the Group to purchase property, plant and equipment are included in non-current liabilities as deferred income and are credited to the statement of comprehensive income on a straight line basis over the expected lives of the related assets.

(f) Research and development

Research and development expenditure is expensed as incurred. To the extent that future recoverability is probable and can be reliably measured, these costs are recognized as intangible assets. Intangible assets are amortized from the point at which the asset is ready for use on a straight line basis over the period in which the related benefits are expected to be realized.

The carrying value of any capitalized development costs are reviewed for impairment annually when the asset is not yet in use or when an indicator of impairment arises during the reporting year indicating that the carrying value may not be recoverable.

(g) Income tax

The income tax expense or benefit for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Group's subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting, nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred tax assets are recognized for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilize those temporary differences and losses.

Deferred tax liabilities and assets are not recognized for temporary differences between the carrying amount and tax bases of investments in controlled entities where the parent entity is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Current and deferred tax is recognized in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

(h) Investments and other financial assets

Classification

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held to maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and, in the case of assets classified as held-to-maturity, re-evaluates this designation at the end of each reporting date.

(i) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term. Derivatives are classified as held for trading. Assets in this category are classified as current assets if they are expected to be settled within 12 months, otherwise they are classified as non-current.

(ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for those with maturities greater than 12 months after the reporting period which are classified as non-current assets. Loans and receivables are included in trade and other receivables (note 8) in the balance sheet.

(iii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive

intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available-for-sale. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the end of the reporting period, which are classified as current assets.

(i) Leases

Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Group as lessee are classified as operating leases (note 22). Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease.

(j) Business combinations

The acquisition method of accounting is used to account for all business combinations, including business combinations involving entities or businesses under common control, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred also includes the fair value of any contingent consideration arrangement and the fair value of any pre existing equity interest in the subsidiary. Acquisition related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are, with limited exceptions, measured initially at their fair values at the acquisition date. On an acquisition by acquisition basis, the Group recognizes any non controlling interest in the acquiree either at fair value or at the non controlling interest's proportionate share of the acquiree's net identifiable assets.

The excess of the consideration transferred and the amount of any non-controlling interest in the acquiree over the fair value of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the subsidiary acquired and the measurement of all amounts has been reviewed, the difference is recognized directly in profit or loss as a bargain purchase.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

Contingent consideration is classified either as equity or a financial liability. Amounts classified as a financial liability are subsequently remeasured to fair value with changes in fair value recognized in profit or loss.

Notes to the Financial Statements for the year ended 30 June 2012

1. Significant Accounting Policies (continued)

(k) Impairment of assets

Goodwill and intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

(l) Cash and cash equivalents

For the purpose of presentation in the statement of cash flows, cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term and highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(m) Trade and other receivables

Trade receivables and other receivables represent the principal amounts due at balance date less, where applicable, any provision for doubtful debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable and there is objective evidence of impairment. Debts which are known to be uncollectible are written off in the statement of comprehensive income. All trade receivables and other receivables are recognized at the value of the amounts receivable, as they are due for settlement within 60 days and therefore do not require re-measurement.

(n) Investments accounted for using the equity method

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. The financial statements of the associate are used by the Group to apply the equity method. The reporting dates of the associate and the Group are identical and both use consistent accounting policies.

The investment in the associate is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value. The statement of comprehensive income reflects the Group's share of the results of operations of the associate.

Where there has been a change recognized directly in the associate's equity, the Group recognized its share of any change and disclosed this, when applicable, in the statement of changes in equity.

The carrying amount of an investment accounted for using the equity method is assessed annually to determine whether there is any indication that the asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of the recoverable amount. Where the carrying amount of the asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

(o) Property, plant and equipment

Plant and equipment are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of the item.

Property, plant and equipment, other than freehold land, are depreciated over their estimated useful lives using the straight line method. The expected useful lives are between two and nine years, with the majority being depreciated over four years.

Gains and losses on disposal of plant and equipment are taken into account in determining the profit for the year.

(p) Intangible assets

(i) Goodwill

Goodwill on acquisition of subsidiaries is included in intangible assets (note 11). Goodwill is not amortized but it is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, and is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash generating units for the purpose of impairment testing. The allocation is made to those cash generating units or groups of cash generating units that are expected to benefit from the business combination in which the goodwill arose.

(ii) Trademarks and licenses

Trademarks and licenses have a finite useful life and are carried at cost less accumulated amortization and impairment losses. Amortization is calculated using the straight line method to allocate the cost of trademarks and licenses over their estimated useful lives, which are 20 years.

(iii) Intellectual property

Other intellectual property is amortized from the point at which the asset is ready for use on a straight line basis over its useful life. The useful life is typically the life of the patent, which is 20 years.

(q) Trade and other payables

Payables represent the principal amounts outstanding at balance date plus, where applicable, any accrued interest. Liabilities for payables and other amounts are carried at cost which approximates fair value of the consideration to be paid in the future for goods and services received, whether or not billed. The amounts are unsecured and are usually paid within 30 to 60 days of recognition.

(r) Provisions

Provisions are recognized when the Group has a present obligation (legal and constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The discount rate used to determine the present value is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The increase in the provision due to the passage of time is recognized as interest expense.

Provisions are recorded on acquisition of a subsidiary, to the extent they relate to a subsidiaries contingent liabilities, if the amounts can be reliably measured and it relates to a past event, regardless of whether it is probable the amount will be paid.

(s) Employee benefits

A liability is recognized for benefits accruing to employees in respect of wages and salaries, bonuses, annual leave and long service leave.

Liabilities recognized in respect of employee benefits which are expected to be settled within 12 months, are measured at their nominal values using the remuneration rates expected to apply at the time of settlement.

Liabilities recognized in respect of employee benefits which are not expected to be settled within 12 months, are measured as the present value of the estimated future cash outflows to be made by the Group in respect of services provided by employees up to reporting date.

(t) Share-based payments

Share-based payments are provided to employees, directors and consultants via the Mesoblast Employee Share Option Plan and the Mesoblast Australian Loan Funded Share Plan.

Equity-settled share-based payments with employees and others providing similar services are measured at the fair value of the equity instrument at grant date. Fair value is measured using the Black-Scholes model. The expected life used in the model has been adjusted, based on management's

best estimate, for the effects of non-transferability, exercise restrictions, and behavioral considerations. It does not make any allowance for the impact of any service and non-market performance vesting conditions. Further details on how the fair value of equity-settled share-based transactions has been determined can be found in note 24.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on management's estimate of shares that will eventually vest, with a corresponding increase in equity. At the end of each period, the entity revises its estimates of the number of share-based payments that are expected to vest based on the non-market vesting conditions. It recognizes the impact of the revision to original estimates, if any, in profit or loss, with a corresponding adjustment to equity.

(u) Contributed equity

Ordinary shares are classified as equity.

Transaction costs arising on the issue of equity instruments are recognized directly in equity as a reduction of the proceeds of the equity instruments to which the costs relate. Transaction costs are the costs that are incurred directly in connection with the issue of those equity instruments and which would not have been incurred had those instruments not been issued.

(v) Earnings per share**(i) Basic earnings per share**

Basic earnings per share is calculated by dividing:

- the profit or loss attributable to equity holders of the Group, excluding any costs of servicing equity other than ordinary shares.
- by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the year.

(ii) Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account

- the after income tax effect of interest and other financing costs associated with 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.

(w) Goods and services tax (GST)

Revenues, expenses and assets are recognized net of the amount of GST except where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognized as part of the cost of acquisition of the asset or as part of the expense.

Notes to the Financial Statements for the year ended 30 June 2012

1. Significant Accounting Policies (continued)

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the Balance Sheet.

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

(x) Changes in accounting policies

There have been no significant changes in accounting policies during the reporting period.

(y) Comparative figures

Comparatives have been reclassified where necessary so as to be consistent with the figures presented in the current year. The prior year amounts include the results for the subsidiary since acquisition date and are accordingly presented on a consolidated basis.

(z) New and revised accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2012 reporting periods. The Group's assessment of the impact of these new standards and interpretations is set out below:

- i. *AASB 10 Consolidated Financial Statements, AASB 11 Joint Arrangements, AASB 12 Disclosure of Interests in Other Entities, revised AASB 127 Separate Financial Statements and AASB 128 Investments in Associates and Joint Ventures and AASB 2011-7 Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards (effective 1 January 2013).*

In August 2011, the AASB issued a suite of five new and amended standards which address the accounting for joint arrangements, consolidated financial statements and associated disclosures.

AASB 10 replaces all of the guidance on control and consolidation in AASB 127 Consolidated and Separate Financial Statements, and Interpretation 12 Consolidation – Special Purpose Entities. The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single economic entity remains unchanged, as do the mechanics of consolidation. However, the standard introduces a single definition of control that applies to all entities. It focuses on the need to have both power and rights or exposure to variable returns. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both. Control exists when the investor can use its power to affect the amount of its

returns. There is also new guidance on participating and protective rights and on agent/principal relationships. While the Group does not expect the new standard to have a significant impact on its composition, it has yet to perform a detailed analysis of the new guidance in the context of its various investees that may or may not be controlled under the new rules.

AASB 11 introduces a principles based approach to accounting for joint arrangements. The focus is no longer on the legal structure of joint arrangements, but rather on how rights and obligations are shared by the parties to the joint arrangement. Based on the assessment of rights and obligations, a joint arrangement will be classified as either a joint operation or a joint venture. Joint ventures are accounted for using the equity method, and the choice to proportionately consolidate will no longer be permitted. Parties to a joint operation will account their share of revenues, expenses, assets and liabilities in much the same way as under the previous standard. AASB 11 also provides guidance for parties that participate in joint arrangements but do not share joint control.

AASB 12 sets out the required disclosures for entities reporting under the two new standards, AASB 10 and AASB 11, and replaces the disclosure requirements currently found in AASB 127 and AASB 128. Application of this standard by the Group will not affect any of the amounts recognized in the financial statements, but will impact the type of information disclosed in relation to the Group's investments.

Amendments to AASB 128 provide clarification that an entity continues to apply the equity method and does not remeasure its retained interest as part of ownership changes where a joint venture becomes an associate, and vice versa. The amendments also introduce a 'partial disposal' concept. The Group is still assessing the impact of these amendments.

The Group does not expect to adopt the new standards before their operative date. They would therefore be first applied in the financial statements for the annual reporting period ending 30 June 2014.

- ii. *AASB 13 Fair Value Measurement and AASB 2011-8 Amendments to Australian Accounting Standards arising from AASB 13 (effective 1 January 2013)*

AASB 13 was released in September 2011. It explains how to measure fair value and aims to enhance fair value disclosures. The Group has yet to determine which, if any, of its current measurement techniques will have to change as a result of the new guidance. It is therefore not possible to state the impact, if any, of the new rules on any of the amounts recognized in the financial statements. However, application of the new standard will impact the

type of information disclosed in the notes to the financial statements. The Group does not intend to adopt the new standard before its operative date, which means that it would be first applied in the annual reporting period ending 30 June 2014.

- iii. *Revised AASB 119 Employee Benefits, AASB 2011-10 Amendments to Australian Accounting Standards arising from AASB 119 (September 2011) and AASB 2011-11 Amendments to AASB 119 (September 2011) arising from Reduced Disclosure Requirements (effective 1 January 2013)*

In September 2011, the AASB released a revised standard on accounting for employee benefits. It requires the recognition of all remeasurements of defined benefit liabilities/assets immediately in other comprehensive income (removal of the so-called 'corridor' method) and the calculation of a net interest expense or income by applying the discount rate to the net defined benefit liability or asset. This replaces the expected return on plan assets that is currently included in profit or loss. The standard also introduces a number of additional disclosures for defined benefit liabilities/assets and could affect the timing of the recognition of termination benefits. The Group has not yet decided when to adopt the new standard.

There are no other standards that are not yet effective and that are expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

(y) Parent entity financial information

The financial information for the parent entity, Mesoblast Limited, disclosed in note 21 has been prepared on the same basis as the consolidated financial statements, except as set out below.

- (i) *Investments in subsidiaries, associates and joint venture entities*

Investments in subsidiaries, associates and joint venture entities are accounted for at cost in the financial statements of Mesoblast Limited.

Notes to the Financial Statements for the year ended 30 June 2012

2. Revenue and Expenses from Continuing Operations

	30 June 2012 \$	30 June 2011 \$
(a) Revenue from continuing operations		
Commercialization revenue ^	27,682,896	14,609,186
Interest revenue	10,471,695	4,648,636
	38,154,591	19,257,822
(b) Other income		
Government grant revenue	125,311	–
Gain on revaluation of investment to fair value	–	86,737,561
Share of losses of equity accounted associates written back on acquisition	–	14,873,899
	125,311	101,611,460
(c) Expenses from continuing operations		
The following items are an extract of items included in expenses from continuing operations		
Employee benefits		
Salaries and employee benefits	17,566,787	4,644,510
Defined contribution superannuation expenses	282,541	123,462
Share-based payments – employees & directors	10,052,491	2,464,627
	27,901,819	7,232,599
Depreciation and amortization of non-current assets		
Plant and equipment depreciation	313,901	135,153
Loss on disposal of fixed assets	47	–
Intellectual property amortization	64,637	43,731
	378,585	178,884
Other expenses		
Intellectual property costs (excluding amortization as shown above)	1,134,332	840,782
Share-based payments – consultants	2,065,132	835,816
Finance costs	289	14,912
Foreign exchange losses	1,302,009	165,154
Rent	1,300,130	316,005

^ In November 2010, the Group signed a development and commercialization agreement with Cephalon Inc., a major global biopharmaceutical company. On 14 October 2011 Cephalon Inc. was acquired by Teva Pharmaceutical Industries Ltd (NYSE: TEVA), a leading global pharmaceutical company with a presence in over 60 countries (source: Teva Pharmaceutical Industries Ltd press release dated 14 October 2011). Therefore the company will be referred to as Teva Pharmaceutical Industries Ltd in this report.

The Group received US\$130m as a non-refundable upfront fee. This revenue is being recognized over the collaboration period in the agreement, with any unrecognized portion being recorded as deferred revenue (refer note 13).

3. Segment Information

The Group predominately operates in one segment being the research and development of MPCs.

4. Income Tax Expense

	30 June 2012 \$	30 June 2011 \$
(a) Reconciliation of income tax to prima facie tax payable		
(Loss)/profit from continuing operations before income tax	(48,722,818)	92,241,504
Tax at the Australian tax rate of 30% (2011: 30%)	(14,616,845)	27,672,451
Tax effect of amounts which are (not deductible)/taxable in calculating taxable income:		
Share-based payments expense	3,643,586	1,074,610
Equity accounting loss	–	451,604
R&D tax concessions	(672,131)	(407,823)
Gain on revaluation of Angioblast	–	(26,021,268)
Share of losses in associate: written back	–	(4,462,170)
Other sundry items	(2,189)	28,050
Tax credits brought to account	–	(92,548)
Current year tax expense/(benefit)	(11,647,579)	(1,757,094)
Adjustments for current tax of prior periods	(993,858)	(462,560)
Differences in overseas tax rates	2,815,964	233,559
Tax benefit not recognized	29,599,896	3,621,009
USA City and State tax expense	2,648,073	–
Income tax expense attributable to profit before income tax	22,422,496	1,634,914
(b) Income tax expense		
Current tax	(188,335)	1,634,914
Deferred tax	22,610,831	–
	22,422,496	1,634,914
(c) Amounts that would be recognized directly in equity if brought to account		
Aggregate current and deferred tax arising in the reporting period and not recognized in net profit or loss or other comprehensive income but which would have been directly applied to equity had it been brought to account:		
Current tax recorded in equity (if brought to account)	564,276	16,383
Deferred tax recorded in equity (if brought to account)	214,712	–
	778,988	16,383
(d) Amounts recognized directly in equity		
Aggregate current and deferred tax arising in the reporting period and not recognized in net profit or loss or other comprehensive income but debited/credited to equity:		
Current tax recorded in equity	55,548	–
Deferred tax recorded in equity	–	–
(e) Tax Losses		
Unused tax losses for which no deferred tax asset has been bought to account	73,784,086	16,190,927
Potential tax benefit at local tax rates	22,163,440	4,857,278
(f) Unrecognized temporary differences		
Temporary differences not bought to account	27,600,006	329,706
	27,600,006	329,706

Temporary differences have been bought to account only to the extent that it is foreseeable that they are recoverable against future tax liabilities.

Notes to the Financial Statements for the year ended 30 June 2012

5. Remuneration of Auditors

	30 June 2012	30 June 2011
	\$	\$
PricewaterhouseCoopers		
(i) Audit and other assurance services		
Audit and review of financial reports	230,000	323,000
(ii) Taxation services		
Employee share scheme reporting obligations	2,200	–
Employee long-term incentive structuring advice	–	47,500
Total taxation services	2,200	47,500
Total remuneration of PricewaterhouseCoopers	232,200	370,500

6. Earnings Per Share

Net (loss)/profit used in calculating basic earnings per share	(71,145,314)	90,606,590
Net (loss)/profit used in calculating diluted earnings per share	(71,145,314)	90,606,590
Weighted average number of ordinary shares used in calculating basic earnings per share	282,860,783	216,797,657
Dilutive potential ordinary shares	–	10,962,597
Weighted average number of ordinary shares and potential ordinary shares used in calculating diluted earnings per share	282,860,783	227,760,254

7. Cash and Cash Equivalents

Cash at bank ^	2,537,528	3,139,378
Deposit at call	879,216	572,245
Term deposits	203,332,054	259,515,962
	206,748,798	263,227,585

^ Of this balance, US\$1,180,431 (AU\$1,158,239) is not available for use. These funds are held in an account named Mesoblast Inc. at the Bank of America according to the terms of an Irrevocable Standby Letter of Credit which is security for the sublease agreement for our occupancy of 505 Fifth Avenue, New York, New York, United States of America. The Letter of Credit is security for the full and faithful performance and observance by the subtenant of the terms, covenants and conditions of the sublease. The Letter of Credit is deemed to automatically extend without amendment for a period of one year at each anniversary but it will not automatically extend beyond the final expiration of 31 July 2021.

Refer note 27 for the Group's exposure to interest rate risk.

8. Trade and Other Receivables

	30 June 2012	30 June 2011
	\$	\$
Interest receivable	3,121,999	1,953,569
Sundry debtors	2,139,159	70,837
Goods and services tax recoverable	1,080,315	76,539
Income tax recoverable	3,475,269	–
Loan to an employee covered by a contract ^	852,000	–
	10,668,742	2,100,945

^ The Group issued interest free loans to employees to cover the exercise of options that could not be funded as planned due to an ASX share trading black out period.

All trade and other receivable balances are within their due dates and none are considered to be impaired at both 30 June 2012 and 30 June 2011. See note 27 for the impact of credit risk on the Group.

9. Property, Plant and Equipment

	Total ^ \$
At 30 June 2010 parent	
Cost or fair value	494,855
Accumulated depreciation	(271,160)
Net book value	223,695
Year Ended 30 June 2011 consolidated	
Opening net book amount	223,695
Exchange differences	(2,643)
Acquired in acquisition of subsidiary	63,909
Additions	460,041
Depreciation charge	(135,153)
Closing net book value	609,849
At 30 June 2011 consolidated	
Cost or fair value	977,982
Accumulated depreciation	(368,133)
Net book value	609,849
Year Ended 30 June 2012 consolidated	
Opening net book amount	609,849
Exchange differences	42,208
Additions	1,663,989
Disposals	(3,715)
Depreciation charge	(313,901)
Closing net book value	1,998,430
At 30 June 2012 consolidated	
Cost or fair value	2,656,377
Accumulated depreciation	(657,947)
Net book value	1,998,430

^ Fixed assets are primarily office equipment, furniture and leasehold fitout.

Notes to the Financial Statements for the year ended 30 June 2012

10. Deferred Tax Assets

	30 June 2012 \$	30 June 2011 \$	
The balance comprises temporary differences attributable to:			
Tax losses	3,446,881	9,621,768	
Tax deductions available for share option expenses	55,548	12,198,624	
Total deferred tax assets	3,502,429	21,820,392	
Set-off of deferred tax liabilities pursuant to set-off provisions	–	–	
Net deferred tax assets	3,502,429	21,820,392	
Deferred tax assets expected to be recovered within 12 months	3,502,429	21,820,392	
Deferred tax assets expected to be recovered after more than 12 months	–	–	
	3,502,429	21,820,392	
	Share option tax deductions \$	Net operating losses & tax credits \$	Total \$
Movements			
At 30 June 2010			
(Charged)/credited to profit or loss	–	(2,022,043)	(2,022,043)
(Charged)/credited to equity	12,198,624	–	12,198,624
Tax losses acquired on acquisition of subsidiary	–	11,643,811	11,643,811
At 30 June 2011	12,198,624	9,621,768	21,820,392
(Charged)/credited to profit or loss	–	3,446,881	3,446,881
(Charged)/credited to equity	55,548	–	55,548
Utilization of tax losses against current year tax payable	(12,198,624)	(9,621,768)	(21,820,392)
At 30 June 2012	55,548	3,446,881	3,502,429

11. Intangible Assets

	Goodwill \$	License to orthopedic patents, trademarks and other \$	Intellectual property acquired \$	Total \$
Parent				
At 30 June 2010				
Cost	–	690,000	–	690,000
Accumulated amortization and impairment	–	(251,456)	–	(251,456)
Net book value	–	438,544	–	438,544
Consolidated				
Year ended 30 June 2011				
Opening net book value	–	438,544	–	438,544
Acquired on acquisition of subsidiary company ^	116,520,265	–	387,760,010	504,280,275
Exchange differences	(6,781,428)	–	(22,567,460)	(29,348,888)
Amortization charge ^ ^	–	(43,731)	–	(43,731)
Closing net book value	109,738,837	394,813	365,192,550	475,326,200
At 30 June 2011				
Cost	109,738,837	690,000	365,192,550	475,621,387
Accumulated amortization and impairment	–	(295,187)	–	(295,187)
Net book amount	109,738,837	394,813	365,192,550	475,326,200
Consolidated				
Year ended 30 June 2012				
Opening net book value	109,738,837	394,813	365,192,550	475,326,200
Additions	–	924,823	–	924,823
Adjustment for final value on acquisition of subsidiary company	2,142,907	–	–	2,142,907
Exchange differences	4,329,219	5,774	14,554,285	18,889,278
Amortization charge ^ ^	–	(64,637)	–	(64,637)
Closing net book value	116,210,963	1,260,773	379,746,835	497,218,571
At 30 June 2012				
Cost	116,210,963	1,620,404	379,746,835	497,578,202
Accumulated amortization and impairment	–	(359,631)	–	(359,631)
Net book amount	116,210,963	1,260,773	379,746,835	497,218,571

^ Intellectual property acquired is attributed to the clinical development program of Mesoblast Inc. and the patents granted which underpin these programs, which are for worldwide exclusivity for the development and commercialization of mesenchymal precursor cells (MPCs) for use in the repair and regeneration of non-orthopedic indications.

^ ^ Intellectual property amortization expenses are included in research and development expense in the consolidated statement of comprehensive income.

Notes to the Financial Statements for the year ended 30 June 2012

12. Trade and Other Payables

	30 June 2012	30 June 2011
	\$	\$
Current		
Trade payables	11,572,820	3,038,030
Employee benefits	396,327	627,377
	11,969,147	3,665,407

(a) Risk Exposure

Information about the Group's exposure to foreign exchange risk with respect to trade and other payables is provided in Note 27.

13. Deferred Revenue

Opening balance	108,464,074	–
Commercialization revenue received during the year	–	130,708,000
Amount recognized as revenue in the year	(27,682,896)	(14,609,186)
Foreign exchange difference	3,789,431	(7,634,740)
Balance at the end of the year	84,570,609	108,464,074
• in the next twelve months (current deferred revenue)	28,209,500	27,129,937
• beyond twelve months (non-current deferred revenue)	56,361,109	81,334,137
	84,570,609	108,464,074

14. Derivative Financial Instruments

Current liabilities

Forward foreign exchange contracts	1,406,762	–
	1,406,762	–

All derivative financial instruments held at 30 June 2012 mature within the next 6 months.

(a) Instruments used by the Group

The Group is party to derivative financial instruments in the normal course of business in order to hedge exposure to fluctuations in foreign exchange rates in accordance with the Group's financial risk management policies (refer to note 27).

Forward exchange contracts

The Group has entered into forward exchange contracts which are economic hedges but do not satisfy the requirements for hedge accounting. These contracts are subject to the same risk management policies as all other derivative contracts, see note 2 for details. However, they are classified and accounted for as held for trading in accordance with AASB 139.

(b) Risk exposures and fair value measurement

Information about the Group's exposure to credit risk, foreign exchange and interest rate risk is provided in note 27. The maximum exposure to credit risk at the end of the reporting period is the carrying amount of each class of derivative financial assets mentioned above. The fair value of the derivative financial instruments at 30 June 2012 has been measured by through obtaining a commercial quote for the purchase of a derivative financial instrument with the identical interest rate, maturity and terms.

15. Deferred Tax Liabilities

	30 June 2012	30 June 2011
	\$	\$
(a) Deferred tax liabilities		
The balance comprises temporary differences attributable to:		
Intangible assets	132,911,392	127,817,393
Total deferred tax liabilities	132,911,392	127,817,393
Deferred tax liabilities expected to be settled within 12 months	–	–
Deferred tax liabilities expected to be settled after 12 months	132,911,392	127,817,393

(b) Movements

	Intellectual Property	Total
	\$	\$
At 30 June 2010	–	–
Acquired on acquisition of subsidiary	135,716,003	135,716,003
Foreign exchange difference	(7,898,610)	(7,898,610)
At 30 June 2011	127,817,393	127,817,393
Foreign exchange difference	5,093,999	5,093,999
At 30 June 2012	132,911,392	132,911,392

16. Provisions

	30 June 2012	30 June 2011
	\$	\$
Current		
Provision for short term incentives	2,908,900	–
Non-current		
Provision for long service leave	143,717	57,227
Provisions other ^(b)	7,697,240	7,402,233
	7,840,957	7,459,460

(a) Movements

Movements in each class of provision during the financial year, other than employee benefits, are set out below:

	Total
	\$
Carrying amount at start of year – 1 July 2011	7,402,233
Foreign exchange difference	295,007
Carrying amount at end of year – 30 June 2012	7,697,240

(b) Provisions other

During the ordinary course of business the Group occasionally has disputes with suppliers. This provision allows for those disputes in the event the disputed amounts may become due and payable. Further disclosure is considered to be prejudicial to the Group.

Notes to the Financial Statements for the year ended 30 June 2012

17. Issued Capital

	2012 Shares	2011 Shares	2012 \$	2011 \$
(a) Share capital				
Ordinary shares	285,835,106	280,345,258	485,004,166	477,114,981

(b) Movements in ordinary share capital

Date	Details	Shares No.	Issue price	\$
1 July 2010	Opening Balance	154,880,556		87,949,316
Quarter 3&4 2010	Share issue to institutions and sophisticated investors	7,061,000	\$1.70	12,003,700
Quarter 3&4 2010	Exercise of share options	316,000	\$1.00	316,000
Quarter 4 2010	Shares issued on acquisition of Mesoblast Inc.	81,722,752	\$2.88	235,361,526
Quarter 4 2010	Exercise of share options	9,091,198	\$0.33	3,018,746
Quarter 4 2010	Exercise of share options	100,000	\$1.20	120,000
Quarter 4 2010	Exercise of share options	90,000	\$1.58	142,200
Quarter 4 2010	Exercise of share options	15,000	\$1.96	29,400
Quarter 4 2010	Exercise of share options	820,000	\$2.13	1,746,600
Quarter 1 2011	Shares issued to Teva Pharmaceutical Industries Ltd ^	24,702,056	\$4.35	107,453,944
Quarter 1 2011	Exercise of share options	160,000	\$0.96	153,600
Quarter 1 2011	Exercise of share options	280,000	\$1.00	280,000
Quarter 1 2011	Exercise of share options	180,000	\$1.58	284,400
Quarter 1 2011	Exercise of share options	15,000	\$2.00	30,000
Quarter 1 2011	Exercise of share options	100,000	\$2.13	213,000
Quarter 2 2011	Exercise of share options	67,740	US \$0.44	28,155
Quarter 2 2011	Exercise of share options	127,956	US \$0.47	56,779
Quarter 2 2011	Exercise of share options	176,000	\$1.00	176,000
Quarter 2 2011	Exercise of share options	100,000	\$1.20	120,000
Quarter 2 2011	Exercise of share options	60,000	\$1.58	94,800
Quarter 2 2011	Exercise of share options	280,000	\$2.13	596,400
		125,464,702		362,225,250
	Transaction costs arising on share issues			(770,314)
				361,454,936
	Share options reserve transferred to equity on exercise of options			27,710,729
	Movement for the year			389,165,665
30 June 2011	Closing balance	280,345,258		477,114,981

(b) Movements in ordinary share capital (continued)

Date	Details	Shares No.	Issue price	\$
30 June 2011	Closing balance	280,345,258		477,114,981
Quarter 3 2011	Exercise of share options	220,000	\$1.00	220,000
Quarter 3 2011	Exercise of share options	34,000	\$2.13	72,420
Quarter 3 2011	Exercise of share options	3,000	\$2.00	6,000
Quarter 4 2011	Exercise of share options	159,822	\$0.00	–
Quarter 4 2011	Exercise of share options	69,892	US \$0.44	30,212
Quarter 4 2011	Exercise of share options	230,000	\$1.00	230,000
Quarter 4 2011	Exercise of share options	277,389	\$1.20	332,867
Quarter 4 2011	Exercise of share options	280,000	\$1.58	442,400
Quarter 4 2011	Exercise of share options	266,000	\$2.13	566,580
Quarter 4 2011	Exercise of share options	323,000	\$3.48	1,124,040
Quarter 4 2011	Placement of shares under LFSP ^ ^	2,040,000	\$7.99	–
Quarter 1 2012	Exercise of share options	150,000	US \$0.44	63,282
Quarter 1 2012	Exercise of share options	170,000	\$1.00	170,000
Quarter 1 2012	Exercise of share options	60,000	\$1.58	94,800
Quarter 1 2012	Exercise of share options	150,000	\$2.13	319,500
Quarter 1 2012	Exercise of share options	40,000	\$2.64	105,600
Quarter 1 2012	Exercise of share options	32,400	\$3.48	112,752
Quarter 1 2012	Placement of shares under LFSP ^ ^	170,000	\$8.48	–
Quarter 2 2012	Exercise of share options	127,956	US \$0.31	37,967
Quarter 2 2012	Exercise of share options	400,000	\$2.13	852,000
Quarter 2 2012	Exercise of share options	277,389	\$3.44	954,218
Quarter 2 2012	Exercise of share options	9,000	\$3.48	31,320
		5,489,848		5,765,958
	Share options reserve transferred to equity on exercise of options			2,123,227
	Movement for the year			7,889,185
30 June 2012	Closing balance	285,835,106		485,004,166

^ Shares were issued to Teva Pharmaceutical Industries Ltd (as approved by shareholders at the Extraordinary General Meeting held 9th February 2011) at \$4.35 per share, contributing \$107.5m to the Group. This resulted in Teva Pharmaceutical Industries Ltd owning 19.9% of the Group. This equity investment was additional to the revenue received as described in note 2.

^ ^ Initially these shares are issued and held in trust. Therefore there is no dollar movement recorded in ordinary share capital at this time. If the shares are purchased in accordance with the conditions of the LFSP a dollar movement will be recorded at that date.

Notes to the Financial Statements for the year ended 30 June 2012

17. Issued Capital (continued)

(c) Ordinary Shares

Ordinary shares participate in dividends and the proceeds on winding up of the Group in equal proportion to the number of shares held. At shareholders meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands. Ordinary shares have no par value and the Company does not have a limited amount of authorized capital.

(d) Employee Share Options

Information relating the Group's employee share option plan and loan funded share plan, including details of shares issued under the scheme, is set out in note 24.

(e) Capital risk management

The Group's objective when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. Refer to note 19(a) for the cash reserves of the Group as at the end of the financial reporting period.

18. Reserves

	30 June 2012	30 June 2011
	\$	\$
(a) Reserves		
Share-based payments reserve	37,504,679	25,664,152
Foreign currency translation reserve	(7,496,518)	(21,915,730)
	30,008,161	3,748,422
(b) Reconciliation of reserves		
<i>Share-based payments reserve</i>		
Balance 1 July 2011	25,664,152	5,175,760
Transfer to ordinary shares on exercise of options	(2,123,227)	(3,519,335)
Share option expense for the year	12,117,623	3,300,443
Tax effect of options deductible for tax	1,360,275	11,806,925
Currency gain on translation of foreign share-based payments reserve ^	485,856	-
Fair value of options issued on acquisition of subsidiary	-	33,091,753
Shares exercised and sold on acquisition of subsidiary	-	(24,191,394)
Balance 30 June 2012	37,504,679	25,664,152
<i>Foreign currency translation reserve</i>		
Balance 1 July 2011	(21,915,730)	420,004
Currency gain on translation of share of losses from foreign associate	-	1,704,870
Write back of foreign currency reserve upon acquisition of Mesoblast Inc. (an associate prior to acquisition)	-	(2,124,874)
Currency gain/(loss) on translation of foreign operations net assets ^	15,123,457	(21,735,999)
Currency (loss) on translation of foreign operations profits and losses for the year ^	(704,245)	(179,731)
Balance 30 June 2012	(7,496,518)	(21,915,730)
^ Total currency difference on translation of foreign operations	14,905,068	(21,915,730)

(c) Nature and purpose of reserves

Share-based payment reserve

The share-based payments reserve is used to recognize the fair value of options issued under the Group's employee share option plan that have not been exercised and shares issued under the Group's loan funded share plan that have not been disposed or bought back.

Foreign currency translation reserve

Exchange differences arising on translation of a foreign controlled entity are recognized in other comprehensive income and accumulated in a separate reserve within equity. The cumulative amount is reclassified to profit or loss when the net investment is disposed.

19. Cash Flow Information

	30 June 2012 \$	30 June 2011 \$
(a) Reconciliation of cash and cash equivalents		
Cash at bank	2,537,528	3,139,378
Deposit at call	879,216	572,245
Term deposits	203,332,054	259,515,962
	206,748,798	263,227,585
(b) Reconciliation of net cash flows used in Operations with loss after income tax		
(Loss)/profit for the year	(71,145,314)	90,606,590
Add/(deduct) profit and loss items as follows:		
Depreciation and amortization	378,585	178,884
Interest received (investing activity)	(10,464,157)	(4,648,636)
Interest paid (investing activity)	289	14,912
Foreign exchange (gain)/losses on bank translation	(2,664,404)	207,999
Equity settled share-based payment	12,117,623	3,300,443
Equity accounted losses (Mesoblast Inc.)	–	1,505,345
Gain on revaluation of Mesoblast Inc.	–	(86,737,561)
Write back of share of losses of equity accounted associates on acquisition	–	(14,873,899)
Change in operating assets & liabilities:		
(Increase)/decrease in trade and other receivables	(2,805,064)	137,349
(Increase)/decrease in tax assets	18,492,077	1,634,914
Increase/(decrease) in trade creditors and accruals	14,763,695	803,719
Increase/(decrease) in tax liabilities	(3,107,217)	–
(Decrease)/Increase in accrued income	(27,682,896)	116,098,814
Net cash (outflows)/inflows used in operations	(72,116,783)	108,228,873

20. Business Combination

During the reporting year ending on 30 June 2011, Mesoblast Limited acquired the remaining 67.7% of the issued securities of Mesoblast Inc., a researcher and developer of the Mesenchymal Precursor Cells (MPCs) platform technology for use in non-orthopedic applications, for a consideration of AU\$268,453,278.

In accordance with AASB 3 (Revised): *Business Combinations* and the Group's policy on principals of consolidation (note 1), Mesoblast Limited has accounted for this business combination from the date on which it had the ability to exercise its control over the operations and financial policies of Mesoblast Inc. This date is considered to be 12 November 2010. Prior to this the 32.3% ownership was equity accounted and recorded as an associate in the results of the Group.

Notes to the Financial Statements for the year ended 30 June 2012

20. Business Combination (continued)

Details of the purchase consideration, the net assets acquired and goodwill are as follows:

	Final Fair Value 30 June 2012 \$	Preliminary Fair value 30 June 2011 \$
Purchase consideration		
Securities allotment (94,590,000 shares and options)	268,453,278	268,453,278
Fair value of previously held investment	105,020,352	105,020,352
Total purchase consideration	373,473,630	373,473,630

The assets and liabilities recognized as a result of the business combination at fair value are as follows:

Cash and cash equivalents	3,448,299	3,448,299
Prepayments and other receivables	337,321	337,321
Property, plant and equipment	63,909	63,909
Intangible assets: intellectual property	387,760,010	387,760,010
Payables & provisions	(11,303,524)	(11,303,524)
Deferred tax assets	10,220,447	12,363,353
Deferred tax liabilities	(135,716,003)	(135,716,003)
	254,810,459	256,953,365
Add: Goodwill	118,663,171	116,520,265
	373,473,630	373,473,630

All assets and liabilities acquired are denominated in US dollars. The amounts presented above are in AU\$ translated at the rate applicable at the acquisition date of 1AUD:0.99804USD. The goodwill is attributable to commercialization, manufacturing and operational synergies as a result of owning 100% of the platform technology. No amount of goodwill is expected to be deducted for tax purposes.

(i) Acquisition-related costs

Directly attributable acquisition-related costs of approximately \$500,000 are included in management and administration expenses in the statement of comprehensive income in the year ended 30 June 2011.

(ii) Revenue and profit contribution

Mesoblast Inc. contributed revenues of \$30,840,957 and a net loss after tax of \$46,518,996 to the Group for the year ended 30 June 2012. Mesoblast Inc. contributed revenues of \$14,708,512 and net profits after tax of \$3,226,997 to the Group for the period from 12 November 2010 to 30 June 2011. If the business combination had occurred on 1 July 2010, consolidated revenue from continuing operations and consolidated profits for the year ended 30 June 2011 would have been \$19,264,424 and \$86,233,408 respectively.

(iii) Business combinations achieved in stages

In accordance with AASB 3 (Revised): *Business Combinations*, the Group has remeasured its previously held equity interest (32.3% fully diluted) in Mesoblast Inc. at fair value.

In the year ended 30 June 2011 the revaluation resulted in a gain of \$86,737,561 which was recognized in 'other income', in the Consolidated Statement of Comprehensive Income. In addition, the Group wrote back to other income \$14,873,899 of equity accounted losses. The total amount recognized in other income totalled \$101,611,460.

In the year ended 30 June 2012 the assets and liabilities to be recognized at fair value were finalized. The deferred tax assets were revised down to \$10,220,447 which in turn effectively increased the value of the goodwill to \$118,663,171.

21. Parent Entity Financial Information

	30 June 2012 \$	30 June 2011 \$
Balance Sheet		
Current assets	210,095,734	263,888,512
Total assets	594,923,812	638,210,255
Current liabilities	10,292,882	115,457,531
Total liabilities	80,988,585	115,514,758
Shareholders' equity		
Issued capital	485,004,166	477,114,981
<i>Reserves</i>		
Share options reserve	23,821,139	13,826,743
Accumulated profit	5,109,922	31,753,773
	513,935,227	522,695,497
Statement of Comprehensive Income		
(Loss)/profit for the period	(26,643,851)	87,379,593
Total comprehensive (loss)/income for the period	(26,643,851)	86,959,589

22. Commitments

(a) Capital commitments

The Group does not consider it has any commitments for future capital expenditure outstanding as at 30 June 2012 (2011: nil).

(b) Lease Commitments: Group as lessee

(i) Non-cancellable operating leases

The Group leases various offices under non-cancellable operating leases expiring within 1 to 9 years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

	30 June 2012 \$	30 June 2011 \$
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	853,993	–
Later than one year but no later than five years	3,551,955	–
Later than five years	4,395,600	–
	8,801,548	–

Lease commitments include US Dollar and Singapore Dollar amounts which have been translated to Australian Dollars at the 30 June 2012 foreign exchange rates published by the Reserve Bank of Australia.

Notes to the Financial Statements for the year ended 30 June 2012

22. Commitments (continued)

(c) Purchase commitments

The Group has established a strategic alliance for clinical and long-term commercial production of Mesoblast's off-the-shelf (allogeneic) adult stem cell products with Lonza Group (SWS: LONN).

As part of this agreement Mesoblast has an option to trigger a process requiring Lonza Group to construct a purpose-built manufacturing facility exclusively for Mesoblast's marketed products. In return, Mesoblast will purchase agreed quantities of marketed products from the facility.

23. Contingent Assets and Liabilities

(a) Contingent assets

The Group does not consider it has any contingent assets outstanding as at 30 June 2012 (2011: nil).

(b) Contingent liabilities

(i) *Central Adelaide Local Health Network Incorporated (CALHNI), formerly to Medvet*

Mesoblast will be required to make a milestone payment to CALHNI of US\$250,000 on completion of Phase III (human) clinical trials and US\$350,000 on FDA marketing approval for products in the orthopedic field. Mesoblast will pay CALHNI a commercial arm's length royalty based on net sales by Mesoblast of licensed products in the orthopedic field each quarter.

Additionally, in regards to certain intellectual property assets originally assigned to Mesoblast Inc, the Group may be required to pay consideration to CALHNI depending on the achievement of future milestones. They represent payments on successful completion of subsequent clinical milestones in fields other than orthopedic. If all milestones were to be reached these payments total US\$1,500,000. In addition it stipulates the requirement for royalty payments as a percentage of sales of product in fields other than orthopedic at a commercial arm's length rate as well as minimum annual royalties after commercial sale of product scaling up from US\$100,000 to US\$500,000, over 5 years.

24. Share-Based Payments

The Company has adopted an Employee Share Option Plan (ESOP) and a Loan Funded Share Plan (LFSP) to foster an ownership culture within the Company and to motivate directors, senior management and consultants to achieve performance targets.

Selected directors, employees and consultants may be eligible to participate in the Plans at the absolute discretion of the board of directors. Except as outlined in the remuneration report no options or shares will be issued under these share ownership plans to any directors without the prior approval of the Mesoblast shareholders.

Grant policy

In accordance with the Company's current policy, options and loan funded shares are issued in three equal tranches, each tranche having an expiry date of five years following grant date. The first tranche typically vests 12 months after grant date, the second tranche 24 months after grant date, and the third tranche 36 months after grant date.

The exercise price for options is determined by reference to Company policy which is generally the volume weighted market price of a share sold on the ASX on the 5 trading days immediately before the grant date plus a premium determined by the Board (typically 10%). The same approach is used to determine the purchase price to acquire loan-funded shares for the purposes of the LFSP.

The aggregate number of options which may be issued pursuant to the ESOP must not exceed 10,000,000 with respect to US incentive stock options, and with respect to Australian residents, that limit imposed under ASIC Class Order [CO 03/184].

(a) Reconciliation of outstanding share-based payments

Share options over ordinary shares	2012		2011	
	No.	Weighted average exercise price \$	No.	Weighted average exercise price \$
Balance at beginning of financial year	10,962,597	1.92	6,963,000	1.54
Granted during the year	3,218,700	7.73	3,201,300	3.34
Granted upon acquisition of Mesoblast Inc.	–	–	12,867,190	0.49
Exercised during the year	(3,279,848)	1.76	(2,692,000)	1.60
Exercised upon acquisition of Mesoblast Inc.	–	–	(9,286,893)	0.33
Expired or forfeited during the year	(380,058)	3.49	(90,000)	1.00
Balance at end of financial year	10,521,391	3.66	10,962,597	1.92
Unvested at end of financial year	5,578,999	5.32	5,322,300	2.55
Exercisable at end of financial year	4,942,392	1.46	5,640,297	1.17
	10,521,391	3.66	10,962,597	1.92
Loan funded shares				
Balance at beginning of financial year	–	–	–	–
Granted during the year	2,210,000	8.03	–	–
Balance at end of financial year	2,210,000	8.03	–	–
Unvested at end of financial year	1,580,000	8.04	–	–
Vested at end of financial year	630,000	7.99	–	–
	2,210,000	8.03	–	–

(b) Existing share-based payment arrangements

	Balance	Weighted average remaining contractual life – years	Price to purchase share – Minimum \$	Price to purchase share – Maximum \$
Share options outstanding at 30 June 2012	10,521,391	3.50	0.05	8.48
Share options outstanding at 30 June 2011	10,962,597	3.25	0.00	3.48
Loan funded shares outstanding at 30 June 2012	2,210,000	4.05	7.99	8.48
Loan funded shares outstanding at 30 June 2011	–	–	–	–

Notes to the Financial Statements for the year ended 30 June 2012

24. Share-Based Payments (continued)

(i) The following share-based payment arrangements were in existence during the current and comparative reporting periods:

Series	Grant Date	Opening Balance	Granted No. (during the year)	Exercised No. (during the year)	Lapsed/Cancelled No. (during the year)
7	27/07/07	930,000	–	(850,000)	(80,000)
8	07/07/08	1,446,000	–	(620,000)	–
9	19/01/09	80,000	–	–	–
10	30/11/09	75,000	–	–	–
10	30/11/09	75,000	–	–	–
10	30/11/09	75,000	–	–	–
10	30/11/09	75,000	–	–	–
11	30/11/09	1,350,000	–	(340,000)	–
12(a)	26/02/10	15,000	–	(3,000)	–
12(b)	26/02/10	30,000	–	–	–
12(c)	26/02/10	30,000	–	–	–
13	22/09/10	175,000	–	(40,000)	–
13	22/09/10	175,000	–	–	–
13	22/09/10	175,000	–	–	–
14	29/11/10	435,800	–	(355,400)	–
14	29/11/10	435,800	–	–	–
14	29/11/10	435,800	98,700	(9,000)	–
14	29/11/10	1,368,900	–	–	(45,000)
15	22/12/11	–	2,850,000	–	(120,000)
16	24/02/12	–	270,000	–	–
AGB	07/12/10	159,822	–	(159,822)	–
AGB	07/12/10	287,903	–	–	–
AGB	07/12/10	127,956	–	(127,956)	–
AGB	07/12/10	434,865	–	–	(88,866)
AGB	07/12/10	255,913	–	–	–
AGB	07/12/10	749,953	–	–	(46,192)
AGB	07/12/10	347,848	–	(219,892)	–
AGB	07/12/10	127,956	–	–	–
AGB	07/12/10	255,913	–	–	–
Conv	07/12/10	277,389	–	(277,389)	–
Conv	07/12/10	277,389	–	(277,389)	–
Conv	07/12/10	277,390	–	–	–
	30 June 2012	10,962,597	3,218,700	(3,279,848)	(380,058)
	30 June 2011	6,963,000	16,068,490	(11,978,893)	(90,000)
LFSP1	22/12/11	–	2,040,000	–	–
LFSP2	24/02/12	–	170,000	–	–
	30 June 2012	–	2,210,000	–	–
	30 June 2011	–	–	–	–

*Refer Note 24 (c) for vesting details.

Closing Balance	Earliest Vesting Date	Expiry Date	Exercise/Purchase Price \$	Fair Value at Grant Date \$
–	01/07/08	30/06/12	2.13	0.74
826,000	01/07/09	30/06/13	1.00	0.48
80,000	19/01/10	18/01/14	0.96	0.40
75,000	07/12/10	30/11/14	1.73	0.70
75,000	17/03/11	30/11/14	1.73	0.70
75,000	Milestone*	30/11/14	1.73	0.70
75,000	20/07/10	30/11/14	1.73	0.70
1,010,000	30/11/10	30/11/14	1.58	0.73
12,000	26/02/11	26/02/15	2.00	0.92
30,000	26/02/12	26/02/15	2.00	0.92
30,000	26/02/13	26/02/15	2.00	0.92
135,000	22/09/11	21/09/15	2.64	1.38
175,000	22/09/12	21/09/15	2.64	1.38
175,000	22/09/13	21/09/15	2.64	1.38
80,400	29/11/11	29/11/15	3.48	2.26
435,800	29/11/12	29/11/15	3.48	2.66
525,500	29/11/13	29/11/15	3.48	2.98
1,323,900	29/11/13	29/11/15	3.48	3.47
2,730,000	22/12/11	30/06/16	7.99	1.14-3.49
270,000	24/02/13	23/02/17	8.48	2.72
–	07/12/10	30/11/12	USD0.005	3.32
287,903	07/12/10	07/07/15	USD0.046	3.2905
–	07/12/10	07/12/14	USD0.305	3.0805
345,999	07/12/10	26/10/18	USD0.305	3.1421
255,913	07/12/10	07/12/14	USD0.340	3.0492
703,761	07/12/10	26/10/19	USD0.340	3.1356
127,956	07/12/10	25/04/17	USD0.444	3.0294
127,956	07/12/10	02/05/17	USD0.444	3.0298
255,913	07/12/10	07/12/14	USD0.474	2.9501
–	07/12/10	07/12/11	1.20	2.1956
–	07/12/10	07/06/12	3.44	1.0000
277,390	07/12/10	07/12/12	3.78	1.0461
10,521,391				
10,962,597				
2,040,000	22/12/11	30/06/16	\$7.99	1.15-3.48
170,000	24/02/13	23/02/17	\$8.48	2.72
2,210,000				
–				

Notes to the Financial Statements for the year ended 30 June 2012

24. Share-Based Payments (continued)

(c) Existing share-based payment arrangements

General terms and conditions attached to share-based payments

Share options and shares pursuant to the employee share option plan and loan funded share plan are granted in three equal tranches with expiry dates five years post grant date. Vesting occurs progressively over the life of the option/share with the first tranche vesting one year from grant date, the second tranche two years from grant date, and the third tranche three years from grant date. The table above shows the earliest vesting date (tranche one) for each series. This policy applies to all issues shown in the above table with the exception of the following:

Series

- 10** Options granted to the Chairman were approved by shareholders at the Annual General Meeting held on 30 November 2010. The options were granted in four equal tranches vesting on the achievement of certain milestones, being the date on which:
- Mesoblast signs a commercial partnering contract, e.g. a commercial license to one of its products [vested 7 December 2010];
 - Mesoblast receives IND clearance from the FDA for its first clinical trial for Intervertebral Disc Repair [vested 17 March 2011];
 - Mesoblast completes patient enrolment for its first clinical trial under IND for Intervertebral Disc Repair [not yet vested];
 - Mesoblast obtains a license from the Therapeutics Goods Administration (TGA) for the manufacture [vested 20 July 2010].

All four tranches expire on 30 November 2014.

- INC.** As part of the acquisition of Mesoblast Inc., Mesoblast Inc. options were converted to Mesoblast options at a conversion ratio of 63.978. The Mesoblast Inc. option exercise price per option was adjusted using the same conversion ratio. All options vested on acquisition date (7 Dec 2010), and will expire according to their original expiry dates (with the exception of options held by Directors which were limited to an expiry date not exceeding four years from acquisition).

- Conv** Options issued on conversion of the Mesoblast Inc. convertible notes which converted to shares on 7 December 2010. These options are outside the Employee Share Option Plan.

Modifications to terms and conditions

There has been no modification to terms and conditions in either the current or previous financial years.

(d) Fair values of share-based payments

The weighted average fair value of share options granted during the year was \$2.87 (2011: \$2.79 excluding the options awarded under the Mesoblast Inc. acquisition, the weighted average fair value of all options granted during the year was \$2.96).

The weighted average fair value of loan funded shares granted during the year was \$2.92 (2011: nil).

The fair value of all share-based payments made has been calculated using the Black-Scholes model. This model requires the following inputs:

Share price at grant date

The share price underpinning the exercise price has been used as the share price at grant date for valuation purposes. This price is generally the volume weighted average share price for the 5 trading days leading up to grant date.

Exercise price

The exercise price is a known value that is contained in the agreements.

Share price volatility

The model requires the Company's share price volatility to be measured. For 2011 and prior years, the share price volatility has been measured with reference to the historical share prices of similar (biotechnology) companies. In addition, an independent measurement of an appropriate share price volatility of the Company was made for options granted on 23 February 2007 and 23 November 2007 which was 55% and 54% respectively. Given the consistency of the two volatility measurements, the highest volatility rate of 55% was used in the valuations of options for 10, 11 and 12. For series 13 and 14 the Company completed its own calculation of the Company's share price volatility, the result was 63%, and 55% after adjusting for years 2008 and 2009 (global financial crisis). For series 15 and 16, and LFSP 1 & 2 the historical two year share price volatility of the Company was used.

Life of the option/share

The life is generally the time period from grant date through to expiry. Certain assumptions have been made regarding 'early exercise' ie. options exercised ahead of the expiry date, with respect to option series 14 and later. These assumptions have been based on historical trends for option exercises within the Company and take into consideration exercise trends that are also evident as a result of local taxation laws.

Dividend yield

The Company has yet to pay a dividend so it has been assumed the dividend yield on the shares underlying the options will be 0%.

Risk free interest rate

This has been sourced from the Reserve Bank of Australia historical interest rate tables for government bonds.

The model inputs for the valuations of options approved and issued during the current and previous financial years are as follows:

Series	Financial year of grant	Exercise/Loan Price per share \$	Share price at grant date \$	Expected share price volatility	Life	Dividend yield	Risk-free interest rate
13	2011	2.64	2.40	55.0%	5 yrs	0%	4.62%
14	2011	3.48	5.46	55.0%	0.75 yrs	0%	4.79%
14	2011	3.48	5.46	55.0%	1.75 yrs	0%	4.92%
14	2011	3.48	5.46	55.0%	2.75 yrs	0%	5.06%
14	2011	3.48	5.46	55.0%	4.75 yrs	0%	5.24%
AGB ^	2011	US0.00	2.88	55.0%	2.05 yrs	0%	5.05%
AGB ^	2011	US0.05	2.88	55.0%	4 & 4.65 yrs	0%	5.19%
AGB ^	2011	US0.31	2.88	55.0%	4 & 8 yrs	0%	5.19 & 5.34%
AGB ^	2011	US0.34	2.88	55.0%	9 yrs	0%	5.34%
AGB ^	2011	US0.44	2.88	55.0%	4, 4.65 & 6.45 yrs	0%	5.19%
AGB ^	2011	US0.47	2.88	55.0%	4 & 6.65 yrs	0%	5.19%
15/LFSP1	2012	7.99	7.00-7.48	51.48%	0.6-4.5 yrs	0%	3.13%
16/LFSP2	2012	8.48	7.71	49.41%	3.30 yrs	0%	3.78%

^ valued on date of acquisition when Mesoblast Inc. options were deemed to vest into Mesoblast options.

The closing share market price of an ordinary share of Mesoblast Limited on the Australian Stock Exchange at 30 June 2012 was \$6.19 (30 June 2011: \$8.65).

Notes to the Financial Statements for the year ended 30 June 2012

24. Share-Based Payments (continued)

(e) Share options exercised during the year

Option series	Number exercised	Exercise date	Share price at exercise date
2012			
7	66,000	22 November 2011	\$7.367
7	34,000	9 August 2011	\$7.466
7	67,000	22 December 2011	\$7.379
7	67,000	22 December 2011	\$7.281
7	66,000	22 December 2011	\$7.476
7	50,000	28 February 2012	\$7.651
7	100,000	29 February 2012	\$7.653
7	400,000	29 June 2012	\$6.19
8	80,000	4 July 2011	\$8.69
8	30,000	8 July 2011	\$7.466
8	30,000	9 August 2011	\$7.466
8	80,000	29 September 2011	\$8.065
8	120,000	7 October 2011	\$8.851
8	30,000	18 October 2011	\$9.579
8	30,000	19 October 2011	\$9.454
8	5,000	16 December 2011	\$7.800
8	45,000	20 December 2011	\$7.235
8	80,000	5 January 2012	\$8.784
8	90,000	28 February 2012	\$7.651
11	80,000	1 December 2011	\$6.862
11	50,000	30 November 2011	\$6.862
11	90,000	14 December 2011	\$7.697
11	60,000	20 December 2011	\$7.235
11	60,000	28 February 2012	\$7.651
12	3,000	28 September 2011	\$8.000
13	35,000	28 February 2012	\$7.665
13	5,000	29 February 2012	\$7.637
14	23,400	30 November 2011	\$6.862
14	122,800	14 December 2011	\$7.697
14	73,400	16 December 2011	\$7.240
14	54,930	19 December 2011	\$7.248
14	23,400	20 December 2011	\$7.235
14	25,070	20 December 2011	\$7.267
14	5,000	28 February 2012	\$7.665
14	4,000	29 February 2012	\$7.637
14	23,400	29 February 2012	\$7.653
14	9,000	28 June 2012	\$5.920
INC.	159,822	18 October 2011	\$9.787
INC.	30,000	18 October 2011	\$9.591
INC.	39,892	11 November 2011	\$7.817
INC.	150,000	3 February 2012	\$6.496
INC.	32,094	4 May 2012	\$7.446
INC.	95,862	4 May 2012	\$7.599
Conv	277,389	21 November 2011	\$7.467
Conv	277,389	19 June 2012	\$ 5.97
	3,279,848		

Option series	Number exercised	Exercise date	Share price at exercise date
2011			
INC.	8,526,414	7 December 2010	\$4.10
INC.	564,783	30 December 2010	\$4.67
INC.	195,696	31 May 2011	\$8.03
4(b)	100,000	15 December 2010	\$4.52
4(b)	100,000	4 May 2011	\$8.62
6(d)	15,000	9 December 2010	\$4.87
7	100,000	1 October 2010	\$2.52
7	100,000	8 December 2010	\$4.11
7	100,000	9 December 2010	\$4.88
7	184,919	14 December 2010	\$4.67
7	15,081	15 December 2010	\$4.52
7	70,000	20 December 2010	\$4.53
7	250,000	24 December 2010	\$4.58
7	300,000	28 March 2011	\$7.95
7	80,000	20 June 2011	\$8.26
8	60,000	2 September 2010	\$1.88
8	160,000	8 December 2010	\$4.04
8	80,000	15 December 2010	\$4.52
8	16,000	20 December 2010	\$4.35
8	60,000	8 February 2011	\$5.58
8	160,000	23 March 2011	\$7.31
8	60,000	28 March 2011	\$7.95
8	100,000	27 April 2011	\$8.16
8	60,000	4 May 2011	\$8.71
8	16,000	20 June 2011	\$8.61
9	80,000	19 January 2011	\$5.65
9	80,000	2 February 2011	\$5.52
11	60,000	8 December 2010	\$4.11
11	30,000	16 December 2010	\$4.46
11	50,000	19 January 2011	\$5.65
11	80,000	23 March 2011	\$7.31
11	50,000	28 March 2011	\$7.95
11	60,000	27 April 2011	\$8.16
12	15,000	9 March 2011	\$6.64
	11,978,893		

There have been no purchases of shares and repayments of share loans pursuant to the loan funded share plan in the current year (2011:nil).

Notes to the Financial Statements for the year ended 30 June 2012

25. Key Management Personnel

(a) Details of key management personnel (KMP)

The directors and other members of key management personnel of the Group during the current and prior years were:

Name	Position	Effective Date	
		2012	2011
Brian Jamieson	Non-executive Chairman	Full Year	Full Year
Byron McAllister	Non-executive Director	–	1 Jul 2010 to 29 Nov 2010 ^(R)
Donal O'Dwyer	Non-executive Director	Full Year	Full Year
Michael Spooner	Non-executive Director	Full Year	Full Year
Kevin Buchi	Non-executive Director	1 Jul 2011 to 9 May 2012 ^(R)	30 Dec 2010 ^(A) to 30 June 2011
Dr Ben-Zion Weiner	Non-executive Director	9 May 2012 ^(A) to 30 Jun 2012	–
Silviu Itescu	Executive Director (CEO)	Full Year	Full Year

(A) Appointed to this position; (R) Resigned from this position

(b) Key management personnel compensation

The aggregate compensation made to directors and other members of key management personnel of the Group is set out below:

	30 June 2012	30 June 2011
	\$	\$
Short-term employee benefits	2,453,447	1,174,445
Post-employment benefits	58,374	34,190
Share-based payments	11,801	87,057
	2,523,622	1,295,692

Further disclosures regarding key management personnel compensation are contained within the remuneration report.

(c) Key management personnel equity holdings

Options

	Balance at 1 July No.	Granted as compensation No.	Exercised No.	Net change other No.	Balance at 30 June No.	Total vested 30 June No.	Vested and exercisable No.	Unvested No.
2012								
Brian Jamieson	300,000	–	–	–	300,000	225,000	225,000	75,000
Donal O'Dwyer	799,727	–	–	–	799,727	799,727	799,727	–
2011								
Brian Jamieson	300,000	–	–	–	300,000	225,000	225,000	75,000
Donal O'Dwyer	–	–	(639,784)	1,439,511*	799,727	799,727	799,727	–

* Options received on acquisition of Mesoblast Inc.

Shareholdings

Fully paid ordinary shares held by directors and key management personnel or their personally related parties (as defined by AASB 124):

	Balance at 1 July No.	Granted as compensation No.	Received on exercise of options No.	Net change other No.	Balance at 30 June No.
2012					
Brian Jamieson*	310,000	–	–	–	310,000
Donal O'Dwyer*	305,000	–	–	–	305,000
Michael Spooner*	1,081,335	–	–	–	1,081,335
Silviu Itescu*	68,244,642	–	–	–	68,244,642
2011					
Brian Jamieson*	310,000	–	–	–	310,000
Byron McAllister ^(R)	41,315	–	–	–	41,315
Donal O'Dwyer*	578,950	–	639,784	(913,734)	305,000
Michael Spooner*	1,148,255	–	–	(66,920)	1,081,335
Silviu Itescu*	37,125,000	–	–	31,119,642 [^]	68,244,642

* Shares detailed above include the following shares which are held by a related party of the KMP, as defined by the accounting standard

AASB124 Related Party Disclosures:

Brian Jamieson 275,000 (2011:275,000)

Donal O'Dwyer 5,000 (2011:5,000)

Michael Spooner 22,335 (2011:22,335)

Silviu Itescu 487,804 (2011:487,804)

(R) Byron McAllister resigned from this position on 29 Nov 2010.

[^] Shares were received on acquisition of Mesoblast Inc.

Notes to the Financial Statements for the year ended 30 June 2012

26. Related Party Transactions

(a) Parent entity

The parent entity within the Group is Mesoblast Limited.

(b) Associates and subsidiaries

Details of interests in associates and subsidiaries are disclosed in note 28 to the financial statements.

(c) Key management personnel

Disclosures relating to key management personnel are set out in note 25 to the financial statements.

(d) Transactions with other related parties

Accounts receivable from, accounts payable to and loans from subsidiaries as at the end of the financial year have been eliminated on consolidation of the Group. The amounts disclosed as associates relate to pre-acquisition transactions between Mesoblast Limited and Mesoblast Inc., while Mesoblast Inc. was an associate. The amounts disclosed under the heading of subsidiaries relates to post-acquisition transactions between the parent and its subsidiaries. These transactions are fully eliminated in the Group accounts.

Both parties may pay invoices in their local currency on behalf of the other party to facilitate timely payment of suppliers. This results in a loan account between both parties which is settled monthly. The transactions being paid for are described below:

(d) Transactions with other related parties (continued)

	30 June 2012 \$	30 June 2011 \$
Associates		
<i>Amounts paid on behalf of Mesoblast Inc., by Mesoblast Limited</i>		
50% sharing of research and SAB fees	–	36,112
50% sharing of cell and antibody manufacturing	–	39,090
Intellectual property costs	–	83,668
	–	158,870
<i>Amounts paid on behalf of Mesoblast Limited, by Mesoblast Inc.</i>		
Employees and consultants (US based)	–	358,665
Research and development (US based)	–	96,110
Intellectual property costs	–	5,929
Other (US based)	–	21,855
	–	482,559
Subsidiaries		
<i>Amounts paid on behalf of Mesoblast Inc., by Mesoblast Limited</i>		
50% sharing of research for the platform and SAB fees	102,200	55,850
50% sharing of cell and antibody manufacturing	9,563	230,972
Intellectual property costs	665,471	216,960
Research and development (Australia based)	1,008,717	169,295
Other	415,958	116,563
	2,201,909	789,640
<i>Amounts paid on behalf of Mesoblast International SA, by Mesoblast Limited</i>		
Research and development (Singapore based)	80,034	–
Other	3,402	–
	83,436	–
<i>Amounts paid on behalf of Mesoblast Australia, by Mesoblast Limited</i>		
Other	977	–
	977	–
<i>Amounts paid on behalf of Mesoblast Limited, by Mesoblast Inc.</i>		
Employees and consultants (US based)	23,602	499,281
Research and development (US based)	579,552	199,659
Intellectual property costs	–	6,541
Other (US based)	548,770	72,352
	2,396,492	777,833
Intercompany service fee		
Service Fee owing from Mesoblast Ltd to Mesoblast Inc.	1,244,568	–
	1,244,568	–

No allowance has been made for impaired receivables in relation to the above balances, nor has any expense been recognized in the year (2011: nil) in respect of any impaired receivables due from related parties. All transactions were made on normal commercial terms and conditions and at prevailing market rates.

Notes to the Financial Statements for the year ended 30 June 2012

26. Related Party Transactions (continued)

(e) Outstanding balances arising from purchases of goods and services

The following balances are outstanding at the end of the reporting period in relation to transactions with related parties:

	30 June 2012 \$	30 June 2011 \$
Trade receivables AUD		
Mesoblast Inc	1,881,969	93,369
Mesoblast Australia Pty Ltd ATF Mesoblast Ltd Employee Share Trust	977	–
Mesoblast International SA	83,436	–
Intercompany ESOP	8,355,780	1,307,401
Balance due from related party	10,322,162	1,440,770
Trade receivables USD		
Teva Pharmaceutical Industries Ltd	USD 1,783,848	–
Balance due from related party	USD 1,783,848	–
Trade creditors USD		
Mesoblast Inc	USD 2,401,149	USD 57,190
Balance owing to related party	USD 2,401,149	USD 57,190

(f) Loans to/from related parties

Associates

Loan to Mesoblast Inc.

Beginning of the year	–	USD 750,000
Loans advanced	–	USD 1,000,000
Interest charged	–	USD 41,667
Amount on Acquisition	–	(USD 1,791,667)
End of year	–	–

Subsidiaries

Loan to Mesoblast Inc.

Amount on Acquisition	–	USD 1,791,667
Loan repayments received	–	(USD 1,750,000)
Interest charged	–	USD 17,111
Interest received	–	(USD 58,778)
End of year	–	–

Subsidiaries

Loan from Mesoblast Inc.

Beginning of the year	USD 120,063,688	–
Loans advanced	–	USD 120,063,688
Loan repayments made	(USD 50,565,308)	–
Interest charged	USD 377,543	–
Interest paid	(USD 377,543)	–
End of year	USD 69,498,380	USD 120,063,688

There is no allowance account for impaired receivables in relation to any outstanding balances, and no expense has been recognized in respect of impaired receivables due from related parties. Outstanding balances are unsecured and are repayable in cash.

(g) Terms and conditions

All other transactions were made on normal commercial terms and conditions and at market rates, except that there are no fixed terms for the repayment of loans between the parties.

27. Financial Risk Management

Financial risks impacting the Group fall into three categories:

- Market risk (includes currency, interest rate and price risks)
- Credit risk
- Liquidity risk

A description of each risk, together with the risk as it relates to the Group, is presented below.

(a) Market risk

(i) Currency risk

The Group has certain clinical, regulatory and manufacturing activities which are being conducted internationally. The primary currency exposure to the Group is the clinical trial activities which are occurring offshore on behalf of the parent (an Australian company) in the United States of America and manufacturing activities occurring in Singapore. As a result of these activities, the Group has certain amounts owing which are denominated in US dollars (USD) and Singapore dollars (SGD). These foreign currency balances give rise to a currency risk, which is the risk of the exchange rate moving, in either direction, and the impact it may have on the Group's financial performance.

The Group manages the currency risk by evaluating the trend of the relevant foreign currency rates (FX rates) to the Australian dollar and making decisions as to the levels to hold in each currency by assessing its future activities which will likely be incurred in those currencies. Forward contracts to meet future commitments in Singapore are currently being considered.

As at 30 June 2012, the Group held 2% of its cash in USD, and 98% in AUD. 31% of the AUD balance is subject to forward contracts to purchase USD at a predetermined rate in the future. After allowing for financial derivative contracts, at year end the Group held 34% USD and 66% AUD. The Group has entered financial derivative contracts to take advantage of enhanced interest rates yields available on AUD deposit when compare to USD deposits (*refer to Note 27(a)(iv) Enhanced foreign currency deposits (EFCDs)*). The Group sells USD and buys AUD from the bank at a pre-agreed FX rate and agrees to then sell that AUD and buy USD to the bank on maturity also at a pre-agreed rate. As these FX rates are known at the outset there is no currency risk. It should be noted that trading in speculative derivatives are strictly prohibited in accordance with the Group's treasury and financial risk management policy.

The balances held at the end of the year that give rise to currency risk exposure are presented in the table below, together with a sensitivity analysis which assesses the impact that a change of +/-20% (2011: +/-20%) in the exchange rate as at 30 June would have had on the Group's reported net profits/(losses) and/or equity balance. The AUD:USD rate prevailing as at 30 June 2012 was 1.0191 (2011:1.0596).

The Group's exposure to foreign currency risk at the end of the reporting period was as follows:

	Foreign currency balance held	+20%	-20%
30 June 2012		Profit/(Loss) AU\$	Equity AU\$
Bank accounts	USD 5,004,828	(805,681)	–
Bank accounts	CHF 100,000	(17,550)	–
Forward exchange contracts:			
– buy foreign currency (Note 14)*	USD 66,212,432	(10,658,925)	–
Intercompany loan*	(USD 68,799,305)	11,075,362	–
Trade and other receivables	USD 6,075,528	(978,043)	–
Trade payables & accruals – USD	(USD 3,909,855)	629,411	–
Trade payables & accruals ^ – AUD	(AUD 586,331)	101,179	–
Trade payables & accruals – SGD	(SGD 351,002)	36,312	–
Trade payables & accruals – GBP	(GBP 6,912)	2,482	–
Trade payables & accruals – EUR	(EUR 6,000)	1,469	–
Trade payables & accruals – DKK	(DKK 7,147)	38	–
		(613,946)	–
			915,127

Notes to the Financial Statements for the year ended 30 June 2012

27. Financial Risk Management (continued)

30 June 2011	Foreign currency balance held	+20%		-20%	
		Profit/(Loss) AU\$	Equity AU\$	Profit/(Loss) AU\$	Equity AU\$
Bank accounts* – USD	USD 120,120,552	(18,891,960)	–	22,670,352	–
Intercompany loan* – USD	USD (120,063,688)	18,883,016	–	(22,659,620)	–
Bank accounts ^ – AUD	AUD 419,648	(69,941)	–	94,252	–
Trade and other receivables – USD	USD 20,329	(3,197)	–	3,837	–
Trade payables & accruals – USD	USD (409,229)	64,362	–	(77,234)	–
Trade payables & accruals ^ – AUD	AUD (1,377,511)	243,295	–	(291,954)	–
Trade payables & accruals – Euro	Euro (4,800)	1,086	–	(1,303)	–
Trade payables & accruals – GBP	GBP (4,800)	1,209	–	(1,451)	–
	–	227,870	–	(263,121)	–

*Relates to monies owned by the US subsidiary, which have been lent to Corporate to centrally manage the investment, therefore the FX exposure is mitigated through the intercompany loan balance.

^ these AUD balances are held by the US based subsidiary and are therefore subject to currency risk.

(ii) Interest rate risk

The Group is not exposed to typical interest rate risk, being the impact of fixed versus floating interest rates on debt. The Groups exposure is to interest rate movements from the interest income it earns on its term deposits and deposits at call. The interest income derived from these balances can fluctuate due to interest rate changes. This interest rate risk is managed by spreading our deposits across various maturity periods and by keeping deposits subject to floating interest rates at a level where they can be used for managing the cash flows of the Group.

The deposits held which derive interest revenue are described in the table below, together with the maximum and minimum interest rates being earned at 30 June 2012. The effect on profit is shown if interest rates change by 10%, in either direction, is as follows:

AUD	2012			2011		
	Low	High	AU\$	Low	High	AU\$
Funds invested at 30 June	5.10%	6.00%	200,353,445	5.90%	6.20%	146,164,610
Rate increase by 10%	5.61%	6.60%	1,132,187	6.49%	6.82%	887,918
Rate decrease by 10%	5.05%	5.94%	(1,132,187)	5.31%	5.58%	(887,918)
USD	Low	High	US\$	Low	High	US\$
Funds invested at 30 June	0.70%	0.70%	3,035,500	0.10%	0.66%	120,120,120
Rate increase by 10%	0.77%	0.77%	2,125	0.11%	0.73%	36,436
Rate decrease by 10%	0.69%	0.69%	(2,125)	0.09%	0.59%	(36,436)

(iii) Price risk

Price risk is the risk that future cash flows derived from financial instruments will be altered as a result of a market price movement, other than foreign currency rates and interest rates. The Group does not consider it has any exposure to price risk other than those already described above.

(b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge its obligation and cause financial loss to the other party. As the Group is non-revenue generating it generally does not have trade receivables. The Group's receivables are tabled below.

The credit risk to the Group is detailed below:

	30 June 2012	30 June 2011
	\$	\$
Cash and cash equivalents		
Cash and cash equivalents (note 7) – minimum A rated	206,748,798	263,227,585
Trade and other receivables		
Receivable from Australian Government (GST)	1,080,315	76,539
Receivable from minimum A rated bank deposits (interest)	3,121,999	1,953,569
Receivable from United States Government (Income Tax)	3,365,972	–
Employee loan contracts	852,000	–
Receivable from related parties (non-rated)	1,750,415	–
Receivable from other parties (non-rated)	388,744	70,837

(c) Liquidity risk

Liquidity risk is the risk that the Group will not be able to pay its debts as and when they fall due. The Group has no borrowings to date and the directors ensure that cash on hand is sufficient to meet the commitments of the Group at all times while it is in a loss making phase of research and development. The going concern basis of preparation of these financial statements is further described in note 1.

All financial liabilities held by the Group at 30 June 2012 and 30 June 2011 are non-interest bearing and mature within 6 months. The total contractual cash flows associated with these liabilities equate to the carrying amount disclosed within the financial statements.

28. Subsidiaries**(a) Significant investments in subsidiaries**

Name of entity	Country of incorporation	Class of shares	Equity holding	
			30 June 2012	30 June 2011
			%	%
Mesoblast, Inc.	USA	Ordinary	100	100
Mesoblast International SA	Switzerland	Ordinary	100	–
Mesoblast Australia Pty Ltd	Australia	Ordinary	100	–
Mesoblast UK Limited	United Kingdom	Ordinary	100	–

29. Subsequent Events

There are no events that have arisen after 30 June 2012 and prior to the signing of this financial report that would likely have a material impact on the financial results presented.

Directors' Declaration

In accordance with a resolution of directors of Mesoblast Limited,

In the directors' opinion:

- (a) the financial statements and notes set out on pages 24 to 67 are in accordance with the *Corporations Act 2001*, including:
 - (i) Complying with Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements, and
 - (ii) Giving a true and fair view of the consolidated entity's financial position as at 30 June 2012 and of its performance for the financial year ended on that date, and
- (b) There are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.

Note 1 'Basis of preparation' confirms that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The directors have been given the declarations by the chief executive officer and chief financial officer required by section 295A of the *Corporations Act 2001*.

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



Mr Brian Jamieson

Director

22 August 2012, Melbourne



Independent auditor's report to the members of Mesoblast Limited

Report on the financial report

We have audited the accompanying financial report of Mesoblast Limited (the company), which comprises the balance sheet as at 30 June 2012, and the income statement, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for Mesoblast Limited (the consolidated entity). The consolidated entity comprises the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards*.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

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

Independence

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

PricewaterhouseCoopers, ABN 52 780 433 757
 Freshwater Place, 2 Southbank Boulevard, SOUTHBANK VIC 3006, GPO Box 1331, MELBOURNE VIC 3001
 T: 61 3 8603 1000, F: 61 3 8603 1999, www.pwc.com.au



Auditor's opinion

In our opinion:

- (a) the financial report of Mesoblast Limited is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2012 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*; and
- (b) the financial report and notes also comply with International Financial Reporting Standards as disclosed in Note 1.

Report on the Remuneration Report

We have audited the remuneration report included in pages 16 to 21 of the directors' report for the year ended 30 June 2012. 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.

Auditor's opinion

In our opinion, the remuneration report of Mesoblast Limited for the year ended 30 June 2012, complies with section 300A of the *Corporations Act 2001*.

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

PricewaterhouseCoopers

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

Anton Linschoten
Partner

Melbourne
22 August 2012