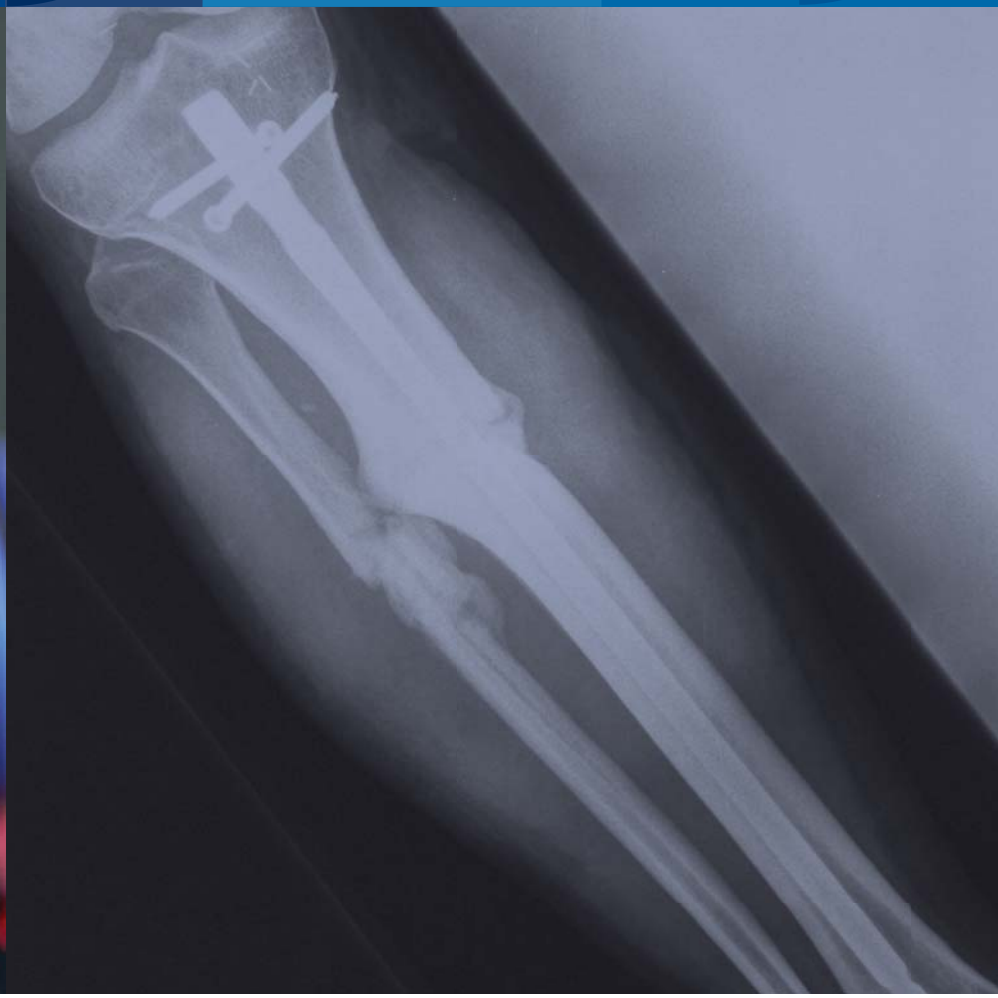
mesoblast
the regenerative medicine company

Mesoblast Limited
Annual Report 2008



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Message from the Chairman

When I joined Mesoblast last November, my expectation was that Mesoblast was an organisation with great potential and solid capability to produce excellent results and new treatments for a wide range of people needing medical help. I am pleased to say that my expectations have been exceeded, with Mesoblast clearly on the way to providing better outcomes for people worldwide.

As you all know, 2008 has been a challenging year in the financial markets. Throughout this period, the Mesoblast team has shown considerable strength, depth and character by consistently delivering successful outcomes.

During the 2008 financial year, Mesoblast made substantial progress in advancing development of our cutting-edge technology towards the creation of new treatment paradigms for major diseases in need of effective solutions. We have continued to build on the existing foundations, progressed our clinical programs, and broadened the clinical indications which can be addressed by our adult stem cell platform technology.

We have continued to work closely with our sister company in the United States, Angioblast Systems Inc., to hit our milestones on time and on budget. During the year, we increased our equity in Angioblast to 39.1 percent. Your Board believes that this investment will increase its intrinsic value as Angioblast continues to unlock our shared platform technology for cardio-vascular, eye, bone marrow transplant and other conditions. In addition, an equity investment by Abbott Laboratories of USD$5 million in Angioblast underscores the value inherent in the common platform technology, and means that Mesoblast's ascribed asset value in Angioblast has appreciated over three-fold.

Significant accomplishments during the financial year included the US Food and Drug Administration clearance of three submissions to begin Phase 2 trials. Mesoblast's Phase 2 trial for spinal fusion in the US is underway, and Angioblast had two Investigational New Drug submissions cleared for two major applications – heart attacks and congestive heart failure. Preclinical programs have shown outstanding results in conditions ranging from osteoarthritis of the knee to diabetic retinopathy and both companies plan to move quickly on the path to market.

The successful transition from autologous to allogeneic trials has allowed Mesoblast and Angioblast to execute on commercialisation plans. Our business model, using cells from an unrelated donor to treat thousands of patients, will allow low cost of goods and high margins.

The timely raising of $13.4 million in equity last December has helped fund Mesoblast's clinical and preclinical trials. The investment by existing and new institutional and sophisticated shareholders shows the shared belief in the great potential for our patented cells to achieve better outcomes for numerous patient populations.

Our year-end financial results are in line with our expecta-tions and demonstrate the continued strong control over our costs. Your Board is confident that we have sufficient capital to maintain our strong momentum in meeting our commercial and clinical ambitions.

We will continue to build and develop our first-rate team as we continue to expand and grow. We are able to attract and retain some of the best in the business, with our staff and consultants showing extraordinary dedication and excellence in progressing our technology towards delivery of clinical products.

The results over the past financial year have made your Board and management more confident than ever in the realistic clinical and commercial opportunities for our proprietary technology.

On your behalf, I would like to record my appreciation to the staff, consultants, members of the Scientific Advisory Board and fellow Board members for their fine efforts, diligence and commitment.

Finally, and most importantly, I would like to thank you, our shareholders, for your support. We look forward to building on our record of achievements and establishing a world-class regenerative medicine company.

Mr Brian Jamieson

Executive Director's Report

During 2008 Mesoblast continued to make significant advances in the clinical and commercial development of our unique adult stem cell platform technology. After less than four years as a public company, our technology platform has been advanced to commercial grade scale-up and manufacturing, has been substantially protected through United States granted patents, and forms the basis of a sound, high margin business model. Major global markets with well defined unmet clinical needs have been identified, and we are currently in the midst of three United States Food and Drug Administration (FDA) cleared Phase 2 clinical trials. We are well on the way to having multiple real products developed for treating patients.

Our allogeneic business model: "off-the-shelf" stem cell products have potential for greater consistency and higher margins

The unique commercial advantages of our Mesenchymal Precursor Cell (MPC) platform technology reside in two key properties: (1) our MPCs can be highly expanded from a very small number of starting cells, and (2) these cells do not activate the immune system, and therefore can be used from one healthy donor to potentially treat thousands of unrelated recipients. This use of MPCs in unrelated recipients is termed allogeneic, and means that we can develop "off-the-shelf" products. Such allogeneic cell products can be produced with high confidence of batch-to-batch safety and efficacy, and low manufacturing costs. This results in a business model that can generate a more consistent product and high margins akin to pharmaceutical sales.

Products for Orthopaedic Indications

Traumatic Bone Fractures

A major focus of the Company is to develop an allogeneic MPC product for the treatment of traumatic bone fractures. Results from our clinical and preclinical trials have clearly shown that our MPC product may be ideal for the treatment of severe fractures which are either at high risk of not healing or have failed to heal for at least six months (termed non-union fractures). In the United States alone, this market accounts for over 220,000 new cases annually and is forecast to generate over US$425 million in sales of biological products by 2011.

Since approximately 80% of this market is accounted for by non-union fractures, we performed a pilot clinical trial at The Royal Melbourne Hospital to evaluate the effectiveness of our MPC technology for non-healing, long bone fractures. In 10 patients, a total of 11 non-healing fractures of the long bones in the legs were treated with Mesoblast's proprietary stem cells. On completion of the trial at 12 months, the results were outstanding, with bony union occurring in 9 non-healing fractures within a median time of 4 months after stem cell implantation. Prior to cell implantation, these fractures had been persistently non-united for up to 41 months with a median time of 10 months.

Current therapies for non-healing fractures use bone harvested from a patient's own hip (termed autograft), requiring a second surgical procedure which frequently results in long-term complications such as chronic pain and infection. The results of Mesoblast's pilot non-union clinical trial showed that our MPC therapy can eliminate the need for autograft and the potential complications arising from this second surgical procedure.

Mesoblast is now in discussions with potential commercial partners regarding the specific clinical indication and regulatory strategy needed to achieve early clearance from the FDA and commercialisation of a fracture repair product.

Spinal Fusion

Mesoblast's second product is NeoFuse™, an allogeneic MPC product that will be used to generate bony fusion to treat patients with degenerative intervertebral disc disease. Today, almost 500,000 spinal fusion procedures are performed annually in the United States alone. Almost half of these are treated with autograft (bone harvested from the patient) and the rest are treated with various biological therapies, most notably recombinant human Bone Morphogenetic Protein (rhBMP).

Biological therapies for spinal fusion generated over US$800 million in sales in 2006. NeoFuse™ will target the entire autograft and biological fusion markets, which are growing at an average rate of 7% per year.

Mesoblast's preclinical stem cell trials showed that NeoFuse™ generated equally or more robust, continuous, and mechanically strong fusion when compared with hip bone autograft in the lumbar spine. These results indicate that Mesoblast's allogeneic MPC therapy can eliminate

the need for autograft and the potential complications of this second surgical procedure. These preclinical results are supported by encouraging initial results from Mesoblast's ongoing Phase 2 clinical trial for lumbar spinal fusion at the Hospital for Special Surgery in the United States where our allogeneic MPC product is being compared to hip bone autograft.

In July 2008, the FDA issued a formal public health notification concerning life-threatening complications associated with use of rhBMP for cervical spinal fusion, including swelling of neck and throat tissue, which resulted in compression of the airway and/or neurological structures in the neck. Fusion of the cervical spine accounts for up to 40% of all spinal fusion procedures performed.

Given the limited treatment options available for patients in need of cervical spinal fusion, Mesoblast believes that this clinical indication may provide an accelerated path to regulatory market approval and successful targeting of the biological fusion market by its NeoFuse™ product.

To achieve this, Mesoblast initiated a preclinical trial at Monash University during the year to determine the safety and efficacy profile of its allogeneic stem cell therapy in cervical fusion. Significantly, no cell-related adverse events were noted at any time throughout the study. Treatment groups receiving Mesoblast's allogeneic cells had earlier and more robust fusion than the other groups.

We are encouraged that the profile of our allogeneic cells in the cervical interbody space may translate into a safer and more effective clinical alternative to existing therapies. These commercial advantages, particularly in light of the FDA notification concerning life threatening complications of rhBMP, will strongly assist us in locking in the optimal global partner to execute our sales and marketing strategies.

Intervertebral Disc Repair

For patients with intervertebral disc disease, Mesoblast is developing an allogeneic MPC product which can be injected using a minimally invasive approach into degenerating discs of unrelated recipients in order to repair and regenerate disc cartilage. This product is expected to significantly increase Mesoblast's potential revenue in the spine market as it will address the needs of a much larger segment of patients with chronic back pain than those at the extreme end who are in need of fusion. Results of preclinical trials from existing studies with this product are expected shortly.

Knee Osteoarthritis

During the course of the year, Mesoblast announced exciting results from two large preclinical trials examining the effects of its allogeneic MPC product injected into knees with osteoarthritis. Osteoarthritis is the most common musculoskeletal disorder and the leading cause of joint pain and disability among the elderly. It is a degenerative disease which is characterised by the loss of cartilage. More than 15 million people in the United States alone suffer from osteoarthritis of the knee.

Current therapies attempt to alleviate painful symptoms but are unable to preserve the cartilage lining the joint. Moreover, many of the currently used pharmaceutical therapies are associated with severe side effects and can even cause death. Joint replacement is often the only option for restoring function.

Mesoblast's preclinical trials evaluated the effects of our allogeneic MPC product injected early in the course of mild arthritis and late in the course of severe arthritis. The results of both preclinical trials have shown that a single injection of Mesoblast's allogeneic cells into knee joints damaged by osteoarthritis can both prevent further deterioration and regenerate/regrow cartilage tissue lining the damaged joint.

Over the six months of follow-up in the severe arthritis group, osteoarthritic knees that received Mesoblast's allogeneic cells demonstrated as much as 20–25% thicker and greater area of cartilage lining the damaged joint compared with baseline measurements of joints before treatment (both parameters $p<0.001$). This cartilage was rich in proteoglycan, the natural constituent of joint lining cartilage, indicating that the regenerative process had induced normal, functional knee cartilage. In contrast, no significant improvement over baseline was seen with a single injection of hyaluronic acid alone at either three or six months.

These results form the basis for an IND submission to the FDA for multiple Phase 2 clinical trials for treatment of patients with degenerative osteoarthritis of the knee.

Products for Non-Orthopaedic Indications

Significantly, Mesoblast has increased its equity in its United States sister company, Angioblast Systems Inc., to 39.1 percent. Angioblast is simultaneously advancing the platform stem cell technology towards commercialisation of novel treatments for cardiovascular, eye, and bone marrow conditions. To date, Angioblast has attained very positive clinical and preclinical results in these indications, supporting Mesoblast's significant equity investment and the intrinsic value associated with these indications.

Congestive Heart Failure

Congestive heart failure remains a leading cause of hospital admissions, morbidity and mortality in the western world. There are currently five million people in the United States with congestive heart failure, with over 550,000 new cases annually. Revascor™, a trademark of Angioblast Systems Inc, is an allogeneic MPC product being developed to rebuild both blood vessels and heart muscle in order to reverse congestive heart failure.

Heart failure results from the progressive deterioration of heart muscle function, leading to its inability to pump sufficient blood to the body's tissues, organs and limbs. The most common causes of heart failure are atherosclerosis (blockage of the coronary arteries), prior heart attack, hypertension, and rhythm disturbances. Existing therapies do not repair nor regenerate heart muscle.

In October 2008, Angioblast announced successful early safety results in the world's first clinical trial to use allogeneic, or "off-the-shelf", adult stem cells from an unrelated donor to treat patients with congestive heart failure. The FDA cleared multi-centre Phase 2 trial will randomise up to 60 patients suffering from congestive heart failure to receive either injection of Revascor™ by catheter into damaged heart muscle or standard-of-care.

Safety data from the first seven patients enrolled in the Phase 2 trial by Angioblast at medical centres in Arizona, California and Minnesota, were presented in October at the Transcatheter Cardiovascular Therapeutics (TCT) Conference in Washington D.C. No cell-related adverse events had occurred in any of the first patients implanted. The Company expects to have the first cohort of patients recruited by the end of the year, and to report on efficacy results during 2009.

Coronary Artery Disease

A pilot clinical trial for chronic, multi-vessel coronary artery disease was successfully conducted at the John Hunter Hospital in New South Wales. This trial showed that the MPC technology could be used effectively to reduce angina, the need for anti-anginal medications, and improvement of heart function in patients with severe, chronic coronary artery disease.

At the other end of the disease spectrum, Angioblast is evaluating the MPC technology in the treatment of acute coronary artery disease and heart attacks. The aim of the stem cell treatment is to prevent the onset of heart failure after a heart attack, which ensues in a significant proportion of the 1 million patients per year in the United States who survive a heart attack. The multi-centre FDA cleared Phase 2 trial is focusing on the safety and effectiveness of the Company's allogeneic stem cells injected by catheter into the damaged heart muscle around 10 days after an acute heart attack. Patients recruited to date have demonstrated no cell-related safety issues.

AMD/Diabetic Retinopathy

Angioblast is developing an allogeneic MPC product for the treatment of eye diseases associated with abnormal blood vessels. These diseases include diabetic retinopathy and age-related macular degeneration (AMD), the leading causes of blindness in the western world.

In the United States alone, there are approximately 1.5 million people suffering from some form of AMD associated with abnormal blood vessels, and over 200,000 new cases arising per year. An additional 500,000 diabetics suffer from macular oedema caused by abnormally leaky vessels, indicating that both AMD and diabetic macular oedema constitute major market opportunities.

In July 2008, Angioblast announced the results of a trial using the allogeneic MPCs in 42 non-human primates for the treatment of leaky blood vessels in the eye. The results of this primate study, together with earlier preclinical results, show that a single intra-ocular injection of the Company's proprietary allogeneic adult stem cells is highly effective for reducing blood vessel leakage. Moreover, it shows that combining the Company's proprietary stem cells with the current standard-of-care, an anti-VEGF agent, results in superior outcomes compared with use of an anti-VEGF agent alone.

These trials will form the basis of an IND submission to the FDA to commence a Phase 2 clinical trial of the Company's allogeneic stem cells in combination with an anti-VEGF agent, with the objective to show improvement in vision, long-term disease remission, and reduction in frequency of intra-ocular anti-VEGF maintenance injections.

Angioblast intends to form a strategic partnership with a major global health care company in order to rapidly commercialise its stem cell product for the treatment of eye diseases caused by abnormal blood vessels, such as diabetic retinopathy and AMD.

Bone Marrow Transplantation

In September 2008 the FDA granted Angioblast an orphan drug designation to use the proprietary "off-the-shelf" allogeneic mesenchymal precursor cells in patients with haematologic malignancies who need a bone marrow transplant but have insufficient haematopoietic stem cell production.

The FDA granted this designation to Angioblast based on results generated in collaboration with investigators at the MD Anderson Cancer Centre in Houston in the United States, which showed that the MPCs can be used to expand the number of haematopoietic stem cells in culture.

Haematopoietic stem cells are needed to regenerate bone marrow in patients whose own bone marrow is damaged and destroyed by treatments for various cancers. The greater the number of haematopoietic stem cells transplanted, the greater the likelihood that the bone marrow transplant will successfully engraft and regenerate a patient's damaged bone marrow.

According to the March 2008 issue of Biology and Bone Marrow Transplantation, the probability that an individual in the United States will require a haematopoietic stem cell bone marrow transplant sometime during their life is 1 in 217. Orphan drug designation allows for an accelerated review process by the FDA, seven-year market exclusivity in the United States upon obtaining marketing authorisation, tax benefits, and exemption from user fees.

The future

In the next 12 months we will continue to focus on clinical and commercial value drivers. Specifically, the emphasis will be on:

- Executing commercial relationships that will add substantial value to both companies and enhance market-oriented execution capability
- Completion of ongoing and commencement of new Phase 2 trials
- Progression of clinical programs towards Phase 3 registration trials

In the 2009 financial year, both companies are set to capitalise on the leading edge shared platform technology. They are supported by robust and broadened patent protection, strong management, adherence to good corporate governance, sufficient funds, and solid communication capabilities.

These characteristics, driven by the extraordinary talent and dedication of our staff and consultants, will underpin both companies as they emerge as global leaders in the very rewarding field of regenerative medicine.

Making a difference

Courtesy of HWT

Patient Tony Giancola, 36, with the Principal Investigator of the non-healing, long bone fracture trial at The Royal Melbourne Hospital, orthopaedic surgeon Richard de Steiger.

Tony is playing football again

Stem cells heal where surgery fails

Adult stem cells could improve healing of serious fractures, writes Lynnette Hoffman in The Weekend Australian

By the time Dean Spizzirri arrived at the Royal Melbourne Hospital for an experimental treatment to repair his badly fractured tibia, 33 months had passed since he smashed his leg in a motorbike accident one October night.

Before the crash, Spizzirri had been a fit and active bloke: a bricklayer who cycled, boxed, and enjoyed kicking the footy around with his son during his spare time.

But for some reason – and doctors couldn't say what that was – Spizzirri's shin bone had refused to heal.

He'd had three operations, including one that involved taking bone from his pelvis and grafting it to the fracture site, the standard treatment doctors use when a bone hasn't healed by the six-month mark. But no luck. Spizzirri could no longer work, and couldn't walk without crutches, let alone play sport.

So when the Gold Coast man headed to Melbourne for the experimental treatment, his expectations were understandably low.

In the procedure, doctors take stem cells from the patient's bone marrow, isolate those responsible for growing bone and inject them into the fracture site to stimulate growth.

"It was the last resort," Spizzirri said. Six months after that fourth surgery, he was surprised to find the bone healed. "The break is actually stronger than the rest of my leg."

He still hasn't regained the fitness and agility he once had, but he's back at work, walking, and able to do light exercises.

Spizzirri was one of 10 patients with severe non-healing fractures in their leg bones who took part in the clinical trial at Royal Melbourne Hospital. Earlier this month doctors announced they had used the patients' own stem cells to successfully repair nine out of 11 fractures in 10 patients.

After 12 months of follow-up, eight patients had achieved "complete bone union" – in other words, the fractures had fully healed. A ninth patient had fractures in both his femur (thigh bone) and tibia. The tibia healed, but the fracture in the femur did not. Another patient, a particularly complex case, did not respond to the treatment and required more surgery.

The median healing time for the patients in the trial was four months; they had had non-uniting fractures for a median of 10 months prior to the stem cell treatment.

As yet, none has suffered adverse events related to the stem cell therapy.

The phase 1 clinical trial showed the procedure was safe, and independent trial leader and orthopaedic surgeon Richard de Steiger says if further randomised controlled trials at multiple centres can replicate those results, and the procedure becomes commercialised, it could have significant implications.

Data from the Victorian Orthopaedic Trauma Register shows that up to 15 per cent of severe bone fractures do not heal. Worldwide, there are millions of people suffering from long bone fractures that do not heal. The majority are victims of road accident trauma, but industrial and sporting accidents account for some of the cases as well. Other patients suffer from severe fractures that heal slowly or poorly, and are at high risk for non-union.

If fractures heal more quickly, it will not only reduce the pain patients experience, but also the economic burden to the community, de Steiger says. "There's a large economic cost to broken bones that don't heal. It prevents people from working and returning to normal activities," he said.

There are only two types of adult stem cells: the more common type are called haematopoietic stem cells, which are currently used to rebuild bone marrow in cancer patients.

The 10 patients in the trial received much more specialised and less common stem cells called mesenchymal precursor cells, found in only about 1 in 100,000 bone marrow cells.

Dean Spizzirri, 51, had three operations to heal his fractured tibia, including autograft and Bone Morphogenetic Protein, but with no success. After 33 months, he was implanted with Mesoblast's proprietary stem cells and within four months, his fractured tibia had united.

Although they are much rarer, these cells have several advantages. They can develop into many types of tissue, not just bone marrow; they reproduce and expand to a much greater level than the other stem cells because they continue to keep dividing without stopping; and they aren't recognised as foreign by the immune system, even when they are transplanted into unrelated people, says Silviu Itescu, executive director of Mesoblast, the listed biotech company that funded the trial and holds the worldwide licence to commercialise adult stem cell technology for orthopaedic applications.

Antibodies are used to isolate the cells, which are then cultured in a lab until enough are formed that they can be implanted onto the site of the fracture. In Melbourne, it took about six weeks to culture enough cells.

De Steiger and Itescu both say it's unlikely that particular method of harvesting the stem cells from individual patients will ever be commercially viable – it takes too long and it's too expensive to go through the whole process each time.

The quality and quantity of the stem cells also vary from person to person, so it may not be possible to get enough direct from each patient, especially as poorly growing stem cells may be one of the reasons the bone didn't heal in the first place. According to Itescu, that was probably the case in the patient in the trial who had two fractures, only one of which healed.

But Mesoblast is currently trialling a procedure that uses stem cells cultured from a single donor, which would probably be at least 10 times cheaper than the method used in this trial, Itescu says. Mass-produced cells from a donor would also mean the cells were readily available, so they could be used to treat fresh fractures as well.

Early results seem promising.

Researchers have successfully used cells from one donor to treat hundreds of related sheep. They are now testing the process in a phase 2 clinical trial in New York in human patients with end-stage vertebral disease, to see if they can use donor stem cells to grow new spine.

De Steiger says the results so far represent significant potential for improving on existing treatments. "If we could use stem cells as an initial treatment in people with fresh fractures, then we may be able to reduce the healing time," he said.

"The stem cells are delivered directly to the fracture site, which could help bone heal more quickly. This would be especially beneficial in patients who had a high risk of not healing, such as patients who had open fractures or high-speed motorcycle injuries."

De Steiger says one potential risk is that the stem cells could continue to grow and form too much bone. "That hasn't happened with any of these patients though, and I think, if anything, overall there are less likely to be risks because you're saving a second operation. Patients have a faster recovery and less pain because there is no other site being operated on."

The standard procedure in patients whose bones haven't healed is to perform a second operation where bone is harvested from the pelvis, and in those cases there is up to a 10 per cent risk of complications including bleeding, ongoing pain or infection.

Because the stem cell procedure uses a needle to retrieve the cells rather than an additional surgery, it is far less invasive. This is what appealed to Tony Giancola, another patient who participated in the trial.

For him, it wasn't the last-resort option. But when given the choice between surgery on his hip to graft part of his pelvic bone, and the trial where they would use a needle to extract stem cells, he picked option two.

"They explained both of the procedures and said I would be walking around a lot quicker, so I chose it," he says.

Two weeks after the operation, he was walking; eight weeks later the bone had healed. "There's no limp, nothing," he says.

This article is reproduced courtesy of The Weekend Australian.

Directors' Report

The Board of Directors of Mesoblast Limited has resolved to submit the following annual financial report of the Company for the financial year ended 30 June 2008. 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	Effective Date
Brian Jamieson	Non-executive Chairman (A)	22 November 07
Byron McAllister	Non-executive Director	Full year
Donal O'Dwyer	Non-executive Director	Full year
Michael Spooner	Non-executive Director (A); Non-executive Chairman (R)	22 November 07
Michael Spooner	Non-executive Chairman (A); Executive Chairman (R);	8 August 07
Silviu Itescu	Executive Director and Chief Scientific Adviser	Full year

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

Details of directors qualifications, experience and special responsibilities, together with meetings attended, can be found on pages 14 to 16 of this report.

Principal Activities & Strategy

Mesoblast Limited is an Australian biotechnology company committed to the development of innovative biological products in the emerging and potentially highly lucrative field of regenerative medicine.

Our adult stem cell platform is being developed for use in the global orthopaedic industry. We are specifically targeting a range of bone, cartilage and musculo-skeletal conditions.

Our aim is to bring at least three products to market in the near term for treatment of these conditions which affect many people.

Mesoblast Limited has the worldwide exclusive rights for orthopedic indications relating to a series of patents and technologies that have been developed over more than 10 years and which relate to the identification, extraction and culture of adult Mesenchymal Precursor Cells (MPCs).

The Company also holds a substantial interest in Angioblast Systems, Inc. (Angioblast), an American company developing the same platform technology for the treatment of cardiovascular diseases, including repair and regeneration of blood vessels and heart muscle.

Overview

During the last financial year, which ended 30 June 2008, Mesoblast remained on track to achieve its goals for commercialising our unique adult stem cell technology platform. These goals include bringing to market multiple cell-based products for the treatment of a wide range of degenerative conditions. Significant clinical and preclinical achievements during the past year mean that Mesoblast's products are progressively getting closer to commercialisation. These highlights, discussed in detail below, emphasise the progress made in the programs of our cell-based products for large unmet global markets, including diseases of bone, cartilage, heart muscle and blood vessels.

Business Model

From the outset we have outlined a business model that is based on low cost of goods and high margins, similar to pharmaceutical drug development. To achieve this, the focus has been on allogeneic or 'off-the-shelf' products which are generated by large-scale expansion of a small amount of donor starting material. Additional advantages of allogeneic products are that they can be batched, with each batch being highly reproducible and consistent to ensure product safety and effectiveness. Equally as important is that "off-the-shelf" products will be available for immediate use at hospitals when the acute trauma or injury needs rapid treatment.

Intellectual Property

Mesoblast continues to exploit and expand its patent and intellectual property portfolio. Key patents have been granted in the United States, the world's largest market for commercialisation of our products. The expanding patent portfolio will continue to deliver major commercial advantages, ensuring exclusive commercialisation of our stem cell platform globally.

Funding

In December, Mesoblast Limited successfully completed a capital raising of $13.44 million from Australian institutional and sophisticated investors. The capital is being used for ongoing clinical trial activities, expansion of preclinical opportunities, and general administrative operations. At 30 June 2008, Mesoblast had cash reserves of $14.1 million.

Key achievements

Non-healing bone fractures

A pilot clinical trial for non-healing, long bone fractures was completed just after the financial year with 10 patients, with a total of 11 non-healing fractures of the long bones in the legs, operated on using Mesoblast's proprietary stem cells. The patients had non-union for up to 41 months prior to cell implantation, with a median time of 10 months. Outstanding results were achieved in this trial with bony union achieved within a median time of four months after stem cell implantation. Mesoblast's focus is now on Phase 2 IND submissions to the FDA for use of its allogeneic stem cells in the treatment of non-union and high-risk fresh fractures.

Spinal Fusion

Patients with end-stage degenerative intervertebral disc disease are usually treated with bone grafts from their own pelvis to induce bony fusion, a procedure termed autograft. Mesoblast is developing a cell product, called Neofuse, to generate bony fusion eliminating the need for an autograft and its associated pain and infection risk. Spinal fusion for end-stage disc disease is a major global market opportunity for Mesoblast, with over 500,000 patients expected to require this procedure in the United States alone by 2010.

A Phase 2 trial for spinal fusion, using Mesoblast's allogeneic or "off-the-shelf" adult stem cells, commenced at New York's Hospital for Special Surgery, one of the world's leading orthopaedic, rheumatologic and rehabilitation specialty hospitals. After encouraging initial safety data, Mesoblast announced that it would accelerate its clinical trial timetable by expanding its Phase 2 trial activities to up to 10 new major clinical sites throughout the US.

Intervertebral Disc Repair

For patients with earlier-stage intervertebral disc disease, Mesoblast is developing an allogeneic adult stem cell product which can be injected by a minimally invasive approach into degenerating discs of unrelated recipients in order to repair and regenerate disc cartilage. This is likely to be a significantly larger market than spinal fusion. Results of preclinical trials are expected this calendar year.

Knee Osteoarthritis

Osteoarthritis is a major degenerative disease of cartilage in joints, with the knee being the most commonly affected. Knee osteoarthritis affects as many as 15 million people in the United States alone, and no approved therapies currently have any effect on cartilage repair or regeneration. The outstanding results of our preclinical cartilage trials have shown that a single injection of Mesoblast's allogeneic cells into knee joints damaged by osteoarthritis can both prevent further deterioration and regenerate/regrow cartilage tissue lining the damaged joint. These results form the basis for a planned IND submission to the FDA for multiple Phase 2 clinical trials for treatment of patients with degenerative osteoarthritis of the knee.

Strengthened relationship with Angioblast Systems Inc. in the United States

Mesoblast has increased its equity in its United States sister company, Angioblast Systems Inc., to 39.1 percent. Angioblast is simultaneously advancing the platform stem cell technology towards commercialisation of novel treatments for cardiac, vascular, and eye conditions. To date, Angioblast has attained strong clinical and preclinical results in these indications, supporting Mesoblast's significant equity investment and the intrinsic value associated with these indications.

All of Angioblast's clinical trials to date have been performed collaboratively with Johnson & Johnson's Cordis Corporation and Biosense Webster who have provided their latest generation cardiac catheter technologies for these trials.

During the financial year, Angioblast entered into an important new collaborative arrangement with Abbott, a major healthcare company. Abbott is providing funding for a collaborative program in heart failure, and has made an equity-based investment of $US5 million.

Congestive Heart Failure

This condition affects an estimated 5 million people in the United States alone, with 550,000 new cases each year. A pilot clinical trial using the Company's stem cells for heart disease was successfully conducted at the John Hunter Hospital in New South Wales. The primary endpoint of safety at six months was achieved with no cell-related adverse events. Equally as important, all patients showed improvement in heart muscle function and reduced symptoms of both heart failure and severe angina.

The results of this pilot trial, together with additional preclinical trials, formed the basis of a successful IND submission to the FDA, which cleared Angioblast to commence a Phase 2 trial of the stem cell technology for treating patients with congestive heart failure. Patient recruitment for this trial is actively occurring.

Heart Attack

Following rapid approval of an IND submission to the FDA for a Phase 2 clinical trial in patients with heart attacks, the study was launched at one of the world's premier cardiovascular medical centers, the Texas Heart Institute. The trial is focusing on the safety and effectiveness of the Company's allogeneic stem cells injected into the damaged heart muscle around 10 days after an acute heart attack. The aim of the stem cell treatment is to prevent the onset of heart failure after a heart attack.

AMD/Diabetic Retinopathy

Preclinical trials showed that the proprietary stem cells were highly effective for the treatment of leaky blood vessels in the eye, the major cause of vision loss in patients with wet age-related macular degeneration (AMD) and diabetic retinopathy. These clinical indications represent additional major market opportunities for Angioblast.

Financial Summary

Operating results

The net loss for the year was $10,062,379 (2007: $8,728,131) and is in line with expectations. The result reflects full year operations for the Company and the continued development of our platform technology.

Income

Revenue during the period was $909,807 (2007: $1,679,317) and is made up of:

	30 June 2008 $	30 June 2007 $
Revenue from continuing operations		
Commercial Ready government grant	-	719,698
Interest revenue	909,807	939,557
Other income	-	20,062
	909,807	1,679,317

Expenditure

In line with the Company'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 Company can yet demonstrate all the factors required in order to capitalise development expenditure.

Total operating expenses for the period were $10,972,186 (2007: $10,407,448) and is made up of:

	30 June 2008 $	30 June 2007 $
Research and development	6,207,372	6,325,130
Management and administration	2,642,016	2,368,192
Share of losses of equity accounted associates	2,122,798	1,714,126
	10,972,186	10,407,448

Cash flow statement

Net cash outflow from operations decreased to $6,202,589 in 2008 (2007: $9,102,676) largely due to the following reasons:

- government grant funding received in 2007 was approximately $0.5m higher than in 2008;
- 2007 operating cashflow included $2.1m of research and development expenses which related to 2006.

During the period under review the Company issued a further 10,500,000 shares at $1.28 (2007: 13,882,800 shares at $1.25), providing approximately $13.4m in cash which has largely been used to fund and support phase 2 clinical trials.

Balance sheet

At 30 June 2008 the Company's cash position was $14,094,219 (2007: $12,055,040) whilst Angioblast Systems, Inc. had a cash balance of $6,084,775 (USD $5,850,511) (2007: $449,923). When combined, the total cash balance of $20.2m (2007: $12.5m) represents the amount by which the platform adult stem cell technology could be further developed and commercialized.

The Company's policy is to hold its cash and cash equivalent deposits in "A" rated or better deposits.

The Company's strategy is to outsource manufacturing and all continuing research to specialist, best of breed partner organisations. As a consequence the Company has not incurred any major capital expenditure for the period and does not intend to incur substantial commitments for capital expenditure in the immediate future.

Mesoblast has now substantially completed its investment in Angioblast under the Series B agreement and as a result owns 39.1% of Angioblast. This investment is carried on the balance sheet of Mesoblast and is made up of the cash invested of $18,082,792 (2007: $11,663,339) together with the Company's share of Angioblast losses of $5,321,545 (2007: $3,995,244) giving a net investment of $12,761,247 (2007: $7,668,095).

Earnings per share

	2008 Cents	2007 Cents
Basic earnings/(losses) per share	(8.81)	(8.20)
Diluted earnings/(losses) per share	(8.81)	(8.20)

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 2008.

Investment in Angioblast Systems, Inc.

Mesoblast has now substantially completed its investment in Angioblast under the Series B agreement and as a result now owns 39.1% of Angioblast. The remaining 0.1% investment under this agreement, being $200,000, will be invested in furthering the platform technology, most likely in the next six months.

Angioblast Systems, Inc. is a non-listed biotechnology company based in New York. The company was incorporated on 27 April 2001 in Delaware, United States of America.

Angioblast's principal focus is to commercialise cardiovascular applications of our adult stem cell technology which was acquired from the Hanson Institute/Institute of Medical and Veterinary Science in South Australia.

Share Options

Shares under option

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

Option Series	Issue Date	Number of shares under option	Exercise price of options	Expiry date of options
1	29 September 2004	4,120,000	$0.55	29 September 2009
2(a),(b),(c)	16 December 2004	700,000	$0.60	16 December 2008
2(c)	16 December 2004	80,000	$0.60	04 July 2009
3	25 August 2005	350,000	$0.65	31 December 2008
3	25 August 2005	350,000	$0.65	30 June 2009
4(a)	23 February 2006	34,000	$0.65	31 March 2009
4(a)	23 February 2006	66,000	$0.65	1 May 2010
4(b)	23 February 2006	166,667	$0.65	30 June 2009
4(b)	23 February 2006	200,000	$1.20	30 June 2010
4(b)	23 February 2006	350,000	$1.20	30 June 2011
4(c)	23 February 2006	20,000	$0.65	23 February 2009
5	23 November 2006	150,000	$0.65	23 November 2009
6(a)	17 March 2006	50,000	$2.02	17 March 2009
6(b)	17 May 2006	10,000	$1.52	17 May 2009
6(d)	1 January 2007	15,000	$1.96	1 July 2008
6(d)	1 January 2007	45,000	$1.96	1 January 2009
6(d)	1 January 2007	30,000	$1.96	1 January 2010
6(d)	1 January 2007	40,000	$1.96	1 January 2011
6(d)	1 January 2007	30,000	$1.96	1 August 2008
6(d)	1 January 2007	30,000	$1.96	1 February 2009
7	27 July 2007	2,480,000	$2.13	30 June 2012
8	7 July 2008	2,736,000	$1.00	30 June 2013
		12,052,667		

No option holder has any right under the options to participate in any other share issue of the Company. Further details of the options series can be found in Note 18 to the financial statements.

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:

Option Series	Grant Date	Number of shares issued	Amount paid per share	Amount unpaid per share
1	29 September 2004	600,000	$0.55	Nil
2(c)	16 December 2004	80,000	$0.60	Nil
4(b)	23 February 2006	150,000	$0.65	Nil
4(b)	23 February 2006	150,000	$1.20	Nil
4(c)	23 February 2006	60,000	$0.65	Nil
		1,040,000		

Significant Changes in the State of Affairs

No significant changes occurred in the state of affairs of the Company during the financial year other than those disclosed in the review of operations.

Matters Subsequent to the End of the Financial Year

No matters or circumstances have arisen since 30 June 2008 up to the date of this report that the directors believe have significantly affected or may significantly affect:

- the Company's operations in future financial years; or
- the results of those operations in future financial years; or
- the Company's state of affairs in future financial years.

Business Strategy Prospects for Future Years

Mesoblast is committed to the rapid commercialisation of its adult stem cell platform technology. Our ongoing strategy is to maximise shareholder wealth through rapid completion of existing clinical trial programs and to significantly extend our market opportunities by initiating new programs that build logically on extensive work that has been completed. Mesoblast will continue to aggressively engage commercial partner organisations as a key part of our ongoing strategy.

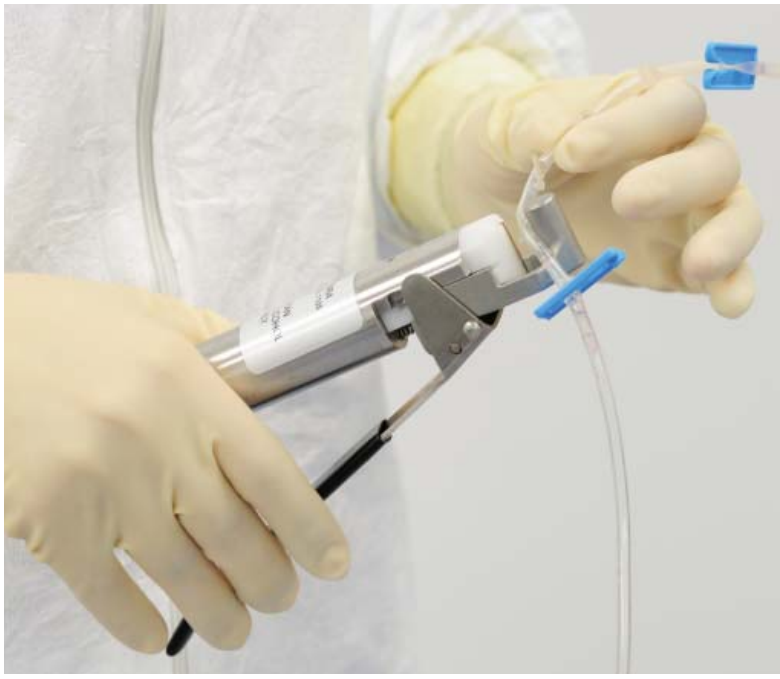
At the date of this report, Mesoblast's business strategy is to:

- focus on patient enrollment and trial completion associated with our phase 2 clinical trial program in the United States for spinal fusion;
- consider the filing of a new indication with the United States Food and Drug Administration for the commencement of clinical trials associated with long bone fractures and/or knee osteoarthritis;
- pursue clinical and preclinical trial programs associated with the treatment of diseases caused by cartilage degeneration

Mesoblast has a strong and ongoing relationship with its sister company Angioblast Systems, Inc. in the United States. We will continue to work closely with the management and board of directors of Angioblast to protect and enhance our significant investment in that company.

Environmental Regulations

Mesoblasts operations are not subject to any significant environmental regulation under either Commonwealth or State legislation. The Board, however, considers that adequate systems are in place to manage the Company's obligations and is not aware of any breach of environmental requirements as they relate to the Company.



Indemnification of Officers

During the financial year, the Company paid premiums in respect of a contract insuring the directors and company secretary of the Company, and all executive officers of the Company. 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 Company

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

Non-Audit Services

The Company 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. PricewaterhouseCoopers did not provide any non-audit services during the year and accordingly there were no amounts paid or payable to PWC for such services (2007: nil).

Auditor's Independence Declaration

A copy of the auditor's declaration under Section 307C in relation to the audit for the year ended 30 June 2008 is included on page 25 of the annual report.

Information on Directors

Brian Jamieson, Non-executive Chairman – FCA

Shares held: 125,000
Options held: -

Mr Jamieson has over 30 years experience in providing advice and audit services to a diverse range of public and large private companies. He was chief executive of Minter Ellison, Melbourne, from 2002 – 2005. Prior to that he was chief executive officer of KPMG 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 is currently a non-executive director of Tatts Group Limited (since May 2005), Sigma Pharmaceuticals Limited (since December 2005) and Oz Minerals Limited (since August 2004), all ASX listed companies. He is also a non-executive director HBOS Australia Pty Ltd, director and treasurer of Care Australia and the Bionic Ear Institute, and a director of Veski, The Sir Robert Menzies Foundation, the Australian Council Major Performing Arts Board.

Donal O'Dwyer, Non-executive Director – BE, MBA

Shares held: -
Options held: 300,000

Mr O'Dwyer has had 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. Cordis is the world's largest manufacturer of innovative products for interventional medicine, minimally invasive computer-based imaging, and electrophysiology. 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. He directly supervised an increase in sales from $US500 million in 2000 to $US2 billion in 2003. 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, has an MBA and is on the board of a number of companies including Cochlear Limited, Atcor Medical Holdings Ltd and Sunshine Heart Inc.

Mr O'Dwyer is currently Mesoblast's representative on the Board of Directors for Angioblast Systems, Inc.

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

Shares held: 36,632,196
Options held: -

A medically trained physician scientist, Professor Itescu has established an outstanding international reputation in the fields of stem cell biology, autoimmune diseases, organ transplantation, and heart failure. He has been a faculty member of Columbia University in New York and of the University of Melbourne. His pioneering work in the use of adult stem cells for heart disease has laid the groundwork for a potential paradigm shift in the treatment of cardiovascular disorders. 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 several publicly-listed Australian life sciences companies. In addition, he is the founder and a member of the Board of Directors of Angioblast Systems Inc.

Byron McAllister, Non-executive Director – BS M.Agr

Shares held: -
Options held: 150,000

Mr McAllister has extensive expertise in product development, quality assurance, and obtaining FDA regulatory approvals within the healthcare industry. He has extensive expertise within the biologics, pharmaceutical and medical device industries, and has prepared full documentation for approval by the US FDA, UK MCA, and other world health regulatory authorities. Most recently, Mr McAllister has served as Vice President, Worldwide Quality Assurance, for the Ares-Serono Group based in Geneva and Boston, overseeing operations in over a dozen countries. Mr McAllister has held senior management positions in manufacturing and quality assurance with Abbott Laboratories' Ross Laboratories and Diagnostics Divisions, Amersham Corporation, and Coulter Electronics Corporation. He is a member of the PDA (Parenteral Drug Association), American Society for Quality (ASQ), and the Regulatory Affairs Professionals Society (RAPS).

Michael Spooner, Non-executive Director – Bcom, ACA, MAICD

Shares held: -
Options held: 1,100,000

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 is Executive Chairman of Hunter Immunology Limited, a late stage respiratory biopharmaceutical company, and is a non-executive director of Peplin Inc, a dermatology focused skin cancer company. Most recently, Mr Spooner was the previous Chairman of Mesoblast Limited. Previously, he was 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 in 2003. He was a Principal Partner and Director of Consulting Services with PricewaterhouseCoopers (Coopers & Lybrand) in Hong Kong for several years.

Kevin Hollingsworth, Company secretary – FCPA, FCMA

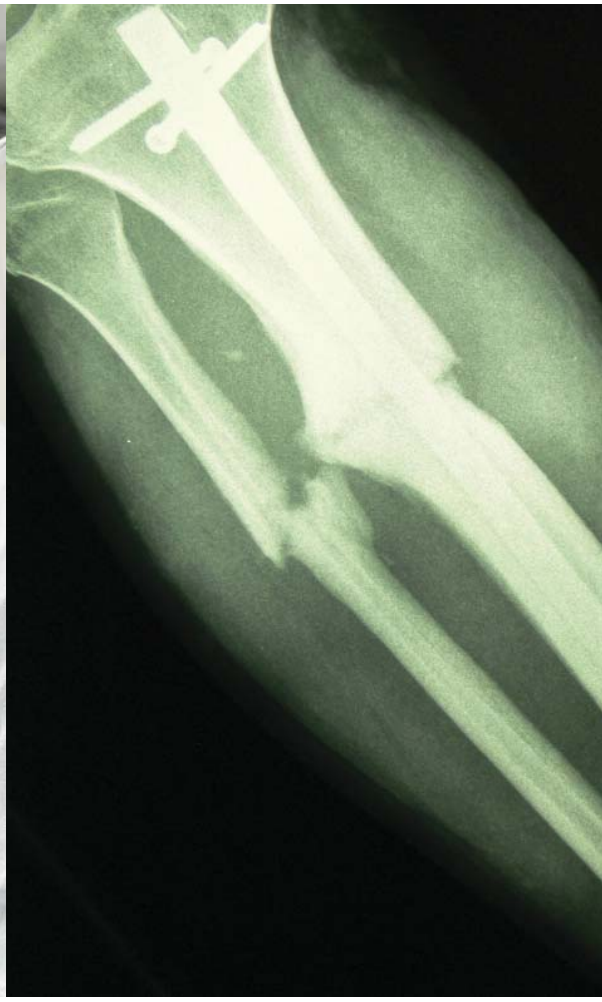
Shares held: -
Options held: 200,000

Mr Hollingsworth is a Fellow of CPA Australia, and a past chairman of both the National and Victorian Industry and Commerce Accountants Committees. He is also a Fellow of the Chartered Management Accountants and a Past National President of CIMA Australia. Mr Hollingsworth has most recently been non-executive director and company secretary for Alpha Technologies Corporation Ltd, a global company with operations in the US, Mexico, Europe and China, designing and manufacturing temperature sensors for disposable medical devices, as well as precision thermometry and instrumentation for the biotechnical and life science industry.

Meetings of Directors

The number of meetings of the Company's directors (including committee meetings of directors) held during the year ended 30 June 2008 and the numbers of meetings attended by each director were:

	Board of Directors		Audit & Risk Committee		Nomination & Remuneration committee	
Director	Held	Attended	Held	Attended	Held	Attended
Michael Spooner	12	12	5	5	2	2
Silviu Itescu	12	12	5	5	2	2
Byron McAllister	12	12	5	5	2	2
Donal O'Dwyer	12	12	5	5	2	2
Brian Jamieson	7	7	2	2	2	2



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 is set out under the following main headings:

A. Remuneration principles and policies
B. Remuneration of key management personnel
C. Service agreements
D. Share-based compensation

A. Remuneration Principles and Policies

Board policy for determining remuneration

The Company's goal is to engage and promote excellence at Board level, in staff members and in partner organisations. The Company looks to engage the services of individuals and organisations with the experience necessary to assist the Company in meeting its strategic objectives.

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

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

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

The Company's remuneration framework is aligned to shareholders interests and in particular aligned to the rapid commercialisation of the Company'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.

The Board has established a remuneration committee which provides advice on remuneration and incentive policies and practices and specific recommendations on remuneration packages and other terms of employment for executive directors, non-executive directors, and executives of the Company.

Remuneration structure

(a) Non-executive directors fees

Director's fees were determined initially at the date of the Company's public listing on 16 December 2004 by reference to industry standard. Director's fees were set at this time at $75,000 for the non-executive chairman and $40,000 for each non-executive director. A limit to total directors' fees of $500,000 was set at the time of the public listing and has not subsequently changed.

On the appointment of Brian Jamieson to the role of Chairman in November 2007, the non-executive chairman fee was raised to $120,000. Recently the board approved an increase to non-executive fees. These fees were raised to $60,000, effective 1 July 2008, on the basis of industry standard.

Components of the remuneration package include a cash element together with unquoted medium term options in some cases.

(b) Executive pay

The executive pay and reward framework has three components, which in combination comprises the executives' total remuneration:

- Base pay and benefits (i)
- Short term performance incentives (ii)
- Long term performance incentives (iii)

(i) Base pay and benefits

A total employment cost package may include a combination of cash and prescribed non-financial benefits at the executives' discretion.

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.

(ii) Short term performance incentives

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

(iii) Long term performance incentives

Performance conditions were attached to the following options granted to key management personnel in previous financial years, which may form part of their remuneration in the current and prior financial year. These performance conditions are described as follows:

*Options granted to Paul Rennie**

- 80,000 options will vest on achieving a Standard Operating Procedure (SOP) for the manufacture of cells. This milestone was reached on 6 September 2006;
- 80,000 options vest on approval of Mesoblast's US Food and Drug Administration (FDA) Investigative New Drug (IND) approval. This milestone was reached on 16 December 2006;
- 80,000 options vest on completing human pre-regulatory trials for a Mesoblast Orthopaedic Application of the licensed technology. This milestone was reached on 4 July 2008;

Options granted to Byron McAllister

- 75,000 options vest should the Company achieve an IND approval from the US FDA for initiating multi-centre orthopaedic clinical trials within a period of 2 years after the Company became listed on the ASX (16 December 2004). This milestone was reached on 16 December 2006;
- 75,000 options vest should Angioblast Systems, Inc. achieve IND approval from the US FDA for initiating multi-centre cardiovascular clinical trials within a period of 3 years after the Company became listed on the ASX (16 December 2004). This milestone was reached on 1 May 2007.

These performance conditions were chosen as they are fundamental to the Company's progress towards the commercialisation of its products. The dates these milestones are deemed to have been met are as follows:

- For options that are granted on obtaining IND approval, IND approval is deemed to be the date 30 days following the date when the IND application is lodged with the FDA, provided the FDA has not placed a hold on the clinical trial.
- For options granted on achieving an SOP, the SOP is deemed to have been achieved on the date when the SOP has been approved and released by Quality Assurance.
- For options granted on completing a human pre-regulatory trial, the completion date is deemed to be the date of the last patient's follow-up visit, which normally occurs 12 months after MPCs have been implanted into the patient.

* Paul Rennie transferred these options to another holder on 15 November 2007, consequently he no longer holds these options.

Relationship between remuneration policy and company performance

	16 December 2004 (date of listing)	30 June 2005	30 June 2006	30 June 2007	30 June 2008
Closing share price (IPO price)	$0.50	$0.43	$1.52	$2.02	$0.91
Price increase/(decrease) $		$(0.07)	$1.09	$0.50	$(1.11)
Price increase/(decrease) %		(14%)	255%	33%	(55%)
Total key management personnel remuneration		503,703	1,368,039	1,189,907	1,802,804

The Company's remuneration policies seek to reward staff members for their contribution to achieving significant clinical and regulatory milestones. These milestones build sustainable and long term shareholder value. The increase in remuneration since IPO reflects the expansion of the clinical program of the Company.

The directors do note that the stock market has corrected significantly over the 12 months to 30 June 2008. The stock price for Mesoblast has similarly corrected in line with a difficult market. It is in this respect that we work diligently to ensure that our shareholders and other stakeholders are regularly informed of our progress and the exciting opportunity that is associated with our adult stem cell platform technology.

B. Remuneration of Key Management Personnel

Details of the remuneration of key management personnel are set out in this section of the remuneration report. Key management personnel includes all directors (as disclosed on page X), and certain executives of the Company, who all belong to the Senior Executive Management Group and they have authority and responsibility for planning, directing and controlling the activities of the Company together with the Board of Directors.

In addition to the directors of the Company, key management personnel, as described above, also includes the following people and positions held during the reporting periods:

Name	Position	Effective date
Kevin Hollingsworth	Company Secretary Chief Financial Officer (R)	Full year 21 November 07
Suzanne Lipe	Vice President of Operations	18 March 08 (A)
Jenni Pilcher	Chief Financial Officer	21 November 07 (A)
Paul Rennie	Special Projects Consultant Chief Operating Officer	12 May 08 (A) 11 May 08 (R)
Jim Ryaby	Vice President of Research and Clinical Affairs	3 March 08 (A)
Donna Skerrett	Clinical and Regulatory Affairs	Full year

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

Details of the remuneration of each director of Mesoblast Limited and the other key management personnel of the Company are set out below:

	Short term employee benefits		Post-employment benefits	Sharebased payments
Name	Salary & fees $	Bonus $	Superannuation $	Options & rights $
Directors 2008				
Executive directors				
Silviu Itescu	174,312	-	15,688	-
Michael Spooner*	63,008	137,615	14,990	-
Non-executive directors				
Brian Jamieson**	66,935	-	6,024	-
Byron McAllister	40,000	-	-	-
Donal O'Dwyer	36,697	-	3,303	33,571
Michael Spooner*	41,958	-	3,777	-
	422,910	137,615	43,782	33,571
2007				
Executive directors				
Michael Spooner	275,229	137,615	37,156	29,000
Silviu Itescu	160,130	-	6,537	-
Non-executive directors				
Byron McAllister (iii)	40,000	-	-	10,875
Donal O'Dwyer	36,697	-	3,303	70,571
	512,056	137,615	46,996	110,446
Other Key Management Personnel* 2008**				
Suzanne Lipe	47,256	-	4,253	-
Jenni Pilcher	130,000	21,918	13,682	60,335
Paul Rennie****	122,552	76,697	27,912	168,032
James Ryaby	56,520	-	-	-
Donna Skerrett	65,472	20,252	-	125,152
Kevin Hollingsworth	112,600	-	-	90,330
	534,400	118,867	45,847	443,849
2007				
Paul Rennie (iv)	176,583	50,000	21,248	21,894
Kevin Hollingsworth	113,069	-	-	-
	289,652	50,000	21,248	21,894
Total 2008	957,310	256,482	89,629	477,420
Total 2007	801,708	187,615	68,244	132,340

Termination benefits $	Total $	Remuneration consisting of options %	Performance based remuneration (ii) %
-	190,000	0%	-
-	215,613	0%	63.8%
-	72,959	0%	-
-	40,000	0%	-
-	73,571	45.6%	-
-	45,735	0%	-
-	637,878		
-	479,000	6.1%	28.7%
-	166,667	-	-
-	50,875	21.4%	-
-	110,571	63.8%	-
-	807,113		
-	51,509	-	-
-	225,935	27.5%	10%
21,963	417,156	40.3%	18.4%
-	56,520	-	-
-	210,876	59.3%	9.6%
-	202,930	44.5%	-
21,963	1,164,926		
-	269,725	8.1%	20.7%
-	113,069	-	-
-	382,794		
21,963	1,802,804		
-	1,189,907		

* Michael Spooner was an executive up until 8 August 2007, after that date became a non-executive director. His remuneration has been shown separately.

** Brian Jamieson was appointed Chairman on 22 November 2007.

*** Refer to the table on page 11 for periods that remuneration has been disclosed.

**** Termination benefits included annual leave entitlements for Paul Rennie upon the expiry of his employment contract. His new contract is as a consultant with no leave entitlements.

(i) All bonuses reported in the above table are 100% of the bonus entitlement for each relevant executive. Bonuses forfeited during the year as a result of performance targets not being met were nil (2007: nil).

(ii) Performance-based remuneration includes all bonuses paid, and certain amounts of share-based remuneration, as described in (iii) and (iv) below. The grants of options that are subject to performance criteria are further described in sub-section (iii) and (iv) below. Share-based remuneration and bonuses that are not subject to performance criteria relate to options issued in order to facilitate the growth and performance of the Company as a whole, rather than for a specific milestone to be met.

(iii) Byron McAllister's share-based remuneration is 100% performance based in 2007. He did not receive share-based remuneration in the current year as the options had vested.

(iv) Paul Rennie's share-based remuneration that was performance based for the year was nil (2007: $5,945).

C. 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 1/3 of all non executive directors retire annually and are eligible for re-election at the Company's Annual General Meeting.

Remuneration and other terms of employment for the Chief Scientific Advisor and other key management personnel are formalised in service agreements. These agreements may provide for the provision of performance related cash bonuses and the award of options. Provisions of the agreements relating to remuneration are set out as follows:

Silviu Itescu, Director and Chief Scientific Adviser
- Term of agreement: commencing 1 February 2007;
- Salary: $190,000 inclusive of superannuation per annum;
- Termination: no terms have been agreed;

Suzanne Lipe, Vice President of Operations (from 18 March 2008)
- Term of agreement: commencing 18 March 2008;
- Salary: $190,000 per annum;
- Superannuation: 9% of $190,000 per annum;
- Termination: One month;
- Bonus: eligible to participate in the Company's bonus scheme.

Jenni Pilcher, Chief Financial Officer (from 22 November 2007)
- Term of agreement: commencing 22 November 2007;
- Salary: $150,000 per annum, four days per week;
- Superannuation: 9% of $150,000 per annum;
- Termination: One month;
- Bonus: eligible to participate in the Company's bonus scheme.

Paul Rennie, Special Projects Consultant (from 12 May 2008)
- Term of agreement: commencing 12 May 2008;
- Consulting fees: $1,000 per day, three days per week;
- Termination: 30 days
- Bonus: eligible to participate in the company's bonus scheme.

Jim Ryaby, Vice President of Research and Clinical Affairs (from 3 March 2008)
- Term of agreement: commencing 3 March 2008;
- Consulting fees: US$156,000 per annum, 3 days per week;
- Other benefits: Dental and health fully covered;
- Bonus: eligible to participate in the Company's bonus scheme.

Donna Skerrett, Clinical and Regulatory Affairs
- Term of agreement: commencing December 2004;
- Salary: $71,424 per annum, part time;
- Bonus: eligible to participate in the Company's bonus scheme.

D. Share-Based Compensation

Options to purchase fully paid shares of the Company were granted as remuneration during the year as follows:

	Grant Date	Granted No.	Vesting date(s)	Expiry Date	Exercise price $	Fair value $
2008						
Kevin Hollingsworth	27/07/2007	200,000*	01/07/2008	30/06/2012	2.13	0.74
Jenni Pilcher	27/07/2007	100,000*	01/07/2008	30/06/2012	2.13	0.74
Paul Rennie	27/07/2007	250,000*	01/07/2008	30/06/2012	2.13	0.74
Donna Skerrett	27/07/2007	200,000*	01/07/2008	30/06/2012	2.13	0.74
2007						
Donal O'Dwyer(i)	23/11/2006	50,000	23/11/2006	23/11/2009	0.65	0.589
Donal O'Dwyer(i)	23/11/2006	50,000	23/11/2007	23/11/2009	0.65	0.678
Donal O'Dwyer(i)	23/11/2006	50,000	23/11/2008	23/11/2009	0.65	0.718

* Each grant of options is divided into three equal tranches. Tranche A has a vesting date which is shown in the above table. Tranches B and C have vesting dates one and two years respectively after Tranche A. All tranches have the same expiry date, exercise price and fair value which are as shown in the above table.

All share options issued to key management personnel were made in accordance with the provisions of the executive share option plan. All options issued were issued for no consideration, therefore there are no amounts unpaid with respect to these options. There are no performance criteria attached to any of the options granted during the year (2007: nil).

Modifications to terms and conditions of options granted

There has been no modification to any terms and conditions of options during the current financial year. On 5 June 2007, the Board of Directors approved that the conditions described below be removed from the terms and conditions of affected options:

- 1/3 of the vested options could be exercised in the first 12 months following vesting date;
- up to a total of 2/3 could be exercised between 12 and 24 months following vesting date;
- the balance being able to be exercised (to the extent not already exercised) between 24 months and 36 months of vesting.

By removing the above terms, those options held by Donal O'Dwyer in the table above are now able to be exercised in full once vested. The share price of the securities under option as at the date of the modification was $2.20.

Michael Spooner's options, at the time of resignation from executive director, are to be held in Escrow in either shares or as options until the earlier of Mr Spooner's retirement from the Board or 31 July 2008. Mr Spooner may only exercise these options within 60 days from the expiry of the escrow period, after which time they will lapse.

The directors do not believe there is any incremental fair value granted as a result of the above modifications. The share price of the securities under option as at the date of the modification was $1.95.

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

	Number of options exercised during the year		Number of options vested during the year	
	2008	2007	2008	2007
Donal O'Dwyer	-	-	50,000	125,000
Byron McAllister	-	-	-	150,000
Michael Spooner	-	-	-	200,000
Jenni Pilcher	-	-	60,000	-
Donna Skerrett	-	-	100,000	100,000

Value of options issued to directors and key management personnel

The following table summarises the value of options granted, exercised or lapsed during the annual reporting period to the identified directors and executives:

	Value of options granted at grant date (i) $	Value of options exercised at the exercise date $	Value of options lapsed at the date of lapse $
Kevin Hollingsworth	147,478	-	-
Jenni Pilcher	73,739	-	-
Paul Rennie	184,349	-	-
Donna Skerrett	147,478	-	-

(i) The value of options granted during the period is recognised in compensation over the vesting period of the grant, in accordance with Australian accounting standards.

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

	Vested %	Forfeited %	Subsequent financial years in which options vest	Minimum total value of grant yet to vest $	Maximum total value of grant not yet expensed $
Donal O'Dwyer	83.3%	-	2009	-	5,983
Kevin Hollingsworth	-	-	2009/10/11	-	57,148
Jenni Pilcher	27%	-	2009/10/11	-	28,881
Paul Rennie	-	-	2009/10/11	-	71,896
Donna Skerrett	60%	-	2009/10/11	-	57,148

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

Mr Brian Jamieson
Chairman
28 August 2008, Melbourne

PRICEWATERHOUSECOOPERS

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Website:www.pwc.com/au

Auditor's Independence Declaration

As lead auditor for the audit of Mesoblast Limited for the year ended 30 June 2008, 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 during the period.

Anton Linschoten
Partner
PricewaterhouseCoopers

Melbourne
28 August 2008

Corporate Governance

The Board of Directors of Mesoblast Limited is responsible for the corporate governance of the Company. The Board guides and monitors the business and affairs of the Company on behalf of the shareholders by whom they are elected and to whom they are accountable. The Company is committed to implementing the highest standards of corporate governance.

In setting its standards the Company has considered the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations ("ASXCGC recommendations") which were released in March 2003. Details of these recommendations can be found on the ASX website at http://www.asx.com.au/supervision/governance/index.htm. Whilst the Company continues to develop and improve its corporate governance processes and standards, the Board is pleased to advise that Mesoblast's practices are largely consistent with the ASXCGC recommendations. The Board will continue to ensure that the model is relevant, efficient and cost effective to the Company and its shareholders.

In accordance with the ASXCGC recommendations, the corporate governance statement that follows contains certain specific information and discloses the extent to which the Company has followed the guidelines during the 2008 year. Any departures to the guidelines have been fully explained. Mesoblast's corporate governance statement is structured with reference to the ASXCGC principles and recommendations.

Principle 1. Lay solid foundations for management and oversight

In general, the Board is responsible for, and has authority to determine, all matters relating to the policies, practices, management and operations of the Company. Specifically the Boards functions include:

- setting the overall Company financial goals;
- approving strategies, objectives and plans for the Company's businesses to achieve these goals;
- reporting to shareholders on the Company's strategic direction and performance including constructive engagement in the development, execution and modification of the Company's strategies;
- ensuring risks to the business are identified, and approving systems and controls to manage these risks and monitor compliance;
- meeting statutory and regulatory requirements and overseeing the way in which business risks and the assets of the Company are managed.
- approving the Company's major human resources (HR) policies and overseeing the development strategies for senior and high performing executives;
- monitoring executive management and business performance in the implementation and achievement of strategic and business objectives;
- ratifying and approving the appointment and removal of executives;
- approving financial plans and annual budgets;
- monitoring financial results on an on-going basis;
- determining that satisfactory arrangements are in place for auditing the Company's financial affairs;
- approving key management recommendations (such as major capital expenditure, acquisitions, divestments, restructuring and funding); and
- over-seeing the management of occupational health and safety and environmental performance.

Principle 2. Structure the Board to add value

2.1 Board composition and independence

During the 2008 year, the Board of Directors initially comprised four Directors (two executives and two non-executives), then from 22 November 2007 onwards the Board comprised five Directors (one executive director and four non-executive directors).

The term in office held by each Director in office as at 30 June 2008 is as follows:

Name	Term as director	Position held at 30 June 2008
Brian Jamieson	7 mths	Independent Chairman
Michael Spooner	3 yrs 9 mths	Independent Director
Byron McAllister	3 yrs 9 mths	Independent Director
Donal O'Dwyer	3 yrs 9 mths	Independent Director
Silviu Itescu	4 yrs 1 mths	Executive Director

The skills, experience and expertise relevant to their position for all Directors is contained in the Directors' Report.

Directors are appointed to the Board based on the specific governance skills required by the Company and on the independence of their decision making and judgment. The skills, experience and expertise relevant to the position of director held by each Director in office at the date of the annual report is included in the Director's Report. Each member of the Board is committed to spending sufficient time to enable them to carry out their duties as a Director of the Company.

Directors of Mesoblast are considered to be independent when they are independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their unfettered and independent judgement. In the context of director independence, "materiality" is considered from both the Company's and an individual director's perspective. The determination of materiality requires consideration of both quantitative and qualitative elements. An item is presumed to be quantitatively immaterial if it is equal or less than 2% of the Company's gross revenue or expenditure (whichever is the greater). In accordance with the definition of independence above, and the materiality thresholds set by the Board, the following Directors of Mesoblast were considered to be independent:

- Brian Jamieson (Chairman)
- Donal O'Dwyer (Deputy Chairman and Chairman of the Audit & Risk Committee)
- Byron McAllister
- Michael Spooner

There are procedures in place, agreed by the Board, to enable Directors, in furtherance of their duties, to seek independent professional advice at the Company's expense.

2.2 Independent Chairman

On 8th August 2007, Michael Spooner resigned as the Executive Chairman and remained as the non-executive Chairman until 22 November 2007. On this date Brian Jamieson was appointed to the role of non-executive Chairman and Michael Spooner became a non-executive director of the Company.

2.3 Role of the CEO (or equivalent)

At the date of this annual report, the equivalent role to that of CEO for the Company is not held by the Chairman, which is in accordance with the ASXCGC recommendations.

2.4 Nomination committee

The Board has established a nomination committee comprising four directors as follows:

Name	Position held during the year
Michael Spooner	Independent Chairman*
Silviu Itescu	Executive member
Byron McAllister	Independent member
Donal O'Dwyer	Independent member

** Michael Spooner was an executive chairman up until 8th August 2007.*

Whilst the committee has been formed, given the size and nature of the Company's operations to date the Board has chosen to discuss those matters usually considered by the nomination committee at the regular Board meetings. Details of meetings attended are found in the Directors' Report.

Principle 3. Promote ethical and responsible decision-making

3.1 Code of conduct

As part of its commitment to recognising the legitimate interests of stakeholders, the Company has established certain Codes of Conduct to guide all employees, particularly Directors, the Chief Financial Officer and other senior executives in respect of ethical behaviour expected

by the Company. These Codes of Conduct cover conflicts of interest, confidentiality, fair dealing, protection of assets, compliance with laws and regulations, whistle blowing, security trading and commitments to stakeholders.

3.2 Trading policy applied to directors, officers and employees

The Board of Directors is committed to a free and open market for the Company's securities. Accordingly, the Board fully supports the spirit and letter of the law and the ASX listing rules concerning adequate and reasonable disclosure of information relevant to the Company and its securities in line with contemporary continuous disclosure requirements.

The Board is also mindful that trading by directors and other employees of the Company at certain times may not be in the best interests of the above commitment. Accordingly, the Board has established and promulgated to all directors, staff and key consultants, a Security Trading Code of Conduct to guide those officers in their responsibilities in respect of trading in the Company's and other companies' securities.

Trading restrictions

The directors, employees and key consultants are permitted to trade in the Company's securities at any time subject to the following approval procedures:

- a request to trade is submitted to the Chief Financial Officer who circulates this request to the Chairman and any executive Directors;
- the Board have 7 business days to respond and either approve or deny the request; and
- at the end of this 7 day period, if there is no objection, then that person has a trading window of 7 business days from the deemed approval date, provided they do not hold any price sensitive information.

Reporting of trading

The Company Secretary is committed to reviewing regularly the contents of the share register, which is currently maintained by Link Market Services Limited. Any share trading by Directors of the Company is duly noted and shall be reported to the ASX in accordance with the ASX Listing Rules.

Price sensitive information

The Company has published for officers' guidance an exhaustive definition and explanation of what may amount to price sensitive information.

Trading in other companies' securities

The Company's Security Trading Code of Conduct is also expressly applied to other companies with which the Company may have dealings where an officer may have, or be perceived to have, price sensitive information.

Principle 4. Safeguard integrity in financial reporting

4.1 Chief Scientific Adviser (CSA) and Chief Financial Officer (CFO) declarations

The Company has processes in place designed to ensure the truthful and factual presentation of the Company's financial position, and prepares and maintains its accounts fairly and accurately in accordance with the generally accepted accounting and financial reporting standards. In accordance with the Board's policy and the requirements of the Corporations Act 2001, the CSA and the CFO made the attestations recommended by the ASX Corporate Governance Council Best Practice Recommendation 4.1 as to the Company's financial condition and its operating results prior to the Board signing this annual report.

4.2 Audit and risk committee establishment

The Board has established an audit and risk committee, to which it has delegated the responsibility for ensuring that an effective internal control framework exists within the entity. This includes internal controls to deal with both the effectiveness and efficiency of significant business processes, the safeguarding of assets, the maintenance of proper accounting records, and the reliability of financial information as well as non-financial considerations such as the benchmarking of operational key performance indicators.

4.3 Audit and risk committee structure

As at 30 June 2008, the audit and risk committee comprised of at least three members, the majority of whom are independent directors and the chairperson of the committee is not the chairperson of the Board. The members of the audit and risk committee during the year and their qualifications can be found in the Directors' Report.

4.4 Formal charter

The audit and risk committee operates under a formal charter approved by the Board.

Details of the number of meetings of the audit and risk committee held during the year and the attendees at those meetings can be found in the Directors' Report.

In line with best practice the audit and risk committee is charged with the selection, independence and rotation of the external auditor.

The audit and risk committee reports to the Board the following information:

- an assessment of whether the external reporting is consistent with committee members' information and knowledge and is adequate for shareholder needs;
- an assessment of the management processes supporting external reporting;

- procedures for the selection and appointment of the external auditor and for the rotation of external audit engagement partners;
- recommendations for the appointment or removal of an auditor;
- an assessment of the performance and independence of the external auditors and whether the audit committee is satisfied that independence has been maintained, particularly with reference to any non-audit services provided; and
- results of its review of risk management and internal compliance and control systems.

Principle 5. Make timely and balanced disclosure

The Board has established a policy governing continuous disclosure and has designated the Company Secretary as the person responsible for overseeing and coordinating disclosure of information to the ASX as well as communicating with the ASX. In accordance with the ASX Listing Rules, the Company immediately notifies the ASX of information:

- concerning the Company that a reasonable person would expect to have a material effect on the price or value of the Company's securities; and
- that would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the Company's securities.

Upon confirmation of receipt from the ASX, the Company posts all information disclosed in accordance with this policy on the Company's website at www.mesoblast.com.

Principle 6. Respect the rights of shareholders

6.1 Communications strategy

The Company respects the rights of its shareholders and to facilitate the effective exercise of those rights the Company is committed to:

- communicating effectively with shareholders through releases to the market via the ASX, the Company's website, information mailed and emailed to shareholders and the general meetings of the Company;
- giving shareholders ready access to balanced and understandable information about the Company and corporate proposals;
- making it easy for shareholders to participate in general meetings of the Company.

The Company also makes available a telephone number and e-mail address for shareholders to make enquiries of the Company.

6.2 External auditor requested to attend annual general meeting

The Board has requested the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report.

Principle 7. Recognise and manage risk

7.1 Establish policies on risk oversight and management

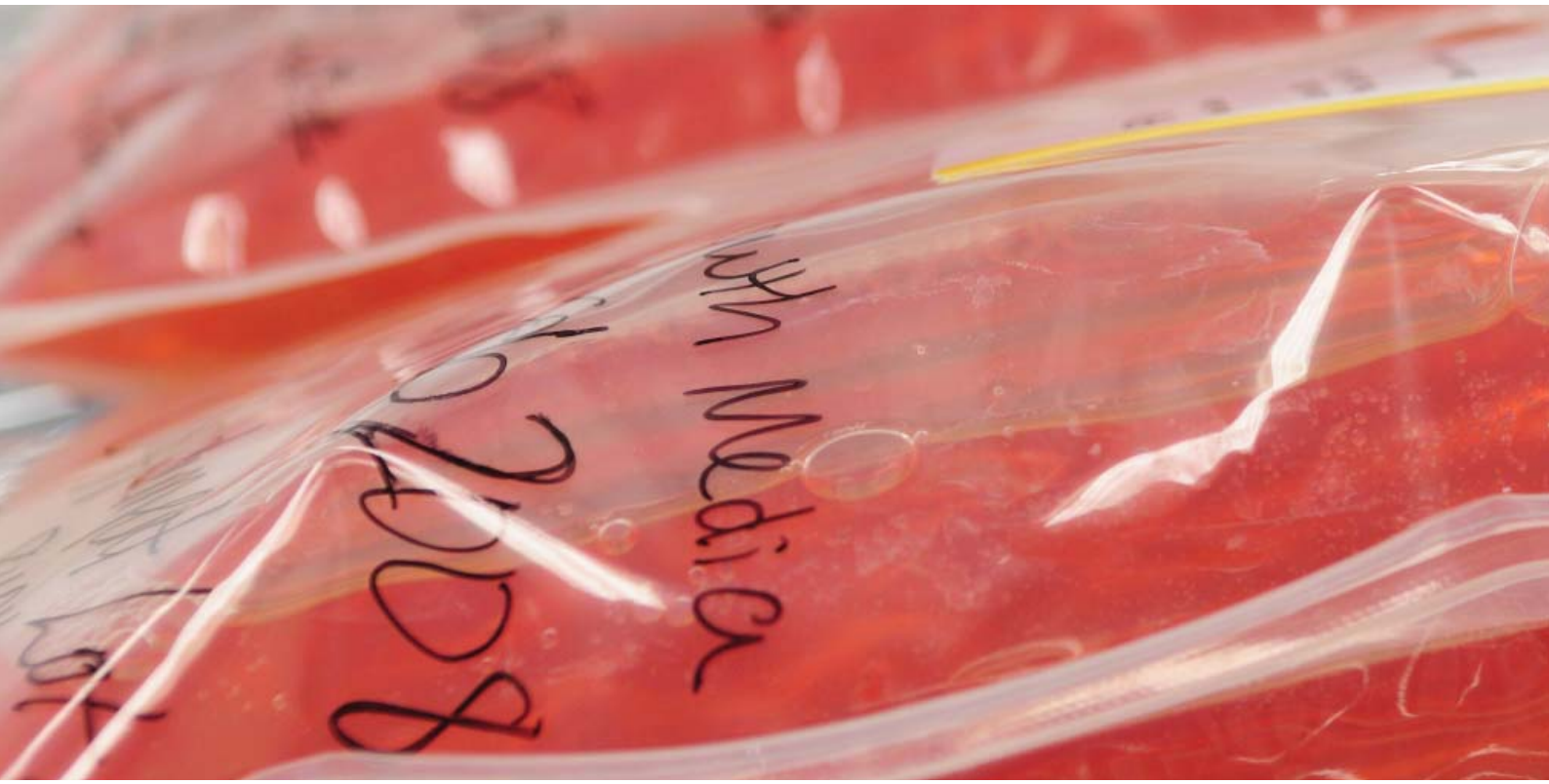
As mentioned above the Board has established an audit and risk committee ("the committee") to inter alias, review and monitor management's risk management and internal compliance and control systems.

On a continuous basis the Board has charged the committee with responsibility to:

- clearly describe the respective roles of the Board, the committee, and executive management;
- recommend independent internal audit reviews be undertaken when deemed appropriate, given the Company does not have a designated internal audit function; and
- prescribe the necessary elements of an effective risk management system, namely, oversight, risk profile, risk management, compliance and control, and assessment of system effectiveness.

7.2 Establish policies on risk oversight and management

The Chief Scientific Adviser and the Chief Financial Officer in providing written certifications in accordance with the requirements of Section 295A (2) of the Corporations Act have also certified in writing to the Board that such certification is founded on a sound system of risk management and internal compliance and control, which implement the policies adopted by the Board, and the Company's risk management and internal compliance and control systems are operating efficiently and effectively in all material respects.



Principle 8. Encourage enhanced performance

The performance of key executives of the Company is reviewed annually and assessed against the overall Company objectives, and specific milestones where applicable. This review is used in the majority of cases to determine annual bonuses and remuneration packages for the ensuing year.

Review of performance of the Board of Directors, both individually and collectively, is currently being progressed by the remuneration committee. The remuneration committee will endeavour to complete its review by the end of the calendar year.

Principle 9. Remunerate fairly and responsibly

9.1 Disclosure of remuneration policy and procedures

The Board is responsible for determining and reviewing compensation arrangements for the directors themselves, the Chairman, the Chief Scientific Adviser and the executive team. Details of the nature and amount of each element of remuneration, including both monetary and non-monetary components, for each director and the five highest-paid executives during the year can be found in the Directors' Report.

9.2 Remuneration committee

Composition and charter

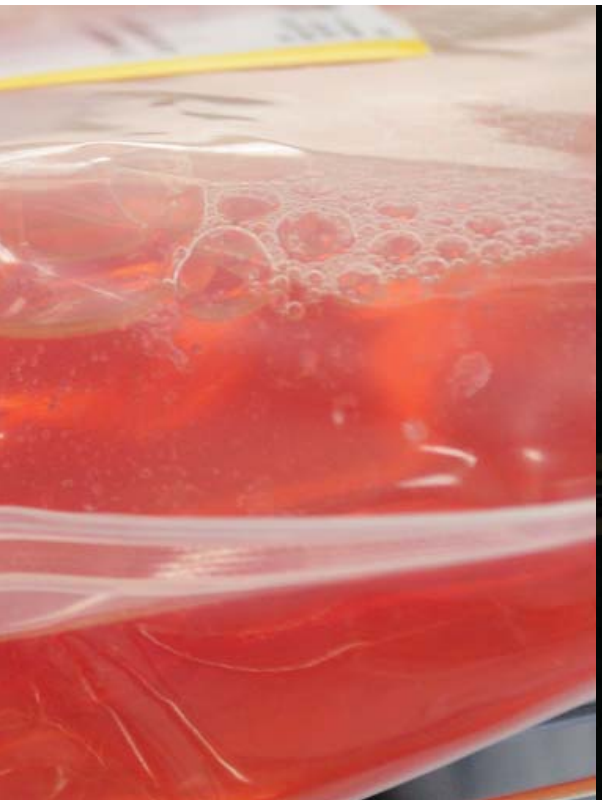
The Board has established a remuneration committee, comprising three directors, the majority of which are non-executive directors, and Chairperson of the remuneration committee is not the Chairperson of the Board. The remuneration committee operates under a formal charter approved by the Board.

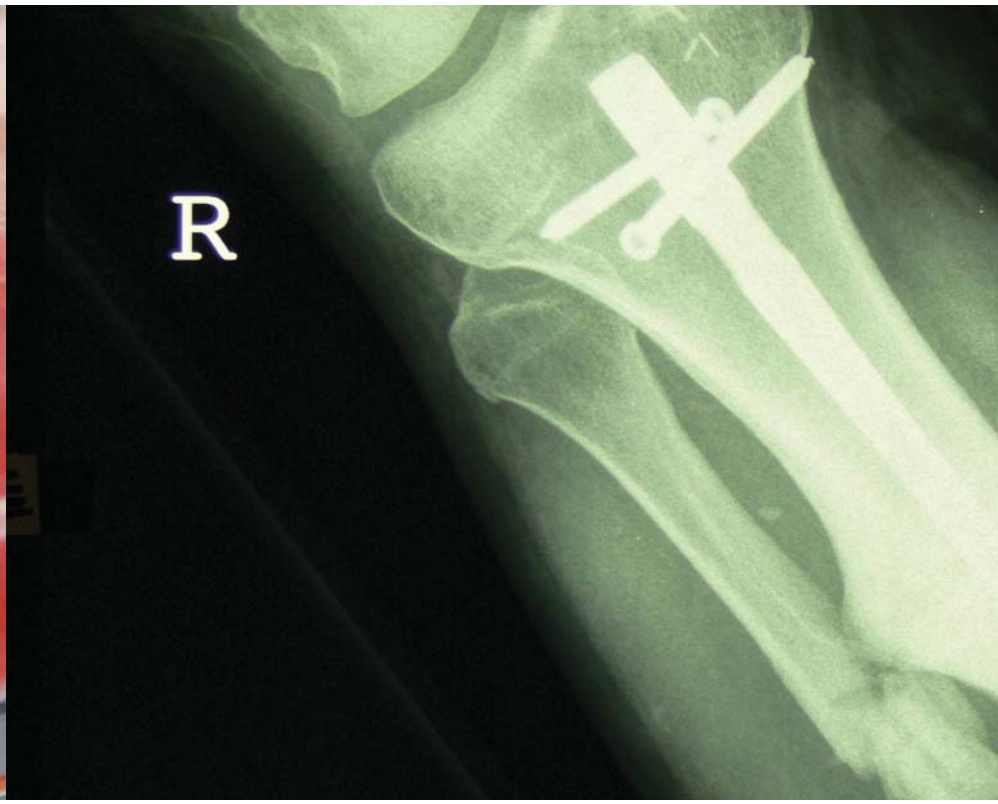
Whilst the committee has been formed, given the size and nature of the Company's operations to date, the Board has chosen to discuss those matters usually considered by the remuneration committee, at the regular meetings of the Board.

Responsibilities

The responsibilities of the remuneration committee include providing a review and recommendation to the Board of:

- executive remuneration and incentive policies;
- remuneration packages of senior management;
- the Company's recruitment, retention and termination policies and procedures for senior management;
- incentive schemes; and
- the remuneration framework for directors.





Remuneration policies

The expected outcomes of the remuneration structure are to retain and motivate key executives, attract quality management and provide performance incentives which align performance and Company success in a manner that is market competitive, consistent with best practice and in the interests of shareholders.

Executives are given limited salary packaging options for their base salary including superannuation. It is intended that the manner of payment is optimal for the recipient without increasing the cost to the Company. Executive performance and remuneration includes an "at-risk" component, the payment of which is dependent upon individual and team performance relative to specific targets.

Details of the nature and amount of each element of remuneration for each director and the Company's highest-paid executives during the year can be found in the remuneration report section of the Directors' Report.

9.3 Directors remuneration framework

Executive Directors are remunerated in the same manner as other executives of the Company, as described above. Non-executive Directors are paid a director's fee only, and are not paid bonuses or provided with retirement benefits other than statutory superannuation.

During the first period following listing of the Company on the ASX, it was considered appropriate to align the interests of the Directors with the long-term goals of the Company by granting options to non-executive Directors. At the last Annual General Meeting held 23 November 2006, the shareholders approved the issue of share options to one non-executive director on his appointment as Deputy Chairman of the Company. No further share options have been issued to non-executive directors.

9.4 Share-based executive remuneration

Long-term incentive arrangements have been provided by participation in the Executive Share Option Plan, which has been approved by shareholders, to ensure key employees maintain a long-term interest in the growth and value of the Company.

Principle 10. Recognise the legitimate interests of stakeholders

The Board recognises the legitimate interests of wider stakeholders in the Company and has, in its Code of Conduct, made specific commitments to these respective stakeholders.

The above information can also be found on the Company's website at www.mesoblast.com.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Financial Statements
for the year ended 30 June 2008

Income Statement
for the year ended 30 June 2008

	Notes	30 June 2008 $	30 June 2007 $
Revenues from continuing operations	2(a)	909,807	1,679,317
Expenses from continuing operations			
Research and development		(6,207,372)	(6,325,130)
Management and administration		(2,642,016)	(2,368,192)
Share of losses of equity accounted associates		(2,122,798)	(1,714,126)
Total expenses from continuing operations		(10,972,186)	(10,407,448)
Loss before income tax expense		(10,062,379)	(8,728,131)
Income tax (expense)/benefit	4	-	-
Loss after related income tax expense from continuing operations		(10,062,379)	(8,728,131)
Loss attributable to members of the company		(10,062,379)	(8,728,131)

Earnings/(losses) per share – from continuing operations:		**cents**	**cents**
Basic – cents per share	6	(8.81)	(8.20)
Diluted – cents per share	6	(8.81)	(8.20)

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

Statement of Changes in Equity
for the year ended 30 June 2008

	Notes	Contributed Equity $	Accumulated Losses $	Share Based Payment Reserve $	Foreign Currency Translation Reserve $	Total $
As of 1 July 2006		20,667,608	(9,768,956)	1,066,393	-	11,965,045
Loss for the year		-	(8,728,131)	-	-	(8,728,131)
Total recognised income and expense for the year		-	**(8,728,131)**	-	-	**(8,728,131)**
Contributions of equity net of transaction costs	13	16,754,575	-	-	-	16,754,575
Share based payment		-	-	547,850	-	547,850
At 30 June 2007		**37,422,183**	**(18,497,087)**	**1,614,243**	**-**	**20,539,339**
As of 1 July 2007		37,422,183	(18,497,087)	1,614,243	-	20,539,339
Exchange differences on translation of overseas associate		-	-	-	796,498	796,498
Net income recognised directly in equity		-	-	-	796,498	796,498
Loss for the year		-	(10,062,379)	-	-	(10,062,379)
Total recognised income and expense for the year		**-**	**(10,062,379)**	**-**	**796,498**	**(9,265,881)**
Contributions of equity net of transaction costs	13	13,596,900	-	-	-	13,596,900
Share based payment		-	-	1,345,774	-	1,345,774
At 30 June 2008		**51,019,083**	**(28,559,466)**	**2,960,017**	**796,498**	**26,216,132**

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

Balance Sheet
as at 30 June 2008

	Notes	30 June 2008 $	30 June 2007 $
Current Assets			
Cash and cash equivalents	7	14,094,219	12,055,040
Trade and other receivables	8	123,900	509,907
Prepayments		85,533	28,735
Total Current Assets		14,303,652	12,593,682
Non-Current Assets			
Property, plant and equipment	9	197,997	158,235
Investments accounted for using the equity method	10	12,761,247	7,668,095
Intangible assets	11	526,006	818,226
Total Non-Current Assets		13,485,250	8,644,556
Total Assets		27,788,902	21,238,238
Current Liabilities			
Trade and other payables	12	1,572,770	698,899
Total Current Liabilities		1,572,770	698,899
Total Liabilities		1,572,770	698,899
Net Assets		**26,216,132**	**20,539,339**
Equity			
Issued capital	13	51,019,083	37,422,183
Reserves	14	3,756,515	1,614,243
Accumulated losses		(28,559,466)	(18,497,087)
Total Equity		**26,216,132**	**20,539,339**

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

Cash Flow Statement
for the year ended 30 June 2008

	Notes	30 June 2008 $	30 June 2007 $
Cash Flows from Operating Activities			
Payments to suppliers and employees		(6,326,130)	(9,757,907)
Government grants and other income received		123,541	655,773
Interest and other costs of financing paid		-	(542)
Net cash used in operating activities	15(b)	(6,202,589)	(9,102,676)
Cash Flows from Investing Activities			
Interest received		841,725	939,557
Investment in fixed assets		(100,956)	(146,665)
Investment in patents & licenses		-	(35,187)
Investment in equity accounted associate		(6,419,452)	(3,880,548)
Loan repaid/(advanced) to associate company		330,645	(258,660)
Net cash used in investing activities		(5,348,038)	(3,381,503)
Cash Flows from Financing Activities			
Proceeds from issue of shares		14,134,500	17,559,666
Payments for share issue costs		(537,600)	(805,091)
Net cash provided by financing activities		13,596,900	16,754,575
Net increase in cash and cash equivalents		2,046,273	4,270,396
Cash and cash equivalents at beginning of year		12,055,040	7,854,843
FX losses on the translation of foreign bank accounts		(7,094)	(70,199)
Cash and cash equivalents at end of year	15(a)	14,094,219	12,055,040

The above cash flow statement should be read in conjunction with the accompanying notes.

Notes to the Financial Statements
for the year ended 30 June 2008

INTRODUCTION

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

Registered office	Principal place of business
Level 2 517 Flinders Lane Melbourne	Level 39 55 Collins Street Melbourne

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

1. SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with the Corporations Act 2001, Accounting Standards and Urgent Issue Group Interpretations, and complies with other requirements of the law. Accounting Standards include Australian equivalents to International Financial reporting Standards ("A-IFRS"). Compliance with AIFRS ensures that the financial report, comprising the financial statements and notes thereto, complies with International Financial Reporting Standards ('IFRS').

The financial statements were authorised for issue by the Board of Directors of Mesoblast on the date shown on the Directors' Declaration attached to the Financial Statements.

Basis of preparation

The financial report has been prepared on the basis of historical cost, except for the revaluation of certain non-current assets and financial instruments. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars unless otherwise noted.

The accounting policies have been consistently applied and, except where there is a change in accounting policy, are consistent with those of the previous year.

1. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Going concern

For the year ended 30 June 2008, the company incurred an operating loss of $10,062,379 (2007 loss: $8,728,131) as it continued to further its investment in research initiatives. As at year end, the company's net assets stood at $26,216,132 (2007: $20,539,339), with available cash of $14,094,219 (2007: $12,055,040).

During the financial year ending 30 June 2009, the company will work to further advance both the development of its core technologies, and if possible, the commercialisation of those technologies. Based on the forecast cash flows approved by the Board of Directors for the period ending 31 August 2009, which excludes any cash that may be raised through further allotment of capital or through collaboration arrangements with third parties, the Directors believe that sufficient cash will be available to fund the company's operations over the 12 month period subsequent to the date of signing the financial statements.

Accordingly the financial statements have been prepared on a going concern basis. The financial statements do not include any adjustments to the carrying values or classification of assets or liabilities that would be necessary in the event that the company, were unable to continue as a going concern.

Early adoption of standards
The Company has decided to adopt AASB 8 *Operating Segments* for the current reporting period. AASB 8 replaces AASB 114 *Segment Reporting.* The new standard requires a "management approach", which aligns the disclosure to that used internally for management reporting.

Critical accounting judgements and key assumptions

In the application of the Company's accounting policies, which are described below, management is required to make judgements, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making the judgements. Actual results may differ from these estimates.

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

There have been no significant judgements made in applying accounting policies that the Directors consider would have a significant effect on the amounts recognised in the financial statements.

There have been no key assumptions made concerning the future, and there are no other key sources of estimation uncertainty at the balance date, that the Directors consider have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

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

(a) Cash and cash equivalents

Cash comprises cash on hand and demand deposits. Cash equivalents are short-term deposits with an insignificant risk of change in value.

Bank overdrafts are shown within borrowing in current liabilities in the balance sheet. For the purposes of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Notes to the Financial Statements
for the year ended 30 June 2008

1. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(b) Contributed equity

Ordinary shares are classified as equity.

Transaction costs arising on the issue of equity instruments are recognised 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.

(c) Earnings per share

Basic earnings per share
Basic earnings per share is calculated by dividing the profit attributable to equity holders of the company, 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.

Diluted earnings per share
Diluted earning 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.

(d) Employee benefits

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

Liabilities recognised 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 recognised 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 Company in respect of services provided by employees up to reporting date.

(e) Foreign currency

Foreign currency transactions are translated to Australian currency, which is the Company's functional currency, at the rates of exchange ruling at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions are recognised in the income statement, except when they are deferred in equity as qualifying cash flow hedges and qualifying net investment hedges or are attributable to part of the net investment in a foreign operation.

Monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange ruling at balance date. Foreign exchange gains and losses resulting from the translation of monetary assets and liabilities at year end exchange rates are recognised in the income statement.

Exchange differences arising from the translation of any investment in foreign entities are taken to the foreign currency translation reserve in shareholders equity. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange differences are recognised in the income statement, as part of the gain or loss on sale where applicable.

(f) Goods and services tax (GST)

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

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 cash flow statement 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.

(g) Government grants

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

Government grants relating to costs are deferred and recognised in the income statement 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 Company to purchase property, plant and equipment are included in non-current liabilities as deferred income and are credited to the income statement on a straight line basis over the expected lives of the related assets.

(h) Impairment of assets

At each reporting date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually and whenever there is an indication that the asset may be impaired.

An impairment loss would be recognised if the amount by which the assets carrying amount exceeds its recoverable amount. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment of goodwill is not subsequently reversed.

(i) Intangible assets

Patents and Licences
Patents and licences have a finite useful life and are carried at cost less accumulated amortisation and impairment. Amortisation is calculated using the straight-line method to allocate the cost of the asset over its remaining useful life, which equates to the remaining life of the underlying patent.

(j) Income taxes

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

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 amount in the financial statements. Deferred income tax is not provided if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted by the reporting date and are expected to apply when the related deferred income tax assets is realised or the deferred liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probably that future taxable amounts will be available to utilise those temporary differences and losses. Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

Notes to the Financial Statements
for the year ended 30 June 2008

1. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(k) Investments accounted for using the equity method

Associates are all entities over which the Company 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 Company to apply the equity method. The reporting dates of the associate and the Company 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 Company's share of net assets of the associate, less any impairment in value. The income statement reflects the Company's share of the results of operations of the associate.

Where there has been a change recognised directly in the associate's equity, the Company recognised 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 Company 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.

(l) 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.

Impairment
The carrying values of plant and equipment are reviewed for impairment at each reporting date with recoverable amount being estimated when events or changes in circumstances indicate that the carrying value may be impaired. Impairment exists when the carrying value of an asset or cash-generating units exceeds its estimated recoverable amount. The asset or cash-generating unit is then written down to its recoverable amount. Impairment losses are recognised in the income statement.

(m) Provisions

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

(n) Research and development costs

Research and development expenditure is expensed as incurred except to the extent that its future recoverability can reasonably be regarded as assured, in which case it is deferred and amortised on a straight line basis over the period in which the related benefits are expected to be realised.

The carrying value of development cost is 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.

(o) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. The Company recognises revenue when the amount of revenue can be reliably measured, it is probably that future economic benefits will flow to the entity and specific criteria have been met for each of the Company's activities.

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.

(p) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Senior Management Executive Group and the Board of Directors, both of which make strategic decisions for the Company.

(q) Share-based payments

Equity-settled share-based payments with employees and others providing similar services are measured at the fair value of the equity instrument at the grant date. Fair value is measured by use of 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 behavioural considerations. Further details on how the fair value of equity-settled share-based transactions has been determined can be found in note 18.

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 the Company's estimate of shares that will eventually vest.

The above policy is applied to all equity-settled share-based payments that were granted since the date of incorporation and that vested after 1 January 2005. No amount has been recognised in the financial statements in respect of the other equity-settled share-based payments.

(r) 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 income statement. All trade receivables and other receivables are recognised at the value of the amounts receivable, as they are due for settlement within 60 days and therefore do not require re-measurement.

(s) 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 days of recognition.

(t) Changes in accounting policies

There have been no significant changes in accounting policy during the reporting period, other than the early adoption of AASB 8 Operating Segments.

(u) Comparative figures

Comparatives have been reclassified where necessary so as to be consistent with the figures presented in the current year.

Notes to the Financial Statements
for the year ended 30 June 2008

1. SIGNIFICANT ACCOUNTING POLICIES CONTINUED

(v) New and revised accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2008 reporting periods. The Company's assessment of the impact of these new standards and interpretations is set out below:

(i) AASB 8 Operating Segments and AASB 2007-3 Amendments to Australian Accounting Standards arising from AASB 8

AASB 8 is effective for annual reporting periods commencing on or after 1 January 2009. This standard allows for a "management" style of disclosure of operating segments. The Company has decided to adopt this standard for the current reporting period on the basis that it more accurately discloses the financial information pertaining to the segments of the Company.

(ii) Revised AASB 123 Borrowing Costs and AASB 2007-6 Amendments to Australian Accounting Standards arising from AASB 123

Revised AASB 123 is effective for annual reporting periods commencing on or after 1 January 2009. The Company has not adopted this standard for the current reporting period as it has no borrowing costs.

(iii) Revised AASB 101 Presentation of Financial Statements and AASB 2007-8 Amendments to Australian Accounting Standards arising from AASB 101

Revised AASB 101 is effective for annual reporting periods commencing on or after 1 January 2009. It requires the presentation of a statement of comprehensive income and makes changes to the statement of equity. The Company has decided not to adopt this standard on the basis that the changes are of a disclosure nature only and do not impact what is recognised in the financial statements.

(iv) AASB-I 14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their interaction

AASB-I 14 is effective for annual reporting periods commencing on or after 1 January 2008. This standard does not impact the financial statements of the Company and therefore has not been adopted.

(v) AASB 2008-1 Amendments to Australian Accounting Standard - Share-based Payments: Vesting Conditions and Cancellations

AASB 2008-1 was issued in February 2008 and will become applicable for annual reporting periods beginning on or after 1 January 2009. The revised standard clarifies that vesting conditions are service conditions and performance conditions only and that other features of a share-based payment are not vesting conditions. It also specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The Company will apply the revised standard from 1 July 2009, however it is not expected to affect the accounting for the Company's share-based payments.

	30 June 2008 $	30 June 2007 $
2. REVENUE AND EXPENSES FROM CONTINUING OPERATIONS		
(a) Revenue from continuing operations		
Commercial Ready government grant*	-	719,698
Interest revenue	909,807	939,557
Other	-	20,062
	909,807	1,679,317

**Further details of the grant are contained in note 17(a) to the financial statements.*

(b) Expenses		
Employee benefits		
Salaries and employee benefits	1,530,719	1,198,932
Defined contribution superannuation expenses	110,662	99,207
Share based payments	425,435	259,182
	2,066,816	1,557,321
Depreciation and amortisation of non-current assets		
Plant and equipment depreciation	62,721	26,335
Intellectual property amortisation	94,038	36,185
	156,759	62,520
Other		
Research & development – external	3,075,548	3,675,794
Intellectual property costs (excluding amortisation)	396,762	104,810
Share based payments – consultants	920,339	288,668
Finance costs	-	542
Foreign exchange losses	10,032	38,274
Write-off of intangible assets	198,182	-

Notes to the Financial Statements
for the year ended 30 June 2008

3. SEGMENT INFORMATION

(a) Description of segments

Management has determined the operating segments presented here are those that are internally reported on a regular basis to the board of directors, who are ultimately responsible for the allocation of resources to those segments and for making strategic decisions for the Company.

Two reportable operating segments have been identified, the orthopaedic segment and the cardiovascular segment, both having two distinct markets for which the MPC platform technology is currently being developed. The orthopaedic segment operates in Australia, and the cardiovascular segment operates in the United States of America through our investment in Angioblast systems, Inc.

(b) Segment information	**Orthopaedic $**	**Cardiovascular $**	**Total $**
2008			
Revenue from external customers	-	-	-
Total segment revenue	-	-	-
Net loss after tax	5,287,033	2,122,798	7,409,831
Net loss after tax includes:			
Research and development	5,192,995	-	5,192,995
Equity accounted losses	-	2,122,798	2,122,798
Amortisation of intellectual property purchased	94,038	-	94,038
Total segment assets	549,519	12,761,247	13,310,766
Total segment assets include:			
Carrying value of investments accounted for using the equity method	-	12,761,247	-
Total segment liabilities	1,194,186	-	1,194,186
2007			
Revenue from external customers	-	-	-
Revenue from government grants	719,698	-	719,698
Total segment revenue	719,698	-	719,698
Net loss after tax	5,352,949	1,714,126	7,067,075
Net loss after tax includes:			
Research and development	6,036,462	-	6,036,462
Equity accounted losses	-	1,714,126	1,714,126
Amortisation of intellectual property purchased	36,185	-	36,185
Total segment assets	954,824	7,668,095	8,622,919
Total segment assets include:			
Carrying value of investments accounted for using the equity method	-	7,668,095	7,668,095
Total segment liabilities	206,186	-	206,186

3. SEGMENT INFORMATION CONTINUED

(c) Segment reconciliations

The following table reconciles each of the segment totals to the totals reported for the Company in the income statement and balance sheet. These reconciling items are not considered by the Company to be an operating segment as defined in AASB 8 *Operating Segments* (which has been early adopted in this current financial year) and therefore are not disclosed as such. They are administrative in nature and relate largely to the running of the Mesoblast head office.

	30 June 2008 $	30 June 2007 $
Total segment revenue	**-**	**719,698**
Interest revenue	909,807	939,557
Other revenue	-	20,062
Total revenue from continuing operations	909,807	1,679,317
Total segment net loss after tax	**(7,409,831)**	**(7,067,075)**
Interest revenue	909,807	939,557
Administration expenses	(2,206,549)	(2,019,895)
Other expenses	(10,032)	(32,868)
Share-based payments	(1,345,774)	(547,850)
Total net loss after tax	(10,062,379)	(8,728,131)
Total segment assets	**13,310,766**	**8,622,919**
Property, plant and equipment	197,997	158,235
Interest receivable	68,081	-
GST receivable	39,195	26,215
Prepayments	62,021	15,681
Receivable from associate	16,623	360,148
Cash	14,094,219	12,055,040
Total assets	27,788,902	21,238,238
Total segment liabilities	**1,194,186**	**206,186**
Trade payables and accruals – administration	293,317	267,725
Employee entitlements – administration	22,523	199,763
Payable to Angioblast	62,744	25,225
Total liabilities	1,572,770	698,899

Notes to the Financial Statements
for the year ended 30 June 2008

	30 June 2008 $	30 June 2007 $
4. INCOME TAX EXPENSE		
(a) Reconciliation of income tax to prima facie tax payable		
Loss from continuing operations before income tax	10,062,379	8,728,131
Prima facie tax benefit on operating loss before income tax at 30%	3,018,713	2,618,439
Tax effect of amounts which are (not deductible)/taxable in calculating taxable income:		
Share based payments expense	(403,732)	(164,355)
Equity accounting loss	(636,839)	(514,238)
Tax benefit not recognised	(1,978,142)	(1,929,846)
Income tax expense attributable to loss before income tax	-	-
(b) Income tax losses		
Tax losses for which no deferred tax has been booked*	19,123,222	11,859,453
Deferred tax asset at 30% not booked	**5,736,967**	**3,557,836**

** Tax losses carried forward has not been brought to account at 30 June 2008 because the Directors do not consider it probable, at this stage of the Company's program, that sufficient taxable amounts will become available which deductible temporary differences and unused tax losses can be applied to. Realisation of the benefit of tax losses would also be subject to the Company satisfying the conditions for deductibility imposed by tax legislation. The Company has made no assessment as to the satisfaction of these conditions at 30 June 2008.*

5. REMUNERATION OF AUDITORS		
(a) Assurance services		
Audit services		
Audit and review of financial reports and other audit work under the *Corporations Act 2001*		
• PKF Australian Firm	-	68,980
• PricewaterhouseCoopers (PWC)	87,500	-
	87,500	68,980

There has been no remuneration for other assurance services, non-audit services or taxation services in the current or prior year.

6. EARNINGS PER SHARE		
Net loss used in calculating basic earnings per share:	10,062,379	8,728,131
Net loss used in calculating diluted earnings per share:	10,062,379	8,728,131
	No. of shares	**No. of shares**
Weighted average number of ordinary shares used in calculating basic earnings per share	114,209,029	106,445,430
Dilutive potential ordinary shares	-	-
Weighted average number of ordinary shares and potential ordinary shares used in calculating diluted earnings per share	114,209,029	106,445,430

	30 June 2008 $	30 June 2007 $
7. CASH AND CASH EQUIVALENTS		
Cash at bank	753,606	302,986
Deposit at call	4,231,882	5,935,957
Term deposits	9,108,731	5,816,097
	14,094,219	12,055,040

8. TRADE AND OTHER RECEIVABLES		
Current		
Government grant receivable	-	123,541
Interest receivable	68,082	-
Goods and services tax recoverable	39,195	26,218
Loan to Angioblast Systems, Inc. (associate)	16,623	360,148
	123,900	509,907

All trade and other receivable balances are within their due dates and none are considered to be impaired at both 30 June 2008 and 30 June 2007. See note 21 for the impact of credit risk on the Company.

9. PROPERTY, PLANT AND EQUIPMENT		
Plant and equipment		
Cost		
Balance at the beginning of year	197,319	50,654
Additions	102,483	146,665
Balance at the end of year	299,802	197,319
Accumulated depreciation		
Balance at the beginning of year	(39,084)	(12,749)
Depreciation expense	(62,721)	(26,335)
Balance at the end of year	(101,805)	(39,084)
Net book value at the end of the year	197,997	158,235

Notes to the Financial Statements
for the year ended 30 June 2008

10. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

Entity	Country of Incorporation	Principal Activity
Angioblast Systems, Inc.	USA	Adult stem cell research and development for cardiovascular indications

	Ownership Interest			
	30 June 2008	30 June 2007	30 June 2008	30 June 2007
(a) Carrying amount	%	%	$	$
Angioblast Systems, Inc.	39.1	34.6	12,761,247	7,668,095
(b) Movement in carrying amount				
Carrying amount at the beginning of year			7,668,095	7,501,673
Additional investment			6,419,452	1,880,548
Share of losses			(2,122,798)	(1,714,126)
Exchange difference on translation			796,498	-
Carrying amount at the end of year			12,761,247	7,668,095

The following information has been extracted from the audited report of Angioblast Systems, Inc. and translated at the exchange rate prevailing at year end:

Summaries financial information of associates:

Financial position		
Total assets	6,244,935	935,631
Total liabilities	(6,089,556)	(1,425,873)
Net assets/(liabilities)	155,379	(490,242)
Company's share of net assets/(liabilities)	60,753	(169,816)
Financial performance		
Income	873,380	67,035
Expenses	(6,153,802)	(4,772,141)
Company's share of associates' loss		
Share of associates' loss before tax	(2,122,798)	(1,709,332)
Share of associates' income tax expense	-	(4,794)
Share of associates' loss	(2,122,798)	(1,714,126)

The Directors have followed the guidance of AASB136 in determining whether an investment is impaired. The Directors have made an assessment of the value of this investment in the accounts, reviewing the results to date against the original milestones and work plans and having considered current market conditions and are comfortable to continue to carry it at equity accounted cost. The value of the investment is dependent on its research and development and subsequent commercialisation. The Directors are of the view that the investment in Angioblast Systems, Inc. is not impaired at balance date.

The contingent liabilities of the associate are disclosed in Note 17(c).

	30 June 2008 $	30 June 2007 $
11. INTANGIBLE ASSETS		
Patents and licences		
Gross carrying amount		
Balance at the beginning of year	904,226	855,439
Additions	-	48,787
Patent costs written off (i)	(214,226)	-
Carrying amount at the end of year	690,000	904,226
Accumulated amortisation		
Balance at the beginning of year	(86,000)	(49,815)
Amortisation expense (i)	(94,038)	(36,185)
Patent costs written off (i)	16,044	-
Carrying amount at the end of year	(163,994)	(86,000)
Net book value	526,006	818,226

(i) Intellectual property expenses are included in research and development in the income statement.

12. TRADE AND OTHER PAYABLES		
Current		
Trade payables	1,428,780	458,371
Employee benefits	81,216	215,303
Payable to Angioblast Systems, Inc.*	62,774	25,225
	1,572,770	698,899

** associate and related party of the Company*

Notes to the Financial Statements
for the year ended 30 June 2008

13. ISSUED CAPITAL

Ordinary shares participate in dividends and the proceeds on winding up of the company 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.

	30 June 2008 No.	30 June 2008 $	30 June 2007 No.	30 June 2007 $
(a) Movements in issued capital during the year				
Fully paid ordinary shares				
Balance at beginning of financial year	107,716,133	37,422,183	93,510,000	20,667,608
Shares issued at $1.25 07 July 2007	-	-	13,882,800	17,353,500
Shares issued at $1.28 14 December 2007	10,500,000	13,440,000	-	-
Transaction costs arising on issue of shares	-	(537,600)	-	(805,091)
Issue of shares under employee share option plan (note 18)	1,040,000	694,500	323,333	206,166
Balance at end of financial year	119,256,133	51,019,083	107,716,133	37,422,183
(b) Share options over ordinary shares				
Balance at end of financial year	9,316,667		7,956,667	
Amounts unvested at end of financial year	2,680,000		1,180,000	

Share options granted under the employee share option plan carry no rights to dividends and no voting rights. Further details of the employee share option plan are contained in note 18 to the financial statements.

	30 June 2008 $	30 June 2007 $
14. RESERVES		
(a) Reconciliation of reserves		
Share based payments reserve	2,960,017	1,614,243
Foreign currency translation reserve	796,498	-
	3,756,515	1,614,243

(b) Nature and purpose of reserves

Share based payment reserve
The share based payments reserve is used to recognise the fair value of options issued and vested but not exercised.

Foreign currency translation reserve
Exchange differences arising on translation of the equity accounted investment are taken to the foreign currency translation reserve.

15. CASH FLOW INFORMATION		
(a) Reconciliation of cash and cash equivalents		
Cash at bank	753,606	302,986
Deposit at call	4,231,882	5,935,957
Term deposits	9,108,731	5,816,097
	14,094,219	12,055,040
(b) Reconciliation of net cash flows used in Operations with loss after income tax		
Loss from ordinary activities	(10,062,379)	(8,728,131)
Add/(deduct) profit and loss items as follows:		
Depreciation and amortisation	156,759	62,520
Intellectual property disposal costs	198,182	-
Interest received	(909,807)	(939,557)
Foreign exchange losses	7,094	50,503
Equity settled share based payment	1,345,774	547,850
Equity accounted losses (Angioblast)	2,122,798	1,714,126
Change in operating assets & liabilities:		
(Increase)/decrease in trade and other receivables	53,766	(19,040)
Increase/(decrease) in trade creditors and accruals	885,224	(1,790,947)
Cash flows used in operations	(6,202,589)	(9,102,676)

Notes to the Financial Statements
for the year ended 30 June 2008

	30 June 2008 $	30 June 2007 $
16. COMMITMENTS FOR EXPENDITURE		
(a) Capital commitments		
Not longer than 1 year	-	21,000
(b) Further investment in associate*		
Not longer than 1 year	200,000	5,280,000
Longer than 1 year and not longer than 5 years	-	1,139,452
	200,000	6,419,452

*At an Extraordinary General Meeting held on 23 November 2006, the shareholders of the Company passed the following resolution:

- that pursuant to ASX Listing Rule 10.1 Chapter 2E of the Corporations Act 2001 and for all other purposes, approval is granted for the Company to invest up to $8.5m in additional funds to subscribe for up to 425,000 further preference shares (designated "Series B Preferred") in Angioblast Systems, Inc.

The structure of the payments to be invested under the Series B agreement is as follows:

(a) an initial outlay of $1m in exchange for 50,000 preference shares ;

(b) five equal quarterly instalments of $360,000 (totalling $1.8m) in exchange for a total of 90,000 preference shares;

(c) $5.5m invested in Angioblast following Angioblast's satisfactory demonstration of strict adherence to the pre-approved Joint Expenditure Program for completion of a phase II clinical trial, in exchange for a total of 275,000 preference shares;

(d) Mesoblast has committed to incurring project costs of $200,000 for the purpose of continuing development of the common platform adult stem cell technology in exchange for 10,000 preference shares.

As at 30 June 2008 the company has forwarded funds relating to (a) to (c) above. Funds for step (d) will be invested in the financial year ended 30 June 2009.

As at 30 June 2007, payments (a) and (b) had been made, and $160,548 of (c).

(c) Company's share of associates expenditure commitments

Angioblast have report no expenditure commitments for the year ended 30 June 2008 (2007: nil).

17. CONTINGENT ASSETS AND LIABILITIES

(a) Contingent assets

A government grant was awarded to the Company under the Commercial Ready Program for reimbursement of 50% of eligible expenditure incurred under the Allogeneic Stem Cell Based Therapy for Cartilage Regeneration project. The maximum amount payable under the grant is $2,760,041 for the period 10 October 2005 through to 30 September 2008. The total amount received as at 30 June 2008 is $2,573,746. The remaining amount of $186,294 will become due to the Company upon completion of the cartilage program, provided the terms of the Commercial Ready government grant are met. The Commercial Ready Program was abolished in the last Federal Budget, however this will not impact any outstanding payments due to the Company under the current grant as at 30 June 2008.

(b) Contingent liabilities

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

The company has no pending litigation as at the end of the financial year.

(c) Contingent liabilities of Angioblast in relation to Medvet

The contingent liabilities described below represent 100 per cent of the contingent obligations of Angioblast. By way of its equity interest, Mesoblast currently has a 39.1% interest in these contingent liabilities. Mesoblast is not liable for these contingent liabilities.

Angioblast has agreed to pay consideration for certain intellectual property assets assigned to it by Medvet on the basis of future milestones being reached. These milestones will not be reached as part of the current development program which envisages funding through to IND approvals. They represent payments on successful completion of subsequent clinical milestones. If all milestones were to be reached these payments total US$1,500,000. In addition royalties at 2.5% of net sales with stipulated minimum annual royalties scaling up from US$100,000 to US$500,000 over 5 years exist.

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18. SHARE-BASED PAYMENTS

The Company has adopted an Employee Share Option Plan to foster an ownership culture within the Company and to motivate directors, senior management and consultants to achieve performance targets of the Company and/or their respective business units. Selected directors, employees and consultants of the Company may be eligible to participate in the Plan at the absolute discretion of the Company's board of directors. Except as outlined in the remuneration report no options or shares will be issued under this Plan to any directors without the prior approval of the Mesoblast shareholders.

The aggregate number of options which may be issued pursuant to the Plan and all other share purchase plans shall not at any time exceed 5% of the total number of issued shares of the Company. All grants of options are subject to the following general terms and conditions:

- option grants require approval from the board of directors;
- options are granted under the plan for no consideration;
- each share option converts into one ordinary share of Mesoblast Limited;
- options carry neither rights to dividends nor voting rights.

Per the Company's current policy, options 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 is the greater of $0.20 and:

- in relation to an option on or before the date of the official quotation of the Company's shares, an amount per share that is 20% higher than the offer price of $0.50; and
- in relation to an option granted after the official quotation of the company's shares, 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; and
- any other amount that is specified by the Board.

18. SHARE-BASED PAYMENTS CONTINUED

(a) Existing share-based payment arrangements

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

Series	Grant date	Granted No.	Exercised No.	Lapsed No.	Balance No.	Vesting date	Expiry date	Exercise price $	Fair value $
1(a)(i)	29/09/04	2,160,000	(200,000)	-	1,960,000	29/09/05	29/09/09	0.55	0.290
1(a)(ii)	29/09/04	2,160,000	-	-	2,160,000	16/12/05	16/12/09	0.55	0.290
1(b)	26/10/04	400,000	(400,000)	-	-	16/12/04	30/12/07	0.55	0.290
2(a)	16/12/04	550,000	-	-	550,000	16/12/05	16/12/08	0.60	0.290
2(b)	16/12/04	75,000	-	-	75,000	16/12/06	16/12/08	0.60	0.290
2(b)	16/12/04	75,000	-	-	75,000	01/05/07	16/12/08	0.60	0.290
2(c)	16/12/04	80,000	(80,000)	-	-	06/09/06	06/09/07	0.60	0.171
2(c)	16/12/04	80,000	(80,000)	-	-	16/12/06	16/12/07	0.60	0.229
2(c)	16/12/04	80,000	-	-	80,000	04/07/08	04/07/09	0.60	0.251
3	25/08/05	350,000	-	-	350,000	31/12/05	31/12/08	0.65	0.19
3	25/08/05	350,000	-	-	350,000	30/06/06	30/06/09	0.65	0.21
4(a)	23/02/06	150,000	(116,000)	-	34,000	31/03/06	31/03/09	0.65	0.96
4(a)	23/02/06	150,000	(84,000)	-	66,000	01/05/07	01/05/10	0.65	0.96
4(b)	23/02/06	150,000	(150,000)	-	-	30/06/06	30/06/09	0.65	0.89
4(b)	23/02/06	150,000	(150,000)	-	-	30/06/07	30/06/10	1.20	0.65
4(b)	23/02/06	150,000	-	-	150,000	30/06/08	30/06/11	1.20	0.75
4(b)	23/02/06	200,000	(33,333)	-	166,667	30/06/06	30/06/09	0.65	0.89
4(b)	23/02/06	200,000	-	-	200,000	30/06/07	30/06/10	1.20	0.65
4(b)	23/02/06	200,000	-	-	200,000	30/06/08	30/06/11	1.20	0.75
4(c)	23/02/06	90,000	(70,000)	-	20,000	23/02/06	23/02/09	0.65	0.92
5	23/11/06	50,000	-	-	50,000	23/11/06	23/11/09	0.65	0.589
5	23/11/06	50,000	-	-	50,000	23/11/07	23/11/09	0.65	0.678
5	23/11/06	50,000	-	-	50,000	23/11/08	23/11/09	0.65	0.718
6(a)	17/03/06	50,000	-	(50,000)	-	17/03/07	17/03/08	2.02	0.554
6(a)	17/03/06	50,000	-	-	50,000	17/03/08	17/03/09	2.02	0.702
6(b)	17/05/06	10,000	-	(10,000)	-	17/05/07	17/05/08	1.52	0.404
6(b)	17/05/06	10,000	-	-	10,000	17/05/08	17/05/09	1.52	0.521
6(c)	06/06/06	10,000	-	(10,000)	-	06/12/06	06/12/07	1.75	0.303
6(c)	06/06/06	10,000	-	(10,000)	-	06/06/07	06/06/08	1.75	0.380
6(d)	01/01/07	15,000	-	-	15,000	01/07/07	01/07/08	1.96	0.512
6(d)	01/01/07	15,000	-	-	15,000	01/01/08	01/01/09	1.96	0.601
6(d)	01/01/07	30,000	-	-	30,000	01/01/08	01/01/09	1.96	0.601
6(d)	01/01/07	30,000	-	-	30,000	01/01/09	01/01/09	1.96	0.749
6(d)	01/01/07	40,000	-	-	40,000	01/01/10	01/01/09	1.96	0.873
6(d)	01/01/07	30,000	-	-	30,000	01/08/07	01/08/08	1.96	0.512
6(d)	01/01/07	30,000	-	-	30,000	01/02/08	01/02/09	1.96	0.601
7	27/07/07	2,480,000	-	-	2,480,000	01/07/09	30/06/12	2.13	0.74
		10,760,000	(1,363,333)	(80,000)	9,316,667				

The share options outstanding at the end of the financial year have a weighted average remaining contractual life of 714 days (2007: 762 days) and a range of exercises prices from 55c to $2.13. A further 2,736,000 share options were issued subsequent to the end of the financial year in accordance with the provisions of the employee share option plan.

18. SHARE-BASED PAYMENTS CONTINUED

(a) Existing share-based payment arrangements (continued)

(ii) General terms and conditions attached to each series are as follows:

1. At the time of the IPO the Company provided initial seed investors and the underwriter with share options as follows:
   (a) Seed investors, who subscribed for 4,320,000 fully paid preference shares, were provided with 4,320,000 options to acquire ordinary shares at an exercise price of $0.55. These options expire on the fourth anniversary of the expiry of two relevant imposed escrow periods being:
      (i) 50% of each holder's options are subject to an escrow period expiring on 29 September 2005, therefore these options expire on 29 September 2009
      (ii) 50% of each holder's options are subject to an escrow period which expired on 16 December 2005, therefore these options expire on 16 December 2009.
   (b) Lodge Partners Pty Limited (or nominee), as underwriter to the Offer received in aggregate 400,000 options to acquire 400,000 ordinary shares on the terms set out in 9.5(a) of the prospectus. These options have since been transferred to Thorney Holdings Pty Ltd and were exercised during the current financial year.
2. These options were granted as follows:
   (a) Two equal tranches, the first tranche vesting 12 months after listing date, the second 24 months after listing. Both tranches expire on the fourth anniversary of the listing date.
   (b) Two equal tranches, each expiring on the third anniversary of the Company being listed on the ASX. Vesting occurs upon reaching the following milestones:
      - The Company obtaining IND approval from the US Food and Drug Administration (FDA) for initiating multi-centre orthopaedic clinical trials within a period of two years after the options were granted, which was the date of listing on the ASX (16 December 2004). This milestone was reached on 16 December 2006, consequently the options vested on this date.
      - Angioblast Systems, Inc. (associate) must achieve IND approval from the US FDA for initiating multi-centre cardiovascular clinical trials within a period of three years after the options were granted. This milestone was reached on 1 May 2007 consequently the options vested on this date.
   (c) Three equal tranches, each expiring 12 months after vesting. Vesting occurs upon reaching the following milestones:
      - On achieving Standard Operating Procedure (SOP) for the manufacture of cells. This milestone was reached on 6 September 2006, consequently the options vested on this date.
      - On approval of Mesoblast's FDA Investigative New Drug (IND) approval. Approval was obtained on 16 December 2006, therefore the options vested on this date.
      - On completing human pre-regulatory trials for a Mesoblast Orthopaedic Application of the licensed technology. The last patient for this trial had their final follow up visit on 4 July 2008, so the options will vest on this date.
3. Options granted were approved by shareholders at the Annual General Meeting held 15 November 2005. The options were issued in two equal tranches. There are no performance conditions attached to these options.

(a) Existing share-based payment arrangements (continued)

4. Options granted are subject to the following conditions:
   (a) Two equal tranches, each expiring 36 months after vesting. Vesting occurs upon reaching the following milestones:
   - The first patient is treated with Human Autologous Mesenchymal Prescursor Cells (MPC's). This milestone was reached on 31 March 2006 and these options vested accordingly.
   - Angioblast Systems, Inc. (associate) receives Investigational New Drug Approval from the US FDA. This was received on 1 May 2007 and these options vested accordingly.

   (b) Three equal tranches, each expiring 36 months after vesting. The vesting dates for tranches 1, 2 and 3 are 30 June 2006, 30 June 2007 and 30 June 2008 respectively, and the exercise prices are $0.65, $1.20 and $1.20 respectively. There are no performance conditions attached to these options.

   (c) One tranche only, with a vesting date equal to grant date, and an exercise period of 36 months. There are no performance conditions attached to these options.
5. Options granted were approved by shareholders at the Annual General Meeting held 23 November 2006. Options were issued in three equal tranches, each having a three year life. The first tranche vested on grant date, the second tranche 12 months after grant date, and the third tranche 24 months after grant date. All tranches expire 36 months after grant date. There are no performance conditions attached to these options.
6. Options granted were approved by the Remuneration Committee on 14 February 2007. Options granted were in two equal tranches, the first tranche exercisable in twelve months following grant date, and the second exercisable in 18 months following grant date. Grant dates are equal to commencement of employment/contract and the options have exercise periods of 12 months. There are no performance conditions attached to these options.
7. Options granted were approved by the Remuneration Committee on 27 July 2007. The options were granted in three equal tranches vesting on 1 July 2008, 1 July 2009 and 1 July 2010 respectively. All tranches expire on 30 June 2012.

(iii) Modifications to terms and conditions

There have been no modification to terms and conditions in the current financial year.

During the prior financial year, the Board of Directors approved that certain conditions in series 3 and 4 options be removed. The conditions removed were as follows:

- 1/3 of the vested options could be exercised in the first 12 months following vesting date;
- up to a total of 2/3 could be exercised between 12 and 24 months following vesting date;
- the balance being able to be exercised (to the extent not already exercised) between 24 months and 36 months of vesting.

These options are now able to be exercised in full, between the vesting date and expiry date of the relevant tranche of option. The directors do not believe there is any incremental fair value granted as a result of the modification.

(b) Fair values of share options

The weighted average fair value of options granted during the year was $0.74 (2007: $0.633). The fair value of all options granted has been calculated using the Black-Scholes option pricing model. The model requires the Company share price volatility to be measured. The share price volatility has been measured with reference to the historical share prices of the Company, and also similar company's given the Company has only been listed since 16 December 2004. The official measurement of share price volatility for the options granted on 23 February 2006 was 55%, and for the options granted 23 November 2006 it was 54%. Given the consistency of the two volatility measurements, both volatility rates have been used for series 6 and 7.

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18. SHARE-BASED PAYMENTS CONTINUED

(b) Fair values of share options (continued)

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

Option series	Share price at grant date $	Exercise Price $	Expected share price volatility	Option life	Dividend yield	Risk-free interest rate
3	0.505	0.65	56.57%	128 & 310 days	0%	5.085%
4(a)	1.48	0.65	55.0%	3yrs & 3.98yrs	0%	5.18%
4(b)	1.48	0.65 & $1.20	55.0%	1.35–3.35 yrs	0%	5.18%
4(c)	1.48	0.60	55.0%	1.1–3.1 yrs	0%	5.18%
5	1.205	0.65	54.0%	3 yrs	0%	5.725%
6(a)	1.81	2.02	54.0%	18 & 24 months	0%	6.39%
6(b)	1.35	1.52	54.0%	18 & 24 months	0%	6.39% & 6.46%
6(c)	1.41	1.75	54.0%	18 & 24 months	0%	6.27% & 6.39%
6(d)	1.84	1.96	55.0%	18 & 24 months	0%	6.39%, 6.45% & 6.46%
7	1.91	2.13	55.0%	5 years	0%	6.25%

The closing share market price of an ordinary share of Mesoblast Limited (MSB) on the Australian Stock Exchange at 30 June 2008 was $0.91 (30 June 2007: $2.02).

(c) Reconciliation of outstanding share options

	2008		2007	
Share options over ordinary shares	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $
Balance at beginning of financial year	7,956,667	0.69	7,800,000	0.63
Granted during the year	2,480,000	2.13	480,000	1.33
Exercised during the year	(1,040,000)	0.67	(323,333)	0.64
Expired or forfeited during the year	(80,000)	1.89	-	-
Balance at end of financial year	9,316,667	1.06	7,956,667	0.69
Unvested at end of financial year	2,680,000	2.05	1,180,000	1.13
Exercisable at end of financial year	6,636,667	1.51	6,776,667	0.62

18. SHARE-BASED PAYMENTS CONTINUED

(d) Share options exercised during the year

Option series	Number exercised	Exercise date(s)	Share price at exercise date
2008			
2(c)	80,000	10 October 2007	$1.50
4(b)	300,000	10 October 2007	$1.50
4(c)	60,000	10 October 2007	$1.50
1	200,000	13 December 2007	$1.28
1	400,000	20 December 2007	$1.27
	1,040,000		
2007			
2(c)	80,000	18 December 2006	$1.78
4(a)	50,000	28 September 2006	$1.25
4(a)	66,000	18 December 2006	$1.78
4(a)	84,000	08 June 2007	$2.16
4(b)	33,333	28 September 2006	$1.25
4(c)	10,000	28 September 2006	$1.25
	323,333		

19. KEY MANAGEMENT PERSONNEL COMPENSATION

(a) Details of key management personnel

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

Name	Position	2008	2007
Brian Jamieson	Non-executive Chairman (A)	22 November 07	-
Byron McAllister	Non-executive Director	Full year	Full year
Donal O'Dwyer	Non-executive Director	Full year	Full year
Michael Spooner	Non-executive Director (A); Executive Chairman (R)	8 August 07	Full year
Silviu Itescu	Executive Director	Full year	Full year
Kevin Hollingsworth	Chief Financial Officer (R); Company Secretary	21 November 07	Full year
Suzanne Lipe	Vice President of Operations (A)	18 March 08	-
Jenni Pilcher	Chief Financial Officer (A); Financial Controller (R)	21 November 07	-
Paul Rennie	Special Projects Consultant (A) Chief Operating Officer (R);	12 May 08	Full year
Jim Ryaby	Vice President of Research and Clinical Affairs (A)	3 March 08	-
Donna Skerrett	Clinical and Regulatory Affairs	Full year	-

(A) Appointed to this position

(R) Resigned from this position

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19. KEY MANAGEMENT PERSONNEL COMPENSATION CONTINUED

(b) Key management personnel compensation

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

	30 June 2008 $	30 June 2007 $
Short-term employee benefits	1,235,755	1,030,882
Post-employment benefits	89,629	68,244
Share based payments	477,420	132,340
	1,802,804	1,231,466

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 compen-sation No.	Exercised No.	Net change other No.	Balance at 30 June No.	Total vested 30 June No.	Vested and exer-cisable No.	Unvested No
2008								
Brian Jamieson	-	-	-	-	-	-	-	-
Byron McAllister	150,000	-	-	-	150,000	150,000	150,000	-
Donal O'Dwyer	300,000	-	-		300,000	250,000	250,000	50,000
Michael Spooner	1,100,000	-	-	-	1,100,000	1,100,000	1,100,000	-
Silviu Itescu	-	-	-	-	-	-	-	-
Kevin Hollingsworth	-	200,000	-	-	200,000	-	-	200,000
Suzanne Lipe	-	-	-	-	-	-	-	-
Jenni Pilcher	60,000	100,000	-	-	160,000	-	-	160,000
Paul Rennie	-	250,000	-	-	250,000	-	-	250,000
James Ryaby	-	-	-	-	-	-	-	-
Donna Skerrett	300,000	200,000	-	-	500,000	300,000	300,000	200,000
2007								
Silviu Itescu	-	-	-	-	-	-	-	-
Byron McAllister	150,000	-	-	-	150,000	150,000	150,000	-
Donal O'Dwyer	150,000	150,000	-	-	300,000	200,000	200,000	-
Michael Spooner	1,100,000	-	-	-	1,100,000	1,100,000	1,100,000	-
Paul Rennie (i)	690,000	-	-	(690,000)	-	-	-	-
Kevin Hollingsworth	-	-	-	-	-	-	-	-

On 15 November 2007, 690,000 options granted to Paul Rennie were transferred to a non-related party.

19. KEY MANAGEMENT PERSONNEL COMPENSATION CONTINUED

c) Key management personnel equity holdings continued

Shareholdings

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

2008	Balance at 1 July No.	Granted as compensation No.	Received on exercise of options No.	Net change other No.	Balance at 30 June No.
Brian Jamieson (i)	-	-	-	200,000	200,000
Byron McAllister	-	-	-	-	-
Donal O'Dwyer	-	-	-	-	-
Michael Spooner (ii)	839,255	-	-	-	839,255
Silviu Itescu	36,632,196	-	-	-	36,632,196
Kevin Hollingsworth	-	-	-	-	-
Suzanne Lipe	-	-	-	-	-
Jenni Pilcher	6,000	-	-	-	6,000
Paul Rennie	-	-	-	-	-
James Ryaby	-	-	-	-	-
Donna Skerrett	-	-	-	-	-
2007					
Silviu Itescu	43,120,000	-	-	(6,487,804)	36,632,196
Byron McAllister	-	-	-	-	-
Donal O'Dwyer	-	-	-	-	-
Michael Spooner (ii)	839,255	-	-	-	839,255
Paul Rennie	-	-	-	-	-
Kevin Hollingsworth	-	-	-	-	-

(i) Brian Jamieson owns 125,000 shares in his own name, with the balance held by a related party as defined by the accounting standard AASB124 *Related Party Disclosures.*

(ii) Michael Spooner's shareholding disclosed above is entirely held by a related party as defined by AASB124 *Related Party Disclosures.*

20. RELATED PARTY TRANSACTIONS CONTINUED

(a) Equity interests in related parties

Details of interests in associates are disclosed in note 10 to the financial statements.

(b) Transactions with other related parties

Accounts receivable from and accounts payable to Angioblast Systems, Inc. as at the end of the financial year are disclosed in notes 8 and 12 respectively. 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 types of transactions being paid for are detailed below:

	30 June 2008 $	30 June 2007 $
Amounts paid on behalf of Angioblast, by Mesoblast		
50% sharing of researchers and SAB fees	98,418	81,136
50% sharing of cell and antibody manufacturing	118,515	379,365
50% sharing of clinical research organisation costs	-	198,049
50% sharing of intellectual property costs	157,606	64,278
Research and development (Australia based)	209,802	86,452
Professional fees (Australia based)	-	67,921
Other	19,950	46,605
	604,291	923,806
Amounts paid on behalf of Mesoblast, by Angioblast		
Research and development (US based)	428,299	93,048
Employees and consultants (US based)	112,513	-
Other (US based)	57,385	5,922
	598,197	98,970

20. RELATED PARTY TRANSACTIONS CONTINUED

(c) Transactions between related parties of the company

Together, Mesoblast and Angioblast have been jointly developing process manufacturing and scale-up of the MPC technology, as well as pre-clinical and clinical components which were necessary to obtain Investigational New Drug (IND) clearance from the FDA for orthopaedic and cardiovascular applications (respectively). Both companies have received IND clearance for their respective applications during the current financial year and are now embarking on phase 2 clinical trials. In order to maximise economies of scale and expertise in both entities, certain members of key management personnel provide expert services to both entities. These relationships are outlined below:

Mesoblast key management personnel	Relationship(s) with Angioblast	Nature of transaction(s)(i)
Silviu Itescu	Director, Chief Scientist and Chairman of the Scientific Advisory Board	Directors fees & contract for services
Donal O'Dwyer	Director and leader of medical device collaboration strategies	Directors fees & Angioblast share options
Byron McAllister	Consultant	Contract for services
Paul Rennie	Consultant	Contract for services
Angioblast key management personnel	**Relationship(s) with Mesoblast**	**Nature of transaction(s)(i)**
Michael Schuster	Consultant	Contract for services & Mesoblast share options (ii)
Donna Skerrett	Consultant	Contract for services & Mesoblast share options (ii)

(i) All contracts for services are prepared on normal commercial terms.

(ii) Mesoblast share options held by Angioblast employees are included in the table disclosed in note 18 to the financial statements.

21. FINANCIAL RISK MANAGEMENT

Financial risks impacting the company 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 Company, is presented below.

(a) Market risk

(i) Currency risk

The Company has certain clinical, regulatory and manufacturing activities in the United States of America. As a result of these activities, the Company has certain amounts owing to creditors and Angioblast Systems, Inc. and a bank account that are denominated in US dollars. These 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 Company's financial performance.

The Company manages the currency risk by evaluating the trend of the US dollar in comparison to the Australian dollar and making decisions whether to purchase US dollars in advance for the purposes of settling these liabilities. The Company has a USD bank account for this purpose.

21. FINANCIAL RISK MANAGEMENT CONTINUED

(a) Market risk continued

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 sensitive analysis which assesses the impact that a change of +/-10% in the exchange rate as at 30 June would have had on the Company's reported net losses.

30 June 2008	Balance held	+10%		-10%	
	US$	Profit AU$	Equity AU$	Profit AU$	Equity AU$
USD bank account	47,368	(4,478)	-	4,478	-
Trade payables	(268,803)	25,816	-	(25,816)	-
Amounts owing to Angioblast Systems, Inc	(60,040)	6,007	-	(6,007)	-

(ii) Interest rate risk

The Company has exposure 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 the 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 Company. The balances held which derive interest revenue are described in note 21(c). There is no material impact on the Company's net loss and equity if the interest rates were to be different, by any reasonable amount, as at the end of the financial year. This is because interest is calculated daily and has largely already been earned at the prescribed bank rates at this point in time.

(iii) Price risk

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

21. FINANCIAL RISK MANAGEMENT CONTINUED

(b) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge its obligation and will therefore cause financial loss to the other party. As the Company is non-revenue generating it generally does not have trade receivables. Its receivables are typically due from the government in the form of GST and government grants, and from its related party. The Company manages the exposure to credit risk by ensuring all amounts due from Angioblast are received monthly and that the balance is not more than $200,000 at any one time without prior approval of a director. The credit risk to the Company is detailed below:

	30 June 2008 $	30 June 2007 $
Cash and cash equivalents		
Cash and cash equivalents (note 7) – AAA rated	14,094,219	12,055,040
Trade receivables		
Receivable from Australian Government	39,195	149,759
Receivable from AAA rated bank deposits	68,082	-
Receivable from related party	16,623	360,148

(c) Liquidity risk

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

All financial liabilities held by the Company at 30 June 2008 and 30 June 2007 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.

22. SUBSEQUENT EVENTS

On 7 July 2008 the directors approved a total of 2,736,000 share options to be granted to employees and consultants, including those disclosed in the director's report.

There are no other subsequent events that the directors consider would have a material impact on the results of the Company for the year ending 30 June 2008.

Directors' Declaration

In accordance with a resolution of directors of Mesoblast Limited,

In the opinion of the directors:

(a) the accompanying financial statements and notes on pages 33 to 67 are in accordance with the Corporations Regulations 2001 and comply with the accounting standards and give a true and fair view of the company's financial position as at 30 June 2008 and of its performance for the year ended on that date.

(b) At the date of this declaration there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

(c) The remuneration disclosures set out on pages 17 to 24 of the director's report comply with accounting standard AASB 124 Related Party Disclosures and the Corporations Regulations 2001.

(d) The directors have been given the declarations by the Chief Executive Officer and the Chief Financial Officer required by Section 295 A.

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

Mr Brian Jamieson
Director

28 August 2008, Melbourne

PRICEWATERHOUSECOOPERS

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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 2008, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that compliance with the Australian equivalents to International Financial Reporting Standards ensures that the financial report, comprising the financial statements and notes, complies 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.

For further explanation of an audit, visit our website http://www.pwc.com/au/financialstatementaudit.

PRICEWATERHOUSECOOPERS

Independent auditor's report to the members of Mesoblast Limited (continued)

Our audit did not involve an analysis of the prudence of business decisions made by directors or management.

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*.

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 company's financial position as at 30 June 2008 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 company's financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

Report on the Remuneration Report

We have audited the Remuneration Report included in sections A to D of the directors' report for the year ended 30 June 2008. 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 2008, complies with section 300A of the *Corporations Act 2001*.

PricewaterhouseCoopers

Anton Linschoten
Partner

Melbourne
28 August 2008

Shareholder Information

A. SUBSTANTIAL SHAREHOLDERS

The Company's Holders of Relevant Interests as notified by ASX Substantial Shareholders and the number of shares in which they have an interest as disclosed by notices received under Part 6.7 of the Corporation Act 2001 as at 16 September 2008 are:

Shareholder	Number of ordinary shares held
AMP Life Ltd	8,228,525
Portfolio Partners Limited	6,198,261
Silviu Itescu	37,120,000
Thorney Holdings Pty Ltd	8,350,957

B. NUMBER OF HOLDERS OF EQUITY SECURITIES AND VOTING RIGHTS

	Ordinary shares (i)	Share options (ii)
Number of holders	1,994	28

The voting rights attaching to each class of equity securities are:

(i) Ordinary shares

On a show of hands, every member present at a meeting, in person or by proxy, shall have one vote and upon a poll each share shall have one vote.

(ii) Share options

No voting rights.

C. DISTRIBUTION OF EQUITY SECURITIES

Distribution of holders of equity securities as at 16 September 2008

No. of holders	Ordinary shares	Share options
1 – 1,000	332	-
1,001 – 5,000	733	-
5,001 – 10,000	377	-
10,001 – 100,000	475	7
100,000 and over	77	21
	1,994	28

Number of holders of less than a marketable parcel of shares	65

Shareholder Information
continued

D. TWENTY LARGEST HOLDERS OF QUOTED SECURITIES

The names of the 20 largest shareholders of each class of equity security as at 16 September 2008 are listed below:

No.	Name	No. of shares held	% of total shares
1	Professor Silviu Itescu	36,632,196	30.39%
2	J P Morgan Nominees Australia	10,936,581	9.07%
3	National Nominees Limited	8,507,206	7.06%
4	AMP Life Limited	5,280,877	4.38%
5	ANZ Nominees Limited	3,891,993	3.23%
6	Invia Custodian Pty Limited	3,864,796	3.21%
7	Medvet Science Pty Ltd	2,790,000	2.31%
8	Dalit Pty Ltd	2,660,000	2.21%
9	ANZ Nominees Limited	2,597,144	2.15%
10	J G M Investment Group Pty Ltd	2,340,000	1.94%
11	Thorney Holdings Pty Ltd	2,021,392	1.68%
12	Cogent Nominees Pty Limited	1,570,522	1.30%
13	HSBC Custody Nominees (Australia) Limited	1,330,375	1.10%
14	Cogent Nominees Pty Limited	1,240,541	1.03%
15	Michael Spooner	1,100,000	0.91%
16	RBC Dexia Investor Services	896,554	0.74%
17	Citicorp Nominees Pty Limited	800,114	0.66%
18	Queensland Investment Corporation	690,702	0.57%
19	Hazlaha Investments Limited	637,600	0.53%
20	Mr Gregory John Conlan	526,500	0.44%
		90,315,093	74.92%

Mesoblast Limited ABN 68 109 431 870

Board of Directors and Company Particulars

DIRECTORS
Brian Jamieson
Donal O'Dwyer
Silviu Itescu
Byron McAllister
Michael Spooner

COMPANY SECRETARY
Kevin Hollingsworth

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SOLICITORS
Middletons Lawyers
Level 25, Rialto Tower
525 Collins Street
MELBOURNE VIC 3000

BANKERS
National Australia Bank Ltd
221 Drummond Street
CARLTON VIC 3053

SHARE REGISTRY
Link Market Services Limited
Level 4
333 Collins Street
MELBOURNE VIC 3000