

Financial Report for the year ended 30 June 2013

Directors' Report and Audited Financial Statements

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Directors' Report (incorporating Remuneration Report)

The Board of Directors of Mesoblast Group has resolved to submit the following annual financial report of the Group for the financial year ended 30 June 2013. In order to comply with the provisions of the *Corporations Act 2001*, the Directors report the following information.

Principal Activities

Mesoblast is a clinical development company leveraging its proprietary core technologies, which include the Mesenchymal Precursor Cell (MPC) technology platform for bone marrow and adipose tissue derived products, Dental Pulp Stem Cells (DPSCs), and expanded Hematopoietic Stem Cells (HSCs). Our product pipeline is specifically being optimized to target those major unmet medical indications wherein our technologies may offer unique scientific and clinical advantages and have the potential to deliver significant and sustainable revenues.

Review of Operations

In the period to 30 June 2013 we made significant progress in both clinical development and critical manufacturing processes, both of which enable Mesoblast to become a late-stage development Company preparing to enter into multiple additional Phase 3 clinical trials.

With support from new and existing global investors, the Company raised \$170 million during the reporting period, providing a cash balance at 30 June 2013 of \$315.3 million. This working capital enables the Company to execute additional Phase 3 trials for our spine disease products, to broaden our clinical development programs in diseases of inflammation and immunity, to access to complementary technologies for product diversification, and to ramp up our commercial manufacturing operations.

The Company continues to work closely with commercial partner Teva Pharmaceutical Industries Ltd to finalize the detailed clinical protocol for the Phase 3 congestive heart failure trial. Mesoblast anticipates regulatory submissions to occur shortly.

2013 Highlights

The 2013 fiscal year has seen the Company continue to progress its clinical pipeline, further invest in long-term manufacturing, and strengthen its financial resources.

The following highlights were achieved during the 2013 financial year:

- Completed \$170 million financing from targeted global financial investors
- Expanded clinical manufacturing operations to Singapore plant, in addition to ongoing operations at United States plant
- Obtained United States Food and Drug Administration (FDA) agreement that clinical manufacturing of cell products at both the Singapore and United States plants meet FDA requirements for commencing Phase 3 trial, including the congestive heart failure trial
- Worked closely with commercial partner Teva Pharmaceutical Industries Ltd to finalize the Phase 3 congestive heart failure protocol and associated documentation for regulatory submission to the FDA
- Obtained positive 12-month results in a Phase 2 trial in lumbar spinal fusion
- Obtained positive 6-month interim results in a Phase 2 trial for intervertebral disc repair
- Completed recruitment in a Phase 2 trial of patients with inadequately controlled type 2 diabetes
- Received ethics approval and commenced recruitment in an Australian Phase 2 trial for diabetic nephropathy
- Received clearance from the FDA and commenced recruitment in a Phase 2 trial in rheumatoid arthritis patients who have failed biologic therapies
- Continued to strengthen intellectual property portfolio, with key patents being granted in Japan, China and the United States.

Product Diversity

Our investigational products target four distinct and substantial market areas of unmet medical need based on deep understanding of the mechanisms of action of our technologies:

1. investigational products delivered intravenously for systemic inflammatory and immune-mediated conditions;
2. investigational products administered locally for orthopedic conditions of the spine;
3. investigational products being commercialized in partnership with Teva, primarily for the treatment of cardiovascular and neurologic diseases; and
4. other investigational products, primarily for local administration, such as vascular conditions of the eye.

Each of the products is discussed in more detail in the following sections of this report.

1. Inflammatory and Immune-Mediated Diseases

Mesoblast is developing products for intravenous administration to target major unmet medical needs in diseases of excessive inflammation and immune dysfunction, including type 2 diabetes, inflammatory joint diseases, and inflammatory lung diseases. Common to each of these diseases is dysregulated activation of monocytes, T cells and B cells, and activation of multiple pro-inflammatory pathways.

Whereas small molecules or monoclonal antibodies typically target single pathways of the aberrant immune response in these diseases, Mesoblast's mesenchymal lineage stem cells secrete factors that target multiple arms of the immune system concomitantly. Consequently our cells may be able to provide an immunomodulatory effect that may translate to improved outcomes compared with small molecules and/or biologics that target single pathways of the human immune system.

Type 2 diabetes and end-stage kidney disease

The aberrant activation of the immune system that occurs in type 2 diabetes is associated with inflammation of fat tissues, resistance to the effects of insulin in the fat tissues, poor glucose control, and ultimately end-organ damage involving the kidneys, heart, and eyes. While a number of drugs are effective at improving glucose control in type 2 diabetics, there is a significant need to identify safe and effective therapies that can dampen the inflammatory response and reverse end-organ complications in type 2 diabetes.

End-stage kidney disease has a high rate of annual progression to dialysis, and is the major predictor of cardiovascular death in diabetics. This progression is independent of blood sugar, lipids, and blood pressure. The annual incidence of cardiovascular disease and death

in diabetics with end-stage kidney disease approaches 10%, and this is amplified in diabetics with high circulating levels of C-reactive protein (C-RP), a marker of systemic inflammation. Mesoblast's preclinical studies in non-human primates with type 2 diabetes showed that a single intravenous injection of allogeneic MPCs resulted in reduced levels of C-RP and improved glucose control compared with placebo. Consequently, we have embarked on a clinical development program to evaluate whether intravenously administered MPCs can reduce inflammation sufficiently in type 2 diabetics to reverse or stabilise end-stage kidney disease and/or have a cardioprotective effect.

In order to move to a comprehensive program in diabetic kidney disease, it was necessary first to demonstrate safety of intravenously delivered MPCs in type 2 diabetics without renal disease. Enrollment has been completed in Mesoblast's Phase 2 clinical trial using intravenous delivery of its MPC intravenous product in 60 patients with early type 2 diabetes. This trial has set the foundation for evaluating MPCs in the treatment of patients with more advanced diabetes in order to target life-threatening complications of the disease including kidney failure.

On the basis of safety data generated in the type 2 diabetes trial and published reports of mesenchymal lineage stem cells in preclinical models of diabetic kidney disease, Mesoblast has received approvals during 2013 from Australian ethics committees to evaluate whether a single intravenous MPC injection can stabilize or reverse end-stage kidney disease in type 2 diabetic patients. This phase 2 trial is currently enrolling.

Rheumatoid Arthritis (RA)

Rheumatoid arthritis is a disease that affects approximately 1.5% of adults and today represents a \$10 billion market annually for biologics. Existing biologic therapies have made major inroads to the treatment of RA. These therapies are limited by their narrow mechanisms of action which affect single pathways of inflammation in a disease that is driven by multiple inflammatory cytokine pathways. Consequently, these therapies result in modest clinical improvements with few long-term remissions. Moreover, existing therapies require regular and long-term use which is associated with significant risk of infection and cancer.

Mesoblast's preclinical data and mechanistic studies indicate that intravenously delivered MPCs may concomitantly suppress multiple pathways of inflammation in both the circulation and the joints. Our goal is to determine whether MPCs have the potential to both induce early and sustained improvement in patients with active inflammatory joint disease. During 2013, Mesoblast commenced a Phase 2 program to evaluate the ability of a single MPC injection to rescue RA patients who have failed existing biologic therapies (48-patient United States trial). The results will guide the future direction of the RA program.

2. Orthopedic Diseases of the Spine

During 2013, we made significant progress developing MPC treatment therapies for major market opportunities for diseases of the spine. Depending upon final Phase 2 trial results, we intend to progress to Phase 3 trials for lumbar spinal fusion and intervertebral disc repair during 2014.

Surgical treatments for diseases of the spine represent the fastest growing market segment in orthopedics. Over four million patients in the United States alone suffer from chronic low back pain due to degenerative intervertebral disc disease. Apart from analgesia, there is no treatment that prevents progression of disc degeneration, reduces pain and improves function over a sustained period of 6-12 months. When disc degeneration has progressed so significantly that pain and loss of function mandate intervention, major invasive surgery such as spinal fusion using autograft bone is a well-accepted option.

Intervertebral disc repair

Based on successful preclinical results, Mesoblast is developing a non-surgical adult stem cell treatment for the large numbers of patients with low back pain due to disc degeneration. Mesoblast's double-blind, placebo-controlled Phase 2 clinical trial, which is being conducted across 15 sites in the United States, has completed enrollment of 100 patients with intervertebral disc disease. The trial aims to show that a single MPC injection can reduce low back pain and improve function for more than six months, improve disc anatomy, and eliminate the need for a surgical procedure.

In 2013, Mesoblast reported a pre-specified interim analysis of the first 50 patients who had completed six months of follow-up. The analysis showed a single low-dose injection of MPCs caused a significantly greater reduction in low back pain, significantly greater improvement in function, and significantly greater treatment success compared with patients who received hyaluronic acid carrier alone. There were no cell-related serious adverse events. Full results from this study are expected to be available in 2H 2013, and if the positive interim results continue to be seen in the full 100-patient dataset, we intend to progress towards a Phase 3 trial.

Fusion of the spine

In addition to disc repair, Mesoblast is developing a spinal fusion product for those patients with advanced disc degeneration who need surgery. According to Millennium Research Group, in the United States there were approximately 380,000 lumbar spinal fusion procedures performed in 2012. They estimate the overall worldwide market for bone graft substitutes to be nearly \$1.6 billion dollars in 2012 with the majority of bone graft revenues, approximately 70%, coming from spinal fusion procedures.

Mesoblast has completed a randomized, controlled Phase 2 trial which showed that implantation with MPCs was equivalent to hip autograft at 12 months in terms of reducing pain and improving function, without the need for a second surgical procedure which can cause blood loss and chronic pain at the bone harvest site. Based on these results, Mesoblast intends to initiate a Phase 3 trial for its product in posterior lumbar fusion by the end of this year.

3. Cardiovascular Diseases

Mesoblast is developing adult stem cell-based therapies together with Teva for the treatment of cardiovascular diseases, including congestive heart failure (CHF), the principal cause of hospitalization and death in the industrialized world.

In Mesoblast's Phase 2 trial for congestive heart failure, patients treated with a single intra-cardiac injection of the highest MPC dose have not experienced any hospitalizations for decompensated heart failure nor any cardiac-related deaths over three years of follow-up.

Mesoblast worked closely during the year with Teva Pharmaceutical Industries Ltd to finalize the detailed clinical protocol and associated documentation for the Phase 3 congestive heart failure trial as required for regulatory submission to the FDA.

Additional cardiovascular indications are being investigated in the partnership with Teva, including intracoronary injection of MPCs for prevention of heart failure after AMI. An ongoing placebo-controlled Phase 2 trial in patients with AMI is actively recruiting in Europe and Australia.

4. Other Products

Eye diseases

Mesoblast's lead ophthalmic indication is for neovascular ('wet') Age-related Macular Degeneration (AMD), the leading cause of blindness in the Western world. AMD already affects around 25 million people globally, with the incidence expected to increase significantly as the average age of the population increases. Wet AMD accounts for over 90% of severe loss of vision in elderly people. The current standard-of-care therapy for wet AMD is repeated intravitreal injections using an anti-vascular endothelial growth factor (VEGF) agent.

Patients are being enrolled across sites in Singapore and Australia in a Phase 2 safety study where patients with active wet AMD receive a single injection of allogeneic MPCs into their eye. Mesoblast will look to results from this study to develop larger programs in diabetic eye disease and dry AMD.

Cord blood expansion

The Phase 3 clinical trial using MPCs to expand hematopoietic precursors from cord blood for transplantation in cancer patients whose bone marrow has been destroyed by high dose chemotherapy is ongoing. If our product is successful, it could result in a process that may increase the total number of unrelated donor transplants performed by 3-4 fold, providing a therapy for patients who currently cannot find a donor and who would otherwise die.

Intellectual Property

Mesoblast has significantly strengthened and extended the reach of its patent portfolio in the 2013 financial year. The Company was granted three key new patents by the United States Patent and Trade Mark Office and the State Intellectual Property Office of the People's Republic of China. More recently, Mesoblast was granted a key patent by the Japanese Patent Office, providing exclusive commercial rights in Japan through to September 2025 to all compositions-of-matter and uses of its MPC technology platform, irrespective of the MPC tissue source, including bone marrow, adipose, placenta, umbilical cord and dental pulp.

These patents deliver major commercial advantages and offer long term protection in these territories for the Company's products based on its MPC adult stem cell technology platform, and supports Mesoblast's corporate strategy to target the largest mature and emerging healthcare markets for regenerative medicines.

Manufacturing Operations

Mesoblast's manufacturing strategy for its cellular products is based upon maintaining regulatory compliance with best practices, ensuring commercial scale-up and supply, having clear product delineation to protect partner markets, manage product life cycles, and effecting reductions in cost-of-goods and increased margins.

Mesoblast's manufacturing alliance with Lonza, one of the world's leading biologics manufacturers, supports our overall corporate strategy. Importantly, this alliance aims to ensure that product supply will meet anticipated market needs across major geographical jurisdictions, and to facilitate a sustainable cost-of-goods structure that will maximize return on investment.

The Company's manufacturing activities meet stringent criteria set by regulatory agencies in each jurisdiction we operate. By using well characterized cell populations, Mesoblast has established a manufacturing process that promotes reproducibility and batch to batch consistency for its allogeneic cell products.

During the reporting year, the Company reached agreement with the FDA on the manufacturing process to supply its allogeneic MPC products for Phase 3 clinical trials in the United States under Investigational New Drug (IND) protocols from Lonza's contract manufacturing facility in Singapore, as well as its United States facility. Having multiple geographic sites to manufacture our MPC products to FDA compliance is an integral part of Mesoblast's corporate strategy for product delineation, and offsets risks of single site dependence. It is anticipated that our operations in Singapore, where we maintain exclusive access to Lonza's manufacturing facilities for allogeneic cells, will expand in line with our growth in global capacity requirements for product supply.

Team Achievements

Mesoblast is committed to building a strong company. Fundamental to our strategy is the recruitment and retention of experienced staff within our core competencies of clinical, regulatory, technical and manufacturing. Where it is strategically and financially sensible, we outsource certain projects to best of breed global organizations.

The Mesoblast Board was strengthened by the appointment of Dr Eric A. Rose, a world leader in cardiovascular medicine as a non-executive Director. Dr Rose is Chairman and CEO of SIGA Technologies and Executive Vice President, Life Sciences, at MacAndrews & Forbes, Inc., the holding company of Ronald O. Perelman.

In April 2013, Chief Executive Silviu Itescu was awarded the inaugural Pontifical Key Innovation Award at The Vatican. The award acknowledged his leadership and ingenuity in translational science and clinical medicine within the field of adult stem cell therapy.

A number of Mesoblast clinical and preclinical trials were featured in leading journals, including the December 2012 issue of the *New England Journal of Medicine* which published the clinical trial of MPC-expanded hematopoietic stem and progenitor cells from cord blood for bone marrow transplantation in cancer patients, and the May 2013 issue of *Circulation Research* which published preclinical results of intra-coronary MPCs for prevention of heart failure after AMI.

Financial Summary

Net loss after tax

	30 June 2013 \$'000	30 June 2012 \$'000	Movement \$'000
Loss before income tax	60,078	48,723	11,355
Income tax expense	1,585	22,422	20,837
Loss after income tax	61,663	71,145	9,482

The decrease in the loss after income tax of \$9.5m was driven by a reduction to income tax expense (\$20.8m), a reduction in revenue from continuing operations (\$9.4m) and an increase in expenses from continuing operations (\$7.8m).

The prior year tax expense was \$20.8m higher than the current year. In the current year no tax expense was required to be recorded on the revenue received from Teva as the tax losses carried forward were sufficient to fully offset the revenue. In the prior year a tax expense of \$22.4m was recorded as the tax losses carried forward were not sufficient to offset the revenue recorded.

Revenue from continuing operations

Revenue from continuing operations for the 2013 year totals \$28.8m (2012: \$38.2m), resulting in a decrease of \$9.4m compared to 2012, as shown in the table below:

	30 June 2013 \$'000	30 June 2012 \$'000	Movement \$'000
Commercialization revenue	18,260	27,683	(9,423)
Interest revenue	10,526	10,472	54
	28,786	38,155	(9,369)

The decrease in commercialization revenue of \$9.4m reflects an extension of the period over which the upfront payment of USD130.0m is being amortized. This payment was received by the Company upon entering into the development and commercialization agreement with Cephalon, Inc. (now Teva Pharmaceutical Industries Ltd) during the financial year ended 30 June 2011. This payment is being recognized as revenue over the life of the development program in accordance with Australian Accounting Standards.

The interest revenue earned by the Group during the year is in line with the prior year as the drop in revenue from decreasing interest rates was offset by an increase in funds on deposit since March 2013 due to the private placement of shares which contributed proceeds of \$170.0m. Over the last two years the Reserve Bank of Australia has gradually reduced the cash rate from 4.77% at July 2011, to 3.50% at July 2012 and to 2.75% at 30 June 2013. The Group has experienced a similar decline in interest rates available for deposits invested during that period.

Other income

	30 June 2013 \$'000	30 June 2012 \$'000	Movement \$'000
Research & development tax incentive revenue	5,924	–	5,924
Government grant revenue	–	125	(125)
	5,924	125	5,799

During 2013, the Group recorded revenue of \$5.9m under the Australian Government's Innovation Australia Research and Development (R&D) Tax Incentive Program for R&D activities conducted in Australia during both the 2013 and 2012 financial years.

Expenses from continuing operations

Total expenses from continuing operations in 2013 total \$94.8m (2012: \$87.0m), increasing from the prior year by \$7.8m as noted in the table below:

	30 June 2013 \$'000	30 June 2012 \$'000	Movement \$'000
Research and development	43,108	36,937	6,171
Manufacturing commercialization	20,946	22,015	(1,069)
Management and administration	30,734	28,051	2,683
	94,788 ^	87,003 ^	7,785

^ Share-based payments included in expenses from continuing operations total \$12.3m in 2013 (2012: \$12.1m), making up 13% of expenses (2012: 14%).

Research & development

Research & development expenses have increased by \$6.2m (17%) to \$43.1m for 2013 (2012: \$36.9m) as the Group continued to invest in clinical programs, regulatory filings and new product development. The increased spend was as expected given the broadening product pipeline and the advancement of programs through the clinic. Specifically, the net increased spend is a result of the following activities:

Increases in spend

- type 2 diabetes trial recruitment substantially completed during the year;
- initiation of the phase 2 rheumatoid arthritis clinical study;
- completion of recruitment of 100 patients for the disc repair phase 2 trial;
- analysis and final report preparation of the lumbar spinal fusion phase 2 trial that will support progression of clinical development to phase 3;

Decreases in spend

- completion and close-out of 60-patient phase 2 trial for congestive heart failure in 2012; and
- set-up of the AMICI study in 2012.

The above activities have been supported by internal staffing, the costs for which have increased in 2013 by \$4.3m. This increase is a reflection of an increase in staff numbers as required in order to support the above programs and the increase in activities. Included in staffing costs is \$8.4m of share-based payment expenses (2012:\$6.6m), an increase of \$1.8m on the prior year. This expense reflects the annual issue of options and loan-funded shares issued pursuant to the Company's employee share plans which require the issues to be valued (using the Black Scholes valuation model) and expensed over the vesting period in accordance with Australian Accounting Standards.

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

Manufacturing commercialization

Manufacturing commercialization expenses have decreased by \$1.1m (5%) to \$20.9m for 2013 (2012: \$22.0m).

Throughout 2013, the Group expanded its manufacturing operations into Singapore, we further invested in a scale-up of the existing manufacturing to ensure product supply for increased clinical trial needs.

The Group has focused on the establishment of second generation production methods, the costs of which for 2013 were funded by a third party supplier.

Specifically, costs for clinical trial production increased by \$5.0m (58%) to \$16.3m in 2013 (2012: \$11.3m) as a direct result of the expansion into Singapore and the increase in production of clinical grade cell supply.

The increase in clinical production has been offset by a decrease in spend of \$6.1m for supporting manufacturing activities which largely occurred in 2012 and were incurred to a lesser extent in 2013 such as:

- investment into existing manufacturing process efficiencies;
- investment into second generation production methods (funded in 2013 by a third party);
- technical transfer of manufacturing processes into other locations;
- purchase of manufacturing supplies (eg media and growth factors) currently in storage available for use;
- production of animal cells for preclinical studies across a variety of indications;

Management & administration

Management and administration expenses have increased by \$2.7m (10%) to \$30.7m for 2013 (2012: \$28.1m). This increase is a result of the support required for the increase in staff numbers and activities generally.

Earnings per share

	2013 Cents	2012 Cents
Basic (losses)/profit per share	(21.06)	(25.15)
Diluted (losses)/profit per share	(21.06)	(25.15)

Business Strategies and Prospects for Future Years

Mesoblast's corporate strategy is to:

- leverage proprietary cell-based and complementary biologic technologies to develop products for unmet medical needs;
- bring multiple products to market within a parallel timeframe;
- underpin our future financial growth through investing in manufacturing operations; and
- enhance the likelihood of commercial success through strategic partnerships.

Business Risks

Mesoblast is deeply committed to ensuring the safety of its patients and staff, whilst it continues its development of our MPC platform technology.

The Group is currently a loss-making entity in development phase. The long term financial success of the Group will be measured ultimately on the basis of profitable operations. Key to becoming profitable, is the successful development and commercialization of our product portfolio, establishment of efficient manufacturing operations, achieving product distribution capability, and overall, the ability to attract funding to support these activities.

The following specific risks have the potential to affect the Group's achievement of the business goals detailed above. This is not an exhaustive list. The Board and management continually review risks of the business and their potential impact.

1. Safety and effectiveness of our products

An inherent risk to companies operating in the biotechnology industry, is the risk that products being developed are not safe and effective and therefore will not gain approval for sale from various regulatory bodies. To date, the Group has not encountered any safety concerns from the treatment of patients with our products and the Group continues to rigorously test for both safety and efficacy in its clinical trials.

2. Intellectual property risk

Future product sales are impacted by the extent to which there is patent protection over the products. Patent coverage risk includes the risk that competitive products do not infringe the Group's intellectual property rights, and also the risk that our products do not infringe on other parties' products. The Group constantly monitors its patent estate and the intellectual property competitive landscape, both internally and through the use of professional specialists.

3. Funding risk

The Group does not currently earn revenues from product sales. Accordingly, the ability of the company to successfully bring products to market ultimately relies on having access to continued sources of funding, including from partners and investors. The Company ensures it conducts a rigorous annual budget process and has rolling three-year funding forecasts. Short-term incentive payments to staff are also assessed in light of successful management of programs against both timelines and budget.

4. Key personnel risk

Execution of the Group's corporate strategy could be impacted if the Group did not retain its present CEO and certain members of staff. To mitigate this risk, the Board of Directors play an active role in directing the business of the organization. In addition, the Group has significantly expanded its human capital in the last two years. As we get nearer to commercialization the dependency on key specialists should lessen as individuals with broad industry expertise are progressively brought into the company.

5. Major disruption to manufacturing

Disruption to manufacturing operations could impact the Group's ability to deliver clinical grade product required for clinical trials and, in the future, MPC product for commercial sale. The Group has mitigated this risk through increasing the balance of stock on hand and ensuring parallel production of products across multiple approved manufacturing facilities in various jurisdictions in addition to the enforcement of standard operating procedures and monitoring of the current manufacturing process. Additional manufacturing processes are currently being investigated to supplement and optimize the current process.

6. Partnering risk

Future product sales in certain indications are dependent on maintaining existing commercial relationships. In addition, future product sales may also be dependent on the ability of the Group to attract new partners, who will in some cases, be required to help development and distribute our products. The Group has ongoing discussions with a variety of potential commercial partners and will proactively seek to broaden strategic alliances when the timing is right.

Significant Changes in the State of Affairs

During the year the Company completed a capital raising, contributing \$170m cash to the Group. This has resulted in a significant increase in cash reserves for the Group, which sees the Group well placed to execute its business strategy over the next few years.

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

Matters Subsequent to the End of the Financial Year

There are no events that have arisen after 30 June 2013 and prior to the signing of this financial report that would likely have a material impact on the financial results presented.

Likely Developments and Expected Results of Operations

Mesoblast's solid cash position primes the Company for a successful 2014 financial year. Our continued progress in clinical development brings our products closer to approvals and commercial reality. These products will continue to be underpinned by an expanding set of innovative core technologies, a robust and growing intellectual property portfolio, and manufacturing capabilities that facilitate regulatory compliance and safe product supply.

As our Company grows and progresses, we will continuously reassess our priorities and focus in the context of our broadening opportunities, and ensure that our operations remain in alignment with our commercial goals. Our scientific, clinical, and financial strengths will continue to provide marketplace differentiation and position the Company as a leading force in the development of cellular-based therapies for a broad range of intransigent diseases.

Environmental Regulations

Mesoblast's operations are not subject to any significant environmental regulations under either Commonwealth of Australia or State/Territory legislation. The Board considers that adequate systems are in place to manage the Group's obligations and is not aware of any breach of environmental requirements as they relate to the Group.

Dividends

No dividends were paid during the course of the financial year. There are no dividends or distributions recommended or declared for payment to members, but not yet paid, during the year.

Information on Directors

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

Name	Position
Silviu Itescu	Executive Director
Brian Jamieson	Non-executive Chairman
Donal O'Dwyer	Non-executive Director
Eric Rose	Non-executive Director (elected 15 April 2013)
Michael Spooner	Non-executive Director
Dr Ben-Zion Weiner	Non-executive Director



Brian Jamieson FCA
Non-executive Chairman



Donal O'Dwyer BE, MBA
Non-executive Director

Experience and expertise

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

Other current directorships of listed public companies

Chairman, Sigma Pharmaceuticals Limited (since 2005)
Non-executive Director, Tatts Group Limited (since 2005)
Non-executive Director, OZ Minerals Limited (since 2004)
Non-executive Director, Tigers Realm Coal Limited (since 2011)

Former listed public company directorships in the last 3 years

None

Special responsibilities

Chairman of the Board
Member of the Audit & Risk Committee
Member of the Remuneration and Nomination Committee

Experience and expertise

Donal O'Dwyer has over 25 years of experience as a senior executive in the global cardiovascular and medical devices industries. From 1996 to 2003, he worked for Cordis Cardiology, the cardiology division of Johnson & Johnson's Cordis Corporation, initially as its President (Europe) and as its worldwide President from 2000. In his role, Mr O'Dwyer led Cordis through the launch of the revolutionary Cypher drug eluting coronary stent technology, and saw the company take over number one market share of coronary stents worldwide. Prior to joining Cordis, he worked for 12 years with Baxter Healthcare, rising from plant manager in Ireland to President of the Cardiovascular Group, Europe (now Edwards Lifesciences). Mr O'Dwyer is a qualified civil engineer and has an MBA.

Other current directorships of listed public companies

Non-executive Director, Cochlear Limited (since 2005)
Non-executive Director, Atcor Medical Holdings Limited (since 2004)
Non-executive Director, Fisher & Paykel Healthcare (since 2013)

Former listed public company directorships in the last 3 years

Non-executive Director, Sunshine Heart (from 2004 to 2013)

Special responsibilities

Chairman of the Remuneration and Nomination Committee
Member of the Audit & Risk Committee

Information on Directors (continued)



Eric A. Rose MD
Non-executive Director

Experience and expertise

Eric Rose is a world leader in cardiovascular medicine. He is currently Chairman and CEO of SIGA Technologies and Executive Vice President, Life Sciences, at MacAndrews & Forbes, Inc., the holding company of Ronald O. Perelman. From 2008 through 2012, Dr Rose served as the Edmond A. Guggenheim Professor and Chairman of the Department of Health Evidence and Policy at the Mount Sinai School of Medicine, which has an extensive portfolio of research focused on evaluation of complex medical technologies in cardiovascular disease, cancer, diabetes mellitus, and neurologic disease. From 1994 through 2007, Dr Rose served as Chairman of the Department of Surgery and Surgeon-in-Chief of the Columbia Presbyterian Center of New York Presbyterian Hospital. From 1982 to 1992, he led the Columbia Presbyterian heart transplantation program, during which time it became the most active program in the United States. Dr Rose pioneered heart transplantation in children, performing the first successful pediatric heart transplant in 1984. He has investigated many alternatives to heart transplantation, including cross species transplantation and man-made heart pumps and is also Chairman of the Board of Circulite, Inc., a developer of advanced left ventricular assist devices. Dr Rose has authored or co-authored more than 300 scientific publications and has received more than \$25 million in National Institutes of Health support for his research.

Other current directorships of listed public companies

SIGA Technologies (since 2001)

Former listed public company directorships in the last 3 years

ABIOMED (2007 to 2012)

Special responsibilities

None



Michael Spooner Bcom, ACA, MAICD
Non-executive Director

Experience and expertise

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

Other current directorships of listed public companies

None

Former listed public company directorships in the last 3 years

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

Special responsibilities

Chairman of the Audit & Risk Committee

Member of the Remuneration and Nomination Committee



Ben-Zion Weiner BSc, MSc, PhD
Non-executive Director

Experience and expertise

Ben-Zion Weiner was head of global research and development at Teva Pharmaceutical Industries Ltd for over three decades, including as Chief R&D Officer and a member of the Teva Executive Committee. He directly oversaw all pharmaceutical R&D and innovative branded product pipeline development. Dr Weiner has been responsible for the development of hundreds of generic products for the United States, European and other markets. In parallel, he has been responsible for the development and regulatory approval of Teva's innovative product portfolio. Dr Weiner has twice been the recipient of the Rothschild prize for innovation, including for the commercialization of Copaxone in the treatment of multiple sclerosis. He retired from Teva at the end of 2012. Dr Weiner is no longer affiliated with Teva and continues to serve on the Mesoblast Board as an independent non-executive Director.

Other current directorships of listed public companies

None

Former listed public company directorships in the last 3 years

Director of Gefen Biomed Investments Ltd (2010 to 2013)

Board Member of XTL Biopharmaceuticals Limited (2012 to 2013)

Special responsibilities

None



Silviu Itescu MBSS (Hons), FRACP, FACR, FACR
Executive Director

Experience and expertise

Prior to founding Mesoblast in 2004, Professor Silviu Itescu established an outstanding international reputation as a physician scientist in the fields of stem cell biology, autoimmune diseases, organ transplantation, and heart failure. He is an active faculty member of Melbourne and Monash universities in Australia and was previously a faculty member of Columbia University in New York. Under his leadership, Mesoblast has become the world's largest regenerative medicine company, and received the 2011 Deals of Distinction™ Award from The Licensing Executives Society (United States and Canada) Inc. for its alliance with Cephalon, Inc., later acquired by Teva Pharmaceutical Industries Ltd. In 2011, Professor Itescu was named BioSpectrum Asia Person of the Year. In 2013 he received the inaugural Key Innovator Award from the Vatican's Pontifical Council for Culture for his leadership and ingenuity in translational science and clinical medicine in relation to adult stem cell therapy. Professor Itescu has consulted for various international pharmaceutical companies, has been an adviser to biotechnology and health care investor groups, and has served on the Board of Directors of a number of publicly-listed life sciences companies.

Other current directorships of listed public companies

None

Former listed public company directorships in the last 3 years

None

Special responsibilities

Chief Executive

Company Secretary

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

Directors' interests

The relevant interest¹ of each director in the share capital of the Company, as notified by the directors to the ASX in accordance with section 205G(1) of the *Corporations Act 2001*, at the date of this report is as follows:

Director	Mesoblast Limited ordinary shares	Options over ordinary shares
Silviu Itescu	68,244,642	–
Brian Jamieson	135,000	300,000
Donal O'Dwyer	305,000	799,727
Eric Rose	–	–
Michael Spooner	985,606	–
Ben-Zion Weiner	–	–

1. As defined by section 608 of the *Corporations Act 2001*

Meetings of Directors

The number of meetings of the Group's directors (including committee meetings of directors) held during the year ended 30 June 2013 and the numbers of meetings attended by each director were:

Director	Board of Directors		Audit & Risk committee		Remuneration and Nomination committee	
	A	B	A	B	A	B
Silviu Itescu	13	13	**	**	**	**
Brian Jamieson	13	13	5	5	3	3
Donal O'Dwyer	13	12	5	5	3	3
Eric Rose (elected 15 April 2013)	3	3	**	**	**	**
Michael Spooner	13	13	5	5	3	3
Ben-Zion Weiner	13	12	**	**	**	**

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

B = Number of meetings attended.

**Not a member of the relevant committee

Remuneration Report

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

1. Remuneration at a Glance

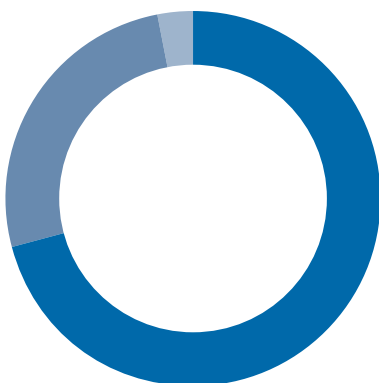
(i) Overview

Mesoblast is a pre-revenue company, headquartered in Australia with operations in the United States and Singapore. Its principal activity is in the research and development of its propriety stem cell technology for use in the treatment of multiple major disease states and other medical conditions. Given our business activity and the current development stage we are at, we generate losses each year and are net users of cash.

Our employees are, in general, highly skilled, performing specialized roles directly engaged in activities developing our proprietary adult stem cell technologies.

As at 30 June 2013, the Group has 76 employees globally:

Employees by Region



- USA – 71%
- Australia – 26%
- Singapore – 3%

54 (71%) of these employees are based in the United States, which is largely where the Group's operational activities occur.

Of the remaining employees, 20 (26%) are located in Australia, including the CEO and other executive team members, and 2 (3%) are based in Singapore.

The Australian operations comprises mainly headquarter activities, and as a result almost half of the Australian employees hold senior positions.

Our CEO, who is also the founder of the company, continues to be the single largest shareholder in the company.

Given that we employ a relatively small number of people, our organization structure is relatively flat, reflecting more a company in its early stage of development as opposed to a mature organization.

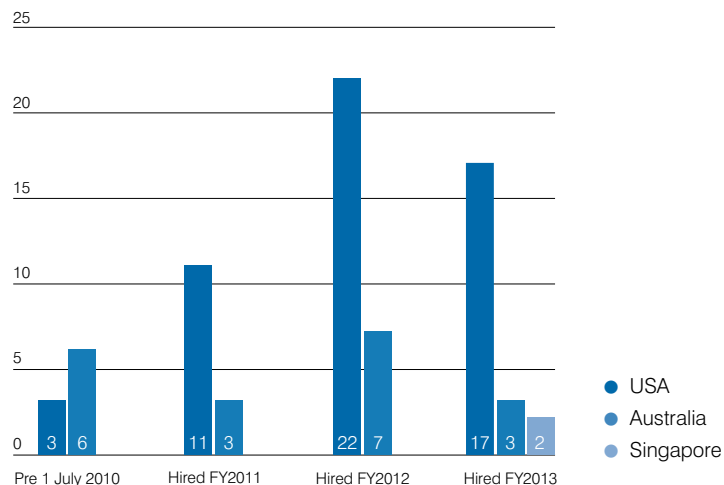
As we operate in a highly specialised environment our approach to remuneration is to provide us with the platform to allow us to be competitive worldwide and in particular within the United States life sciences industry to ensure that we can attract and retain leaders and people with highly specialized skills in our field.

Our remuneration structure is designed to take account of the specific circumstances pertaining to our company as outlined above whilst at the same time applying consideration to both the expectations of our global shareholder base and the Australian regulatory framework by which the Group is governed.

(ii) Rapid growth

The Group's operations have expanded considerably over the last two financial years which has seen an expansion in staffing levels as the graph below illustrates:

New Hires



Due to the fact most roles are newly created in the last two years, remuneration levels have been set at the market rates required in order to attract these staff to Mesoblast. The Group has also recently performed a remuneration benchmarking exercise across all levels of the Group to ensure remuneration packages are aligned with the market.

This rapid growth in personnel over a relatively short time has meant the organizational structure throughout this time has been fairly flat, with the CEO having 12 direct reports, 9 of whom are part of the executive team, as at 30 June 2013. This structure is in the process of transitioning into a more traditional reporting structure which will better support the Company's operations as it continues to grow.

2. Role of the Remuneration Committee

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

- Non-executive director fees
- The executive remuneration framework
- Remuneration levels of executive directors, including the CEO, and other key executives
- The award of short-term and long-term incentives
- Share ownership plans

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

The Corporate Governance Statement provides further information on the role of this committee and its membership.

3. Non-Executive Director Remuneration

The Company has five non-executive Directors, three based in Australia, one in the United States and one in Israel. Non-executive Director fees are paid with due consideration to the Australian regulations with consideration made to the time commitment required of each director. They have been set at market rates for our industry and size of company in order to attract those Directors who have considerable expertise both in our industry and in the Australian capital markets.

(i) Directors' fee structure

Non-executive directors receive fixed fees for their services as a director, plus any applicable compulsory superannuation.

During its start-up phase, the Company issued sign-on options to each of the non-executive Directors joining the Board, as cash was limited and conserved to advance the Company's programs. All grants of options made to directors are subject to shareholder approval. Options have not been issued to any Director since those granted to the Chairman as sign-on options, approved by shareholders in November 2009.

Non-executive directors receive a letter of appointment covering the key terms of their appointment to the Board. Non-executive directors are not entitled to retirement allowances, in line with guidance from the ASX Corporate Governance Council. Superannuation contributions, required under the Australian superannuation guarantee legislation continue to be made.

(ii) Structure of the board and directors fees

In line with the growth of the Company, the Board of Directors' made the decision to expand the skillset of the Board by obtaining new members. To ensure it could attract new high caliber members, the Board, through its Nomination and Remuneration Committee, commissioned Towers Watson to perform a market benchmarking exercise in October 2012.

Towers Watson benchmarked Mesoblast against companies of comparable size and complexity, with a particular focus on companies with a comparable market capitalization because Mesoblast does not currently derive significant revenue, but is well capitalized. Mesoblast's size, profile and international operations brings with it governance and regulatory complexity (as does the business in which it operates) which has a direct bearing on the scope and complexity of the NEDs roles. In addition, other large Australian healthcare companies were referenced.

As a result of that benchmarking exercise, Directors' fees were reset to align with the median reported fees payable to the Chairman, non-executive Directors, the chair of board committees, and committee members.

Fees are paid as follows, and statutory superannuation is paid in addition to the fees below as applicable:

Position	From 1 November 2012 to current			From 1 July 2011 to 31 October 2012		
	Board \$	Audit & Risk Committee \$	Nomination & Remuneration Committee \$	Board \$	Audit & Risk Committee \$	Nomination & Remuneration Committee \$
Chair	320,000	25,000	20,000	220,000	20,000	15,000
Member	125,000	12,500	10,000	100,000	10,000	7,500

(iii) Maximum annual fee pool

The maximum annual fee pool for directors currently available is \$1,000,000 which was approved by shareholders at the extraordinary general meeting held on 9 February 2011. The maximum annual fee pool of those companies included in the benchmarking exercise was a median of \$1,200,000.

(iv) Performance review

During the year the Board conducted a performance review of the Board and its operations as whole. The review was conducted internally using questionnaires and interviews were held between the Chairman and each individual Director. The Board then met and discussed the review.

4. CEO Remuneration

The CEO's remuneration is comprised of the following components:

- Fixed remuneration, comprising base salary and statutory superannuation;
- Performance based remuneration, comprising short-term incentives up to a maximum entitlement of 100% of fixed remuneration, based on business and individual performance.

The CEO of the Mesoblast Group, is also an executive Director, and the founder of Mesoblast. The CEO is the single largest shareholder in the company, and has been since the inception of Mesoblast Limited in 2004. Because of his significant shareholding in the Company, the Board believes he is very closely aligned with shareholders' objectives of achieving long-term shareholder value. For this reason, the CEO does not participate in the long-term incentive schemes of the Group as the Board feels there is no additional value to the Company by having the CEO participating in such schemes.

(i) Fixed remuneration

The CEO's annual fixed pay pursuant to his contract of employment dated 1 April 2011 is \$900,000 plus statutory superannuation. Each year this base is adjusted for a CPI increase. There are no guaranteed base pay increases in the CEO's contract of employment, other than CPI adjustments.

(ii) Performance-based incentives

In order to align the CEO with the shorter-term success of the Group and the achievement of milestones which are designed to ultimately lead to long-term shareholder wealth, the CEO has 50% of this total remuneration package at risk, and is paid subject to meeting annual key performance indicators (KPIs). These KPIs are set by the Board, with reference to the upcoming milestones needed to be achieved in order to grow the company and set the foundation for long-term shareholder wealth.

At the end of the financial year the Board assesses the overall Company performance, and the CEO's individual performance against the set KPIs. The achievement of these KPIs is always assessed in the context of total corporate performance against budget which ensures cost control is always part of the performance framework and is regularly measured and reported.

While the specific details of these milestones are commercially sensitive and therefore are not disclosed, the Board has approved key performance indicators (KPIs) for the CEO in the following performance categories for the financial year ended 30 June 2013:

- Achievement of Prescribed Clinical Trial Milestones
- Achievement of Manufacturing Milestones
- Execution of successful capital raising
- Recruitment and Organizational Development
- Strategic Planning

For the financial year ended 30 June 2013, the performance assessment was 85% of the target short-term incentive.

This performance assessment reflects the milestones achieved within clinical trials and manufacturing. The achievement of the milestones were measured against budgets and timelines. In addition, a major milestone was the completion of the \$170 million capital raised in March 2013. More detail on these milestones can be found on page 22 of this report.

5. Executive Team Remuneration (excluding the CEO)

Closely supporting the CEO in the execution of the Group's strategy is the Mesoblast executive team, which consists of nine people, who report to the CEO. In addition, the CEO has a further three direct reports which are not part of the executive team. The Groups' executive team are currently located across both the United States and Australia with five and four members in each jurisdiction respectively. The executive team is integral to the support of the CEO. They work closely together on a regular basis. The executive team remuneration packages are designed to be competitive in each of the jurisdictions in which they are based, with close alignment across the team where skillsets and experience are similar, to ensure cohesion.

(i) Remuneration Structure

The aim of the Group's executive remuneration structure is to ensure the remuneration package reflects the skills, responsibilities and experience of our people. It is also designed to align the achievement of the Group goals that are ultimately set to achieve long-term shareholder value. The Group is committed to adhering to appropriate corporate governance standards for executive (including the CEO) remuneration, having regard to the ASX Corporate Governance Council's Recommendations and relevant stakeholder bodies, together with mindfulness of the industry and environment the Group is operating within.

Our remuneration arrangements for our executive team (excluding the CEO whose details are discussed in section 4 of this report) are comprised of both fixed and performance-based remuneration. The fixed remuneration component allows us to recruit and retain highly specialised experts in a small and competitive market. The at-risk components of short-term incentives (STIs) and long-term incentives (LTIs) seek to reward our executives for achieving the short-term operational objectives that are essential to reaching our long-term objective of creating regenerative medicine therapies for major unmet clinical needs.

When conducting our annual executive remuneration review, the Remuneration Committee considers the following:

- operational performance and current financial position of the Company;
- the achievement of strategic goals of the Company for the year; and
- the individual performance of our executive team members.

The Committee benchmarks the various components of our executive remuneration to packages paid by other publicly listed companies in our peer group, incorporates compensation data from an international life sciences survey, and considers recommendations from our CEO (other than for his own salary). From time to time the Committee engages the services of outside compensation consultants.

The typical target remuneration mix of our executive team (excluding the CEO) approximates 40% fixed and 60% performance-based. Of the 60% performance-based remuneration, 40% relates to LTIs and 20% STIs.

(ii) Fixed Remuneration

Fixed remuneration consists of base salary, and in keeping with local market practices our Australian executives receive employer superannuation contributions, up to the statutory limits, and our US executives receive medical and insurance benefits.

(iii) Performance-based Remuneration

Our performance-based remuneration components consist of at-risk of STIs and LTIs. STIs are a discretionary bonus paid in cash. Outside Australia, LTIs consists of options over ordinary shares of the Company under the rules of the employee share option plan (ESOP). In Australia, LTIs consist of limited recourse loan-Funded shares of the Company pursuant to the rules of the Loan-funded Share Plan (LFSP). Annual STI and LTI grants are determined each year by the CEO together with the Remuneration Committee, with regard to both individual performance and the overall corporate performance. STI and LTI recommendations are then subject to approval by the Board.

a. Short-term Incentives (STIs)

The Group is in development stage and is pre-revenue, which influences our approach to STI setting, as follows:

1. We set STIs at a smaller proportion of our total target remuneration than LTIs to conserve cash outflow; and
2. We measure individual performance against the achievement of individual key performance indicators, key corporate and budgetary milestones, and achievement of strategic goals, of all which ultimately lead to long term shareholder value creation.

STI allocations for the executive team start with the Company assessment of performance against key milestones and strategic goals and budget performance, and are then adjusted up or down based on each executive's operational ability to contribute to the company's goals and their individual performance against their own individual KPIs. For the 2012/13 financial year, executive STI allocations were between 80% and 100% of target.

b. Long-term Incentives (LTIs)

As a biotechnology company progressing our clinical trials, where cash needs to be conserved in order to fund our programs, we place significant weight on the LTI component of our remuneration mix. This focuses our executives on the value creation that occurs as our products move through development process and ultimately to therapeutic treatment.

While our headquarters are based in Melbourne, only 26% of our employees are in Australia. The majority of employees (71%) are in the United States and the remainder (3%) are in Singapore. In designing a LTI mechanism which supports reward and retention across this employee mix we seek to balance:

- Australian practice and governance expectations, where LTI are expected to have performance hurdles.
- United States practices, where options are a widely distributed remuneration component, typically issued at par value without performance hurdles or milestones; and
- A strong preference for a single reward mechanism to maintain executive cohesion and teamwork, and alignment with driving shareholder value.

Taking into consideration the above points, we have an employee share option plan (ESOP) for our international employees and a loan-funded share plan (LFSP) for our Australian employees. Both plans operate in a similar manner, with the shares/options typically having three-year vesting schedules and a five year life.

As a performance hurdle, we issue the equity at a percentage premium above the volume weighted average share price calculated at grant date.

Loan funded shares are issued with new equity, and the Company does not buy shares on-market under this plan in an effort to conserve cash.

The Company uses a Black-Scholes model calculation to determine a number of options and/or loan-funded shares equivalent to the target dollar value for LTI in each executive's remuneration mix as described above.

6. Key management personnel

Mesoblast is emerging from a period of rapid expansion throughout which the CEO and Board have had the primary responsibility for setting the strategy and the direction of the company. During this establishment period, the organizational structure has remained flat, with the CEO maintaining a total of 12 direct reports, 9 of whom are part of the executive team described above and have operational responsibility for executing their appropriate part of the strategy set by the Board and the CEO. This structure is in the process of review, and is expected to be transitioning into a more traditional reporting structure which will better support the Group's future operational requirements as it continues to grow.

Whilst the current executive team remains critical in the execution of the Company's strategy, the overall planning and decision making responsibilities have rested with the Board and the CEO for the current and previous financial years.

Key management personnel, as per the Australian Accounting Standards Board 124 Related Party Disclosures and the *Corporations Act 2001*, have authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, and include any director (whether executive or otherwise).

With the above definition in mind, and the flatness of the Groups organizational structure as described above, the Board has determined the CEO and directors are the key management personnel of the Group for 2013 and 2012, as listed in table below:

Name	Position	Change from last year (2012)
Brian Jamieson	Chairman of the Board of Directors; Member of the Nomination and Remuneration Committee; and Member of the Audit and Risk Committee	No change
Donal O'Dwyer	Non-executive director; Chairman of the Nomination and Remuneration Committee; and Member of the Audit and Risk Committee	No change
Eric Rose	Non-executive director	Joined the Board 15 April 2013
Michael Spooner	Non-executive director; Chairman of the Audit and Risk Committee; and Member of the Nomination and Remuneration Committee	No change
Ben-Zion Weiner	Non-executive director	No change
Silviu Itescu	CEO (executive director)	No change

7. Service Agreements

The employment of the CEO is formalised in a contract of employment, the key terms of which are as follows:

Position	Term	Notice period	Termination benefit
CEO (Silviu Itescu)	Initial term of 3 years commencing 1 April 2011, and continuing subject to a 12 months' notice period	12 months	12 months base salary

Key management personnel are entitled to receive on termination of employment their statutory entitlements of accrued annual and long service leave, together with any superannuation benefits.

There is no entitlement to a termination payment in the event of resignation or removal for misconduct.

The employment of the executive team is also formalised in contract for employments. Five of the executive team employment contracts are for a fixed term of three years, with 12 month notice periods. Two of those contracts have contractual CPI increases – there are no other contractual increases in remuneration. The remaining four members are continuous employment contracts with no fixed term with notice periods ranging from 'at will' to six months

8. Key Management Personnel (KMP) Remuneration

Key management personnel includes all non-executive directors (as disclosed in section 6 above) and the CEO, who together have the authority and responsibility for planning, directing and controlling the activities of the Group.

(i) Remuneration details

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

2013	Short-term benefits ¹			Post-employment benefits	Long-term benefits	Share-based payments	Other	Total
	Salary & fees	Cash Bonus ²	Non-monetary benefits	Super-annuation	Long service leave	Options	Termination benefits	
Name	\$	\$	\$	\$	\$	\$	\$	\$
Executive director								
Silviu Itescu (CEO)	936,000	795,600 ⁺	–	16,470	–	–	–	1,748,070
Non-executive directors								
Brian Jamieson	286,667	–	–	16,470	–	5,032	–	308,169
Donal O'Dwyer	146,667	–	–	13,200	–	–	–	159,867
Michael Spooner	149,167	–	–	13,425	–	–	–	162,592
Ben-Zion Weiner	117,249	–	–	–	–	–	–	117,249
Eric Rose (from 15 April 2013)	26,042	–	–	–	–	–	–	26,042
Total 2013	1,661,792	795,600	–	59,565	–	5,032	–	2,521,989

⁺ Accrued but not paid as at 30 June 2013;

1. Short-term benefits may include amounts paid to superannuation at the election of the individual;

2. The CEO cash bonus is 85% of his target bonus. The amount of bonus forfeited during the year as a result of performance targets not being met is therefore 15%.

2012	Short-term benefits ¹			Post-employment benefits	Long-term benefits	Share-based payments	Other	Total
	Salary & fees	Cash Bonus ²	Non-monetary benefits	Super-annuation	Long service leave	Options	Termination benefits	
Name	\$	\$	\$	\$	\$	\$	\$	\$
Executive director								
Silviu Itescu (CEO)	920,833 ⁺	585,000 [*]	–	15,775	–	–	–	1,521,608
Non-executive directors								
Brian Jamieson	220,000	125,000	–	15,775	–	11,801	–	372,576
Donal O'Dwyer	125,000	125,000	–	13,319	–	–	–	263,319
Michael Spooner	127,500	125,000	–	13,505	–	–	–	266,005
Kevin Buchi (from 1 July 2011 to 9 May 2012)	85,753	–	–	–	–	–	–	85,753
Ben-Zion Weiner (from 9 May 2012 to 30 June 2012)	14,361 [*]	–	–	–	–	–	–	14,361
Total 2012	1,493,447	960,000	–	58,374	–	11,801	–	2,523,622

+ Base salary includes \$20,833 paid relating to services provided for the preceding financial year.

* Accrued but not paid as at 30 June 2012;

1. Short-term benefits may include amounts paid to superannuation at the election of the individual;

2. The CEO cash bonus is 65% of his target bonus. The amount of bonus forfeited during the year as a result of performance targets not being met is therefore 35%. Non-executive directors bonuses paid were a one-off discretionary bonus to re-compensate directors for workloads in earlier years where director's fees were low in an effort to conserve cash. The bonuses paid to non-executive directors were not subject to specific performance hurdles.

(ii) Performance-based remuneration

Performance-based remuneration consists of short-term incentives and long-term incentives.

The relative proportions of remuneration that are linked to performance and those that are fixed, for key management personnel, are as follows:

Name	Fixed remuneration		At risk – STI		At risk – LTI	
	2013	2012	2013	2012	2013	2012
	%	%	%	%	%	%
Silviu Itescu (CEO)	54	61	46	39	0	0

The proportion of at-risk performance remuneration that was awarded and forfeited during the year is as follows:

Name	At risk – STI	
	Awarded	Forfeited
	%	%
Silviu Itescu (CEO) – 2013	85	15
Silviu Itescu (CEO) – 2012	65	35

9. Company performance and remuneration

Mesoblast is a Group of companies operating in the biotechnology industry. Its core activities are researching & developing a proprietary adult stem cell technology for use to treat a variety of diseases and medical conditions. As is common within the biotechnology industry, the Group is pre-revenue and in development phase. It therefore continues to report net operating losses and negative cash burn, as we advance our programs through the clinic towards commercialisation. The Group has not paid dividends to date nor made any returns of capital to shareholders.

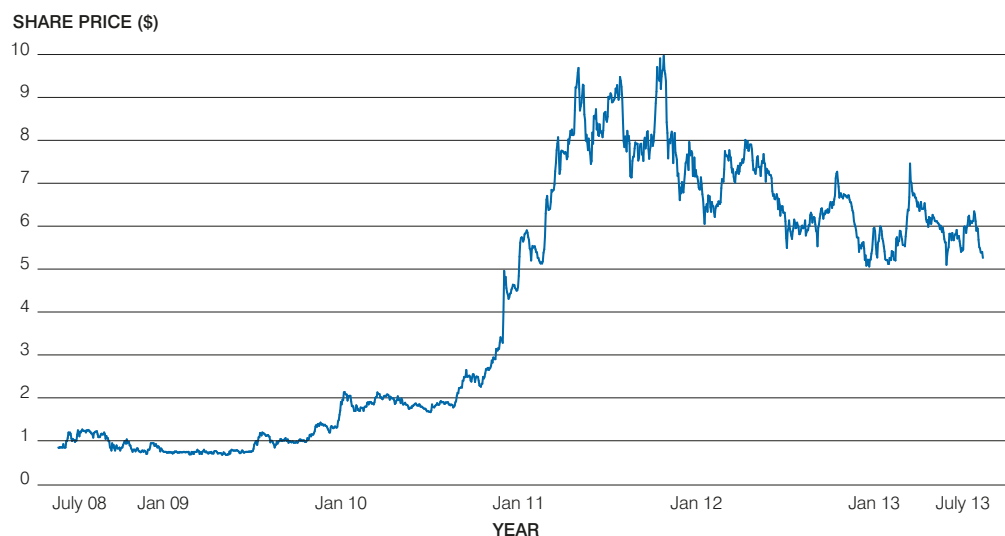
To date, our sources of funding for the programs have predominantly been through capital raises from institutional and sophisticated investors, the signing of a key collaboration with Teva Pharmaceutical Industries, and to a small extent government grants and research and development tax credits. To date, the Group has not utilized any debt financing. The Group remains well-funded with \$317m cash on hand as at 30 June 2013.

Whilst we are in this development phase, we are continuing to advance the proprietary adult stem cell technologies through the clinic, which makes the technology more valuable as it progresses towards registration and sale of products. Our share price generally reflects the achievement of clinical milestones.

When assessing company performance in light of remuneration, traditional financial metrics, such as profitability, total shareholder return (TSR), and earnings per share (EPS) are not meaningful, nor do they reflect appropriately the performance of the company. Rather, the performance of the Company is generally reflected by the long-term growth in market capitalisation. The table and chart below detail Company performance on a market capitalisation basis, against executive key management personnel at-risk compensation:

	2013	2012	2011	2010	2009
Share price (ASX:MSB)					
– closing at 30 June	\$5.30	\$6.19	\$8.65	\$1.85	\$0.83
– high for the year	\$7.49	\$10.04	\$9.95	\$2.26	\$1.35
– low for the year	\$4.22	\$5.44	\$1.72	\$0.78	\$0.68
– share price volatility (annual)	39%	47%	52%	53%	72%
Market capitalization at 30 June					
– increase/(decrease) – \$	\$1,677m	\$1,770m	\$2,425m	\$286m	\$113m
– increase/(decrease) – %	(\$93m)	(\$655m)	\$2,139m	\$173m	
	(5%)	(27%)	748%	153%	
Short-term incentives – % of target paid to CEO	85%	65%	100%	100%	100%
Short-term incentives – % of base salary paid to CEO	85%	65%	42%	40%	40%

The chart of monthly prices over 5 years for security **MSB**:



The table below summaries major milestones achieved in the current and previous financial years:

Year	Key Value Creating Milestones Achieved
2013	<ul style="list-style-type: none"> – \$170m global capital raising – Positive interim results in phase 2 trial for disc repair – Australian Ethics committees' approval for a phase 2 trial to commence in diabetic nephropathy – FDA approval for a phase 2 clinical trial to commence for treating rheumatoid arthritis – Key patents granted in Japan, China and USA
2012	<ul style="list-style-type: none"> – FDA Clearance for Phase 2 Clinical Trial in Type 2 Diabetes – Positive Heart Failure Trial Results Presented to AHA – Clearance for First Phase 2 Clinical Trial for Eye Diseases – MSB and Lonza form strategic global manufacturing alliance – First European Trial for Heart Attack Treatment Cleared – First Minimally Invasive Procedure for Lumbar Disc Repair

10. Use of remuneration consultants

During the year, the nomination and remuneration committee of the Board engaged Towers Watson, to provide market data for non-executive directors' fees for appropriately similar companies. They were paid \$5,000 for providing this report. Their report did not include any recommendations, and consequently they are not considered to be remuneration consultants as defined by section 9 of the *Corporations Act 2001*.

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

Mesoblast Ltd received 94% of the proxy votes in favour of adopting the 2012 remuneration report, and the same resolution was passed on a show of hands at the meeting. The Company did not receive any feedback at the AGM on its remuneration practices.

12. Share-based compensation

The current equity based incentive scheme is described in section 5(iii)(b). The CEO does not participate in the scheme. Sign-on options were awarded to Brian Jamieson, Chairman of the Board of Directors, as approved by shareholders in recognition of him joining the Board. These options consisted of four tranches of 75,000 options, and are subject to the following performance hurdles:

- Receiving IND clearance from the FDA for its first clinical trial for Intervertebral Disc Repair
- Completing patient enrolment for its first clinical trial under IND for Intervertebral Disc Repair;
- Signing a commercial partnering contract, eg a commercial license to one of its products
- Obtaining a licence from the Therapeutics Goods Administration (TGA) for the manufacture of an allogeneic cell product.

As at 30 June 2013, all of those performance hurdles have been met, and no options have been forfeited.

(i) Share options grants affecting remuneration in the current or future period

The terms and conditions of each grant of options affecting remuneration in the current or a future reporting period are as follows:

Award Type	Grant Date	Vesting Date	Expiry Date	Exercise Price	Value per Option at Grant Date	Vested
Performance option	30/11/2009	12/10/2012	30/11/2014	\$1.73	\$0.70	100%

Options granted under the ESOP carry no dividend or voting rights. The exercise price has been determined with referenced to the weighted average price at which the Company's shares are traded on the ASX in the five days up to and including the grant date, plus a pricing hurdle of a 20% premium.

There were no grants of share options made to key management personnel in either the current or prior financial year.

There has been no modification to any terms and conditions of share-based payment transactions during the current and prior financial year.

(ii) Share options forming part of remuneration

Details of options over ordinary shares in the Company provided as remuneration to each director and member of key management personnel for the current and prior financial years are set out in the tables below. Table 1 provides the remuneration value, whilst table 2 provides the number of options.

Table 1:

	Remuneration consisting of options ¹ %	Value of options granted ² \$	Value of options exercised ³ \$	Value of options lapsed ⁴ \$
2013				
Brian Jamieson	1.6%	–	–	–
2012				
Brian Jamieson	3.2%	–	–	–

1. The percentage of the value of remuneration consisting of options, based on the value of options expensed during the year in accordance with AASB2 Share-based payments

2. The accounting value at grant date of options that were granted during the year as part of remuneration, determined using black scholes valuation model and in accordance with AASB2 Share-based payments

3. The intrinsic value at exercise date of options that were exercised during the year, having been granted as part of remuneration previously

4. The intrinsic value at lapse date of options that lapsed during the year because a performance condition was not met, but valued as if the performance condition had been met

Table 2:

	No. of options granted during the year	No. of options vested during the year	No. of options lapsed during the year ¹
2013			
Brian Jamieson	–	75,000	–
2012			
Brian Jamieson	–	–	–

1. Options lapsed because a performance condition was not met

(iii) Options/loan-funded shares that have vested and/or were forfeited

The table below presents the percentages of options granted under the ESOP that vested and those that were forfeited during the current financial year:

	Year of Grant	Vested during the year %	Forfeited during the year %	Subsequent financial years in which options may vest	Minimum value yet to vest	Maximum value yet to vest
2013						
Brian Jamieson	2010	25%	–	–	–	–

(iv) Shares provided on exercise of remuneration options

There were no share options exercised by key management personnel in either the current or prior period.

End of Remuneration Report.

Share Options**Options granted as remuneration**

The following table presents options and loan-funded shares that have been granted over unissued shares during or since the end of the year, to any of the Directors or any of the five most highly remunerated officers (excluding Directors) of the company, as part of their remuneration. Included in these options are options granted as remuneration to officers who are among the five highest remunerated officers of the company and the group (other than Directors), but are not key management persons and hence are not disclosed in the remuneration report:

Name of Officer	Issue Date	Exercise price	Number of shares under option, or loan-funded
Silviu Itescu	–	–	–
Peter Howard ^{1,2}	–	6.70 6.36	165,000 135,000
Michael Schuster ¹	24/09/2012 & 29/10/2012	6.70	200,000
Donna Skerrett ¹	24/09/2012 & 29/10/2012	6.70	200,000
Darin Weber ¹	24/09/2012 & 29/10/2012 24/05/2013	6.70 6.36	200,000 200,000

1. Five most highly remunerated officers, but not designated key management personnel.

2. Loan-funded shares that have been approved by the Board. The terms and conditions of the loan agreement are currently being finalised.

Shares under option

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

Issue Date	Exercise price of options AUD	Expiry date of options	Number of shares under option
07/07/2008	1.00	30/06/2013	180,000
30/11/2009	1.73	30/11/2014	300,000
30/11/2009	1.58	30/11/2014	710,000
22/09/2010	2.64	21/09/2015	445,000
29/11/2010	3.48	29/11/2015	1,866,600
22/12/2011	7.99	30/06/2016	2,520,000
24/02/2012	8.48	23/02/2017	170,000
09/12/2012	6.69	08/07/2018	200,000
21/9/2012; 24/09/2012 & 29/10/2012	6.70	30/06/2017	2,140,000
25/01/2013	6.29	24/01/2018	50,000
24/05/2013	6.36	23/05/2018	765,000
	USD		
07/12/2010	0.046	07/07/2015	287,903
07/12/2010	0.444	25/04/2017	127,956
07/12/2010	0.444	02/05/2017	127,956
07/12/2010	0.305	26/10/2018	195,999
07/12/2010	0.340	26/10/2019	703,761
			<u>10,790,175</u>

No option holder has any right under the options to participate in any other share issues of the Group.

Shares issued on exercise of options during the year

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

Grant Date	Number of shares issued	Issue price of shares	Amount unpaid per share
07/07/2008	646,000	1.00	–
19/01/2009	80,000	0.96	–
30/11/2009	300,000	1.58	–
26/02/2010	72,000	2.00	–
29/11/2010	475,600	3.48	–
22/09/2010	40,000	2.64	–
07/12/2010	277,390	3.78	–
07/12/2010	85,913	USD0.34	–
07/12/2010	85,000	USD0.34	–
07/12/2010	85,000	USD0.34	–
07/12/2010	85,913	USD0.47	–
07/12/2010	85,913	USD0.47	–
07/12/2010	84,087	USD0.47	–
07/12/2010	150,000	USD0.31	–
	<u>2,552,816</u>		

Indemnification of Officers

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

Proceedings on Behalf of the Group

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

Non-Audit Services

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

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

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

	30 June 2013	30 June 2012
	\$	\$
Taxation services		
Employee share option plan tax advice	–	2,200
Total taxation services	–	2,200

Auditor's Independence Declaration

A copy of the auditor's independence declaration under Section 307C in relation to the audit for the year ended 30 June 2013 is included on page 28 of the annual report.

Rounding of Amounts

The company is of a kind referred to in Class Order 98/100, issued by the Australian Securities and Investments Commission, relating to the 'rounding off' of amounts in the Directors' report. Amounts in the Directors' report have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, to the nearest dollar.

Directors Resolution

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

A handwritten signature in blue ink, appearing to be 'Brian Jamieson', written over a circular stamp or seal.

Mr Brian Jamieson
Chairman

29 August 2013, Melbourne



Auditor's Independence Declaration

As lead auditor for the audit of Mesoblast Limited for the year ended 30 June 2013, I declare that to the best of my knowledge and belief, there have been:

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

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

A handwritten signature in black ink, appearing to read 'John Yeoman', written over a horizontal line.

John Yeoman
Partner
PricewaterhouseCoopers

Melbourne
29 August 2013

Financial Statements

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Consolidated Income Statement for the year ended 30 June 2013

	Note	30 June 2013 \$'000	30 June 2012 \$'000
Revenue from continuing operations	2(a)	28,786	38,155
Other income	2(b)	5,924	125
		34,710	38,280
Expenses from continuing operations	2(c)		
Research and development		(43,108)	(36,937)
Manufacturing commercialization		(20,946)	(22,015)
Management and administration		(30,734)	(28,051)
		(94,788)	(87,003)
(Loss)/profit before income tax		(60,078)	(48,723)
Income tax expense	4	(1,585)	(22,422)
(Loss)/profit attributable to the owners of Mesoblast Limited		(61,663)	(71,145)
(Losses)/profits per share from continuing operations attributable to the ordinary equity holders of the Group:		Cents	Cents
Basic – losses per share	6	(21.06)	(25.15)
Diluted – losses per share	6	(21.06)	(25.15)

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

Consolidated Statement of Comprehensive Income for the year ended 30 June 2013

	Note	30 June 2013 \$'000	30 June 2012 \$'000
Loss for the year		(61,663)	(71,145)
Other comprehensive income			
Items that may be subsequently reclassified to profit or loss			
Exchange differences on translation of foreign operations	19	32,003	14,905
Other comprehensive income for the period, net of tax		32,003	14,905
Total comprehensive loss is attributable to the owners of Mesoblast Limited		(29,660)	(56,240)

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

Consolidated Statement of Changes in Equity for the year ended 30 June 2013

	Note	Issued Capital \$'000	Share Option Reserve \$'000	Foreign Currency Translation Reserve \$'000	Retained Earnings \$'000	Total \$'000
Balance at 1 July 2011		477,115	25,664	(21,916)	34,981	515,844
Profit/(loss) for the year		–	–	–	(71,145)	(71,145)
Other comprehensive income		–	486	14,419	–	14,905
Total comprehensive profit/(loss) for the period		–	486	14,419	(71,145)	(56,240)
Transactions with owners in their capacity as owners:						
Contributions of equity net of transaction costs		5,766	–	–	–	5,766
	18	5,766	–	–	–	5,766
Tax effect of options deductible for tax		–	1,360	–	–	1,360
Transfer exercised options		2,123	(2,123)	–	–	–
Fair value of share-based payments	19	–	12,118	–	–	12,118
		2,123	11,355	–	–	13,478
Balance at 30 June 2012		485,004	37,505	(7,497)	(36,164)	478,848
(Loss)/profit for the year		–	–	–	(61,663)	(61,663)
Other comprehensive income		–	–	32,003	–	32,003
Total comprehensive (loss)/profit for the period		–	–	32,003	(61,663)	(29,660)
Transactions with owners in their capacity as owners:						
Contributions of equity net of transaction costs		168,785	–	–	–	168,785
	18	168,785	–	–	–	168,785
Tax effect of options deductible for tax		–	–	–	–	–
Transfer exercised options		669	(669)	–	–	–
Fair value of share-based payments	19	–	12,293	–	–	12,293
		669	11,624	–	–	12,293
Balance at 30 June 2013		654,458	49,129	24,506	(97,827)	630,266

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

Consolidated Balance Sheet as at 30 June 2013

	Note	30 June 2013 \$'000	30 June 2012 \$'000
Assets			
Current Assets			
Cash and cash equivalents	7	315,309	205,591
Trade and other receivables	8	12,063	10,669
Prepayments		986	319
Derivative financial instruments	15	3,486	–
Total Current Assets		331,844	216,578
Non-Current Assets			
Property, plant and equipment	9	2,757	1,998
Deferred tax asset	10	–	3,502
Other non-current assets	11	1,277	1,158
Intangible assets	12	547,834	497,219
Total Non-Current Assets		551,868	503,877
Total Assets		883,712	720,456
Liabilities			
Current Liabilities			
Trade and other payables	13	21,308	11,969
Deferred revenue	14	16,176	28,210
Derivative financial instruments	15	–	1,407
Provisions	17	13,104	2,909
Total Current Liabilities		50,588	44,494
Non-Current Liabilities			
Deferred revenue	14	56,617	56,361
Deferred tax liability	16	146,038	132,911
Provisions	17	203	7,841
Total Non-Current Liabilities		202,858	197,113
Total Liabilities		253,446	241,608
Net Assets		630,266	478,848
Equity			
Issued capital	18	654,458	485,004
Reserves	19	73,635	30,008
Retained earnings/(accumulated losses)		(97,827)	(36,164)
Total Equity		630,266	478,848

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

Consolidated Statement of Cash Flows for the year ended 30 June 2013

	Note	30 June 2013 \$'000	30 June 2012 \$'000
Cash Flows from Operating Activities			
Payments to suppliers and employees (inclusive of goods and services tax)		(67,716)	(65,204)
Government grants and other income received		–	125
Interest received		10,338	9,308
Income taxes refunded/(paid)		3,297	(7,038)
Net cash outflows in operating activities	20(b)	(54,081)	(62,809)
Cash Flows from Investing Activities			
Payments for financial derivatives		(2,204)	(1,274)
Payments for intellectual property and licenses		(1,614)	(722)
Payments for rental deposits		–	(1,147)
Investment in fixed assets		(1,224)	(1,983)
Proceeds from sale of fixed assets		–	4
Net cash inflows in investing activities		(5,042)	(5,123)
Cash Flows from Financing Activities			
Proceeds from issue of shares		174,878	4,883
Payments for share issue costs		(5,529)	–
Net cash inflows by financing activities		169,349	4,883
Net increase/(decrease) in cash and cash equivalents		110,226	(63,049)
Cash and cash equivalents at beginning of year		205,591	263,228
FX (losses)/gains on the translation of foreign bank accounts		(508)	5,413
Cash and cash equivalents at end of year	20(a)	315,309	205,591

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

Notes to the Financial Statements for the year ended 30 June 2013

Introduction

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

Registered office & principal place of business

Level 39
55 Collins Street
Melbourne

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

The financial statements were authorized for issue by the directors on 29 August 2013.

Notes to the Financial Statements for the year ended 30 June 2013

1. Significant Accounting Policies

Statement of compliance

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

Basis of preparation

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

i. Compliance with IFRS

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

ii. New and amended standards adopted by the Group

None of the new standards and amendments to standards that are mandatory for the first time for the financial year beginning 1 July 2013 affected any of the amounts recognized in the current period or any prior period and are not likely to affect future periods.

iii. Early adoption of standards

The Group has not elected to apply any pronouncements before their operative date in the annual reporting period beginning 1 July 2013.

iv. Historical cost convention

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

Critical accounting estimates

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances.

The group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(i) Income taxes

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

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

(ii) Revenue recognition

The total upfront cash received under the development and commercialization agreement is USD130,000k. The Group has recognized revenue of \$17,542k in the current year (2012: \$27,683k) for this payment on the basis that the revenue will be earned through-out the life of the development of those products pertaining to that payment. The development lives of those products are estimates which are reviewed on a half yearly basis as a minimum. During the current period, the Group has revised the development life estimate and adjusted the revenue accordingly.

(iii) Estimated impairment of goodwill and assets with an indefinite useful life

The Group tests annually whether goodwill and its assets with indefinite useful lives have suffered any impairment in accordance with its accounting policy stated in notes 1(j) and 1(n). The recoverable amounts of these assets and cash-generating units have been determined based on fair value less costs to sell calculations, which require the use of certain assumptions. Refer to note 12 for details of these assumptions and potential impact of any changes to the assumptions.

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

(a) Principles of consolidation

i. Subsidiaries

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Mesoblast Limited ('company' or 'parent entity') as at 30 June 2013 and the results of all subsidiaries for the year then ended. Mesoblast Limited and its subsidiaries together are referred to in this financial report as the Group or the consolidated entity.

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

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

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

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

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

ii. Employee share trust

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

(b) Segment reporting

The Group predominately operates in one segment being the research and development of adult Mesenchymal Precursor Cells (MPCs).

(c) Foreign currency translation

Functional and presentation currency

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

Translations and balances

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

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

Group companies

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

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

Notes to the Financial Statements for the year ended 30 June 2013

1. Significant Accounting Policies (continued)

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

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

(d) Revenue recognition

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

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

Revenue is recognized for the major business activities as follows:

Commercialization revenue

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

Interest revenue

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

(e) Research and development undertaken internally

Research expenditure is recognized as an expense as incurred. Costs incurred on development projects, which consist of preclinical and clinical trials, manufacturing development, and general research, are recognized as intangible assets when it is probable that the project will, after considering its commercial and technical feasibility, be completed and generate future economic benefits and its costs can be measured reliably.

The expenditure capitalized comprises all directly attributable costs, including costs of materials, services, direct labor and an appropriate proportion of overheads. Other development costs that do not meet these criteria are expensed as incurred. Development costs previously recognized as expenses, are not recognized as an asset in a subsequent period, and will remain expensed. Capitalized development costs are recorded as intangible assets and amortized from the point at which the asset is ready for use on a straight-line basis over its useful life. The Group currently does not have any capitalized development costs.

(f) Income tax

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

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

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

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

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

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

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

(g) Investments and other financial assets

Classification

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

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

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

(ii) Loans and receivables

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

(iii) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets quoted in an active market with fixed or determinable payments and fixed maturities that the group's management has the positive intention and ability to hold to maturity. If the group were to sell other than an insignificant amount of held-to maturity financial assets, the whole category would be tainted and reclassified as

available-for-sale. Held-to-maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the end of the reporting period, which would be classified as current assets.

(h) Leases

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

(i) Business combinations

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

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

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

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

Notes to the Financial Statements for the year ended 30 June 2013

1. Significant Accounting Policies (continued)

(j) Impairment of assets

Goodwill and intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets (other than goodwill) that have suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

(k) Cash and cash equivalents

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

(l) Trade and other receivables

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

(m) 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.

(n) Intangible assets

(i) Goodwill

Goodwill is measured as described in note 1(i) – Business combinations. Goodwill on acquisition of subsidiaries is included in intangible assets (note 12). Goodwill is not amortized but it is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, and is carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash generating units for the purpose of impairment testing. The allocation is made to those cash generating units or groups of cash generating units that are expected to benefit from the business combination in which the goodwill arose, identified according to operating segments (note 3).

(ii) Trademarks and licenses

Trademarks and licenses have a finite useful life and are carried at cost less accumulated amortization and impairment losses. Amortization is calculated using the straight line method to allocate the cost of trademarks and licenses over their estimated useful lives, which range from 12.7 to 15.8 years.

(iii) In-process research and development acquired

In-process research and development that has been acquired as part of a business acquisition is considered to be an indefinite life intangible asset on the basis that it is incomplete and cannot be used in its current form. Indefinite life intangible assets are not amortized but rather are tested for impairment annually at May 31 of each year, or whenever events or circumstances present an indication of impairment.

In-process research and development will continue to be tested for impairment until the related research and development efforts are either completed or abandoned. Upon completion of the related research and development efforts, management determines the remaining useful life of the intangible assets and amortizes them accordingly. In order for management to determine the remaining useful life of the asset, management would consider the expected flow of future economic benefits to the entity with reference to the product life cycle, competitive landscape, obsolescence, market demand, any remaining patent useful life and various other relevant factors.

In the case of abandonment, the related research and development efforts are considered impaired and the asset is fully expensed.

(o) Trade and other payables

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

(p) Provisions

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

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

Provisions are recorded on acquisition of a subsidiary, to the extent they relate to a subsidiary's contingent liabilities, if it relates to a past event, regardless of whether it is probable the amount will be paid.

(q) Employee benefits

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

Liabilities recognized in respect of employee benefits which are expected to be settled within 12 months after the end of the period in which the employees render the related services are measured at their nominal values using the remuneration rates expected to apply at the time of settlement.

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

(r) Share-based payments

Share-based payments are provided to employees, directors and consultants via the Mesoblast Employee Share Option Plan (ESOP) and the Mesoblast Australian Loan Funded Share Plan (LFSP). The terms and conditions of the LFSP are in substance the same as the employee share options and therefore they are accounted for on the same basis.

Equity-settled share-based payments with employees and others providing similar services are measured at the fair value of the equity instrument at grant date. Fair value is measured using the Black-Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioral considerations. It does not make any allowance for the impact of any service and non-market performance vesting conditions. Further details on how the fair value of equity-settled share-based transactions has been determined can be found in note 24.

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

(s) Contributed equity***Ordinary shares are classified as equity.***

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

Notes to the Financial Statements for the year ended 30 June 2013

1. Significant Accounting Policies (continued)

(t) Earnings per share

(i) Basic earnings per share

Basic earnings per share is calculated by dividing:

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

(ii) Diluted earnings per share

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

- the after income tax effect of interest and other financing costs associated with dilutive potential ordinary shares; and
- the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

(u) Goods and services tax (GST)

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

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

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

(v) Changes in accounting policies

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

(w) Comparative figures

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

(x) Rounding of amounts

The company is of a kind referred to in Class Order 98/100, issued by the Australian Securities and Investments Commission, relating to the 'rounding off' of amounts in the financial statements. Amounts in the financial statements have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, the nearest dollar.

(y) New and revised accounting standards and interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2013 reporting periods and have not been early adopted by the group. The group's assessment of the impact of these new standards and interpretations is set out below.

- (i) AASB 9 *Financial Instruments*, AASB 2009-11 *Amendments to Australian Accounting Standards arising from AASB 9*, AASB 2010-7 *Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)* and AASB 2012-6 *Amendments to Australian Accounting Standards – Mandatory Effective Date of AASB 9 and Transition Disclosures (effective from 1 January 2015)*

AASB 9 Financial Instruments addresses the classification, measurement and derecognition of financial assets and financial liabilities. The standard is not applicable until 1 January 2015 but is available for early adoption.

There will be no impact on the group's accounting for financial assets and liabilities, as the new requirements only affect the accounting for financial assets and liabilities that are designated at fair value through profit or loss and the group does not have any such assets and liabilities. The derecognition rules have been transferred from AASB 139 Financial Instruments: Recognition and Measurement and have not been changed. The group has not yet decided when to adopt AASB 9.

- (ii) AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements*, AASB 12 *Disclosure of Interests in Other Entities*, revised AASB 127 *Separate Financial Statements*, AASB 128 *Investment in Associates and Joint Ventures*, AASB 2011-7 *Amendments to Australian Accounting Standards arising from the consolidation and Joint Arrangements Standards* and AASB 2012-10 *Amendments to Australian Accounting Standards – Transition Guidance and Other Amendments (effective 1 January 2013)*

In August 2011, the AASB issued a suite of five new and amended standards which address the accounting for joint arrangements, consolidated financial statements and associated disclosures. AASB 10 replaces all of the guidance on control and consolidation in AASB 127 Consolidated and Separate Financial Statements, and Interpretation 12 Consolidation – Special Purpose Entities. The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single economic entity remains unchanged, as do the mechanics of consolidation. However, the standard introduces a single definition of control that applies to all entities. It focuses on the need to have both power and rights or exposure to variable returns. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both. Control exists when the investor can use its power to affect the amount of its returns. There is also new guidance on participating and protective rights and on agent/principal relationships. While the group does not expect the new standard to have a significant impact on its composition, it has yet to perform a detailed analysis of the new guidance in the context of its various investees that may or may not be controlled under the new rules.

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

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

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

The group will adopt the new standards from their operative date. They will therefore be applied in the financial statements for the annual reporting period ending 30 June 2014.

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

AASB 13 was released in September 2011. It explains how to measure fair value and aims to enhance fair value disclosures. The group has yet to determine which, if any, of its current measurement techniques will have to change as a result of the new guidance. It is therefore not possible to state the impact, if any, of the new rules on any of the amounts recognized in the financial statements. However, application of the new standard will impact the type of information disclosed in the notes to the financial statements. The group will adopt the new standard from its operative date, which means that it will be applied in the annual reporting period ending 30 June 2014.

(iv) *AASB 2011-4 Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements (effective 1 July 2013)*

In July 2011 the AASB decided to remove the individual key management personnel (KMP) disclosure requirements from AASB 124 Related Party Disclosures, to achieve consistency with the international equivalent standard and remove a duplication of the requirements with the Corporations Act 2001. While this will reduce the disclosures that are currently required in the notes to the financial statements, it will not affect any of the amounts recognised in the financial statements. The amendments apply from 1 July 2013 and cannot be adopted early. The Corporations Act requirements in relation to remuneration reports will remain unchanged for now, but these requirements are currently subject to review and may also be revised in the near future.

(v) *AASB 2012-3 Amendments to Australian Accounting Standard – Offsetting Financial Assets and Financial Liabilities and AASB 2012-2 Disclosures – Offsetting Financial Assets and Financial Liabilities (effective 1 January 2014 and 1 January 2013 respectively)*

Notes to the Financial Statements for the year ended 30 June 2013

In June 2012, the AASB approved amendments to the application guidance in AASB 132 Financial Instruments: Presentation, to clarify some of the requirements for offsetting financial assets and financial liabilities in the balance sheet. These amendments are effective from 1 January 2014. They are unlikely to affect the accounting for any of the entity's current offsetting arrangements. However, the AASB has also introduced more extensive disclosure requirements into AASB 7 which will apply from 1 January 2013. When they become applicable, the group will have to provide a number of additional disclosures in relation to its offsetting arrangements. The group intends to apply the new rules for the first time in the financial year commencing 1 July 2013.

- (vi) *AASB 2013-3 Amendments to AASB 136 Recoverable Amount Disclosures for Non-Financial Assets (effective 1 January 2014)*

The AASB has made small changes to some of the disclosures that are required under AASB 136 Impairment of Assets. These may result in additional disclosures if the group recognizes an impairment loss or the reversal of an impairment loss during the period. They will not affect any of the amounts recognised in the financial statements. The group intends to apply the amendment from 1 July 2014.

Improvements to IFRS (2009-2011 project cycle)/(AASB 2012-5 Amendments to Australian Accounting Standard arising from Annual Improvements 2009-2011 cycle) (effective for annual periods beginning on or after 1 January 2013)

In June 2012, the AASB approved a number of amendments to Australian Accounting Standards as a result of the 2009-2011 annual improvements project. The Group will apply the amendments from 1 July 2013. The group does not expect that any adjustments will be necessary as the result of applying the revised rules.

(z) Parent entity financial information

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

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

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

2. Revenue and Expenses from Continuing Operations

	30 June 2013 \$'000	30 June 2012 \$'000
(a) Revenue from continuing operations		
Commercialization revenue ^	18,260	27,683
Interest revenue	10,526	10,472
	28,786	38,155
(b) Other income		
Research and development tax incentive	5,924	–
Government grant revenue	–	125
	5,924	125
(c) Expenses from continuing operations		
The following items are an extract of items included in expenses from continuing operations		
Employee benefits		
Salaries and employee benefits	20,018	17,567
Defined contribution superannuation expenses	307	283
Share-based payments – employees & directors	11,163	10,052
	31,488	27,902
Depreciation and amortization of non-current assets		
Plant and equipment depreciation	670	314
Intellectual property amortization	102	65
	772	379
Other expenses		
Intellectual property costs (excluding amortization as shown above)	1,446	1,134
Share-based payments – consultants	1,130	2,065
Foreign exchange losses	883	1,302
Rent	1,193	1,300

^ In November 2010, the Group signed a development and commercialization agreement with Cephalon Inc., a major global biopharmaceutical company.

The Group received USD130m as a non-refundable upfront fee. This revenue is being recognized over the collaboration period in the agreement, with any unrecognized portion being recorded as deferred revenue (refer note 14). On 14 October 2011 Cephalon Inc. was acquired by Teva Pharmaceutical Industries Ltd (NYSE: TEVA), a leading global pharmaceutical company with a presence in over 60 countries (source: Teva Pharmaceutical Industries Ltd press release dated 14 October 2011). Therefore the company will be referred to as Teva Pharmaceutical Industries Ltd in this report.

3. Segment Information

The Group predominately operates in one segment being the research and development of its proprietary and patented allogeneic adult Mesenchymal Precursor Cell (MPC) technology platform. Accordingly the segment information is the same as is presented elsewhere in this report and no additional disclosure is provided.

Notes to the Financial Statements for the year ended 30 June 2013

4. Income Tax Expense

	30 June 2013 \$'000	30 June 2012 \$'000
(a) Reconciliation of income tax to prima facie tax payable		
(Loss)/profit from continuing operations before income tax	(60,078)	(48,723)
Tax at the Australian tax rate of 30% (2012: 30%)	(18,023)	(14,617)
Tax effect of amounts which are (not deductible)/taxable in calculating taxable income:		
Share-based payments expense	3,688	3,644
R&D tax concessions	3,594	(672)
Other sundry items	(34)	(2)
Current year tax expense/(benefit)	(10,775)	(11,647)
Adjustments for current tax of prior periods	(219)	(994)
Differences in overseas tax rates	(2,246)	2,816
Tax benefit not recognized	13,239	29,599
Alternative minimum tax charge (USA)	1,588	–
USA City and State tax expenses	1,585	–
USA City and State tax (benefit)/expense – not recognized	(1,587)	2,648
Income tax expense attributable to profit before income tax	1,585	22,422
(b) Income tax expense		
Current tax	1,585	(188)
Deferred tax	–	22,610
	1,585	22,422
(c) Amounts that would be recognized directly in equity if brought to account		
Aggregate current and deferred tax arising in the reporting period and not recognized in net profit or loss or other comprehensive income but which would have been directly applied to equity had it been brought to account:		
Current tax recorded in equity (if brought to account)	1,545	564
Deferred tax recorded in equity (if brought to account)	487	215
	2,032	779
(d) Amounts recognized directly in equity		
Aggregate current and deferred tax arising in the reporting period and not recognized in net profit or loss or other comprehensive income but debited/credited to equity:		
Current tax recorded in equity	–	56
Deferred tax recorded in equity	–	–
(e) Tax Losses		
Unused tax losses for which no deferred tax asset has been brought to account	130,202	73,784
Potential tax benefit at local tax rates	41,660	22,163
(f) Unrecognized temporary differences		
Temporary differences not brought to account	8,895	27,600

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

5. Remuneration of Auditors

	30 June 2013	30 June 2012
	\$	\$
PricewaterhouseCoopers		
(i) Audit and other assurance services		
Audit and review of financial reports	281,255	230,000
(ii) Taxation services		
Employee share scheme reporting obligations	–	2,200
Total taxation services	–	2,200
Total remuneration of PricewaterhouseCoopers	281,255	232,200
	30 June 2013	30 June 2012
	\$'000	\$'000

6. Earnings Per Share

Net loss used in calculating basic earnings per share	(61,663)	(71,145)
Net loss used in calculating diluted earnings per share	(61,663)	(71,145)
	Shares	Shares
Weighted average number of ordinary shares used in calculating basic earnings per share	292,768,143	282,860,783
Weighted average number of ordinary shares and potential ordinary shares used in calculating diluted earnings per share	292,768,143	282,860,783
	30 June 2013	30 June 2012
	\$'000	\$'000

7. Cash and Cash Equivalents

Cash at bank	7,875	1,388
Deposit at call ^	307,434	204,203
	315,309	205,591

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

^ The terms and conditions of the deposits allow the Group to withdraw funds on demand.

8. Trade and Other Receivables

	30 June 2013	30 June 2012
	\$'000	\$'000
Current		
Interest receivable	3,306	3,122
Sundry debtors	7	2,140
Income tax and research and development tax incentive recoverable	8,317	3,475
Other recoverable taxes (GST & VAT)	113	1,080
Loan to an employee covered by a contract ^	320	852
	12,063	10,669

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

All trade and other receivable balances are within their due dates and none are considered to be impaired at both 30 June 2013 and 30 June 2012. See note 27 for the impact of credit risk on the Group.

Notes to the Financial Statements for the year ended 30 June 2013

9. Property, Plant and Equipment

	Plant & Equipment \$'000	Office Furniture & Equipment \$'000	Computer Hardware & Software \$'000	Total \$'000
At 30 June 2011				
Cost or fair value	47	309	622	978
Accumulated depreciation	(9)	(106)	(253)	(368)
Net book value	38	203	369	610
Year Ended 30 June 2012				
Opening net book amount	38	203	369	610
Exchange differences	6	25	11	42
Additions	381	671	612	1,664
Disposals	(3)	–	(1)	(4)
Depreciation charge	(48)	(26)	(240)	(314)
Closing net book value	374	873	751	1,998
At 30 June 2012				
Cost or fair value	431	952	1,273	2,656
Accumulated depreciation	(57)	(79)	(522)	(658)
Net book value	374	873	751	1,998
Year Ended 30 June 2013				
Opening net book amount	374	873	751	1,998
Exchange differences	91	75	39	205
Additions	667	45	512	1,224
Disposals	–	–	–	–
Depreciation charge	(173)	(114)	(383)	(670)
Closing net book value	959	879	919	2,757
At 30 June 2013				
Cost or fair value	1,208	1,085	1,857	4,150
Accumulated depreciation	(249)	(206)	(938)	(1,393)
Net book value	959	879	919	2,757

10. Deferred Tax Assets

	30 June 2013 \$'000	30 June 2012 \$'000	
The balance comprises temporary differences attributable to:			
Tax losses	–	3,447	
Tax deductions available for share option expenses	–	55	
Total deferred tax assets	–	3,502	
Set-off of deferred tax liabilities pursuant to set-off provisions	–	–	
Net deferred tax assets	–	3,502	
Deferred tax assets expected to be recovered within 12 months	–	3,502	
Deferred tax assets expected to be recovered after more than 12 months	–	–	
	–	3,502	
	Share option tax deductions \$'000	Net operating losses & tax credits \$'000	Total \$'000
Movements			
At 30 June 2011	12,199	9,622	21,820
(Charged)/credited to profit or loss	–	3,447	3,447
(Charged)/credited to equity	55	–	55
Utilization of tax losses against current year tax payable	(12,199)	(9,622)	(21,820)
At 30 June 2012	55	3,447	3,502
(Charged)/credited to profit or loss	–	–	–
(Charged)/credited to equity	–	–	–
Utilization of tax losses against current year tax payable	(55)	(3,447)	(3,502)
At 30 June 2013	–	–	–

11. Other Non-current Assets

	30 June 2013 \$'000	30 June 2012 \$'000
Other Non-current Assets		
Letter of Credit	1,277	1,158

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

This balance was reflected as cash in the Australian Securities Exchange Appendix 4C for the quarter ended 30 June 2013.

In the 2012 comparative, this balance has been reclassified from cash and cash equivalents (note 7) to conform to the presentation in the current year.

Notes to the Financial Statements for the year ended 30 June 2013

12. Intangible Assets

	Goodwill \$'000	Acquired licenses to patents \$'000	In-process research & development acquired ¹ \$'000	Total \$'000
At 30 June 2011				
Cost	109,739	691	365,192	475,621
Accumulated amortization	–	(295)	–	(295)
Accumulated impairment	–	–	–	–
Net book value	109,739	396	365,192	475,326
Year ended 30 June 2012				
Opening net book value	109,739	396	365,192	475,326
Additions	–	925	–	925
Adjustment for final value on acquisition of subsidiary company	2,143	–	–	2,143
Exchange differences	4,329	5	14,555	18,889
Amortization charge [^]	–	(65)	–	(65)
Impairment charge	–	–	–	–
Closing net book value	116,211	1,261	379,747	497,219
At 30 June 2012				
Cost	116,211	1,620	379,747	497,578
Accumulated amortization	–	(360)	–	(360)
Accumulated impairment	–	–	–	–
Net book amount	116,211	1,261	379,747	497,219
Year ended 30 June 2013				
Opening net book value	116,211	1,261	379,747	497,219
Additions	–	1,614	–	1,614
Exchange differences	11,476	123	37,504	49,103
Amortization charge [^]	–	(102)	–	(102)
Impairment charge	–	–	–	–
Closing net book value	127,687	2,896	417,251	547,834
At 30 June 2013				
Cost	127,687	3,362	417,251	548,301
Accumulated amortization	–	(466)	–	(466)
Accumulated impairment	–	–	–	–
Net book amount	127,687	2,896	417,251	547,834

1. In-process research and development was acquired during the acquisition of Mesoblast, Inc, and consists of clinical development programs of adult MPCs for use in the repair and regeneration of non-orthopedic indications

[^] The amortization charge (for acquired Licenses to patents) are included in research and development expense in the consolidated statement of comprehensive income.

Carrying value of in-process research & development acquired by product

Other Non-current Assets	30 June 2013 \$'000	30 June 2012 \$'000
Cardiovascular products	274,233	249,584
Intravenous products for metabolic diseases and inflammatory/immunologic conditions	76,259	69,404
Ophthalmic product	33,520	30,507
Bone marrow transplantation	33,239	30,251
	417,251	379,747

The above balances are reported in AUD, however the underlying currency of the item recorded is USD. The year on year movement in all balances are due to the movement in the AUD:USD exchange rate. The underlying USD balance has not changed.

(a) Impairment tests for goodwill and intangible assets with an indefinite useful life

For the purpose of impairment testing, goodwill is monitored by management at the operating segment level. The Group is managed as one operating segment, being the development of adult MPC technology platform for commercialization. The carrying value of Goodwill has been allocated to the Group's operating segment for the purpose of impairment testing.

In-process research and development acquired is considered to be an indefinite life intangible asset on the basis that it is incomplete and cannot be used in its current form (see note 1(n)(iii)). The carrying value of in-process research and development (AUD417m : USD387m) is a separate asset which has been subject to impairment testing.

The recoverable amount of both goodwill and in-process research and development was assessed at 31 May based on the fair value less costs to sell.

(b) Key assumptions used for fair value less costs to sell calculations

In determining the fair value less costs to sell we have given consideration to the following indicators:

- the valuation of the company that was applicable to the recent (14 March 2013) capital raising undertaken through issuing of the companies securities to investors on the Australian Securities Exchange;
- the market capitalization of Mesoblast Ltd on the Australian Securities Exchange (ASX:MSB) on the impairment testing date of 31 May 2013;
- the amount of time that has elapsed since the goodwill acquisition;
- discounted expected future cash flows of programs; and
- the scientific results and progress of the trials since acquisition.

Costs of disposal were assumed to be immaterial.

Discounted cash-flows used a pre-tax discount rate of 21.4%, and include estimated cash inflows and outflows for each program through to patent expiry, at which point a terminal value is assigned to the program.

In relation to cash inflows consideration has been given to the incidence and prevalence data for specific diseases and conditions and current and in-development competition when determining the market size. Only markets with patent protection have been considered. The expected average selling price has been benchmarked against product and procedure charges applicable to current treatments.

In relation to cash outflows consideration has been given to cost of goods sold, selling costs and clinical trial schedules including estimates of numbers of patients and per patient costs. Associated expenses such as regulatory fees and patent maintenance have been included as well as any further pre-clinical development if applicable.

There are no standard growth rates applied, other than our estimates of market penetration which increase initially, plateau and then decline.

The assessment of goodwill showed the recoverable amount of the Group's operating segment, including goodwill and in-process research and development, exceeds the carrying amounts, and therefore there is no impairment.

The assessment of the recoverable amount of each product has been made in accordance with the discounted cash-flow assumptions outlined above. The assessment showed that the recoverable amount of each product exceeds the carrying amount and therefore there is no impairment.

(c) Impact of possible changes in key assumptions

Due to the significant excess value of the recoverable amount over the carrying value, a reasonably possible change in the key assumptions would not cause the carrying amount of the segment to exceed its recoverable amount.

Notes to the Financial Statements for the year ended 30 June 2013

13. Trade and Other Payables

	30 June 2013 \$'000	30 June 2012 \$'000
Current		
Trade payables	20,780	11,573
Employee benefits	528	396
	21,308	11,969

(a) Risk Exposure

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

14. Deferred Revenue

	30 June 2013 \$'000	30 June 2012 \$'000
Opening balance	84,571	108,464
Amount recognized as revenue in the year	(18,261)	(27,683)
Foreign exchange difference	6,483	3,790
Balance at the end of the year	72,793	84,571
• in the next twelve months (current deferred revenue)	16,176	28,210
• beyond twelve months (non-current deferred revenue)	56,617	56,361
Balance at the end of the year	72,793	84,571

15. Derivative Financial Instruments

	30 June 2013 \$'000	30 June 2012 \$'000
Current assets		
Forward foreign exchange contracts	3,486	–
Current liabilities		
Forward foreign exchange contracts	–	1,407

All derivative financial instruments held at 30 June 2013 mature within the next 6 months.

(a) Instruments used by the Group

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

Forward exchange contracts

The Group has entered into forward exchange contracts which are economic hedges but do not satisfy the requirements for hedge accounting. These contracts are subject to the same risk management policies as all other derivative contracts, see note 27 for details. However, they are classified and accounted for as held for trading in accordance with AASB 139.

(b) Risk exposures and fair value measurement

Information about the Group's exposure to credit risk, foreign exchange and interest rate risk is provided in note 27. The maximum exposure to credit risk at the end of the reporting period is the carrying amount of each class of derivative financial assets mentioned above. The fair value of the derivative financial instruments at 30 June 2013 has been measured by through obtaining a commercial quote for the purchase of a derivative financial instrument with the identical interest rate, maturity and terms.

16. Deferred Tax Liabilities

	30 June 2013 \$'000	30 June 2012 \$'000
(a) Deferred tax liabilities		
The balance comprises temporary differences attributable to:		
Intangible assets acquired in a business combination	146,038	132,911
Total deferred tax liabilities	146,038	132,911
Deferred tax liabilities expected to be settled within 12 months	–	–
Deferred tax liabilities expected to be settled after 12 months	146,038	132,911

(b) Movements

	Intellectual Property \$'000	Total \$'000
At 30 June 2011	127,817	127,817
Foreign exchange difference	5,094	5,094
At 30 June 2012	132,911	132,911
Foreign exchange difference	13,127	13,127
At 30 June 2013	146,038	146,038

17. Provisions

	30 June 2013 \$'000	30 June 2012 \$'000
Current		
Provisions other ^(b)	9,266	–
Provision for short term incentives	3,838	2,909
	13,104	2,909
Non-current		
Provision for long service leave	203	144
Provisions other ^(b)	–	7,697
	203	7,841

(a) Movements

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

	Total \$'000
Provisions other	
Carrying amount at start of year – 1 July 2012	7,697
Foreign exchange difference	760
Additional provision recognized (charged to profit/loss)	809
Carrying amount at end of year – 30 June 2013	9,266

(b) Provisions other

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

Notes to the Financial Statements for the year ended 30 June 2013

18. Issued Capital

	2013 Shares	2012 Shares	2013 \$'000	2012 \$'000
(a) Share capital				
Ordinary shares	316,468,901	285,835,106	654,458	485,004
Less: Treasury shares	(3,320,000)	(2,210,000)	–	–
Total contributed equity	313,148,901	283,625,106	654,458	485,004

(b) Movements in ordinary share capital

Date	Details	Shares No.	Issue price	\$'000
1 July 2011	Opening Balance	280,345,258		477,115
Quarter 3 2011	Exercise of share options	220,000	\$1.00	220
Quarter 3 2011	Exercise of share options	34,000	\$2.13	72
Quarter 3 2011	Exercise of share options	3,000	\$2.00	6
Quarter 4 2011	Exercise of share options	159,822	\$0.00	–
Quarter 4 2011	Exercise of share options	69,892	US \$0.44	30
Quarter 4 2011	Exercise of share options	230,000	\$1.00	230
Quarter 4 2011	Exercise of share options	277,389	\$1.20	333
Quarter 4 2011	Exercise of share options	280,000	\$1.58	442
Quarter 4 2011	Exercise of share options	266,000	\$2.13	567
Quarter 4 2011	Exercise of share options	323,000	\$3.48	1,124
Quarter 4 2011	Placement of shares under LFSP ^	2,040,000	\$7.99	–
Quarter 1 2012	Exercise of share options	150,000	US \$0.44	63
Quarter 1 2012	Exercise of share options	170,000	\$1.00	170
Quarter 1 2012	Exercise of share options	60,000	\$1.58	95
Quarter 1 2012	Exercise of share options	150,000	\$2.13	320
Quarter 1 2012	Exercise of share options	40,000	\$2.64	106
Quarter 1 2012	Exercise of share options	32,400	\$3.48	113
Quarter 1 2012	Placement of shares under LFSP ^	170,000	\$8.48	–
Quarter 2 2012	Exercise of share options	127,956	US \$0.31	38
Quarter 2 2012	Exercise of share options	400,000	\$2.13	852
Quarter 2 2012	Exercise of share options	277,389	\$3.44	954
Quarter 2 2012	Exercise of share options	9,000	\$3.48	31
30 June 2012	Contribution of equity (net of transaction costs)	5,489,848		5,766
	Share options reserve transferred to equity on exercise of options			2,123
	Movement for the year			7,889
30 June 2012	Closing balance	285,835,106		485,004

(b) Movements in ordinary share capital (continued)

Date	Details	Shares No.	Issue price	\$'000
30 June 2012	Closing balance	285,835,106		485,004
Quarter 3 2012	Exercise of share options	42,000	\$2.00	84
Quarter 3 2012	Exercise of share options	32,900	\$3.48	114
Quarter 3 2012	Exercise of share options	170,913	US \$0.34	56
Quarter 3 2012	Placement of shares under LFSP ^	50,000	\$6.69	–
Quarter 3 2012	Placement of shares under LFSP ^	775,000	\$6.70	–
Quarter 4 2012	Exercise of share options	16,000	\$1.00	16
Quarter 4 2012	Exercise of share options	120,000	\$1.58	190
Quarter 4 2012	Exercise of share options	40,000	\$2.64	106
Quarter 4 2012	Exercise of share options	140,100	\$3.48	488
Quarter 4 2012	Exercise of share options	85,000	US \$0.34	28
Quarter 4 2012	Exercise of share options	255,913	US \$0.47	116
Quarter 4 2012	Exercise of share options	277,390	\$3.78	1,048
Quarter 1 2013	Exercise of share options	100,000	\$1.58	158
Quarter 1 2013	Exercise of share options	30,000	\$2.00	60
Quarter 1 2013	Exercise of share options	145,800	\$3.48	507
Quarter 1 2013	Exercise of share options	80,000	\$0.96	77
Quarter 1 2013	Share issue to institutions and sophisticated investors	26,970,979	\$6.30	169,917
Quarter 1 2013	Placement of shares under LFSP ^	50,000	\$6.29	–
Quarter 2 2013	Exercise of share options	150,000	US \$0.31	47
Quarter 2 2013	Exercise of share options	630,000	\$1.00	630
Quarter 2 2013	Exercise of share options	80,000	\$1.58	126
Quarter 2 2013	Exercise of share options	156,800	\$3.48	546
Quarter 2 2013	Placement of shares under LFSP ^	235,000	\$6.36	–
		30,633,795		174,314
	Transaction costs arising on share issues			(5,529)
30 June 2013	Contribution of equity (net of transaction costs)			168,785
	Share options reserve transferred to equity on exercise of options			669
	Movement for the year			169,454
30 June 2013	Closing balance	316,468,901		654,458

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

The Company has entered into an agreement that enables a shareholder to maintain its percentage interest in the issued capital of Mesoblast Limited by participating in any issue of shares or subscription for shares in respect of a diluting event, provided they maintain certain minimum shareholding requirements.

Notes to the Financial Statements for the year ended 30 June 2013

18. Issued Capital (continued)

(c) Ordinary Shares

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

(d) Employee Share Options

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

(e) Capital risk management

The Group's objective when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. Refer to note 20(a) for the cash reserves of the Group as at the end of the financial reporting period.

19. Reserves

	30 June 2013 \$'000	30 June 2012 \$'000
(a) Reserves		
Share-based payments reserve	49,129	37,505
Foreign currency translation reserve	24,506	(7,497)
	73,635	30,008
(b) Reconciliation of reserves		
<i>Share-based payments reserve</i>		
Opening Balance	37,505	25,664
Transfer to ordinary shares on exercise of options	(669)	(2,123)
Share option expense for the year	12,293	12,118
Tax effect of options deductible for tax	–	1,360
Currency (loss)/gain on translation of foreign share-based payments reserve ^	–	486
Balance at the end of the year	49,129	37,505
<i>Foreign currency translation reserve</i>		
Opening Balance	(7,497)	(21,916)
Currency gain on translation of foreign operations net assets ^	32,003	14,419
Balance at the end of the year	24,506	(7,497)
	32,003	14,905
^ Total currency difference on translation of foreign operations		

(c) Nature and purpose of reserves

Share-based payment reserve

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

Foreign currency translation reserve

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

20. Cash Flow Information

	30 June 2013 \$'000	30 June 2012 \$'000
(a) Reconciliation of cash and cash equivalents		
Cash at bank	7,875	1,388
Deposit at call	307,434	204,203
	315,309	205,591 ^
(b) Reconciliation of net cash flows used in Operations with loss after income tax		
Loss for the year	(61,663)	(71,145)
Add/(deduct) profit and loss items as follows:		
Depreciation and amortization	772	379
Foreign exchange loss/(gains)	1,696	(2,664)
Equity settled share-based payment	12,294	12,118
Change in operating assets & liabilities:		
Decrease/(increase) in trade and other receivables	2,119	(3,963)
Increase/(decrease) in tax assets	(1,055)	18,492
Increase in trade creditors and accruals	10,017	14,764
Increase/(decrease) in tax liabilities	-	(3,107)
Decrease in accrued income	(18,261)	(27,683)
Net cash outflows used in operations	(54,081)	(62,809) ^^

^ This 2012 comparative balance has changed due to the reclassification of the Letter of Credit from cash and cash equivalents to other non-current assets.

^^ This 2012 comparative balance has changed due to the reclassification of interest received from investing activity to operating activity.

Notes to the Financial Statements for the year ended 30 June 2013

21. Parent Entity Financial Information

	30 June 2013 \$'000	30 June 2012 \$'000
Balance Sheet		
Current assets	326,219	210,096
Total assets	727,247	594,924
<hr/>		
Current liabilities	8,411	10,293
Total liabilities	49,525	80,989
<hr/>		
Shareholders' equity		
Issued capital	654,458	485,004
<i>Reserves</i>		
Share options reserve	35,446	23,821
Accumulated (loss)/profit	(12,182)	5,110
	677,722	513,935
<hr/>		
Statement of Comprehensive Income		
Loss for the period	(17,292)	(26,644)
Total comprehensive loss for the period	(17,292)	(26,644)

22. Commitments

(a) Capital commitments

The Group does not consider it has any commitments for future capital expenditure outstanding as at 30 June 2013 (2012: nil).

(b) Lease Commitments: Group as lessee

i. Non-cancellable operating leases

The Group leases various offices under non-cancellable operating leases expiring within 1 to 8 years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

	30 June 2013 \$'000	30 June 2012 \$'000
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	943	854
Later than one year but no later than five years	3,880	3,552
Later than five years	4,830	4,396
	9,653	8,802

Lease commitments include USD and SGD (Singapore Dollar) amounts which have been translated to Australian Dollars at the 30 June 2013 foreign exchange rates published by the Reserve Bank of Australia.

(c) Purchase commitments

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

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

23. Contingent Assets and Liabilities

(a) Contingent assets

The Group does not consider it has any contingent assets outstanding as at 30 June 2013 (2012: nil).

(b) Contingent liabilities

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

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

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

24. Share-Based Payments

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

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

Grant policy

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

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

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

In addition the LFSP has the following characteristics:

On grant date, the Company issues new equity (rather than purchases shares on market), and the loan funded shares are placed in a trust which holds the shares on behalf of the employee. The trustee issues a limited recourse, interest free, loan to the employee which is equal to the number of shares multiplied by the price. A limited-recourse loan means that the repayment amount will be the lesser of the outstanding loan value (the loan value less any amounts you may have already paid) and the market value of the shares that are subject to the loan. The price is the amount the employee must pay for each loan funded share if exercised.

The trustee continues to hold the shares on behalf of the employee until the employee chooses to settle the loan pertaining to the shares and all vesting conditions have been satisfied, at which point ownership of the shares is fully transferred to the employee.

Any dividends paid by the Company, while the shares are held by the trustee, are applied as a repayment of the loan at the after-tax value of the dividend.

Notes to the Financial Statements for the year ended 30 June 2013

24. Share-Based Payments (continued)

(a) Reconciliation of outstanding shared-based payments

Series	Grant Date	Expiry Date	Exercise Price	Opening Balance	Granted No. (during the year)	Exercised No. (during the year)	Lapsed/ Cancelled No. (during the year)	Closing Balance	Vested and exercisable No. (end of year)
8	07/07/08	30/06/13	\$1.00	826,000	–	(646,000)	–	180,000	180,000
9	19/01/09	18/01/14	\$0.96	80,000	–	(80,000)	–	–	–
10	30/11/09	30/11/14	\$1.73	300,000	–	–	–	300,000	300,000
11	30/11/09	30/11/14	\$1.58	1,010,000	–	(300,000)	–	710,000	710,000
12	26/02/10	26/02/15	\$2.00	72,000	–	(72,000)	–	–	–
13	22/09/10	21/09/15	\$2.64	485,000	–	(40,000)	–	445,000	270,000
14	29/11/10	29/11/15	\$3.48	2,365,600	–	(475,600)	(23,400)	1,866,600	983,000
15	22/12/11	30/06/16	\$7.99	2,730,000	–	–	(210,000)	2,520,000	1,090,005
16	24/02/12	23/02/17	\$8.48	270,000	–	–	(100,000)	170,000	56,667
17	09/07/12	08/07/18	\$6.69	–	200,000	–	–	200,000	–
18	21/09/12	30/06/17	\$6.70	–	1,450,000	–	(80,000)	1,370,000	–
18	24/09/12	30/06/17	\$6.70	–	710,000	–	–	710,000	236,667
18	29/10/12	30/06/17	\$6.70	–	60,000	–	–	60,000	20,000
19	25/01/13	24/01/18	\$6.29	–	50,000	–	–	50,000	–
20	24/05/13	23/05/18	\$6.36	–	765,000	–	–	765,000	–
INC	07/12/10	07/07/15	USD 0.046	287,903	–	–	–	287,903	287,903
INC	07/12/10	26/10/18	USD 0.305	345,999	–	(150,000)	–	195,999	195,999
INC	07/12/10	07/12/14	USD 0.340	255,913	–	(255,913)	–	–	–
INC	07/12/10	26/10/19	USD 0.340	703,761	–	–	–	703,761	703,761
INC	07/12/10	25/04/17	USD 0.444	127,956	–	–	–	127,956	127,956
INC	07/12/10	02/05/17	USD 0.444	127,956	–	–	–	127,956	127,956
INC	07/12/10	07/12/14	USD 0.474	255,913	–	(255,913)	–	–	–
Conv	07/12/10	07/12/12	\$3.78	277,390	–	(277,390)	–	–	–
30 June 2013				10,521,391	3,235,000	(2,552,816)	(413,400)	10,790,175	5,289,914
Weighted average exercise price				\$3.66	\$6.61	\$1.72	\$5.89	\$4.85	\$3.27
30 June 2012				10,962,597	3,218,700	(3,279,848)	(380,058)	10,521,391	4,942,392
Weighted average exercise price				\$1.92	\$7.73	\$1.76	\$3.49	\$3.66	\$1.46
LFSP1	22/12/11	30/06/16	\$7.99	2,040,000	–	–	(100,000)	1,940,000	1,476,668
LFSP2	24/02/12	23/02/17	\$8.48	170,000	–	–	–	170,000	56,667
LFSP3	09/07/12	08/07/18	\$6.69	–	50,000	–	–	50,000	–
LFSP4	30/09/12	30/06/17	\$6.70	–	775,000	–	(45,000)	730,000	200,000
LFSP5	29/01/13	28/01/18	\$6.29	–	50,000	–	–	50,000	–
LFSP6	24/05/13	23/05/18	\$6.36	–	235,000	–	–	235,000	–
30 June 2013				2,210,000	1,110,000	-	(145,000)	3,175,000	1,733,335
Weighted average exercise price				\$8.03	\$6.61	\$0.00	\$7.59	\$7.55	\$7.86
30 June 2012				-	2,210,000	-	-	2,210,000	630,000
Weighted average exercise price				\$0.00	\$8.03	\$0.00	\$0.00	\$8.03	\$7.99

The weighed average share price at the date of exercise of options exercised during the year ended 30 June 2013 was \$5.94 (2012 – \$7.34)

The weighed average remaining contractual life of share options outstanding at the end of the period was 3.35 years (2012 – 3.50 years)

The weighed average remaining contractual life of loan funded shares outstanding at the end of the period was 3.46 years (2012 – 4.05 years)

(b) Existing share-based payment arrangements

General terms and conditions attached to shared-based payments

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

Series

- 10** Options granted to the Chairman were approved by shareholders at the Annual General Meeting held on 30 November 2010. The options were granted in four equal tranches vesting on the achievement of certain milestones, being the date on which:
- Mesoblast signs a commercial partnering contract, e.g. a commercial license to one of its products [vested 7 December 2010];
 - Mesoblast receives IND clearance from the FDA for its first clinical trial for Intervertebral Disc Repair [vested 17 March 2011];
 - Mesoblast completes patient enrolment for its first clinical trial under IND for Intervertebral Disc Repair [vested 12 October 2012];
 - Mesoblast obtains a license from the Therapeutics Goods Administration (TGA) for the manufacture [vested 20 July 2010].

All four tranches expire on 30 November 2014.

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

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

Modifications to terms and conditions

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

(c) Fair values of shared-based payments

The weighted average fair value of share options granted during the year was \$2.64 (2012: \$2.87).

The weighted average fair value of loan funded shares granted during the year was \$2.83 (2012: \$2.92).

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

Share price at grant date

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

Exercise price

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

Share price volatility

The model requires the Company's share price volatility to be measured. In estimating the expected volatility of the underlying shares our objective is to approximate the expectations that would be reflected in a current market or negotiated exchange price for the option or loan funded share.

Notes to the Financial Statements for the year ended 30 June 2013

24. Share-Based Payments (continued)

Share price volatility (continued)

From mid 2010 until the end of 2011 the share price was impacted by the acquisition of a Mesoblast Inc (December 2010), the announcement of a commercialization license agreement (December 2010) and the resulting change in the market capitalization which meant the Company's securities joined the ASX 300 and then the ASX 200. There was also a marked increase in trading volumes in 2011 which is generally understood to relate to these events.

The historical data range for series 15 to 18 and LFSP 1 to 4 covers the two year period prior to grant date with the exclusion of the period from mid 2010 to the end of 2011 because of the events detailed above.

Since the end of 2011 the trading of securities has normalized and provides the best indicator of share price volatility in the current market and therefore the historical data from January 2012 until each grant date has been used for series 19 and 20 and LFSP 5 and 6.

Life of the option/share

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

Dividend yield

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

Risk free interest rate

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

Model inputs

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

Series	Financial year of grant	Exercise/Loan Price per share \$	Share price at grant date \$	Expected share price volatility	Life	Dividend yield	Risk-free interest rate
15 & LFSP1	2012	7.99	7.00-7.48	51.48%	0.6-4.5 yrs	0%	3.13%
16 & LFSP2	2012	8.48	7.71	49.41%	3.30 yrs	0%	3.78%
17 & LFSP3	2013	6.69	6.00	49.61%	5 yrs	0%	2.73%
18 & LFSP4	2013	6.70	5.83-7.14	48.49%	4.75 yrs	0%	2.78%
19 & LFSP5	2013	6.29	5.56-5.61	40.10%	5 yrs	0%	3.09%
20 & LFSP6	2013	6.36	6.01	40.96%	5 yrs	0%	2.84%

The closing share market price of an ordinary share of Mesoblast Limited on the Australian Stock Exchange at 30 June 2013 was \$5.30 (30 June 2012: \$6.19).

25. Key Management Personnel

(a) Details of key management personnel (KMP)

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

Name	Position	Effective Date	
		2013	2012
Brian Jamieson	Non-executive Chairman	Full Year	Full Year
Donal O'Dwyer	Non-executive Director	Full Year	Full Year
Michael Spooner	Non-executive Director	Full Year	Full Year
Ben-Zion Weiner	Non-executive Director	Full Year	9 May 2012 ^(A) to 30 Jun 2012
Eric A. Rose	Non-executive Director	15 Apr 2013 ^(A) to 30 Jun 2013	–
Kevin Buchi	Non-executive Director	–	1 Jul 2011 to 9 May 2012 ^(R)
Silviu Itescu	Executive Director (CEO)	Full Year	Full Year

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

(b) Key management personnel compensation

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

	30 June 2013	30 June 2012
	\$	\$
Short-term employee benefits	2,457,392	2,453,447
Post-employment benefits	59,565	58,374
Share-based payments	5,032	11,801
	2,521,989	2,523,622

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

Notes to the Financial Statements for the year ended 30 June 2013

25. Key Management Personnel (continued)

(c) Key management personnel equity holdings

Options

	Balance at 1 July No.	Granted as compensation No.	Exercised No.	Net change other No.	Balance at 30 June No.	Total vested 30 June No.	Vested and exercisable No.	Unvested No.
2013								
Brian Jamieson	300,000	–	–	–	300,000	300,000	300,000	–
Donal O'Dwyer	799,727	–	–	–	799,727	799,727	799,727	–
2012								
Brian Jamieson	300,000	–	–	–	300,000	225,000	225,000	75,000
Donal O'Dwyer	799,727	–	–	–	799,727	799,727	799,727	–

Shareholdings

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

	Balance at 1 July No.	Granted as compensation No.	Received on exercise of options No.	Net change other No.	Balance at 30 June No.
2013					
Brian Jamieson*	310,000	–	–	–	310,000
Donal O'Dwyer*	305,000	–	–	–	305,000
Michael Spooner*	1,081,335	–	–	–	1,081,335
Silviu Itescu*	68,244,642	–	–	–	68,244,642
2012					
Brian Jamieson*	310,000	–	–	–	310,000
Donal O'Dwyer*	305,000	–	–	–	305,000
Michael Spooner*	1,081,335	–	–	–	1,081,335
Silviu Itescu*	68,244,642	–	–	–	68,244,642

*Shares detailed above include the following shares which are held by a related party of the KMP (as defined by the accounting standard AASB124 Related Party Disclosures), but are not deemed to be a relevant interest.

Brian Jamieson 75,000 (2012:75,000)

Michael Spooner 95,729 (2012:95,729)

26. Related Party Transactions

(a) Parent entity

The parent entity within the Group is Mesoblast Limited.

(b) Associates and subsidiaries

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

(c) Key management personnel

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

(d) Transactions with other related parties

Accounts receivable from, accounts payable to and loans from subsidiaries as at the end of the financial year have been eliminated on consolidation of the Group.

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

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

	30 June 2013	30 June 2012
	\$	\$
Trade receivables		
Teva Pharmaceutical Industries Ltd	–	1,751,396

(f) Terms and conditions

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

Outstanding balances are unsecured and are repayable in cash.

Notes to the Financial Statements for the year ended 30 June 2013

27. Financial Risk Management

Financial risks impacting the Group fall into three categories:

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

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

(a) Market risk

(i) Currency risk

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

The Group manages the currency risk by evaluating the trend of the relevant foreign currency rates (FX rates) to the Australian dollar and making decisions as to the levels to hold in each currency by assessing its future activities which will likely be incurred in those currencies. The Group is currently evaluating the requirement for and use of forward foreign exchange contracts in light of the recent 2013/2014 budget. The Group engages professional advice when considering forward foreign exchange contracts.

As at 30 June 2013, the Group held 2% of its cash in USD, and 98% in AUD. 9% of the AUD balance is subject to forward contracts to purchase USD at a predetermined rate in the future. After allowing for financial derivative contracts, at year end the Group held 12% USD and 88% AUD. The Group has entered financial derivative contracts to take advantage of enhanced interest rates yields available on AUD deposit when compared to USD deposits. The Group sells USD and buys AUD from the bank at a pre-agreed FX rate and agrees to then sell that AUD and buy USD from the bank on maturity also at a pre-agreed rate. As these FX rates are known at the outset there is no currency risk. It should be noted that trading in speculative derivatives are strictly prohibited in accordance with the Group's treasury and financial risk management policy.

The balances held at the end of the year that give rise to currency risk exposure are presented in the table below, together with a sensitivity analysis which assesses the impact that a change of +/-20% (2012: +/-20%) in the exchange rate as at 30 June would have had on the Group's reported net profits/(losses) and/or equity balance. The AUD: USD rate prevailing as at 30 June 2013 was 0.9275 (2012: 1.0191).

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

	Foreign currency balance held	+20%	-20%
30 June 2013	'000	Profit/(Loss) AUD'000	Profit/(Loss) AUD'000
Bank accounts	USD 6,955	(1,250)	1,875
Bank accounts	CHF 100	(19)	29
Forward exchange contracts:			
– buy foreign currency (see note 15)*	USD 28,138	(5,056)	7,584
Intercompany loan*	(USD 28,000)	5,031	(7,547)
Trade and other receivables – USD	USD 3,556	(639)	959
Trade payables & accruals – USD	(USD 9,581)	1,722	(2,582)
Trade payables & accruals ^ – AUD	(AUD 96)	15	(22)
Trade payables & accruals – SGD	(SGD 4,610)	655	(983)
Trade payables & accruals – GBP	(GBP 13)	4	(5)
Trade payables & accruals – SEK	SEK (90)	2	(4)
Trade payables & accruals – EUR	(EUR 8)	2	(3)
		467	(699)

	Foreign currency balance held	+20%	-20%
30 June 2012	'000	Profit/(Loss) AUD'000	Profit/(Loss) AUD'000
Bank accounts	USD 5,005	(819)	1,228
Bank accounts	CHF 100	(17)	26
Forward exchange contracts:			
– buy foreign currency (see note 15)*	USD 66,212	(10,829)	16,243
Intercompany loan*	(USD 68,799)	11,252	(16,877)
Trade and other receivables	USD 6,076	(994)	1,490
Trade payables & accruals – USD	(USD 3,910)	639	(959)
Trade payables & accruals ^ – AUD	(AUD 586)	100	(149)
Trade payables & accruals – SGD	(SGD 351)	45	(68)
Trade payables & accruals – GBP	(GBP 7)	2	(3)
Trade payables & accruals – EUR	(EUR 6)	1	(2)
Trade payables & accruals – DKK	(DKK 7)	–	–
		(620)	929

*Relates to monies owned by the US subsidiary, which have been lent to the parent entity to manage the cash on hand. The FX exposure is mitigated through the forward exchange contract.

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

Notes to the Financial Statements for the year ended 30 June 2013

27. Financial Risk Management (continued)

(a) Market risk (continued)

(ii) Interest rate risk

The Group is not exposed to typical interest rate risk, being the impact of fixed versus floating interest rates on debt. The Groups exposure is to interest rate movements in regards to interest income it earns on its deposits. The interest income derived from these balances can fluctuate due to interest rate changes. This interest rate risk is managed by spreading the maturity date of our deposits across various periods. The Group ensures that sufficient funds are available, in at call accounts, to meet the cash flow requirements of the Group.

The deposits held which derive interest revenue are described in the table below, together with the maximum and minimum interest rates being earned at 30 June 2013. The effect on profit is shown if interest rates change by 10%, in either direction, is as follows:

AUD	2013			2012		
	Low	High	AUD'000	Low	High	AUD'000
Funds invested at 30 June	3.85%	4.66%	302,565	5.10%	6.00%	200,353
Rate increase by 10%	4.24%	5.13%	1,286	5.61%	6.60%	1,132
Rate decrease by 10%	3.47%	4.19%	(1,286)	4.59%	5.40%	(1,132)
USD	Low	High	USD'000	Low	High	USD'000
Funds invested at 30 June	–	–	–	0.70%	0.70%	3,035
Rate increase by 10%	–	–	–	0.77%	0.77%	2
Rate decrease by 10%	–	–	–	0.63%	0.63%	(2)

(iii) Price risk

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

(b) Credit risk

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

	30 June 2013 \$'000	30 June 2012 \$'000
Cash and cash equivalents		
Cash and cash equivalents (note 7) – minimum A rated	315,309	205,591
Trade and other receivables		
Receivable from the Australian Government (GST)	111	1,080
Receivable from the Australian Government (Income Tax)	5,924	–
Receivable from the United States Government (Income Tax)	2,392	3,366
Receivable from the Swiss Government (VAT)	1	–
Receivable from minimum A rated bank deposits (interest)	3,306	3,122
Employee loan contracts ^	320	852
Receivable from related parties (non-rated)	–	1,750
Receivable from other parties (non-rated)	8	498

^ The employee loan balance is covered by a contract.

(c) Liquidity risk

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

All financial liabilities held by the Group at 30 June 2013 and 30 June 2012 are non-interest bearing and mature within 6 months. The total contractual cash flows associated with these liabilities equate to the carrying amount disclosed within the financial statements.

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

Name of entity	Country of incorporation	Class of shares	Equity holding	
			30 June 2013	30 June 2012
			%	%
Mesoblast, Inc.	USA	Ordinary	100	100
Mesoblast International SA	Switzerland	Ordinary	100	100
Mesoblast Australia Pty Ltd	Australia	Ordinary	100	100
Mesoblast UK Limited	United Kingdom	Ordinary	100	100

29. Subsequent Events

There are no events that have arisen after 30 June 2013 and prior to the signing of this financial report that would likely have a material impact on the financial results presented.

Notes to the Financial Statements for the year ended 30 June 2013

Directors' Declaration

In accordance with a resolution of directors of Mesoblast Limited,

In the directors' opinion:

- (a) the financial statements and notes set out on pages 29 to 69 are in accordance with the *Corporations Act 2001*, including:
 - (i) Complying with Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements, and
 - (ii) Giving a true and fair view of the consolidated entity's financial position as at 30 June 2013 and of its performance for the financial year ended on that date, and
- (b) There are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.

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

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

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



Mr Brian Jamieson
Director

29 August 2013, Melbourne



Independent auditor's report to the members of Mesoblast Limited

Report on the financial report

We have audited the accompanying financial report of Mesoblast Limited (the company), which comprises the balance sheet as at 30 June 2013, the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for the Mesoblast Limited Group (the consolidated entity). The consolidated entity comprises the company and the entities it controlled at year's end or from time to time during the financial year.

Directors' responsibility for the financial report

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

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those 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 consolidated 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.

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

Independence

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

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



Auditor's opinion

In our opinion:

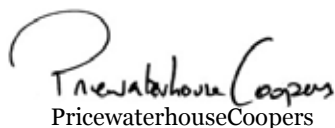
- (a) the financial report of Mesoblast Limited is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the consolidated entity's financial position as at 30 June 2013 and of its performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.
- (b) the financial report and notes also comply with International Financial Reporting Standards as disclosed in Note 1

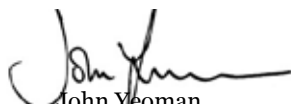
Report on the Remuneration Report

We have audited the remuneration report included in the directors' report for the year ended 30 June 2013. 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 2013, complies with section 300A of the *Corporations Act 2001*.


PricewaterhouseCoopers


John Yeoman
Partner

Melbourne
29 August 2013