mesoblast

Financial Report for the year ended 30 June 2014

Mesoblast Limited ABN: 68 109 431 870
And Controlled Entities (Mesoblast Group)

Directors' Report and Audited Financial Statements

Contents

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 2014. In order to comply with the provisions of the *Corporations Act 2001*, the Directors report the following information:

Principal Activities

Mesoblast is a biotechnology company listed on the Australian Securities Exchange (ASX: MSB), with a level 1 American Depositary Receipt (ADR) program facility trading in the Over-The-Counter (OTC) market in the United States (OTC US: MBLTY)

Mesoblast is a world leader in the development of biologic products for the broad field of regenerative medicine and develops bio-therapeutics based on its proprietary cell-based and protein technologies. Mesoblast's proprietary cell-based technologies include its highly purified, immunoselected Mesenchymal Precursor Cells (MPCs), culture-expanded Mesenchymal Stem Cells (MSCs), Dental Pulp Stem Cells (DPSCs), and expanded Hematopoietic Stem Cells (HSCs). Mesoblast's protein technologies are based on factors derived from its proprietary cellular platforms, including Stromal Derived Factor-1 (SDF-1).

The Company's technology platforms are being developed to deliver a diverse portfolio of products to treat major conditions with unmet medical needs.

OPERATING AND FINANCIAL REVIEW

Review of Operations

During the year, Mesoblast streamlined its operations into a product-focused business and refocused its resources on rapidly advancing its lead products to market. This refocusing has led to a thorough review and prioritization of all products, defining and implementing a product focused organization structure and allocating the Company's cash resources to ensure the priority products are appropriately funded to achieve our objectives.

Product Development and Commercialization

Mesoblast's cell-based products are targeting very distinct and substantial market areas of unmet medical need as outlined below:

Product	Therapeutic area of unmet medical need
Tier 1 – Lead Products	
MSC-100-IV	– Steroid Refractory Acute Graft Versus Host Disease (GVHD) (Lead) – Biologic Refractory Crohn's Disease (Secondary)
MPC-06-ID	– Chronic Low Back Pain (CLBP) due to degenerative disc disease, minimally invasive injection
MPC-150-IM	– Congestive Heart Failure (CHF) – NYHA Class II/III (Lead) – CHF – advanced/NYHA Class IV (Secondary)

Product	Therapeutic area of unmet medical need
Tier 2 – Supporting Products	
MPC-300-IV	– Intravenously administered MPCs for systemic inflammatory and immune-mediated conditions (e.g., Type 2 diabetes and liver/kidney complications, Rheumatoid Arthritis)
MPC-25-IC	– Acute Myocardial Infarction (AMI) – protection of the heart muscle following an acute heart attack, intracoronary
MPC-25-Osteo	– Surgical bone repair • Lumbar Fusion of the Spine (lead)
MPC-CBE	– Bone marrow transplantation • Hematological Malignancies (lead)
MPC-MICRO-IO	– Age-related Macular Degeneration
Pipeline	
Various	– Neurological diseases, lung disease etc.

Products in Tier 1 reflect our highest priority, lead products with potential for mid-term revenue streams. Tier 1 products will be fully funded through to market launch, either directly or with a partner.

These products are as follows:

1. MSC-100-IV: GVHD – Phase 3 clinical development, nearest to market, 'halo' brand for the Group, potential for premium pricing
2. MPC-06-ID: CLBP – Phase 3 ready, high value market opportunity, low dose product
3. MPC-150-IM: CHF – Phase 3 clinical development, high value market opportunity, partnered with Teva Pharmaceuticals Industries

Products in the Tier 2 category represent a robust development portfolio and have the following general characteristics:

- Progressing to next decision point
- Targeted for partnership

Capable of acceleration Pipeline products are in early stage development and have limited funding allocated to their development at this time.

The following table outlines 2014 achievements for our product portfolio:

2014 Highlights for Product Development	
Tier 1	**Lead Indications**
MSC-100-IV	**Steroid Refractory Acute Graft Versus Host Disease (GVHD)** – Peer reviewed publication showing improved survival in children with GVHD after cell therapy – Positive meeting with FDA clarifies pathway to accelerated US product registration for GVHD
MPC-06-ID	**Chronic Lower Back Pain (CLBP) Due to Degenerative Disc Disease** – Positive 12 month Phase 2 results for 100 patients with chronic moderate to severe discogenic low back pain – Positive End of Phase 2 meeting with FDA supports advancing into Phase 3 trial
MPC-150-IM	**Congestive Heart Failure (CHF)** – FDA cleared 1730-patient Phase 3 trial evaluating a single MPC dose in patients with NYHA class II/III heart failure – Commencement of Phase 3 trial and patient recruitment across multiple North American trial sites – 30-patient trial results for end-stage or NYHA class IV heart failure requiring Left Ventricular Assist Device (LVAD) mechanical support, funded by the National Institutes of Health (NIH) showed that a single low dose of MPC improved cardiac function and survival at 90 days, and delayed rehospitalization, thus supporting further development with a higher MPC dose. – NIH & Mesoblast enter into agreement for 120-patient trial in advanced/NYHA Class IV heart failure

2014 Highlights for Product Development	
Tier 2	**Supporting Indications**
MPC-300-IV	**Diabetes and Associated Disease Complications** – Positive Type 2 diabetes trial showed that a single injection of 2 million MPCs per kilogram improved glucose control as determined by a reduction in HbA1c at all time points over three months compared with an increase in the placebo group. – Type 2 diabetes Phase 2 results presented at 74th American Diabetes Association Annual Meeting. Results supported the safety of intravenous MPCs and advancement to Diabetic Nephropathy clinical development, which is ongoing. – Completed recruitment of a 30-patient Phase 2 trial for diabetic kidney disease comparing single dose of 150m or 300m MPC versus placebo. Patient follow-up is ongoing. **Rheumatoid Arthritis** – Completed recruitment of Cohort 1 (24 patients) of the Phase 2 program. Patient follow-up continues.
MPC-25-Osteo	**Bone Repair (Lumbar Spinal Fusion)** – Positive Phase 2 trial results presented at North American Spine Society 28th Annual Meeting – Positive End of Phase 2 meeting with the FDA
Intellectual Property	– Acquisition of culture-expanded MSC patent families to the portfolio bringing the total to more than 60 patent families – 14 new patents granted – two in Japan, five in US, two in China, and five in 'rest of world'

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

TIER 1 PRODUCTS

MSC-100-IV: INTRAVENOUS DELIVERY OF CULTURE-EXPANDED MESENCHYMAL STEM CELLS (MSC)

Target Indications

Lead Indication	**Steroid Refractory Acute Graft Versus Host Disease (aGVHD)**
Development Phase (lead)	Phase 3 – GVHD (pediatrics)
Secondary Indication	Biologic Refractory Crohn's Disease
Partnering Status	JCR Pharmaceuticals Co. Ltd. has the license to manufacture and market the culture expanded MSC product in Japan for acute graft versus host disease in children and adults

STEROID REFRACTORY ACUTE GVHD (LEAD INDICATION)

Market

According to the Center for International Blood and Marrow Transplant Research, there are approximately 30,000 allogeneic hematopoietic stem cell transplants (HSCT) globally per year for diseases including haematological cancers. Nearly 50% of these develop acute GVHD. GVHD occurs when immune cells in the donated cell population attack the recipient cells because the recipient cells are seen as 'foreign'. Organs that are mainly affected by the immunological attack are the gastrointestinal (GI) tract (upper and lower), skin, and liver. There are no approved therapies for steroid refractory acute GVHD.

GlobalData estimates that the total GVHD therapeutics market in the US and 5 largest EU markets was worth $297 million across the six major markets in 2013 and is forecast to grow at a Compound Annual Growth Rate (CAGR) of 6.59% to reach $407 million by 2018.

Clinical Development

MSC-100-IV is the world's first approved allogeneic stem cell therapeutic and the only stem cell therapeutic designated by the United States Food and Drug Administration (FDA) as both an Orphan Drug and Fast Track product. MSC-100-IV is also available for treatments of acute GVHD in children in the United States under an expanded access program.

A peer-reviewed article in the November 2013 scientific journal Biology of Blood and Marrow Transplantation reported that use of MSC-100-IV resulted in a significant survival benefit among responding pediatric bone marrow transplant recipients with refractory acute GVHD. Of the 75 children with acute severe GVHD, 61% responded to MSC-100-IV and 76% of these were alive at day 100. In contrast, non-responders and historical controls have survival rates of between 10% – 30%.

The study was the largest prospective study of its kind in pediatric patients with severe, multi-line refractory acute GVHD.

Acute GVHD with liver or low gut involvement is a life-threatening complication of HSCT with a poor prognosis. A Phase 3 trial showed significant improvements in response rates in the difficult to treat liver and lower gut GVHD subgroup. In subjects with liver GVHD, MSC-100-IV improved day 100 overall response by 76% versus 47% in controls ($p=0.039$, $n=61$) and for subject with lower-GI GVHD SC-100-IV® improved day 100 overall response by 82% versus 64% in controls ($p=0.015$, $n=174$).

Product Launch

Japan: – Mesoblast has provided support to its partner JCR Pharmaceuticals in its plans to file for regulatory approval in Japan in 2014. If successful, it will be the first allogeneic cell-based product approved in Japan. Under its agreement with JCR, Mesoblast is entitled to milestone payments on product regulatory filing and approvals, royalties and other payments at pre-defined thresholds of cumulative net sales.

USA: – Mesoblast has provided the FDA with additional pediatric data generated under the expanded access program. Following discussions with the FDA during the year, a pathway to accelerated approval has been clarified.

BIOLOGIC REFRACTORY CROHN'S DISEASE (SECONDARY INDICATION)

Market

Crohn's Disease (CD) is a chronic inflammatory disorder of the gastrointestinal tract, characterized by periods of remission and symptomatic relapse. The burden of CD is substantial, accounting for more than 1 million cases in the seven major pharmaceutical markets in 2012.

According to Decision Resources, the United States has the highest prevalence of the disease, with more than 600,000 people afflicted and approximately 20,000 new cases diagnosed each year. Decision Resources 2014 report has estimated that the global CD therapeutics market was worth $4.4 billion in 2012 and is forecast to reach $6.8 billion in 2022, at a compounded annual growth rate of 4.5% per year.

A treatment to induce rapid remission is highly needed, particularly in high-risk patients such as those with biologic-resistant disease and those with fistulas, a devastating complication of CD which occurs in 20-25% of patients and often requires invasive surgical procedures.

Clinical Development

MSC-100-IV has demonstrated immunomodulatory properties to regulate T-cell mediated inflammatory responses by inhibiting T-cell proliferation and down-regulating the production of the pro-inflammatory cytokines, tumor necrosis factor-alpha (TNF-alpha) and interferon gamma. More critically, mesenchymal lineage stem cells have been shown to be capable of effective down-regulation of Th17 cells, reduction in IL-17 levels, and induction of FoxP3 regulatory T cells. These inflammatory pathways are central to the pathogenesis of the disease.

Results were obtained from a pilot Phase 1/2 study using MSC-100-IV for the treatment of patients with moderate to severe CD who had failed to respond to standard treatments such as steroids and infliximab (Remicade®). There was a statistically significant decrease in mean Crohn's Disease Activity Index (CDAI) scores of 105 points by day 28 from 341 to 236 ($p=0.004$).

On the basis of these results, an adaptive Phase 3 trial was initiated. The primary endpoint is the proportion of patients experiencing disease remission within 28 days of treatment with MSC-100-IV, defined as an absolute CDAI score below 150, compared to those patients receiving placebo.

The Company will evaluate whether the primary endpoint of day 28 remission in biologic-refractory patients has been achieved, whether there is evidence of efficacy in high-risk groups such as those with fistulizing disease, and whether repeat dosing can result in longer-term maintenance of effect.

MPC-06-ID: INTRA-DISCAL INJECTION OF MPCS FOR THE TREATMENT OF CHRONIC LOWER BACK PAIN DUE TO DEGENERATIVE DISC DISEASE

Product Description

Lead Indication	**Chronic lower back pain due to moderate intervertebral disc degeneration of the lumbar spine**
Development Phase	Phase 3 ready

Market

Over four million patients in the United States alone suffer from chronic low back pain due to degenerative intervertebral disc disease. After failure of conservative measures 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.

The Centers for Disease Control and Prevention (CDC) National Center for Health Statistics reported in 2010 that low back pain was the leading cause of pain, affecting 28% of American adults. 70-85% of all people have back pain at some point in their life. Total costs of low back pain are estimated to be between $100 billion and $200 billion annually, two thirds of which are due to decreased wages and productivity.

Clinical Development

In December 2013, Mesoblast announced the 12-month results of its Phase 2 clinical trial in patients with chronic discogenic low back pain. MPC treatments appeared to be well tolerated. When compared to the findings of the patients receiving placebo (saline) or vehicle (hyaluronic acid) control at 12 months, MPC-treated patients had improvement in chronic low back pain (reduction in mean pain score; increased proportion of patients achieving >50% reduction in pain score; increased proportion of patients achieving minimal residual back pain; reduced opioid use for pain relief; and reduced need for additional surgical and non-surgical interventions for persistent pain); improvement in function (reduction in mean disability score and increased proportion of patients achieving minimal residual functional disability); and improvement in disc stability.

Following the end of Phase 2 meeting with the FDA held in June this year, Mesoblast has performed a post-hoc analysis using a composite end point of pain and function consistent with FDA guidance. In this analysis, 44% of those who received a single injection of 6 million MPCs were deemed to meet positive responder criteria at both six and 12 months. In contrast, only 12.5% of those receiving saline alone and 18% of those receiving hyaluronic acid alone achieved this treatment success outcome ($p=0.006$ and 0.054, respectively). Those receiving 18 million MPC had a 42% success outcome. On the basis of these results, Mesoblast intends to move into Phase 3 by the end of 2014 (calendar year) using the 6 million MPC dose with a composite primary end point above.

MPC-150-IM: INTRA-MYOCARDIAL DELIVERY OF MPCS FOR THE TREATMENT OF CONGESTIVE HEART FAILURE

Target Indications

Lead Indication	**New York Heart Association (NYHA) Class II/III Congestive Heart Failure**
Development Phase (Lead)	Phase 3
Secondary Indication	NYHA Class IV Congestive Heart Failure with Mechanical Support
Partnering Status	Product is partnered with Teva Pharmaceutical Industries (Teva)

CONGESTIVE HEART FAILURE – NYHA CLASS II/III (LEAD INDICATION)

Market

Congestive heart failure is a chronic condition characterized by an enlarged heart and insufficient blood flow to the organs and extremities of the body. According to the 2014 American Heart Association update on heart disease and stroke statistics, congestive heart failure affected about 5.1 million people 20 years or older in the United States in 2014, with 825,000 new cases diagnosed annually. As many as 50% of heart failure patients die within five years of diagnosis. Approximately 30-40% of heart failure patients suffer from moderate/severe class II-III heart failure with low ejection fraction.

Clinical Development

The ongoing Phase 3 trial includes two interim analyses for safety and/or efficacy. The trial design is a double-blinded, 1:1 randomized, placebo-controlled study evaluating a single dose of 150 million MPCs delivered via transendocardial injection catheter to the left ventricle of heart failure patients with NYHA class II or III disease and an ejection fraction ⩽40%. The primary efficacy endpoint of the trial is a time-to-first-event analysis of heart failure-related Major Adverse Cardiac Events (HF-MACE), defined as a composite of cardiac related death or resuscitated cardiac death, or non-fatal decompensated heart failure events. These non-fatal decompensated heart failure events require use of intravenous diuretics or aquapheresis during an in-hospital stay or during an outpatient visit. Adjudication of HF-MACE will be performed by an independent, blinded clinical endpoint committee. A composite endpoint which includes cardiac related death is a standard measure of efficacy used by the FDA for any new heart failure treatment.

The MPC dose for the Phase 3 trial was chosen on the basis of results from a 60-patient Phase 2 trial which has shown that heart failure patients treated with the 150 million MPC dose have not experienced any HF-MACE over the three-year follow-up period compared with an HF-MACE incidence of approximately 30% for the control group over the same period.

CONGESTIVE HEART FAILURE – NYHA CLASS IV WITH MECHANICAL SUPPORT (SECONDARY INDICATION)

Market

Approximately 10% of heart failure patients have advanced to NYHA class IV heart failure. The only treatment options for end-stage or class IV heart failure are a heart transplant or mechanical support with a Left Ventricular Assist Device (LVAD). Heart transplants cannot meet the large need due to limited donor availability, and permanent LVAD support is currently limited by clinical complications.

Clinical Development

The key objectives of using Mesoblast's MPCs in end-stage heart failure patients are to improve heart muscle function sufficiently to reduce the need for LVAD support, and to reduce the long-term complications of LVAD implantation which result in recurrent hospitalizations.

A 120-patient study, to be conducted by the NIH-funded Cardiothoracic Surgical Trials Network, will evaluate the effects of a single injection of 150 million allogeneic MPCs into the hearts of patients with advanced heart failure.

This study builds on the findings published in the June issue of the American Heart Association journal *Circulation* of a double-blind study in 30 patients which showed the potential benefits of a single intra-cardiac injection of 25 million MPCs in advanced heart failure during LVAD implantation. The trial results showed that a single low dose MPC injection was associated with increased ability to maintain circulation without LVAD support, reduced early mortality, and reduced rehospitalization rates compared with control injections.

The 120-patient trial is a double-blind, placebo-controlled, 2:1 randomized design that is being conducted at more than 20 sites across the United States. The primary efficacy endpoint of the study is the number of temporary weans from LVAD tolerated over 12 months. Additionally, the study will evaluate patient survival and re-hospitalization over 12 months.

TIER 2 PRODUCTS

MPC-300-IV: INTRAVENOUS DELIVERY OF MPCS FOR DISEASES OF INFLAMMATION & ENDOTHELIAL DYSFUNCTION

Mesoblast is developing a high-dose product for intravenous administration to target the end-organ complications of diseases associated with systemic inflammation and endothelial dysfunction, including kidney disease in patients with type 2 diabetes and vascular complications associated with rheumatoid arthritis.

Target Indications

Lead Indication	**Diabetes and complications (kidney, liver)**
Development Phase (Lead)	Phase 2
Secondary Indication	Rheumatoid Arthritis

DIABETES AND COMPLICATIONS – KIDNEY, LIVER (LEAD INDICATION)

Market for Diabetic Nephropathy

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 all classes of current anti-diabetic agents are effective at improving glucose control, they are not effective in preventing or potentially reversing end-organ complications in type 2 diabetes.

There are currently no effective therapies to delay or prevent the progression of moderate to severe diabetic kidney disease to kidney failure leading to dialysis or transplant, and is the major predictor of cardiovascular death in people with diabetes. This progression is independent of control of glycemia, lipids, and blood pressure. The annual incidence of cardiovascular events and death in severe diabetic kidney disease approaches 10%.

Approximately 40% of people with diabetes are eventually affected by chronic kidney disease (CKD). CKD leads to progressive deterioration in the body's ability to remove excess fluid and metabolic wastes as defined by the glomerular filtration rate. Ultimately, this leads to end stage renal disease or Stage 5 CKD, with renal replacement therapy (kidney transplantation or dialysis) currently the only option for treatment. In the United States alone, the prevalence of moderate to severe CKD (Stage 3b or 4, as defined by glomerular filtration rate) is estimated to be approximately 6 million people of which about 35-40% have concomitant diabetes. The incidence of CKD Stage 3b-4 in the United States, according to a GlobalData estimate, is approximately 240,000. The treatment goal in Stage 3b-4 is to stabilize renal function and delay or prevent disease progression.

Clinical Development

Type 2 Diabetes
Mesoblast's immunomodulatory MPCs have shown efficacy in preclinical studies in both rodents and non-human primates with type 2 diabetes. During the year, Mesoblast completed a Phase 2 randomized, single-blind, placebo-controlled, dose escalation trial which was conducted across 18 sites in the United States. The trial evaluated the effects of a single intravenous infusion of 0.3, 1.0 or 2.0 million MPCs/kg or placebo over 12 weeks in 61 patients who were inadequately controlled on metformin alone or with one other glucose-lowering agent. Mean diabetes duration was 10 years.

The following were highlighted as key findings from the study:

- During the 12-week study period the cell infusions were safe and well tolerated (with a maximal dose of 246 million cells).
- There was a dose-dependent improvement in glycemic control as evidenced by a decrease at all time points after week 1 in hemoglobin A1c (HbA1c) in MPC-treated patients compared with an increase in HbA1c in placebo-treated subjects.
- A significant reduction in HbA1c was seen after 8 weeks in the 2 million/kg MPC group compared to placebo ($p<0.05$) which was sustained through 12 weeks.

Diabetic Nephropathy
A study confirming safety of MPCs at all levels tested in patients type 2 diabetes, 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. Mesoblast is currently evaluating a 150 million and 300 million MPC fixed dose product for intravenous treatment of end-organ diabetic complications.

During the reporting period, Mesoblast completed recruitment of a 30-patient Phase 2 trial in subjects with type 2 diabetes and stage 3b-4 kidney disease as reflected in average estimated glomerular filtration rate (eGFR) 20-50 ml/min/1.73 m2. Patients were randomized to receive either placebo or a single dose of 150 million MPC or 300 million MPC as an intravenous infusion, and continue to be followed up for a minimum of one year to evaluate safety and efficacy on renal function.

RHEUMATOID ARTHRITIS (SECONDARY INDICATION)

Market

Rheumatoid arthritis (RA) is a disease that affects approximately 1.3 million people in the United States, and is responsible for approximately 250,000 hospitalizations and 9 million physician visits per year in the United States. If left untreated, RA can lead to joint destruction, deformity, disability, and decreased quality of life. Existing biologic therapies have made major inroads to the treatment of rheumatoid arthritis. These therapies often target single pathways of inflammation in a disease that is driven by multiple inflammatory cytokine pathways. Despite the variety of options currently available, approximately one third of patients either do not respond or cannot tolerate these therapies, or lose efficacy over time. There is therefore a segment of the population who would benefit from an alternative therapeutic approach.

Clinical Development

Our goal is to determine whether MPCs have the potential to both induce early and sustained improvement in patients with active inflammatory joint disease.

Mesoblast's Phase 2 program to evaluate the ability of a single MPC injection to treat patients with rheumatoid arthritis who have failed existing biologic therapies has completed its recruitment of the 24 patients in cohort 1 who received a single dose of 1 million MPCs per kg. These patients continue to be followed-up, while patients in the second cohort receive an MPC dose of 2 million per kg.

The results of the Phase 2 program will guide the future direction of this program.

MPC-25-IC: INTRA-CORONARY DELIVERY OF MPCS FOR PATIENTS WHO HAVE SUFFERED A HEART ATTACK

Target Indications

Lead Indication	**Acute Myocardial Infarction**
Development Phase (Lead)	Phase 2

Market

Close to a million new heart attacks occur annually in the United States alone. The majority of patients undergo angioplasty and stent procedures successfully. A high risk subset of patients progress over the ensuing two years to develop heart failure despite maximal therapy. For these patients, a therapy that can protect at-risk heart muscle cells from dying either by delivery via intra-coronary administration at the time of the angioplasty, could prevent this major complication.

Clinical Development

A Phase 2a/2b trial evaluating allogeneic MPCs delivered by intracoronary infusion at the time of angioplasty, named the AMICI trial, is recruiting in Europe, Australia, and New Zealand. The primary endpoint of the study is safety and efficacy at six months in heart attack patients receiving either MPCs at one of two doses, or placebo. Additionally, clinical results obtained from a recent Phase 2b trial performed by Osiris Therapeutics Inc. using allogeneic MSCs delivered intravenously within several days after a large anterior wall myocardial infarction, will be evaluated in the context of the data obtained by intra-coronary MPC administration.

MPC-25-OSTEO: SURGICAL USE OF MPCS FOR BONE REPAIR

Target Indications

Lead Indication	**Lumbar Fusion of the Spine**
Development Phase (Lead)	Phase 3 ready

Market

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 in 2012 with the majority of bone graft revenues, approximately 70%, coming from spinal fusion procedures.

Clinical Development

During the year, Mesoblast's Phase 2 trial results were presented at the North American Spine Society (NASS) 28th Annual Meeting by the trial's independent principal investigator Dr Randall F. Dryer, an orthopedic surgeon with the Central Texas Spine Institute.

The results indicate that Mesoblast's cell therapy product for lumbar spinal fusion was equivalent to hip autograft, the gold standard for this procedure, at 12 months in terms of fusing the spinal segment, reducing pain and improving function, without the need for a second surgical procedure to harvest the patient's own bone, which can cause blood loss and chronic pain at the bone harvest site. As importantly, there were no cell-related serious adverse events such as excessive bone formation or nerve compression, which have been reported with other biologic therapies in lumbar spinal fusion.

During the year, Mesoblast had a successful end of Phase 2 meeting with the FDA as a result of which there is general agreement on the scope and design of a Phase 3 program using MPC-25-Osteo for the treatment of lumbar spinal fusion. Mesoblast intends to partner this product for spinal fusion.

MPC-CBE: CORD BLOOD EXPANSION FOR BONE MARROW TRANSPLANTATION

Target Indications

Lead Indication	**Hematological Malignancies**
Development Phase (Lead)	Phase 3

Market

Bone marrow transplants are the only potential cure for many blood cancers, such as acute myeloid leukemia (AML).

At present, about 30,000 allogeneic bone marrow transplants are performed globally. The vast majority of these transplants use adult donor sources. The number of bone marrow transplants performed could be more than doubled if there was a safe alternative to the existing donor match material used to treat these patients.

Clinical Development

The Phase 3 clinical trial using MPCs to expand hematopoietic precursors from cord blood for transplantation in cancer patients is ongoing. If this product is successful, it has the potential to increase the total number of unrelated donor transplants, and provide therapy for patients with malignant diseases for which transplantation is the only hope for a cure.

MPC-MICRO: INTRA-OCULAR INJECTION FOR THE TREATMENT OF EYE DISEASE

Target Indications

Lead Indication	**Wet Age-related Macular Degeneration (AMD)**
Development Phase (Lead)	Phase 1b/2a

Market

Mesoblast's lead ophthalmic indication is for neovascular, or 'wet', age ('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 antivascular endothelial growth factor (VEGF) agent.

Clinical Development

A dose-ranging phase 1a/2b trial in patients with active wet AMD is ongoing. This trial is evaluating the safety and efficacy of a single intra-ocular injection of allogeneic MPCs in combination with an anti-VEGF agent.

Manufacturing Operations

Mesoblast's manufacturing strategy for its cellular products is centered upon the following important goals:

- Clear product delineation to protect pricing and partner markets;
- Ensuring commercial scale-up and supply;
- Implementing efficiencies and yield improvement measures to ensure reductions in cost-of-goods and increased margins;
- Maintaining regulatory compliance with best practices; and
- Establishing multiple manufacturing sites for commercialized product supply risk mitigation.

As stated above, Mesoblast's corporate strategy is to protect pricing and markets by creating distinct products using discrete manufacturing processes in culture conditions, formulations, and dose regimens.

Our alliance with Lonza, one of the world's leading biologics manufacturers, aims to ensure that product supply will meet anticipated market needs across major geographical jurisdictions, and is underpinned by our exclusive access to Lonza's manufacturing facilities for allogeneic cells in Singapore.

In order to ensure commercial scale up and supply, Mesoblast is transitioning its manufacturing processes to high volume 3D bioreactors and proprietary xeno-free culture conditions. These initiatives enable a cost-of-goods structure that will maximize return on investment.

The Company's manufacturing activities meet stringent criteria set by international regulatory agencies. By using well characterized cell populations, Mesoblast has established manufacturing processes that promote reproducibility and batch to batch consistency for its allogeneic cell products.

Intellectual Property

Mesoblast has significantly strengthened and extended the reach of its patent portfolio in the 2014 financial year. The acquisition of the culture-expanded MSC assets from Osiris Therapeutics in October 2013 added a significant number of new patent families to the portfolio bringing the total to more than 60 patent families.

This financial year we have additionally been granted 14 new patents including two Japanese patents, five US patents, two Chinese patents, and five in other patent jurisdictions.

The patent portfolio includes broad coverage for mesenchymal lineage cells that cover compositions-of-matter and uses of its MPC and MSC technology platform, including bone marrow, adipose, placenta, umbilical cord and dental pulp. Mesoblast's intellectual property portfolio also covers manufacturing processes that are being used with 3D bioreactors and xeno-free culture conditions. These cell manufacturing patents or applications cover, for example, isolation, expansion, purification, scale up, aggregate minimization, cryopreservation, release testing and potency assays, among others.

This broad patent coverage delivers major commercial advantages and offers long-term protection for the Group's products and technology in major markets including the United States, Australia, Europe, Japan and China.

Our People

Mesoblast is rapidly growing, and in the process of transitioning from a platform technology based company to a product focused company. Significant investment has been made in a 50% expansion of our global staff in the past year to ensure the company has sufficient resources to develop, manufacture and commercialize our leading products independently and through our partnerships. The United States remains our lead clinical research & development center, Singapore our manufacturing hub in conjunction together with our external partner (Lonza), and Australia our corporate headquarters.

Fundamental to our product execution strategy, is the creation of product-focused multidisciplinary teams to ensure that absolute priority is placed upon bringing our leading products to the market. We continue to support our technology platform and earlier stage pipeline and we outsource certain projects to the best global providers.

The Board of Directors was further strengthened during the year with the appointment of Mr William (Bill) Burns. Mr Burns brings a wealth of pharmaceutical experience to Mesoblast, having spent his entire career until recently in two companies, the Beecham Group and F. Hoffmann-La Roche Ltd. Mr Burns was Chief Executive Officer of Roche Pharmaceuticals from 2001 to 2009, when he joined the Board of F. Hoffmann-La Roche until his retirement in 2014. His responsibilities spanned from research to commercialization. This appointment follows the appointment of Dr Eric A. Rose to the Board in 2013, who is a world leader in cardiovascular medicine.

Financial Review

Loss before income tax

	30 June 2014 $'000	30 June 2013 $'000	Movement $'000
Loss before income tax	80,953	60,078	20,875
Income tax expense	5	1,585	(1,580)
Loss after income tax	80,958	61,663	19,295

The loss after income tax has increased by $19.3m (31%) to $81.0m (2013: $61.7m) as a result of the Company transitioning to a late stage clinical development company, with multiple phase 3, or phase 3 ready, programs, and the acquisition of the culture-expanded mesemchymal stem cell (ceMSC) programs acquired from Osiris Therapeutics, Inc during the year. Further detail is explained in the following sections.

Revenue from continuing operations

Revenue from continuing operations for the 2014 year have decreased by $2.8m (10%) to $26.0m (2013: $28.8m), as shown in the table below:

	30 June 2014 $'000	30 June 2013 $'000	Movement $'000
Commercialization revenue	16,410	18,260	(1,850)
Interest revenue	9,570	10,526	(956)
	25,980	28,786	(2,806)

An upfront payment of USD130m was received by the Company upon entering into the development and commercialization agreement with Cephalon, Inc. (part of the Teva Pharmaceutical Group) 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. In the latter part of FY2013, the Company extended the revenue recognition period – the decrease in commercialization revenue in FY2014 reflects the full year impact of this extension.

The interest revenue earned by the Group during the year has fallen as cash reserves are consumed for our development programs, together with a decline in interest rates in the current financial year.

Other income

	30 June 2014 $'000	30 June 2013 $'000	Movement $'000
Research & development tax incentive revenue	8,595	5,924	2,671
Release of excess provision for services	2,524	–	2,524
	11,119	5,924	5,195

During 2014, the Group recognized revenue of $8.6m (2013: $5.9m) for the Australian Government's Innovation Australia Research and Development (R&D) Tax Incentive Program for R&D activities conducted in Australia. This amount includes an accrual for $5.2m for FY2014 R&D activities, plus $3.4m of additional FY2013 revenue which was received during the current financial year.

Other income includes a one-off release of a provision of services that has been settled during the year. The settlement was $2.5m less than the recorded provision.

Expenses from continuing operations

	30 June 2014 $'000	30 June 2013 $'000	Movement $'000
Research & development	55,305	47,835	7,470
Manufacturing commercialization	27,608	23,230	4,378
Management and administration	26,562	22,840	3,722
Finance costs	4,329	-	4,329
Other expenses	4,248	883	3,365
	118,052	94,788	23,264

Research & development

Research & development (R&D) expenses have increased by $7.5m (16%) to $55.3m (2013: $47.8m) reflecting the clinical development of the ceMSC programs acquired from Osiris Therapeutics, Inc. during the year, the clinical advancement of our MPC programs as they transition to late-stage development, and the Group's continued investment in resources to execute our late-stage clinical programs.

Approximately one third of the increase ($2.5m) in R&D spend for the year relates to the advancement of our Tier 1 (highest priority) products, and in particular the clinical programs for Graft Versus Host Disease and Crohn's Disease. These programs form part of our new MSC-100-IV product portfolio acquired from Osiris Therapeutics, Inc. during the year. The spend for Tier 1 product MPC-06-ID for the treatment of chronic low back pain is relatively constant compared to last year, and the MPC-150-IM product for congestive heart failure is funded by our partners, Teva (NYHA Class II/III) and the National Institutes of Health (NYHA Class IV).

Tier 2 & pipeline product development spend has had a moderate increase of $1.1m compared to last year. The spend in this category reflects the patient recruitment which occurred for our three programs within the MPC-300-IV product – namely treatment of glucose control in patients with type 2 diabetes, diabetic nephropathy and rheumatoid arthritis. All of these programs recruited heavily in FY2014.

Also included in Tier 2 spend were costs for the ongoing Phase 2 trial in Europe for the treatment of heart attacks (product MPC-25-IC), and the completion of the Phase 2 program for lumbar spinal fusion (product MPC-25-Osteo). Both products had fairly constant spend between FY2014 and FY2013, decreasing by a moderate $0.3m.

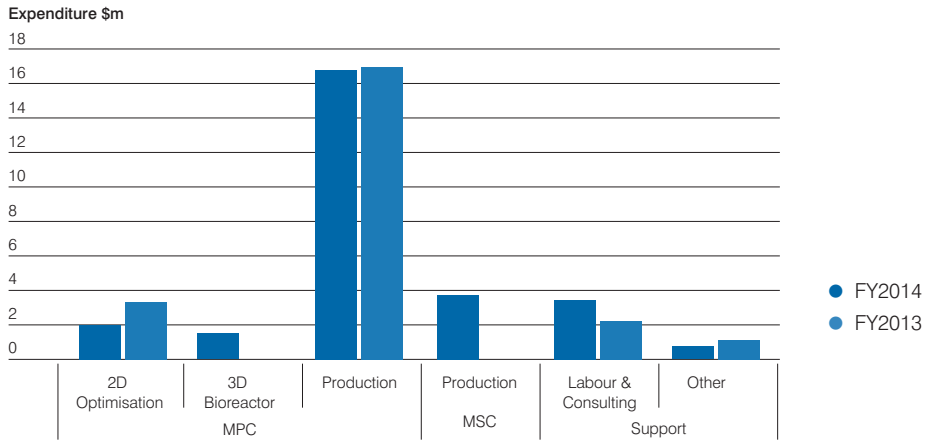
Product development support spend across all programs has increased by $2.4m compared to last year, reflecting primarily the costs of the additional resources required to run the MSC-100-IV product late-stage programs acquired during FY2014, together with an increased pool of resources devoted to our MPC-06-ID product for chronic low back pain as we progress to Phase 3 clinical development.

Also included in R&D are intellectual property portfolio costs, which have risen by $1.2m compared to last year. This reflects the purchase of ceMSC patent families from Osiris Therapeutics in October 2013.

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 increased by $4.4m (19%) to $27.6m (2013: $23.2m).

The graph below depicts our investment in our manufacturing processes:



Of the $4.4m increase in manufacturing spend compared to last year, $3.6m is attributable to production of the ceMSC platform technology, acquired from Osiris in October 2013. This includes the purchase of ceMSC donor cell banks from Lonza, reproduction of the ceMSC production process, and the transfer of the MSC production process into Lonza Singapore.

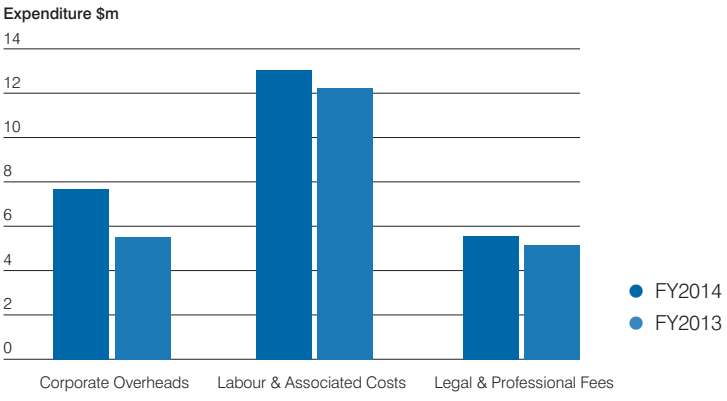
In support of the ceMSC production and our transition from research grade production to commercial production, the manufacturing department has grown from six to 12 employees in 2014 contributing $1.2m of additional expenses for 2014.

Our investment into 3D bioreactor manufacturing processes continues. During FY2013, this development work was funded by a third party supplier, hence the Group's spend on this is relatively low compared to the work performed.

In addition to the above, the Group continues to invest its cash resources to:

- further establish its manufacturing processes in Lonza Singapore;
- produce MPCs and MSCs to support clinical trial activities;
- optimize clinical production processes – including transitioning away from bovine serum; and
- continue to invest in 3D bioreactor development.

Management & administration
Management and administration expenses have increased by $3.7m (16%) to $26.5m (2013: $22.8m).



The costs of management and administration have increased by the same proportion as our research and development costs (16%), primarily as a result of supporting costs incurred associated with the increased head count of 115 staff at 30 June 2014 compared to 76 at 30 June 2013, for example, rent costs due to requiring more office space, information technology support and general compliance.

Finance costs
Finance costs of $4.3m represent the change in fair value of contingent consideration financial liabilities.

Other expenses
Other expenses have increased by $3.3m to $4.2m (2013: $0.9m). This increase is attributable to foreign exchange losses on revaluation of foreign currency denominated monetary assets and liabilities, mostly due to the movement in the AUD:USD exchange rate during the year.

Earnings per share

	2014 Cents	2013 Cents
Basic losses per share	(25.34)	(21.06)
Diluted losses per share	(25.34)	(21.06)

Business Strategies and Prospects for Future Years

Our corporate strategy is to create a broad product portfolio which will be rapidly pursued through regulatory approval and labeling, based upon cost of anticipated clinical programs, time to market and value add to the Group and our shareholders. Specifically, our 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.

In the future we will continue to develop our late-stage programs through to market launch. We will continue to progress our tier 2 and pipeline product portfolios to ensure the Groups products continues to be replenished.

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 product 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.

Product risk
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.

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 and MSC 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.

Commercialization risk
The speed and quality of our clinical trial execution are the primary drivers of our ability to transform into a commercial stage company. In addition, the future profitability of our products depends largely upon the reasonable achievement of

various business assumptions, including product price (reimbursement), size of market, availability of raw materials in the manufacturing process, and cost of goods sold.

These drivers and assumptions also underpin the carrying value of our in-process research and development on the Group's balance sheet, and are reviewed regularly when the Group tests for asset impairment. There is a risk that these assumptions prove to be materially incorrect. Mesoblast seeks to mitigate this risk by developing highly efficient manufacturing processes, eliminating scarce resources from manufacturing processes, conducting payor and market research, and engaging with regulators and reimbursement agencies.

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.

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.

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.

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.

Significant Changes in the State of Affairs

There were no significant changes in the state of affairs of the Group during the 2014 financial year.

Matters Subsequent to the End of the Financial Year

There are no events that have arisen after 30 June 2014 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

Our continued progress in clinical development brings our leading products closer to approvals and commercial reality. Several of these products are now in the final stages of development which thereby brings the company and its partners closer to the market for these lead indications. In addition to final development, we are now focusing on the pre-commercialisation activities for these products to maximise chances of reimbursement where appropriate and where relevant that these products launch effectively post approval. These lead indications continue to be underpinned by our innovative core technologies and a robust and growing intellectual property portfolio.

In addition our manufacturing capabilities with our strategic partner have been progressed much further to ensure clinical and commercial product supply in line with our timing expectations.

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
William M. Burns	Non-executive Director (elected 6 March 2014)
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
Ben-Zion Weiner	Non-executive Director

William M. Burns BA

Non-Executive Director

Experience and expertise

William (Bill) M. Burns has spent his entire management career in two companies, the Beecham Group and F. Hoffmann-La Roche Ltd. He was Chief Executive Officer of Roche Pharmaceuticals from 2001 to 2009, when he joined the Board of F. Hoffmann-La Roche until he retired in 2014. His responsibilities spanned from research to commercialization. Mr Burns has also served on the Board of Directors of Genentech, and as a Director of Chugai Pharmaceutical Co. Additional roles have included as Chairman of biologic company Okairos, acquired in 2013 by GlaxoSmithKline, and Crucell, acquired in October 2011 by Johnson & Johnson. He chaired the Swiss Research Trade Association for several years and represented the company on the European and International Trade Associations Management Boards. He also supports the Wellcome Trust New Technologies group and is a member of the Oncology Advisory Board of the Universities of Cologne/Bonn.

Other current directorships of listed public companies

Vice Chairman, Biotie Therapeutics (Finland) (since 2011)

Non-Executive Director, Shire (UK) (since 2010)

Former listed public company directorships in the last 3 years

Roche Holdings AG (2010-2014)

Chugai Pharmaceuticals (2002-2014)

Crucell (2010-2011)

Special responsibilities

None

Silviu Itescu MBSS, FRACP, FACP, FTSE

CEO (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 Officer

Information on Directors (continued)

Brian Jamieson FCA

Non-executive Chairman

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

Non-executive Director, OZ Minerals Limited (since 2004)

Chairman, Sigma Pharmaceuticals Limited (since 2005)

Non-executive Director, Tatts Group Limited (since 2005)

Former listed public company directorships in the last 3 years

Non-executive Director, Tigers Realm Coal Limited (2011-2014)

Special responsibilities

Chairman of the Board

Member of the Audit & Risk Committee

Member of the Remuneration and Nomination Committee

Donal O'Dwyer BE, MBA

Non-executive Director

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, Atcor Medical Holdings Limited (since 2004)

Non-executive Director, Cochlear Limited (since 2005)

Non-executive Director, Fisher & Paykel Healthcare (since 2013)

Former listed public company directorships in the last 3 years

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

Special responsibilities

Chairman of the Nomination & Remuneration Committee

Member of the Audit & Risk Committee

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 com pany directorships in the last 3 years

ABIOMED (2007 to 2012)

Special responsibilities

Chairman of the Science & Technology Committee

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

None

Special responsibilities

Chairman of the Audit & Risk Committee

Member of the Nomination & Remuneration Committee

Information on Directors (continued)

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 nonexecutive Director.

Other current directorships of listed public companies

None

Former listed public company directorships in the last 3 years

Gefen Biomed Investments Ltd (2010 to 2013)

XTL Biopharmaceuticals Limited (2012 to 2013)

Special responsibilities

Member of the Science & Technology Committee

Company Secretary

Jenni Pilcher AGIA, ACIS, CA, BBS

Ms Pilcher has held the role of CFO with Mesoblast since 2007, and Company Secretary since 2012. Ms Pilcher has recently completed the Graduate Diploma of Applied Corporate Governance and been admitted to the Governance Institute of Australia and the international Institute of Chartered Secretaries & Administrators (ICSA). Prior to joining Mesoblast, Ms Pilcher spent six years with ASX 200 Company, Spotless Group, progressing through a variety of financial roles. Previously Ms Pilcher worked in the finance teams at Cadbury Schweppes plc. and international pharmaceutical group Medeva plc., both based in London, United Kingdom. Ms Pilcher qualified as a Chartered Accountant with Price Waterhouse in 1998.

Directors' interests

The relevant interest[1] 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 Mesoblast Limited ordinary shares
William Burns	–	–
Silviu Itescu	68,244,642	–
Brian Jamieson	385,000	150,000
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 2014 and the numbers of meetings attended by each director were:

	Board of directors		Audit & Risk committee		Nomination & Remuneration committee		Science & Technology committee ^	
Director	**A**	**B**	**A**	**B**	**A**	**B**	**A**	**B**
William Burns*	2	1	–	–	–	–	–	–
Silviu Itescu	9	9	–	–	–	–	3	3
Brian Jamieson	9	9	5	5	7	7	–	–
Donal O'Dwyer	9	9	5	5	7	7	–	–
Eric Rose	9	9	–	–	–	–	3	3
Michael Spooner	9	9	5	5	7	7	–	–
Ben-Zion Weiner	9	8	–	–	–	–	3	3

A = Number of meetings held during the time the director held office or was a member of the committee.
B = Number of meetings attended by committee members
– = Not a member of the relevant committee
**elected to the Board 6 March 2014*
^ Science & Technology Committee was established October 2013.
NB: Certain directors attended various committee meetings by invitation in addition to those shown above.

Remuneration Report

The Directors of the Company are pleased to present the 2013/14 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. Our talent

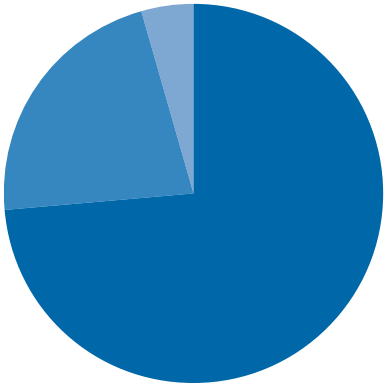
Mesoblast is a pre-revenue company, headquartered in Australia with operations in the United States and Singapore. Its principal activity is in the research and development of its proprietary stem cell technologies for use in the treatment of multiple major disease states and other medical conditions. Mesoblast's cell-based core technologies include its highly purified, immunoselected Mesenchymal Precursor Cells (MPCs), culture-expanded Mesenchymal Stem Cells (ceMSCs) which were acquired during 2014 financial year, Dental Pulp Stem Cells (DPSCs), and expanded Hematopoietic Stem Cells (HSCs). Given our business activity and the current development stage we are at, we generate losses each year and are net users of cash.

As we operate in a highly specialized 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 – which is where the vast number of our employees are based. This helps to ensure that we can attract and retain leaders and people with required specialized skills in our field.

Our employees are, in general, highly skilled and are performing specialized roles directly engaged in activities developing our proprietary adult stem cell technologies. In parallel – our remuneration framework allows us to consider and meet both the expectations of our global shareholder base and the Australian regulatory framework by which the Mesoblast Group is governed.

As at 30 June 2014, the Group has 115 (2013: 76) employees globally:

Employees by Region



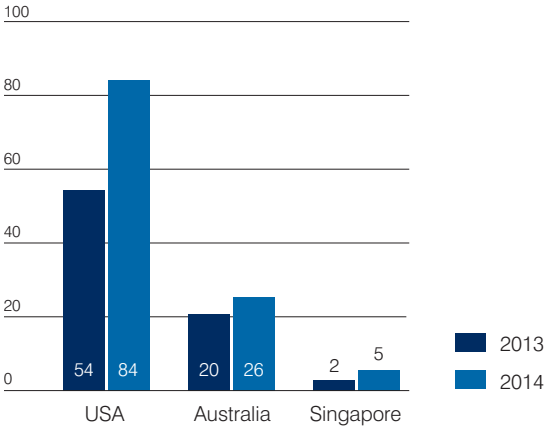
- USA – 84 (73.0%)
- Australia – 26 (22.6%)
- Singapore – 5 (4.4%)

84 (73%) of these employees are based in the United States, which is largely where the Group's operational activities occur.

Of the remaining employees, 26 (23%) are located in Australia, including the CEO and other executive team members, and 5 (4%) are based in Singapore.

The Australian operations comprises mainly headquarter activities, and as a result, more than one-third of the Australian employees hold senior positions.

Year on year growth

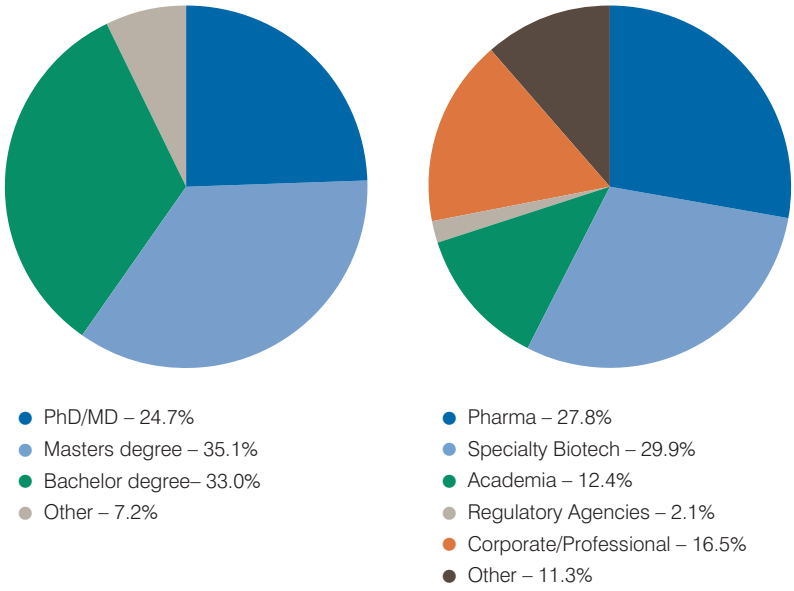


The significant growth in talented resources during the year (as the table illustrates) was required for the following reasons:

- to appropriately resource the development programs of the culture expanded MSC platform technology acquired from Osiris Therapeutics, Inc in October 2013;
- to enable transition into Phase 3 trials for the MPC platform technology; and
- to prepare for commercial manufacturing.

As we recruit new employees into our growing organization we are searching for candidates who will thrive in a small, but rapidly evolving environment where they will apply deep technical expertise across a broad scope of duties. We seek candidates with proven experience in their field who can adapt their experience to both our technology and our scale. Our recruitment activity keeps us current with market pay rates as we see the ranges earned across our candidate pool. During our annual salary review we compare incumbent salary levels to both new hire salaries and market data sourced from external salary surveys.

Employees by Education and Experience



Despite considerable organizational growth over the last two financial years, our organization structure remains relatively flat. As at 30 June 2014, the CEO has 13 direct reports, 10 of whom are part of the executive team.

2. Role of the Nomination and Remuneration Committee

The Nomination and Remuneration Committee (the Committee) is a committee of the Board, and is primarily responsible for making recommendations to the Board on:

- Board appointments
- Non-executive director fees
- Executive remuneration framework
- Remuneration for executive directors, including the CEO, and other key executives
- Short-term and long-term incentive awards
- Share ownership plans

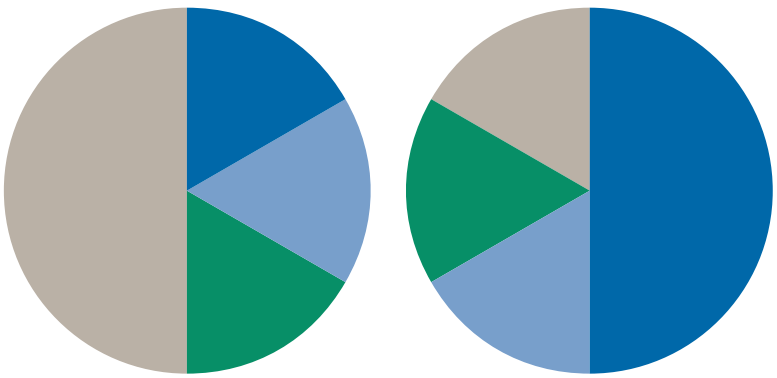
The Committee's objective is to ensure remuneration policies are fair and competitive and in line with similar industry benchmarks whilst aligned with the objectives of the Company. The Committee seeks independent advice from remuneration consultants as and when it deems necessary (see below).

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

3. Non-Executive Director Remuneration

As at 30 June 2014, the Company has six non-executive Directors with diverse industry and regional experience, as the graph below illustrates:

Directors by Region and Experience



(i) Directors' fee structure

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.

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

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 non-executive Director 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.

Since that review, effective from 1 November 2013, non-executive directors were allocated a 2.6% increase to their Board fees only. Committee membership fees were held constant.

Fees and applicable statutory superannuation are paid as follows:

	From 1 November 2013 to Current				From 1 November 2012 to 31 October 2013			
	Board	Audit & Risk Committee	Nomination & Remuneration Committee	Science & Technology Committee	Board	Audit & Risk Committee	Nomination & Remuneration Committee	Science & Technology* Committee
Position	$	$	$	$	$	$	$	$
Chair	328,230	25,000	20,000	20,000	320,000	25,000	20,000	20,000
Member	128,250	12,500	10,000	10,000	125,000	12,500	10,000	10,000

*The science and technology committee of the Board was established in October 2013.

(iii) Maximum annual fee pool

The maximum annual fee pool for directors currently available is $1,250,000 which was approved by shareholders at the last Annual General Meeting held on 15 November 2013. Prior to that, the aggregate of Directors' fees was most recently approved by shareholders on 9 February 2011, in response to the appointment of an additional director to the Board.

At the AGM on 15 November 2013, the Directors considered that the aggregate amount of Directors' fees to be paid out of the funds of the Company by way of remuneration to Non Executive Directors for their services as Non Executive Directors of the Company should be increased from the current aggregate maximum of $1,000,000 previously approved by shareholders, to an aggregate maximum sum of $1,250,000, being an increase of $250,000 or 25%. This increase was to allow specifically for the addition of Dr Eric Rose to the Board in April 2013, and to ensure Mesoblast had capacity within its Directors Fee Pool to appoint any further Directors to the Board should this be in the best interests of the Company at a future time.

Since then, (in March 2014) Mr William Burns joined the Board which furthered strengthen the skills, expertise, and diversity of Board members to ensure the Board is in the best position to fulfill its obligations to shareholders.

(iv) Performance review

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

4. CEO Remuneration

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.

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 Board periodically reviews the CEO's remuneration package including the remuneration mix and has determined that at this stage in the Company's development he has sufficient exposure to the Company's shares to ensure that his personal interests are closely aligned to the creation of long-term shareholder value. The Board believes that the current remuneration package offers an appropriate balance between fixed and performance-based pay and does not believe that the inclusion of a further long-term share-based incentive will offer material additional benefit to the Company at this time.

Since 30 June 2014, a benchmarking study on CEO remuneration was performed by an independent service provider. The findings of this exercise show the CEOs overall remuneration package resides between the 25th percentile and the median of the comparison group. The comparison group included Australian-based companies with a similar market capitalization to that of Mesoblast, of between $1bn to $1.5bn.

(i) Fixed remuneration

The CEO's annual fixed pay pursuant to his contract of employment dated 1 April 2014 is $960,000 plus statutory superannuation. This reflected a 2.6% increase on the prior year – an amount chosen with reference to the adjustments provided to other employees and the CEO's contract of employment which called for a minimum increase of CPI. The CEO's new contract of employment has been amended during the year to remove the requirement of a minimum increase linked to CPI.

(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 his 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 strategic 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.

The Board has approved key performance indicators (KPIs) for the CEO in the following performance categories for the financial year ended 30 June 2014:

Key Performance Indicatior	%	Achievement
Clinical Trial Management: – regulatory and enrollment targets	30	Achieved
Completion of Osiris asset acquisition & Integration	25	Achieved
Company performance versus budget, together with specific strategic and capital market initiatives	27.5	Partially Achieved
Manufacturing achievements	12.5	Achieved
Develop and implementation of a product focussed organisation structure	5	Achieved

Whilst not disclosing the specific details of KPIs due to commercial sensitivity, set out below are certain areas of focus within the KPI categories:

- Clinical trial management: Specific emphasis was placed on receiving regulatory approval to commence certain clinical trials, as well as continued recruitment progress across all of our clinical programs.
- Completion of Osiris asset acquisition & integration: Emphasis was placed on the integration of the assets, including intellectual property, as well as receiving greater clarity from a regulatory perspective on the path to approval of certain programs.
- Manufacturing achievements: Focus has been placed on the improvement/development of our manufacturing processes to ensure scalability, supply and yield. Additionally, a strategic relationship formed with the Singapore Economic Development Board supporting our manufacturing operations.

For the financial year ended 30 June 2014, the total performance assessment of the achievement of the above KPIs was 87.5% of the target/maximum short-term incentive.

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 10 people as at 30 June 2014, who report to the CEO. The Groups' executive team is currently located across both the United States and Australia.

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 specialized 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 Committee considers the following:

- Operational performance and current financial position of the Company;
- Achievement of strategic goals of the Company for the year; and
- 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 recruitment processes and 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.

As approximately 75% of our employees are in the US, it is critical that our approach to remuneration in that market is appropriate and competitive, to ensure we can hire and retain the key individuals we need to give us the best opportunity for success.

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 Short Term Incentives (STIs) and Long-Term Incentives (LTIs).

Annual STI and LTI grants are determined each year by the CEO together with the 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)

Our approach to STI setting is influenced by the fact the Group is in development stage and is pre-revenue, 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 performance against the following;
    - achievement of individual key performance indicators;
    - key corporate and budgetary milestones; and
    - achievement of strategic goals.

All of the factors lead to long-term shareholder value creation.

Individual's KPIs for the executive team are closely aligned to the Company's strategy and objectives, and the CEOs own KPIs. This ensures that by their achievement they will contribute to the overall corporate goals.

STI allocations for the executive team start with an assessment of overall company performance against key milestones, strategic goals and budget performance. The STIs 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 2013/14 financial year, executive STI allocations were between 82.5% and 100% of target. STIs are paid in cash.

The following table outlines a summary of the 2014 Short-Term Incentive Plan (STI)

What is the 2014 STI?	An incentive plan under which eligible employees are (subject to satisfaction of specified performance measures) granted a cash amount, which is based on a percentage range of each participant's fixed remuneration (determined according to role and ability to influence the performance of the Group). Performance is assessed against a combination of Group and individual measures.
When is the 2014 STI grant paid to eligible employees?	The STI amount will be paid to each participant who satisfies applicable performance measures in August 2014, following assessment of performance against the applicable measures during the 2013/14 performance period.
Who participates in the 2014 STI?	All employees hired on or before 31 March 2014 are eligible for consideration. Employees hired during the year are recognised on a pro-rata basis.
Why does the Board consider the 2014 STI an appropriate incentive?	The STI is a globally recognised form of reward for management, aimed at ensuring focus and alignment with Group goals and strategy. Based on both Group and individual measures, and in conjunction with other factors, the Board believes that it helps encourage and reward high performance.
What are the performance conditions under the 2014 STI?	Individual performance is measured against the achievement of individual key performance indicators, key corporate and budgetary milestones and achievement of strategic goals all of which lead to long-term shareholder value creation.
What is the relationship between Group performance and allocation of STI?	At the end of the financial year our Board of Directors assesses our overall company performance based on the achievement of our CEO's Key Performance Indicators. This assessment will adjust how much of our bonus pool is eligible for allocation. For example, if we achieve an 85% Company Performance assessment, then 85% of the total bonus pool will be available for allocation to individual employees. People Leaders evaluate individual performance contributions and make recommendations of the bonus amount each employee should receive based on the bonus pool they have available for allocation and with reference to individual target bonus opportunities.
What is the period over which Group performance is assessed?	The assessment period is the financial year preceding the payment date of the STI (i.e. 1 July to 30 June).

b. Long-term Incentives (LTIs)

As a biotechnology company which is still in the clinical trial development stage, we aim to conserve our cash resources in order to fund our programs, therefore 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 the development process and ultimately to therapeutic treatment.

In designing a LTI mechanism which aims to reward and retain talent across our locations, and considering 84 of our employees are based in the United States, we seek to balance:

- Australian practice and governance expectations, where LTIs are expected to have performance hurdles other than price and employment milestones alone;
- United States practices, where options are a widely distributed remuneration component, typically issued without a price premium, performance hurdles or milestones, and which vest on a more regular basis (eg. rolling monthly basis);
- A strong preference for a single reward mechanism to maintain executive cohesion and teamwork; and
- Alignment with driving shareholder value.

In view of the points outlined above our approach is to issue LTIs to executives that are time based. They are issued at a premium to the actual share price on the day they are issued. It is our belief that this approach is the appropriate one for us at this stage as we believe that the addition of performance hurdles to our LTI programme would make it problematic for us to attract and retain the people we need – particularly in the US – and would ultimately be negative for our company. This is an area we continue to reviewing and assess on an ongoing basis.

In Australia, LTIs consist of limited recourse loan-funded shares of the Company pursuant to the rules of the Loan-funded Share Plan (LFSP). Outside Australia, LTIs consist of options over ordinary shares of the Company under the rules of the Employee Share Ownership Plan (ESOP). Both the ESOP and LFSP were approved by shareholders at the AGM held in November 2013. Both plans operate in a similar manner, with the shares/options typically having a purchase/exercise price premium applied, three-year vesting schedules and a five year life.

Executive LTI allocations are determined with consideration to the nature of the role within our organisation, market value of LTI allocations for comparable roles, previous grants made and the remuneration mix described above where a modified Black-Scholes calculation is used to determine the value of the option.

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.

Summary of the key features of the ESOP and LFSP (LTI Plans):

Why does the Board consider the LFSP/ESOP an appropriate long-term incentive?	The Plans are designed to reward participants for Group performance and to align long-term interests of shareholders, participating employees and the Group, by linking a significant proportion of at-risk remuneration to the Group's future performance, currently assessed over a three-year period from the date of grant of the shares.
In what circumstances are LTI entitlements forfeited?	The LTI will be forfeited upon cessation of employment prior to the conclusion of the performance period in circumstances where a participant is a bad leaver as defined in the Plan rules, or breaches any term of the Loan Agreement in the case of the LFSP. Otherwise a leaver may retain vested Loan Funded Shares or Options subject to repayment of the Loan or exercising the option within 60 days of cessation of employment or within a longer period if so determined by the Board.
What are the performance conditions under the LTI Scheme?	Shares and options are issued at a 10% premium above the volume weighted average share price calculated at grant date. In addition participants have to remain in employment with the Company for the LTIs to vest.
Why did the Board choose the above performance conditions/ hurdles?	High volatility makes it difficult to set meaningful performance hurdles other than price premiums, and applying such hurdles may have a severe impact on the competitiveness of remuneration.

What is the relationship between Group performance and allocation of shares/ options?	Equity-based remuneration is an integral part of remuneration in the biotechnology industry as they reward share price growth and seek to conserve cash. The Board believes that share price growth is an appropriate measure of success as it is the prime driver of investment in the biotechnology sector, and is simply and clearly rewarded using equity-based remuneration.
What is the maximum number of shares/options that may be granted to a participant to the LTI scheme?	The maximum number of shares or options that may be granted is determined by the level of equity based remuneration applicable to each applicant.
When do the shares/ options vest?	Shares/options vest in three equal tranches, one year, two years and three years after the date of grant, provided performance conditions are met.
Is the benefit of participation in the LTI scheme affected by changes in the share price?	Yes, participants in the both the ESOP and LFSP will be affected in the same way as all other shareholders by changes in the Company's share price. The value participants receive through participation in the Plans will be reduced if the share price falls during the performance period and will increase if the share price rises over the performance period.

Australian Loan Funded Share Plan – LFSP

What is the LFSP?	An incentive plan under which eligible employees are granted limited recourse, interest free, loan-funded ordinary shares of the Company. Vesting of the LFSP shares is contingent on the Company achieving certain performance hurdles over a set performance period.
Who participates in the LSFP?	All eligible Australian based employees of the Company, who are in positions to influence achievement of our long-term outcomes and where warranted by market practice for attraction and retention.
What are the key features of the LTI Scheme?	Loan funded shares are issued with a price per shares that is typically 10% higher than the volume weighted average share price calculated at grant date. The Loan-Funded shares are subject to a Loan Agreement between the participant and the Company. Once all conditions are met and the participant no longer has any outstanding obligations pursuant to the Loan Agreement, the loan funded shares revert to being fully paid ordinary shares.
How are shares provided to participants under the Loan-Funded scheme?	Shares issued in the LFSP are issued as new equity and Mesoblast does not buy shares on-market under this plan in an effort to conserve cash.

ESOP

The ESOP operates as a traditional option plan, and is used for non-Australian based employees.

What is the ESOP?	An incentive plan under which eligible employees are granted options over ordinary shares of the Company. Vesting and exercise of the ESOP options is contingent on the Company achieving certain performance hurdles over a set performance period.
Who participates in the ESOP?	All international (non-Australian based) employees of the Company, who are in positions to influence achievement of our long-term outcomes and where warranted by market practice for attraction and retention.
What are the key features of the ESOP?	Options are issued with an exercise price at a percentage premium above the volume weighted average share price calculated at grant date. High volatility makes it difficult to set meaningful performance hurdles and applying such hurdles may have a severe impact on the competitiveness of remuneration.
How are shares provided to participants under the ESOP?	Shares are issued to the participant upon the holder exercising their option and paying the exercise price to the Company (once all vesting conditions are satisfied).

6. Key management personnel

Mesoblast has evolved to a late stage biopharmaceutical company with three distinct products in the final phase of development and multiple products in earlier development phases. Throughout this period the CEO and our expanding Board have continued to set the strategy and direction of the company. A significant appointment to the Board as non-executive director is Mr William Burns who brings deep pharmaceutical operational experience, most recently having served as Chief Executive Officer of Roche Pharmaceuticals from 2001 to 2009, when he joined the Board of F. Hoffmann-La Roche until he retired in 2014.

The role of the executive team, together with the CEO, is to execute the strategy as set by the Board. Recognizing the growing scope of the organization, a significant appointment was recently made to the executive team with the addition of Paul Hodgkinson as Group Chief Financial Officer, reporting to the CEO. Paul brings extensive pharmaceutical industry experience having most recently been Chief Financial Officer, for Novartis Australia. This role will be reported in key management personnel in 2015.

Key management personnel, as defined in 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 recognizing the continuing role of the Board and CEO in guiding and directing strategy, the Board has determined the key management personnel of the Group for 2014 and 2013, as listed in table below:

Name	Position	Change from last year
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
William Burns	Non-executive director	Joined the Board 6 March 2014
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; Chairman of the Science & Technology Committee	No change
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; Member of the Science & Technology Committee	No change
Silviu Itescu	CEO (executive director)	No change

7. Service Agreements

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

Name	Term	Notice period	Termination benefit
CEO (Silviu Itescu)	Initial term of 3 years commencing 1 April 2014, 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 formalized in employment contracts. Five of the executive team have employment contracts with initial terms ranging from 15 months to three years, with notice periods ranging from six to twelve months. The remaining five members have continuous employment contracts with no fixed term and notice periods ranging from 'at will' to twelve months. Four contracts have contractual CPI increases – there are no other contractual increases in remuneration.

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:

2014	Short-term benefits			Post-employment benefits	Long-term benefits	Share-based payments	Other	
Name	Salary & fees $	Cash Bonus^^^ $	Non-monetary benefits $	Super-annuation $	Long service leave $	Options $	Termination benefits $	Total $
Executive director								
Silviu Itescu (CEO)	960,000	840,000	–	17,775	–	–	–	**1,817,775**
Non-executive directors								
William Burns^	44,145	–	–	–	–	–	–	**44,145**
Brian Jamieson	325,547	–	–	17,775	–	–	–	**343,322**
Donal O'Dwyer	159,667	–	–	14,769	–	–	–	**174,436**
Michael Spooner	162,167	–	–	15,000	–	–	–	**177,167**
Ben-Zion Weiner	134,667	–	–	–	–	–	–	**134,667**
Eric Rose^ ^	142,167	–	–	–	–	–	–	**142,167**
Total 2014	**1,928,360**	**840,000**	**–**	**65,319**	**–**	**–**	**–**	**2,833,679**

^ William Burns joined the Board on 6 March 2014;

^ ^ Eric Rose joined the Board on 15 April 2013;

^ ^ ^ STI payable for the year ended 30 June 2014, accrued and not yet paid. This represents 87.5% of target bonus, and therefore an amount of $168,000 (17.5%) was forfeited.

2013	Short-term benefits[1]			Post-employment benefits	Long-term benefits	Share-based payments	Other	
Name	Salary & fees $	Cash Bonus[2] $	Non-monetary benefits $	Super-annuation $	Long service leave $	Options $	Termination benefits $	Total $
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%.

(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:

	Fixed remuneration		At risk – STI		At risk – LTI	
Name	2014 %	2013 %	2014 %	2013 %	2014 %	2013 %
Silviu Itescu (CEO)	54	54	46	46	0	0

	At risk – STI	
Name	Awarded %	Forfeited %
Silviu Itescu (CEO) – 2014	87.5	17.5
Silviu Itescu (CEO) – 2013	85	15

9. Company performance and remuneration

Mesoblast is a Group of companies operating in the biotechnology industry. Its core activities are researching & developing proprietary adult stem cell technologies 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 commercialization. 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.

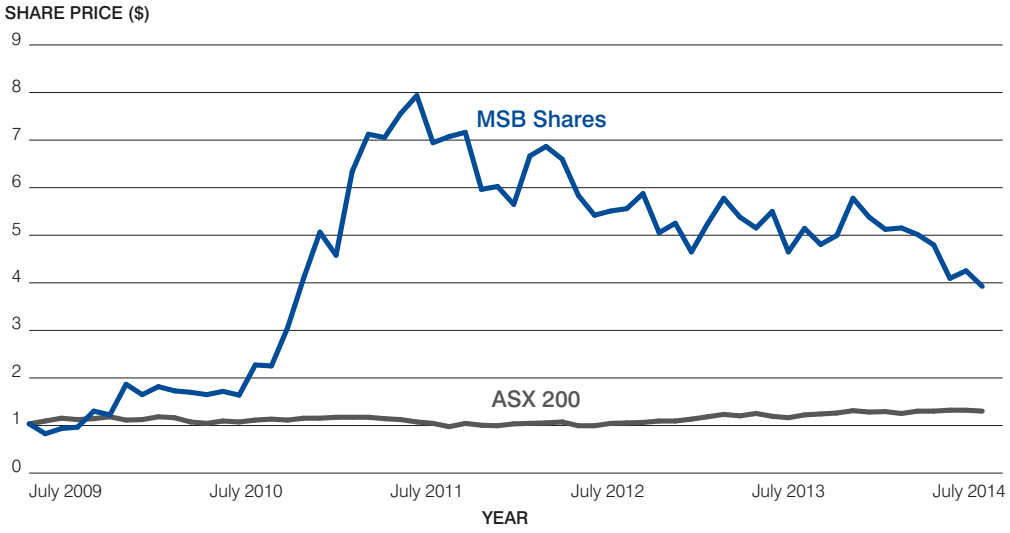
To date, our sources of funding for the programs have predominantly been through capital raisings from institutional and sophisticated investors, the signing of a key collaboration with Teva Pharmaceutical Industries, and to a small extent government grants and research and development tax credits. To date, the Group has not utilized any debt financing. The Group remains well-funded with $196.4m cash on hand as at 30 June 2014. The Group has not paid dividends to date nor made any returns of capital to shareholders.

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 capitalization. This growth requires the achievement of well-defined milestones that are critical for achieving product approval and commercialization, in a timely fashion and within budget. These milestones are reflected in the CEOs KPIs on an annual basis.

The table and chart below detail Company performance on a market capitalization basis, against executive key management personnel at-risk compensation:

	2014	2013	2012	2011	2010
Share price (ASX:MSB)					
– closing at 30 June	$4.47	$5.30	$6.19	$8.65	$1.85
– high for the year	$6.80	$7.49	$10.04	$9.95	$2.26
– low for the year	$4.18	$4.22	$5.44	$1.72	$0.78
– share price volatility (annual)	38%	39%	47%	52%	53%
Market capitalization at 30 June	$1,437m	$1,677m	$1,770m	$2,425m	$286m
– increase/(decrease) – $	($240m)	($93m)	($655m)	$2,139m	$173m
– increase/(decrease) – %	-14%	-5%	-27%	748%	153%
Short-term incentives – % of target paid to CEO	87.5%	85%	65%	100%	100%
Short-term incentives – % of base salary paid to CEO	87.5%	85%	65%	42%	40%

The chart of monthly prices over 5 years for security MSB, against the ASX 200:



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

Year	Key Value Creating Milestones Achieved
FY2014	FDA clears 1730 patient Mesenchymal Precursor Cell (MPC) Phase 3 trial in NYHA class II/III heart failure; actively recruiting across multiple North American sites
	NIH and MSB agree 120 patient MPC trial in advanced / NYHA class IV heart failure
	End of Phase 2 meeting with FDA supports advancing to MPC Phase 3 trial in Chronic Lower Back Pain (CLBP)
	Acquired culture expanded Mesenchymal Stem Cell (MSC) assets from Osiris Therapeutics Inc.
	FDA discussions clarify pathway to accelerated US approval for GVHD
	Strategic relationship formed with Singapore Economic Development Board
	Positive type 2 diabetes trial results presented at 74th American Diabetes Association Annual Meeting, supported progression to ongoing Diabetic Nephropathy trial
FY2013	Australian Ethics approval for a phase 2 trial to commence in diabetic nephropathy
	Positive interim results in phase 2 trial for disc repair
	$170m global capital raising
	Key patents granted in Japan, China and USA
	FDA approval for a phase 2 clinical trial to commence for treating rheumatoid arthritis

10. Use of remuneration consultants

During the year, the Nomination and Remuneration Committee of the Board engaged Towers Watson to provide a report on non-executive directors' fees, including equity components, for appropriately similar companies both in Australia and the United States. They were paid $13,000 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 2013 Annual General Meeting (AGM)

Mesoblast Ltd received 99% of the proxy votes in favour of adopting the 2013 remuneration report, and the same resolution was passed on a show of hands at the meeting.

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.

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

There were no grants of share options made to key management personnel, including Directors, 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 Values

	Remuneration consisting of options[1] %	Value of options granted[2] $	Value of options exercised[3] $	Value of options lapsed[4] $
2014				
Brian Jamieson	–	–	583,950	–
2013				
Brian Jamieson	1.6%	–	–	–

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

	No. of options granted during the year	No. of options vested during the year	No. of options lapsed during the year
2014			
Brian Jamieson	–	–	–
2013			
Brian Jamieson	–	75,000	–

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

There were no options granted under the ESOP that vested and/or forfeited during the current financial year.

(iv) Shares provided on exercise of remuneration options

2014	No. of options exercised during the year	No. of ordinary shares in Mesoblast Limited issued	Exercise Date	Value per share at exercise date (closing price)	Exercise price per option
Brian Jamieson	75,000	75,000	02/09/2013	$5.65	$1.73
Brian Jamieson	75,000	75,000	13/12/2013	$5.58	$1.73

There were no share options exercised by key management personnel in the 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	Exercise price	Issue Date	Number of shares under option, or loan-funded
Silviu Itescu	–	–	–
Peter Howard[1]	5.92	11/12/2013	200,000
Michael Schuster[1]	5.92	3/09/2013	200,000
Donna Skerrett[1]	5.92	3/09/2013	200,000
Darin Weber[1]	5.92	3/09/2013	200,000

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

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
30/11/2009	1.58	30/11/2014	480,000
30/11/2009	1.73	30/11/2014	150,000
22/09/2010	2.64	21/09/2015	135,000
29/11/2010	3.48	29/11/2015	1,569,300
22/12/2011	7.99	30/06/2016	2,203,334
24/02/2012	8.48	23/02/2017	170,000
9/07/2012	6.69	8/07/2018	200,000
21/09/2012	6.70	30/06/2017	1,108,333
24/09/2012	6.70	30/06/2017	710,000
29/10/2012	6.70	30/06/2017	60,000
25/01/2013	6.29	24/01/2018	50,000
24/05/2013	6.36	23/05/2018	765,000
3/09/2013	5.92	9/02/2018	200,000
3/09/2013	5.92	30/06/2018	2,390,000
4/09/2013	6.28	27/08/2018	225,000
19/11/2013	6.20	10/10/2018	50,000
30/11/2013	6.79	29/11/2018	200,000
17/12/2013	6.25	16/12/2018	180,000
10/02/2014	6.41	9/02/2019	100,000
17/02/2014	6.33	16/02/2019	25,000
Sub-total			**10,970,967**

Issue Date	Exercise price of options USD	Expiry date of options	Number of shares under option
07/07/2010	0.046	07/07/15	287,903
07/07/2010	0.305	26/10/18	195,999
07/07/2010	0.340	26/10/19	703,761
07/07/2010	0.444	25/04/17	127,956
07/07/2010	0.444	02/05/17	127,956
Sub-total			**1,443,575**
Grand Total			**12,414,542**

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	Amount unpaid per share
30/11/2009	230,000	1.58	–
30/11/2009	150,000	1.73	–
22/09/2010	310,000	2.64	–
29/11/2010	297,300	3.48	–
Total	**987,300**		

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 both the current and prior financial years, no 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.

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 2014 is included on page 40 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.

Mr Brian Jamieson
Chairman

Mr Silviu Itescu
Chief Executive Officer

26 August 2014, Melbourne

Auditor's Independence Declaration

As lead auditors for the audit of Mesoblast Limited for the year ended 30 June 2014, we declare that to the best of our 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.

John Yeoman
Partner
PricewaterhouseCoopers

26 August 2014

Jon Roberts
Partner
PricewaterhouseCoopers

26 August 2014

Financial Statements

for the year ended 30 June 2014

The financial statements cover the Group consisting of Mesoblast Limited ('Mesoblast') and its subsidiaries, a company limited by shares whose shares are publicly traded on the Australian stock exchange (ASX). A list of major subsidiaries is included in note 13.

The financial statements are presented in the Australian currency.

Mesoblast is incorporated and domiciled in Australia and has its registered office and principal place of business as follows:

Mesoblast Limited
Level 38
55 Collins Street
Melbourne

The principal activity of the consolidated entity during the financial year was developing bio-therapeutics based on its proprietary cell-based and protein technologies. Mesoblast's proprietary cell-based core technologies include its highly purified, immunoselected Mesenchymal Precursor Cells (MPCs), culture-expanded Mesenchymal Stem Cells (MSCs), Dental Pulp Stem Cells (DPSCs), and expanded Hematopoietic Stem Cells (HSCs). Mesoblast's protein technologies are based on factors derived from its proprietary cellular platforms, including Stromal Derived Factor-1 (SDF-1). The Company's technology platforms are being developed to deliver a diverse portfolio of products to treat major conditions with unmet medical needs.

The financial statements were authorized for issue by the directors on 26 August 2014. The directors have the power to amend and reissue the financial statements.

All press releases, financial reports and other information are available on our website: www.mesoblast.com

Consolidated Income Statement for the year ended 30 June 2014

	Note	30 June 2014 $'000	30 June 2013 $'000
Revenue from continuing operations	3(a)	25,980	28,786
Other income	3(b)	11,119	5,924
		37,099	**34,710**
Expenses from continuing operations	3(c)		
Research and development		(55,305)	(47,835)
Manufacturing commercialization		(27,608)	(23,230)
Management and administration		(26,562)	(22,840)
Finance costs		(4,329)	–
Other expenses		(4,248)	(883)
		(118,052)	**(94,788)**
Loss before income tax		**(80,953)**	**(60,078)**
Income tax expense	4	(5)	(1,585)
Loss attributable to the owners of Mesoblast Limited		**(80,958)**	**(61,663)**
Losses per share from continuing operations attributable to the ordinary equity holders of the Group:		Cents	Cents
Basic – losses per share	20	(25.34)	(21.06)
Diluted – losses per share	20	(25.34)	(21.06)

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 2014

	Note	30 June 2014 $'000	30 June 2013 $'000
Loss for the year		**(80,958)**	**(61,663)**
Other comprehensive income			
Items that may be reclassified to profit and loss			
Exchange differences on translation of foreign operations	7(b)	(6,620)	32,003
Other comprehensive income for the period, net of tax		**(6,620)**	**32,003**
Total comprehensive loss attributable to the owners of Mesoblast Limited		**(87,578)**	**(29,660)**

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 2014

	Note	Issued Capital $'000	Share Option Reserve $'000	Foreign Currency Translation Reserve $'000	Retained Earnings $'000	Total $'000
Balance at 1 July 2012		**485,004**	**37,505**	**(7,497)**	**(36,164)**	**478,848**
Loss for the year		–	–	–	(61,663)	(61,663)
Other comprehensive income		–	–	32,003	–	32,003
Total comprehensive profit/(loss) 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
	7(a)	168,785	–	–	–	168,785
Tax effect of options deductible for tax		–	–	–	–	–
Transfer exercised options		669	(669)	–	–	–
Fair value of share-based payments	18	–	12,293	–		12,293
		669	**11,624**	**–**	**–**	**12,293**
Balance at 30 June 2013		**654,458**	**49,129**	**24,506**	**(97,827)**	**630,266**
Loss for the year		–	–	–	(80,958)	(80,958)
Other comprehensive income		–	–	(6,620)	–	(6,620)
Total comprehensive loss for the period		**–**	**–**	**(6,620)**	**(80,958)**	**(87,578)**
Transactions with owners in their capacity as owners:						
Contributions of equity net of transaction costs		19,611	–	–	–	19,611
	7(a)	**19,611**	**–**	**–**	**–**	**19,611**
Tax effect of options deductible for tax		–	–	–	–	–
Transfer exercised options		3,018	(3,018)	–	–	-
Fair value of share-based payments	18	–	9,419	–	–	9,419
		3,018	6,401	–	–	9,419
Balance at 30 June 2014		**677,087**	**55,530**	**17,886**	**(178,785)**	**571,718**

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

Consolidated Balance Sheet as at 30 June 2014

	Note	30 June 2014 $'000	30 June 2013 $'000
Assets			
Current Assets			
Cash and cash equivalents	5(a)	196,394	315,309
Trade and other receivables	5(b)	6,098	12,063
Prepayments		1,257	986
Derivative financial instruments	10(a)	–	3,486
Total Current Assets		**203,749**	**331,844**
Non-Current Assets			
Property, plant and equipment	6(a)	4,683	2,757
Other non-current assets	5(c)	2,978	1,277
Intangible assets	6(b)	687,904	547,834
Total Non-Current Assets		**695,565**	**551,868**
Total Assets		**899,314**	**883,712**
Liabilities			
Current Liabilities			
Trade and other payables	5(d)	20,723	20,780
Deferred revenue	6(c)	15,928	16,176
Derivative financial instruments	10(a)	337	–
Provisions	6(d)	5,687	13,632
Total Current Liabilities		**42,675**	**50,588**
Non-Current Liabilities			
Deferred revenue	6(c)	39,818	56,617
Deferred tax liability	6(f)	158,585	146,038
Provisions	6(d)	86,518	203
Total Non-Current Liabilities		**284,921**	**202,858**
Total Liabilities		**327,596**	**253,446**
Net Assets		**571,718**	**630,266**
Equity			
Issued capital	7(a)	677,087	654,458
Reserves	7(b)	73,416	73,635
Accumulated losses		(178,785)	(97,827)
Total Equity		**571,718**	**630,266**

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 2014

	Note	30 June 2014 $'000	30 June 2013 $'000
Cash Flows from Operating Activities			
R&D tax incentive received		9,340	–
Payments to suppliers and employees (inclusive of goods and services tax)		(106,310)	(67,716)
		(96,970)	(67,716)
Interest received		12,578	10,338
Income taxes refunded		2,531	3,297
Net cash (outflows) in operating activities	8(b)	**(81,861)**	**(54,081)**
Cash Flows from Investing Activities			
Payments for financial derivatives		(1,483)	(2,204)
Payments for in-process research & development		(35,585)	(1,537)
Payments for licenses		(468)	(77)
Payments for rental deposits		(1,728)	–
Investment in fixed assets		(1,865)	(1,224)
Receipts from repayments of loans from employees		320	–
Net cash (outflows) in investing activities		**(40,809)**	**(5,042)**
Cash Flows from Financing Activities			
Proceeds from issue of shares		2,476	174,878
Payments for share issue costs		(46)	(5,529)
Net cash inflows by financing activities		**2,430**	**169,349**
Net (decrease)/increase in cash and cash equivalents		(120,240)	110,226
Cash and cash equivalents at beginning of year		315,309	205,591
FX gains/(losses) on the translation of foreign bank accounts		1,325	(508)
Cash and cash equivalents at end of year	8(a)	**196,394**	**315,309**

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

Contents of the Notes to the Consolidated Financial Statements

1. Significant changes in the current reporting period

The financial position and performance of the Group was particularly affected by the following events and transactions during the reporting period:

- The acquisition of the entire culture-expanded meschymal stem cell (MSC) business of Osiris Therapeutics (NASDAQ: OSIR) (see note 12) which resulted in a recognition of in-process research & development acquired and goodwill (Note 6(b)).

For a detailed discussion about the Group's performance and financial position please refer to our operating and financial review on pages 1 to 16.

How numbers are calculated

2. Segment information
3. Revenue and expenses from continuing operations
4. Income tax expense
5. Financial assets and liabilities
6. Non-financial assets and liabilities
7. Equity
8. Cash flow information

2. Segment information

The Group operates in one segment being the research and development of adult stem cell technology platform. Accordingly the segment information is the same as is presented elsewhere in this report and no additional disclosure is provided.

3. Revenue and expenses from continuing operations

	Note	30 June 2014 $'000	30 June 2013 $'000
(a) Revenue from continuing operations			
Commercialization revenue ^	6(c)	16,410	18,260
Interest revenue		9,570	10,526
		25,980	28,786
(b) Other income			
Research & development tax incentive		8,595	5,924
Release of excess provision for services	6(d)	2,524	–
		11,119	5,924
(c) Expenses from continuing operations			
Clinical trial research & development		20,812	19,769
Manufacturing production & development		22,932	20,199
Employee benefits			
Salaries and employee benefits		28,897	20,018
Defined contribution superannuation expenses		408	307
Equity settled share-based payment transactions ^ ^		9,419	12,293
Total employee benefits		**38,724**	**32,618**
Depreciation and amortization of non-current assets			
Plant and equipment depreciation	6(a)	974	670
Intellectual property amortization	6(b)	146	102
Total depreciation and amortization of non-current assets		**1,120**	**772**
Other management & administration expenses			
Overheads & administration		10,698	8,812
Consultancy		6,831	5,163
Legals, patent and other professional fees		5,522	5,647
Intellectual property expenses (excluding the amount amortized above)		2,836	925
Total other management & administration expenses		**25,887**	**20,547**
Other expenses			
Foreign exchange losses		3,980	883
Remeasurement of contingent consideration		268	–
Total other expenses		**4,248**	**883**

Notes to the Financial Statements for the year ended 30 June 2014

3. Revenue and Expenses from Continuing Operations (continued)

	Note	30 June 2014 $'000	30 June 2013 $'000
Finance costs			
Provisions: unwinding of discount	6(d)(ii)	4,329	–
Total finance costs		**4,329**	**–**
Total expenses from continuing operations		**118,052**	**94,788**

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

The total upfront cash received under the development and commercialization agreement was USD130,000k. The Group has recognized revenue of $16,410k in the current year (2013: $18,260k) 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 Group continuously monitors and reviews the development timelines of the products with no changes being made in the current year.

^ ^ Equity settled share-based payment transactions

Equity settled share-based payment transactions have been reflected in the Income Statement functional expense categories as follows: research & development $5,063k (2013: $7,831k), manufacturing commercialization $865k (2013: $495k) and management & administration $3,491k (2013: $3,968k).

4. Income tax expense

	30 June 2014 $'000	30 June 2013 $'000
(a) Reconciliation of income tax to prima facie tax payable		
Loss from continuing operations before income tax	(80,953)	(60,078)
Tax at the Australian tax rate of 30% (2013: 30%)	(24,286)	(18,023)
Tax effect of amounts which are (not deductible)/taxable in calculating taxable income:		
Share-based payments expense	2,776	3,688
R&D tax concessions	3,771	3,594
Other sundry items	3,509	(34)
Current year tax benefit	**(14,230)**	**(10,775)**
Adjustments for current tax of prior periods	2,485	(219)
Differences in overseas tax rates	(2,584)	(2,246)
Tax benefit not recognized	14,329	13,239
Alternative minimum tax charge (USA)	–	1,588
USA City and State tax (benefit)/expense	(2,836)	1,585
USA City and State tax expense/(benefit) – not recognized	2,841	(1,587)
Income tax expense attributable to profit before income tax	5	1,585
(b) Income tax expense		
Current tax	5	1,585
Deferred tax	–	–
	5	**1,585**
(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 bought to account)	(157)	1,545
Deferred tax recorded in equity (if bought to account)	454	487
	297	**2,032**

	Note	30 June 2014 $'000	30 June 2013 $'000
(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		–	–
Deferred tax recorded in equity		–	–
(e) Tax Losses			
Unused tax losses for which no deferred tax asset has been bought to account		146,798	130,202
Potential tax benefit at local tax rates		44,992	41,660
(f) Unrecognized temporary differences			
Temporary differences not bought to account		8,928	8,895

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

(i) Significant estimates

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 consulted professional tax advisers to estimate 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.

5. Financial assets and liabilities

This note provides information about the Group's financial instruments, including:

- an overview of all financial instruments held by the Group
- specific information about each type of financial instrument
- accounting policies
- information about determining the fair value of the instruments, including judgments and estimation uncertainty involved.

The Group holds the following financial instruments:

Financial assets	Notes	Assets at FVTPL $'000	Financial assets at amortized cost $'000	Total $'000
2014				
Cash & cash equivalents	5(a)	–	196,394	196,394
Trade & other receivables	5(b)	–	6,098	6,098
Other non-current assets	5(c)	–	2,978	2,978
		–	205,470	205,470
2013				
Cash & cash equivalents	5(a)	–	315,309	315,309
Trade & other receivables	5(b)	–	12,063	12,063
Derivative financial instruments	10(a)	3,486	–	3,486
Other non-current assets	5(c)	–	1,277	1,277
		3,486	328,649	332,135

Notes to the Financial Statements for the year ended 30 June 2014

5. Financial assets and liabilities (continued)

Financial liabilities	Notes	Liabilities at FVTPL $'000	Liabilities at amortized cost $'000	Total $'000
2014				
Trade and other payables	5(d)	–	20,723	20,723
Provisions	6(d)(iii)	86,249	–	86,249
Derivative financial instruments	10(a)	337	–	337
		86,586	**20,723**	**107,309**
2013				
Trade and other payables	5(d)	–	20,780	20,780
		–	**20,780**	**20,780**

The Group's exposure to various risks associated with the financial instruments is discussed in note 10. The maximum exposure to credit risk at the end of the reporting period is the carrying amount of each class of financial assets mentioned above.

(a) Cash and cash equivalents

	30 June 2014 $'000	30 June 2013 $'000
Cash at bank	3,827	12,744
Deposits at call ^	192,567	302,565
	196,394	**315,309**

^ Deposits at call include $6.1m (2013: $6.1m) held as security against future FX deals and is restricted for use.

(i) Classification as cash equivalents

Term deposits are presented as cash equivalents if they have a maturity of three months or less from the date of acquisition and are repayable with 24 hours notice with no loss in interest. See note 22(m) for the Group's other accounting policies on cash and cash equivalents.

(b) Trade and other receivables

	30 June 2014 $'000	30 June 2013 $'000
Other receivables	405	–
Interest receivables	296	3,306
Sundry debtors	11	7
Income tax and tax incentives recoverable	5,254	8,317
Other recoverable taxes (GST & VAT)	132	113
Loan to an employee covered by a contract	–	320
	6,098	**12,063**

(i) Classification as trade and other receivables

Interest receivables are amounts due at maturity of Term Deposits. All trade and other receivable balances are within their due dates and none are considered to be impaired at both 30 June 2014 and 30 June 2013. The Group's impairment and other accounting policies for trade and other receivables are outlined in notes 10(c) and 22(n) respectively. 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.

(ii) Other receivables

These amounts generally arise from transactions outside the usual operating activities of the Group.

(iii) Fair values of trade and other receivables
Due to the short-term nature of the current receivables, their carrying amount is assumed to be the same as their fair value.

(iv) Impairment and risk exposure
Information about the impairment of trade and other receivables, their credit quality and the Group's exposure to credit risk, foreign currency risk and interest rate risk can be found in note 10(c) and (b).

(c) Other non-current Assets

	30 June 2014 $'000	30 June 2013 $'000
Bank guarantee	960	–
Letter of credit	2,018	1,277
	2,978	**1,277**

(i) Classification of financial assets as other non-current assets

Bank guarantee
These funds are held in an account named Mesoblast Ltd at National Australia Bank according to the terms of a Bank Guarantee which is security for the sublease agreement for our occupancy of Level 38, 55 Collins Street, Melbourne, Victoria, Australia. The Bank Guarantee is security for the full and faithful performance and observance by the subtenant of the terms, covenants and conditions of the sublease. The Bank Guarantee continues in force until it is released by the lessor.

Letter of credit
These funds are held in an account named Mesoblast Inc. at the Bank of America according to the terms of two Irrevocable Standby Letters of Credit which are security for the sublease agreement for our occupancy of 505 Fifth Avenue, New York, New York, United States of America. The Letters of Credit are security for the full and faithful performance and observance by the subtenant of the terms, covenants and conditions of the sublease. The Letters of Credit are 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 (USD1,186k) and 3 August 2021 (USD715k).

(ii) Impairment and risk exposure
None of the other non-current assets are either past due or impaired.

(d) Trade and other payables

	30 June 2014 $'000	30 June 2013 $'000
Trade payables and other payables	20,723	20,780
	20,723	**20,780**

The carrying amounts of trade and other payables are assumed to be the same as their fair values, due to their short-term nature.

Notes to the Financial Statements for the year ended 30 June 2014

(e) Recognized fair value measurements

(i) Fair value hierarchy

The following table presents the Group's financial assets and financial liabilities measured and recognized at fair value at 30 June 2014 and 30 June 2013 on a recurring basis, categorized by level according to the significance of the inputs used in making the measurements:

At 30 June 2014	Notes	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Financial liabilities					
Financial liabilities at fair value through profit or loss					
Derivative financial instruments	10(a)	–	337	–	337
Provisions	6(d)	–	–	86,249	86,249
Total financial liabilities		–	337	86,249	86,586

At 30 June 2013	Notes	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Financial assets					
Financial assets at fair value through profit or loss					
Derivative financial instruments	10(a)	–	3,486	–	3,486
Total financial assets		–	3,486	–	3,486

There were no transfers between levels 1 and 2 for recurring fair value measurements during the year.

The Group's policy is to recognize transfers into and transfers out of fair value hierarchy levels as at the end of the reporting period.

Level 1: The fair value of financial instruments traded in active markets (such as publicly traded derivatives, and trading and available-for-sale securities) is based on quoted market prices at the end of the reporting period. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1.

Level 2: The fair value of financial instruments that are not traded in an active market (for example, foreign exchange contracts) is determined using valuation techniques which maximize the use of observable market data and rely as little as possible on entity-specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

Level 3: If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3. This is the case for provisions (contingent consideration).

(ii) Valuation techniques used to derive level 2 fair values

The Group used the following techniques to determine the fair value measurements categorized in Level 2:

– The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date.

(iii) Fair value measurements using significant unobservable inputs (level 3)
The following table presents the changes in level 3 instruments for the year ended 30 June 2014 and 30 June 2013:

	Note	Contingent consideration provision $'000	Total $'000
Opening balance 30 June 2013		–	–
Initial recognition	12(b)	81,660	81,660
Unwinding of discount		4,329 ^	4,329
Exchange difference		260	260
Closing balance 30 June 2014		86,249	86,249

^ The unwinding of the risk adjusted discount as the time period shortens between the valuation date and the potential settlement date of the contingent consideration.

(iv) Valuation inputs and relationship to fair value
The following table summarizes the quantitative information about the significant unobservable inputs used in level 3 fair value measurements:

Description	Fair value at 30 June 2014 $'000	Valuation technique	Unobservable Inputs*	Range of inputs (weighted average)	Relationship of unobservable inputs to fair value
Contingent consideration provision	86,249	Discounted cash flows	Risk adjusted discount rate	11%-13% (12.5%)	A change in the discount rate by 0.5% would increase/decrease the fair value by 3%
			Expected unit revenues	n/a	A 10% increase in the price assumptions adopted would increase the fair value by 5%

** There were no significant inter-relationships between unobservable inputs that materially affect fair values.*

(v) Valuation processes
An independent valuation of the contingent consideration, as at 11 October 2013 (acquisition date), was carried out by an independent valuer.

The CFO and the valuation team have reviewed the valuation as at 30 June 2014, and determined there has been no change to the inputs supporting the fair value that was recorded at the date of acquisition (11 October 2013). A key reason for this determination is that the independent valuation was completed recently and no significant events have occurred since it was completed that would lead to the valuation changing.

The main level 3 inputs used by the Group are evaluated as follows:

– Contingent consideration – expected cash flows are estimated based on the terms of the sale contract and the entity's knowledge of the business and how the current economic environment is likely to impact.

6. Non-financial assets and liabilities

This note provides information about the Group's non-financial assets and liabilities, including:

- specific information about each type of non-financial asset and non-financial liability
  - – property, plant and equipment (note 6(a))
  - – intangible assets (note 6(b))
  - – deferred revenue (note 6(c))
  - – provisions (note 6(d))
  - – deferred tax liability (note 6(e))
- accounting policies
- information about determining the fair value of the instruments, including judgments and estimation uncertainty involved.

(a) Property, plant and equipment

	Plant & equipment $'000	Office furniture & equipment $'000	Computer hardware & software $'000	Total $'000
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
Year Ended 30 June 2014				
Opening net book amount	959	879	919	2,757
Exchange differences	(14)	(15)	(6)	(35)
Additions	2,066	245	624	2,935
Disposals	–	–	–	–
Depreciation charge	(306)	(128)	(540)	(974)
Closing net book value	2,705	981	997	4,683
At 30 June 2014				
Cost or fair value	3,248	1,309	2,463	7,020
Accumulated depreciation	(543)	(328)	(1,466)	(2,337)
Net book value	2,705	981	997	4,683

(i) Depreciation methods and useful lives

Depreciation is calculated using the straight-line method to allocate their cost or revalued amounts, net of their residual values, over the estimated useful lives. The estimated useful lives are:

- Plant & equipment 10-15 years
- Office furniture & equipment 5-10 years
- Computer hardware & software 3-4 years

See Note 22(p) for the other accounting policies relevant to property, plant and equipment.

(b) Intangible assets

	Goodwill $'000	Acquired licenses to patents $'000	In-process research & development acquired $'000	Total $'000
At 1 July 2012				
Cost	116,211	1,621	379,747	497,579
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	1,282	418,865	547,834
At 30 June 2013				
Cost	127,687	1,748	418,865	548,300
Accumulated amortization	–	(466)	–	(466)
Accumulated impairment	–	–	–	–
Net book amount	127,687	1,282	418,865	547,834
Year ended 30 June 2014				
Opening net book value	127,687	1,282	418,865	547,834
Additions	14,748	963	132,485 ^	148,196
Exchange differences	(1,918)	(38)	(6,024)	(7,980)
Amortization charge	–	(146)	–	(146)
Impairment charge	–	–	–	–
Closing net book value	140,517	2,061	545,326	687,904
At 30 June 2014				
Cost	140,517	2,667	545,326	688,510
Accumulated amortization	–	(606)	–	(606)
Accumulated impairment	–	–	–	–
Net book amount	140,517	2,061	545,326	687,904

Notes to the Financial Statements for the year ended 30 June 2014

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

	30 June 2014 $'000	30 June 2013 $'000
Cardiovascular products	270,012	274,233
Intravenous products for metabolic diseases and inflammatory/immunologic conditions	75,085	76,259
Ophthalmic product	33,004	33,520
Bone marrow transplantation	32,727	33,239
Mesenchymal stem cells (MSCs)	134,498	1,614
	545,326	**418,865**

For all products the above balances are reported in AUD; however the underlying currency of the item recorded is USD. Apart from the MSCs product which was acquired during the current financial year, the year on year movement in each balance is due to the movement in the AUD:USD exchange rate.

^ The total additions of In-process research & development recorded in Note 12: Business Combination is $134,099k which represents the total for the year ended 30 June 2013 and 30 June 2014.

(i) Amortization methods and useful lives
The Group amortizes intangible assets with a limited useful life using the straight-line method over the following periods:

- Acquired licenses to patents 13-16 years

See Note 22(q) for the other accounting policies relevant to intangible assets and note 22(l) for the Group's policy regarding impairments.

(ii) Significant estimate: 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 22(l). 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.

(iii) Impairment tests for goodwill and intangible assets with an indefinite useful life
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 22(q)(iii)). The carrying value of in-process research and development (AUD545m : USD514m) is a separate asset which has been subject to impairment testing at the cash generating unit level, which has been determined to be at the product level.

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 stem cell technology platform for commercialization. The carrying value of Goodwill has been allocated to the appropriate operating segment for the purpose of impairment testing.

The recoverable amount of both goodwill and in-process research and development was assessed at 31 May 2014 based on the fair value less costs to sell. An valuation was carried out by an independent valuer.

(iv) 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 2014;
- the amount of time that has elapsed since the goodwill acquisition (MSC – October 2013 and all other products – December 2010);
- 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 range of 17.5% to 19.5%, 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. The assessment showed the recoverable amount of goodwill and in-process research and development exceeds the carrying amounts, and therefore there is no impairment.

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 preclinical development if applicable.

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.

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

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.

(v) 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.

Whilst we note there is no impairment the key sensitivities in the valuation remain the continued successful development of our technology platform.

(c) Deferred revenue

	30 June 2014 $'000	30 June 2013 $'000
Opening Balance	72,793	84,571
Amount recognized as revenue in the year	(16,410)	(18,261)
Foreign exchange difference	(637)	6,483
Balance at the end of the year	**55,746**	**72,793**
– To be recognized in the next twelve months (current deferred revenue)	15,928	16,176
– To be recognized in the next twelve months (non-current deferred revenue)	39,818	56,617
Balance at the end of the year	**55,746**	**72,793**

(d) Provisions

	2014			2013		
	Current $'000	Non-current $'000	Total $'000	Current $'000	Non-current $'000	Total $'000
Other	796	–	796	9,266	–	9,266
Employee benefits	4,891	269	5,160	4,366	203	4,569
Contingent consideration	–	86,249	86,249	–	–	–
	5,687	**86,518**	**92,205**	**13,632**	**203**	**13,835**

(i) Information about individual provisions and significant estimates

Other

During the ordinary course of business the Group occasionally has disputes with service providers. 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.

Employee benefits

The provision for employee benefits relates to the Group's liability for annual leave, short-term incentives and long service leave.

Employee benefits include accrued annual leave. The entire amount of the accrual of $590k (2013: $528k) is presented as current, since the Group does not have an unconditional right to defer settlement for any of these obligations. However, based on past experience, the Group expects all employees to take the full amount of the accrued leave or require payment within the next 12 months.

Notes to the Financial Statements for the year ended 30 June 2014

(ii) Movements

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

	Note	Other $'000	Contingent consideration $'000	Total $'000
Carrying amount at start of year – 1 July 2013		9,266	–	9,266
Initial recognition on business combination	12(b)	–	81,660	81,660
Amounts used during the year		(5,922)	–	(5,922)
Charged/(credited) to profit and loss				
– Unwinding of discount	5(e)(iii)	–	4,329	4,329
– Unused amounts reversed		(2,524)	–	(2,524)
Foreign exchange difference		(24)	260	236
Carrying amount at end of year – 30 June 2014		796	86,249	87,045

(e) Deferred tax balances

	30 June 2014 $'000	30 June 2013 $'000
(i) Deferred tax liabilities		
The balance comprises temporary differences attributable to:		
Intangible assets	158,585	146,038
Total deferred tax liabilities	158,585	146,038
Deferred tax liabilities expected to be settled within 12 months	–	–
Deferred tax liabilities expected to be settled after 12 months	158,585	146,038

Movements	Intellectual Property $'000	Total $'000
At 30 June 2012	132,911	132,911
Foreign exchange difference	13,127	13,127
At 30 June 2013	**146,038**	**146,038**
Foreign exchange difference	(2,201)	(2,201)
Acquisition of in-process research & development	14,748	14,748
At 30 June 2014	**158,585**	**158,585**

7. Equity

(a) Contributed equity

	2014 Shares	2013 Shares	2014 $'000	2013 $'000
Contributed equity				
(i) Share capital				
Ordinary shares	321,640,094	316,468,901	677,087	654,458
Less: Treasury Shares	(4,485,000)	(3,320,000)	–	–
Total Contributed Equity	**317,155,094**	**313,148,901**	**677,087**	**654,458**

(ii) Movements in ordinary share capital

Details	Share No.	Issue price	$'000
Opening Balance 1 July 2012	285,835,106		485,004
Exercise of share options	150,000	US $0.31	47
Exercise of share options	255,913	US $0.34	84
Exercise of share options	255,913	US $0.47	116
Exercise of share options	80,000	$0.96	77
Exercise of share options	646,000	$1.00	646
Exercise of share options	300,000	$1.58	474
Exercise of share options	72,000	$2.00	144
Exercise of share options	40,000	$2.64	106
Exercise of share options	475,600	$3.48	1,655
Exercise of share options	277,390	$3.78	1,048
Share issue to institutions and sophisticated investors	26,970,979	$6.30	169,917
Placement of shares under LSFP ^	50,000	$6.29	–
Placement of shares under LSFP ^	235,000	$6.36	–
Placement of shares under LSFP ^	50,000	$6.69	–
Placement of shares under LSFP ^	775,000	$6.70	–
	30,633,795		174,314
Transaction costs arising on share issues			(5,529)
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
Balance 30 June 2013	316,468,901		654,458

Notes to the Financial Statements for the year ended 30 June 2014

7. Equity (continued)

Details	Share No.	Issue price	$'000
Balance 30 June 2013	316,468,901		654,458
Exercise of share options	230,000	$1.58	363
Exercise of share options	150,000	$1.73	260
Exercise of share options	310,000	$2.64	818
Exercise of share options	297,300	$3.48	1,035
Consideration for In-process research & development acquired (note 12)	2,948,729	$5.69	16,764
Consideration for Acquired licenses to patents	70,164	$5.96	417
Placement of shares under LSFP ^	900,000	$5.92	–
Placement of shares under LSFP ^	100,000	$6.28	–
Placement of shares under LSFP ^	165,000	$6.70	–
	5,171,193		19,657
Transaction costs arising on share issues			(46)
Contribution of equity (net of transaction costs)			19,611
Share options reserve transferred to equity on exercise of options			3,018
Movement for the year			22,629
Balance 30 June 2014	321,640,094		677,087

^ 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.

(iii) 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.

(iv) Employee share options

Information relating the Group's employee share option plan, including details of shares issued under the scheme, is set out in note 18.

(b) Reserves

	30 June 2014 $'000	30 June 2013 $'000
(i) Reserves		
Share-based payments reserve	55,530	49,129
Foreign currency translation reserve	17,886	24,506
	73,416	**73,635**
(ii) Reconciliation of reserves		
Share-based payments reserve		
Balance 1 July	49,129	37,505
Transfer to ordinary shares on exercise of options	(3,018)	(669)
Share option expense for the year	9,419	12,293
Balance 30 June	**55,530**	**49,129**
Foreign currency translation reserve		
Balance 1 July	24,506	(7,497)
Currency (loss)/gain on translation of foreign operations net assets ^	(6,620)	32,003
Balance 30 June	**17,886**	**24,506**
^ Total currency exchange differences on translation of foreign operations	(6,620)	32,003

(iii) Nature and purpose of reserves

Share-based payment reserve
The share-based payments reserve is used to recognize:

– the grant date fair value of options issued but not exercised; and

– the grant date fair value of deferred shares granted but not yet vested.

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 of.

8. Cash flow information

	30 June 2014 $'000	30 June 2013 $'000
(a) Reconciliation of cash and cash equivalents		
Cash at bank	3,827	7,875
Deposit at call	192,567	307,434
	196,394	**315,309**
(b) Reconciliation of net cash flows used in operations with loss after income tax		
Loss for the year	(80,958)	(61,663)
Add/(deduct) profit and loss items as follows:		
Commercialization revenue	(16,410)	(18,261)
Depreciation and amortization	1,120	772
Foreign exchange losses	4,016	1,696
Finance costs	4,329	–
Release of excess provision for services	(2,524)	–
Equity settled share-based payment	9,419	12,293
Change in operating assets & liabilities:		
Decrease in trade and other receivables	2,640	2,119
Decrease/(increase) in tax assets	3,281	(1,055)
(Decrease)/increase in trade creditors and accruals	(1,362)	8,221
(Decrease)/increase in provisions	(5,412)	1,797
Net cash outflows used in operations	**(81,861)**	**(54,081)**

Notes to the Financial Statements for the year ended 30 June 2014

Risk

9. Significant estimates, judgments and errors

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgment in applying the Group's accounting policies.

This note provides an overview of the areas that involved a higher degree of judgment or complexity, and of items which are more likely to be materially adjusted due to estimates and assumptions turning out to be wrong. Detailed information about each of these estimates and judgments is included in notes 1 to 8 together with information about the basis of calculation for each affected line item in the financial statements. In addition, this note also explains where there have been actual adjustments this year as a result of an error and of changes to previous estimates.

(a) Significant estimates and judgments

The areas involving significant estimates or judgments are:

- current tax payable and current tax expense – note 4(b)
- fair value of goodwill and other intangible assets including in-process R&D – note 6(b)
- useful life of intangible asset – note 6(b)
- fair value of contingent liabilities and contingent purchase consideration in a business combination – note 12
- recognition of revenue – note 3

Estimates and judgments are continually evaluated. They 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.

10. Financial risk management

This note explains the Group's exposure to financial risks and how these risks could affect the Group's future financial performance. Current year profit and loss information has been included where relevant to add further context.

Risk	Exposure arising from	Measurement	Management
Market risk – currency risk	Future commercial transactions Recognized financial assets and liabilities not denominated in AUD	Cash flow forecasting Sensitivity analysis	Forward foreign exchange contracts
Market risk – interest rate risk	Term deposits at fixed rates	Sensitivity analysis	Vary length of term deposits
Credit risk	Cash and cash equivalents, trade receivables and derivative financial instruments	Aging analysis Credit ratings	Only transact with 'A' rated banks
Liquidity risk	Cash and cash equivalents	Rolling cash flow forecasts	Sufficient cash balance to meet the commitment of the Group

Notes to the Financial Statements for the year ended 30 June 2014

(a) Derivatives

Derivatives are only used for economic hedging purposes and not as trading or speculative instruments. The Group has the following derivative financial instruments:

	30 June 2014 $'000	30 June 2013 $'000
Current assets		
Forward foreign exchange contracts – held for trading	–	3,486
	–	**3,486**
Current liabilities		
Forward foreign exchange contracts – held for trading	337	–
	337	**–**

(i) Classification of derivatives

Derivatives are classified as held for trading and accounted for at fair value through profit or loss. They are presented as current assets or liabilities if they are expected to be settled within 12 months after the end of the reporting period.

(ii) Change in accounting policy

The Group has applied the new standard on fair value measurement from 1 July 2013. As explained in note 23, the adoption of the standard has not affected the measurement of the fair value of certain derivative liabilities.

(iii) Fair value measurement

For information about the methods and assumptions used in determining the fair value of derivatives please refer to note 5(e).

(b) 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 2014/2015 budget. The Group engages professional advice when considering forward foreign exchange contracts.

As at 30 June 2014, the Group held 45% of its cash in USD, and 55% in AUD. 6% 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 51% USD and 49% 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 is 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% (2013: +/-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 2014 was 0.9240 (2013: 0.9275).

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

30 June 2014	Foreign currency balance held '000	+20% Profit/(loss) AUD'000	-20% Profit/(loss) AUD'000
Bank accounts	USD 82,853	(14,659)	21,989
Bank accounts	CHF 632	(125)	188
Forward exchange contracts:			
Buy foreign currency (note 10(a))	USD76,000	(13,447)	20,170
Trade and other receivables – USD	USD 990	(175)	263
Trade and other receivables – CHF	CHF 3	(1)	1
Trade payables & accruals – USD	(USD 16,788)	2,970	(4,455)
Trade payables & accruals ^ – AUD	(AUD 222)	35	(52)
Trade payables & accruals – SGD	(SGD 722)	102	(153)
Trade payables & accruals – GBP	(GBP 27)	8	(12)
Trade payables & accruals – EUR	(EUR 86)	21	(31)
Trade payables & accruals – CHF	(CHF 12)	2	(4)
Trade payables & accruals – DKK	(DKK 2)	0	(0)
Provisions – USD	(USD 3,144)	556	(834)
Provisions – SGD	(SGD 34)	5	(7)
		(24,708)	37,063

30 June 2013	Foreign currency balance held '000	+20% Profit/(loss) AUD'000	-20% 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 10(a))*	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)

**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 2014

(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 Group's 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 2014. The effect on profit is shown if interest rates change by 10%, in either direction, is as follows:

	2014			2013		
AUD	**Low**	**High**	**AUD'000**	**Low**	**High**	**AUD'000**
Funds invested at 30 June	3.41%	3.60%	107,540	3.85%	4.66%	302,565
Rate increase by 10%	3.75%	3.96%	374	4.24%	5.13%	1,286
Rate decrease by 10%	3.07%	3.24%	(374)	3.47%	4.19%	(1,286)
USD	**Low**	**High**	**USD'000**	**Low**	**High**	**USD'000**
Funds invested at 30 June	0.04%	0.27%	81,000	–	–	–
Rate increase by 10%	0.04%	0.30%	3	–	–	–
Rate decrease by 10%	0.04%	0.24%	(3)	–	–	–

(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.

(c) 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 2014 $'000	30 June 2013 $'000
Cash and cash equivalents		
Cash and cash equivalents (note 5(a)) – minimum A rated	196,394	315,309
Trade and other receivables		
Receivable from the Australian Government (GST)	128	111
Receivable from the Australian Government (Income Tax)	5,180	5,924
Receivable from the United States Government (Income Tax)	74	2,393
Receivable from the Swiss Government (VAT)	4	1
Receivable from minimum A rated bank deposits (interest)	296	3,306
Employee loan contracts ^	–	320
Receivable from other parties (non-rated)	416	8

^ *The employee loan balance is covered by a contract.*

(d) Liquidity risk

Liquidity risk is the risk that the Group will not be able to pay its debts as and when they fall due. The Group has no borrowings to date and the Directors ensure that cash on hand is sufficient to meet the commitments of the Group at all times while it is in a loss making phase of research and development.

All financial liabilities held by the Group at 30 June 2014 and 30 June 2013 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.

11. Capital management

The Group's objective when managing capital is to safeguard its ability to continue as a going concern, so that it can provide returns for shareholders and benefits for other stakeholders. Refer to note 5(a) for the cash reserves of the Group as at the end of the financial reporting period.

Notes to the Financial Statements for the year ended 30 June 2014

Group structure

12. Business combination

(a) Summary of acquisition

On 11 October 2013, the Group acquired the culture-expanded mesenchymal stem cell (ceMSC) business of Osiris Therapeutics Inc.

The acquisition is complementary in its nature with many commercial and strategic benefits. The potential benefits derived from acquiring the approved and late-phase ceMSC products include:

- near term market launch of a mesenchymal lineage product in major jurisdictions;
- broadened late-phase clinical programs in strategic areas of focus;
- leveraged roll out of infrastructure, skills and expertise needed to commercialize Mesenchymal Precursor Cell (MPC) products;
- ownership of extensive long-term clinical data from over 1,500 patients treated with cultured MSC's, including safety, efficacy and repeat dosing data; and
- acquisition of new intellectual property which is highly complementary to Mesoblast's existing patent estate.

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

Purchase consideration at fair value

	Fair value at acquisition date AUD'000
Cash on closing	21,196
Cash payment made on the six month anniversary of the agreement (Fair Value) ^	15,610
Securities allotment [2,948,729 shares were allotted] ^ ^	15,873
Contingent consideration ^ ^ ^ (note 6(d)(ii))	81,660
Total purchase consideration	**134,339**

Net assets acquired at fair value

	Fair value at acquisition date AUD'000
Property, plant and equipment	240
Intangible assets: (in-process research & development)	134,099
Deferred tax liability on future revenue streams, recorded in accordance with AASB 3	(14,748)
Net identifiable assets acquired	**119,591**
add: Goodwill	14,748
Net assets acquired	**134,339**

The fair value amounts reported above are final.

All assets acquired and purchase consideration amounts are denominated in USD. The amounts presented above are in AUD and have been translated at the rate applicable at the acquisition date (11 October 2013) being 1AUD:0.9450USD. The goodwill is attributable to the deferred tax liability that is required to be recognized on the difference between the intangible asset's book value compared to its tax value.

No amount of goodwill is expected to be deducted for tax purposes.

^ The cash payment due on the six month anniversary of the agreement of $15,610k has a USD denominated value of USD15,000k.

^ ^ MSB securities were issued as consideration upon the transfer of assets on 18 December 2013, which had a value of $16,717k on that date.

^ ^ ^ At acquisition date contingent consideration of $81,660k was recorded as tabled above. Please refer to note 6(d)(ii) for the reconciliation of the subsequent movements of this contingent consideration provision.

Notes to the Financial Statements for the year ended 30 June 2014

(b) Contingent consideration

In the event that certain pre-determined milestones and royalties are achieved additional consideration is payable. The fair value of the contingent consideration is set out in the table below. The fair value estimates have been calculated on the basis of fair value less cost to sell by using the income approach, with reference to both the excess earnings and relief from royalty methods as set out below:

The fair value of contingent consideration	Fair value at acquisition date AUD'000
Fair value of cash or stock payable, dependent on achievement of future late-stage clinical or regulatory targets (i)	24,507
Fair value of royalty payments from commercialization of the intellectual property acquired (ii)	57,153
	81,660

i. The contingent consideration payable for each milestone is a fixed dollar amount and can be paid either in cash or through the allotment of Mesoblast Ltd securities (ASX: MSB) at the date of payment, at the discretion of the Mesoblast Group. The potential undiscounted amount of the contingent consideration for milestones is a minimum of USDNil and a maximum of USD50m.

ii. The amount of the contingent consideration payable as royalties is variable. The contingent consideration paid could range from zero dollars if no sale of product occurs, up to a maximum that is unlimited. This maximum is calculated at a commercial arm's length percentage of net sales. Royalty payments will cease after a 10 year commercial sales period. Royalties are payable in cash after the conclusion of the period in which the sales were made.

(c) Purchase consideration – cash outflow

	30 June 2014 AUD'000
Cash consideration (fair value) owed pursuant to the asset purchase agreement	36,806
less: amount paid during the full year ended 30 June 2013	(1,537)
Cash outflow reported for the current reporting period ^	**35,269**

^ included within cashflows from investing activities within the statement of cashflows.

(d) Revenue and profit contribution

The acquired business contributed revenues of $Nil and net loss of $3,445k to the Group for the period 11 October 2013 to 30 June 2014.

If the acquisition had occurred on 1 July 2013, consolidated revenue and loss for the year ended 30 June 2014 would have been $25,980k and $82,313k respectively. These amounts have been calculated using the subsidiary's results.

(e) Acquisition-related costs

Directly attributable acquisition-related costs of approximately $954k are included in management and administration expenses in the income statement, and in the operating cash flows section in the statement of cash flows, for the full-year ended 30 June 2014.

13. Interests in other entities

(a) Material subsidiaries

The Group's principal subsidiaries at 30 June 2014 are set out below. Unless otherwise stated, they have share capital consisting solely of ordinary shares that are held directly by the Group, and the proportion of ownership interests held equals the voting rights held by the Group. The country of incorporation or registration is also their principal place of business.

			Equity holding	
Name of entity	Country of incorporation	Class of shares	30 June 2014	30 June 2013
			%	%
Mesoblast, Inc.	USA	Ordinary	100	100
Mesoblast International Sarl	Switzerland	Ordinary	100	100
Mesoblast Australia Pty Ltd	Australia	Ordinary	100	100
Mesoblast UK Limited	United Kingdom	Ordinary	100	100

Notes to the Financial Statements for the year ended 30 June 2014

Unrecognized items

14. Contingent assets and contingent liabilities

(a) Contingent assets

The Group does not consider it has any contingent assets outstanding as at 30 June 2014 (2013: 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.

15. Commitments

(a) Capital commitments

The Group does not consider it has any commitments for future capital expenditure outstanding as at 30 June 2014 (2013: 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 7 years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

	30 June 2014 $'000	30 June 2013 $'000
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	2,814	943
Later than one year but no later than five years	11,567	3,880
Later than five years	5,121	4,830
	19,502	**9,653**

Lease commitments include amounts in the following currencies (USD and SGD) which have been translated to AUD at the 30 June 2014 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.

16. Events occurring after the reporting period

There are no events that have arisen after 30 June 2014 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 2014

Other information

17. Related party transactions

(a) Parent entity

The parent entity within the Group is Mesoblast Limited.

(b) Subsidiaries

Details of interests in subsidiaries are disclosed in note 13 to the financial statements.

(c) 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 2014 $	30 June 2013 $
Short-term employee benefits	2,768,360	2,457,392
Post-employment benefits	65,319	59,565
Share-based payments	–	5,032
	2,833,679	2,521,989

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

(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) 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.

18. 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 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, and in the case of directors, upon approval by 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 a loan-funded share 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 purchasing 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 that may have already been repaid) 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 2014

18. Share-based payments (continued)

(a) Reconciliation of outstanding share-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	7/07/2008	30/06/2013	$1.00	180,000	–	–	(180,000)	–	–
10	30/11/2009	30/11/2014	$1.73	300,000	–	(150,000)	–	150,000	150,000
11	30/11/2009	30/11/2014	$1.58	710,000	–	(230,000)	–	480,000	480,000
13	22/09/2010	21/09/2015	$2.64	445,000	–	(310,000)	–	135,000	135,000
14	29/11/2010	29/11/2015	$3.48	1,866,600	–	(297,300)	–	1,569,300	1,569,300
15/LF1	22/12/2011	30/06/2016	$7.99	4,560,000 ^	–	–	(316,666)	4,243,334	3,543,339
16/LF2	24/02/2012	23/02/2017	$8.48	340,000	–	–	–	340,000	226,668
17/LF3	9/07/2012	8/07/2018	$6.69	250,000	–	–	–	250,000	83,331
18/LF4	21/09/2012-29/10/2012	30/06/2017	$6.70	2,915,000 ^	–	–	(261,667)	2,653,333	1,275,002
19/LF5	25/01/2013-29/01/2013	24/01/2018-28/01/2008	$6.29	100,000	–	–	–	100,000	33,334
20/LF6	24/05/2013	23/05/2018	$6.36	1,000,000	–	–	–	1,000,000	378,338
21/LF7	3/09/2013	30/06/2018	$5.92	–	3,490,000	–	(200,000)	3,290,000	325,001
22/LF8	4/09/2013	27/08/2018	$6.28	–	325,000	–	–	325,000	–
23a	26/11/2013	10/10/2018	$6.20	–	50,000	–	–	50,000	–
23b	30/11/2013	29/11/2018	$6.79	–	200,000	–	–	200,000	–
24	17/12/2013	16/12/2018	$6.25	–	190,000	–	(10,000)	180,000	–
24a (i)	10/02/2014	9/02/2019	$6.41	–	100,000	–	–	100,000	–
24a (ii)	17/02/2014	16/02/2019	$6.33	–	25,000	–	–	25,000	–
25a (i&ii)	1/01/2014	31/12/2018	$6.38	–	650,000	–	–	650,000	–
LF9.4	11/12/2013	30/06/2017	$6.70	–	165,000	–	–	165,000	110,000
LF9.7	3/09/2013	30/06/2018	$5.92	–	200,000	–	–	200,000	66,667
INC	7/12/2010	7/07/2015	USD 0.046	287,903	–	–	–	287,903	287,903
INC	7/12/2010	26/10/2018	USD 0.305	195,999	–	–	–	195,999	195,999
INC	7/12/2010	26/10/2019	USD 0.340	703,761	–	–	–	703,761	703,761
INC	7/12/2010	25/04/2017	USD 0.444	127,956	–	–	–	127,956	127,956
INC	7/12/2010	2/05/2017	USD 0.444	127,956	–	–	–	127,956	127,956
30 June 2014				**14,110,175**	**5,395,000**	**(987,300)**	**(968,333)**	**17,549,242**	**9,819,555**
Weighted average share purchase price				$5.46	$6.08	$2.51	$5.90	$5.82	$5.32
30 June 2013				**12,731,391**	**4,345,000**	**(2,552,816)**	**(558,400)**	**13,965,175**	**7,023,249**
Weighted average share purchase price				$4.42	$6.61	$1.72	$6.33	$5.46	$4.40

^ The opening balance for 15/LF1 and 18/LF4 has been restated to increase the balance by 100,000 and 45,000 loan funded shares respectively. These shares were forfeited by participants in accordance with the terms of the loan funded share plan and are now the property of the Employee Share Trust.

The weighted average share price at the date of exercise of options exercised during the year ended 30 June 2014 was $5.83 (2013: $5.94)

The weighted average remaining contractual life of share options and loan funded shares outstanding at the end of the period was 2.96 years (2013: 3.38 years)

(b) Existing share-based payment arrangements

General terms and conditions attached to share-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. On cessation of employment the Board determines if a leaver is a bad leaver or not. If a participant is deemed a bad leaver, all rights, entitlements and interests in any unexercised options or shares (pursuant to the loan funded share plan) held by the participant will be forfeited and will lapse immediately. If a leaver is not a bad leaver they may retain vested options and shares (pursuant to the loan funded share plan), however, they must be exercised within 60 days of cessation of employment (or within a longer period if so determined by the Board), after which time they will lapse. Unvested Options will normally be forfeited and lapse. 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.

25a(i&ii) Options were granted in two equal tranches and will vest on the date that the option holder has direct involvement (to the reasonable satisfaction of the Board) in Mesoblast achieving certain confidential commercial objectives.

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).

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 share-based payments

The weighted average fair value of share options and loan funded shares granted during the year was $1.71 (2013: $2.69).

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.

Notes to the Financial Statements for the year ended 30 June 2014

18. Share-based payments (continued)

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.

Share price date from 1 January 2012 through to the end of each applicable financial year has been used to calculate share price volatility.

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 & LF1	2014	7.99	7.00-7.48	51.48%	0.6-4.5yrs	0%	3.18%
17 & LF3	2013	6.69	6.00	49.61%	5 yrs	0%	2.73%
18 & LF4	2013/2014	6.70	5.83-7.14	48.49%	4.75 yrs	0%	2.78%
19 & LF5	2013	6.29	5.56-5.61	40.10%	5 yrs	0%	3.09%
20 & LF6	2013	6.36	6.01	40.96%	5 yrs	0%	2.84%
21 & LF7	2014	5.92	5.56	38.80%	3.6 yrs	0%	3.31%
22	2014	6.28	5.49	38.79%	3.7 yrs	0%	3.37%
LF8	2014	5.92	6.28	38.79%	3.7 yrs	0%	3.37%
LF9.4	2014	6.70	5.88	38.79%	2.6 yrs	0%	3.47%
LF9.7	2014	5.92	5.88	38.79%	3.4 yrs	0%	3.47%
23a	2014	6.20	6.04	38.74%	3.6 yrs	0%	3.45%
23b	2014	6.20	6.79	38.73%	3.7 yrs	0%	3.44%
24	2014	6.25	5.58	38.80%	3.7 yrs	0%	3.38%
24a.(i)	2014	6.41	5.75	38.37%	3.7 yrs	0%	3.44%
24a.(ii)	2014	6.33	5.76	38.20%	3.7 yrs	0%	3.45%
25a.(i)	2014	6.38	5.84	38.04%	3.6 yrs	0%	3.43%
25a.(ii)	2014	6.38	5.84	38.04%	4.9 yrs	0%	3.43%

The closing share market price of an ordinary share of Mesoblast Limited on the Australian Stock Exchange at 30 June 2014 was $4.47 (30 June 2013: $5.30).

19. Remuneration of auditors

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

	30 June 2014 $	30 June 2013 $
(a) PricewaterhouseCoopers Australia		
(i) Audit and other assurance services		
Audit and review of financial reports	326,009	213,129
Total remuneration of PricewaterhouseCoopers Australia	326,009	213,129
(b) Network firms of PricewaterhouseCoopers Australia		
(i) Audit and other assurance services		
Audit and review of financial reports	110,393	68,126
Total remuneration of Network firms of PricewaterhouseCoopers Australia	110,393	68,126
Total auditors' remuneration	**436,402**	**281,255**

20. Earnings per share

	30 June 2014 Cents	30 June 2013 Cents
(a) Basic earnings per share		
From continuing operations attributable to the ordinary equity holders of the company	(25.34)	(20.87)
Total basic earnings per share attributable to the ordinary equity holders of the company	**(25.34)**	**(20.87)**
(b) Diluted earnings per share		
From continuing operations attributable to the ordinary equity holders of the company	(25.34)	(20.87)
Total basic earnings per share attributable to the ordinary equity holders of the company	**(25.34)**	**(20.87)**

(c) Reconciliation of earnings used in calculating earnings per share

Basic earnings per share

	30 June 2014 $'000	30 June 2014 $'000
Profit attributable to the ordinary equity holders of the company used in calculating basic earnings per share:		
From continuing operations	(80,958)	(61,663)

Diluted earnings per share

	$'000	$'000
Profit from continuing operations attributable to the ordinary equity holders of the company:		
Used in calculating basic earnings per share	(80,958)	(61,663)
Profit attributable to the ordinary equity holders of the company used in calculating diluted earnings per share	(80,958)	(61,663)

	30 June 2014 Number	30 June 2013 Number
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share	319,450,496	295,529,473
Weighted average number of ordinary shares and potential ordinary shares used in calculating diluted earnings per share	319,450,496	295,529,473

21. Parent entity financial information

(a) Summary financial information

The individual financial statements for the parent entity show the following aggregate amounts:

	30 June 2014 $'000	30 June 2013 $'000
Balance Sheet		
Current assets	204,661	326,219
Total assets	712,877	727,247
Current liabilities	7,456	8,411
Total liabilities	8,132	49,525
Shareholders' Equity		
Issued capital	677,087	654,458
Reserves		
Share options reserve	41,848	35,446
Accumulated losses	(14,190)	(12,182)
	704,745	677,722
Loss for the period	(2,008)	(17,292)
Total comprehensive income for the period	(2,008)	(17,292)

(b) Contingent liabilities of the parent entity

Mesoblast Limited 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.

22. Summary of significant accounting policies

This note provides the principal accounting policies adopted in the preparation of these consolidated financial statements as 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.

(a) 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) 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.

(iii) Changes to comparative figures
Comparative figures, are, where appropriate, reclassified to be comparable with figures presented in the current financial year. During the year, intellectual property costs, travel expenses and employee recruitment fees that have been identified as being directly attributable to research and development and manufacturing commercialization have been reclassified into the appropriate classification for our consolidated statement of income for the year ending 30 June 2013. The change in presentation is considered to provide more relevant information and has also been adopted in the current year.

Research and development was previously stated as $43,108k and is now stated as $47,835k. Manufacturing and commercialization was previously stated as $20,946k and is now stated as $23,230k. Management and administration was previously stated as $30,734k and is now stated as $22,840k. Other expenses was previously stated as $Nil and is now stated as $883k.

(iv) New and amended standards adopted by the Group
The Group has applied the following standards and amendments for first time for their annual reporting period commencing 1 July 2013:

- AASB 10 Consolidated Financial Statements and AASB 2011-7 Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards
- AASB 2012-10 Amendments to Australian Accounting Standards – Transition Guidance and other Amendments which provides an exemption from the requirement to disclose the impact of the change in accounting policy on the current period.
- AASB 13 Fair Value Measurement and AASB 2011-8 Amendments to Australian Accounting Standards arising from AASB 13
- AASB 119 Employee Benefits (September 2011) and AASB 2011-10 Amendments to Australian Accounting Standards arising from AASB 119 (September 2011)
- AASB 2012-5 Amendments to Australian Accounting Standards arising from Annual Improvements 2009-2011 Cycle, and
- AASB 2012-2 Amendments to Australian Accounting Standards – Disclosures – Offsetting Financial Assets and Financial Liabilities

The adoption of AASB 13 and AASB 119 resulted in changes in accounting policies however did not result in an adjustment to the amounts recognized in the financial statements. The amendment to the standards are explained in note 23 below. The other standards only affected the disclosures in the notes to the financial statements.

(v) 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 2014.

(b) 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 2014 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.

(c) Segment reporting

The Group predominately operates in one segment being the research and development of adult stem cell technology.

(d) Foreign currency translation

(i) 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.

(ii) 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.

(iii) 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.

(e) Foreign currency translation

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.

(f) 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:

(i) 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.

(ii) 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.

(g) 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.

(h) 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.

(i) 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 and liabilities at fair value through profit or loss if it is either:

(a) classified as held for trading (acquired or incurred principally for the purpose of selling or repurchasing in the near future), or

(b) upon initial recognition designated as at fair value through profit or loss.

(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 5(b)) 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.

(j) 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 15). 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.

(k) 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 recognized directly in profit or loss as a bargain purchase.

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

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

(l) 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 impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

(m) Cash and cash equivalents

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

(n) 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 remeasurement.

(o) Derivatives

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value at the end of each reporting period.

(i) Derivatives that do not qualify for hedge accounting
Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognized immediately in profit or loss and are included in other income or other expenses.

(p) 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 (see note 6(a)).

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

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

(q) Intangible assets

(i) Goodwill
Goodwill is measured as described in note 22(k) – Business combinations. Goodwill on acquisition of subsidiaries is included in intangible assets (note 6(b)). 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 2).

(ii) Trademarks and licenses
Trademarks and licenses have a finite useful life and are carried at cost less accumulated amortization and impairment losses.

(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.

(r) 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.

(s) Provisions

Provisions are recognized when the Group has a present legal obligation 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.

(t) 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.

(u) 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 18.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on 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 shared-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.

(v) 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.

(w) 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.

(x) 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.

(y) Comparative figures

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

(z) 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.

(aa) 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.

23. Changes in accounting policies

As explained in note 22(a) above, the Group has adopted a number of new or revised accounting standards this year that have resulted in changes in accounting policies. The changes have not resulted in amendments to the amount recognized in the financial statements in the current year.

(a) Consolidated financial statements

AASB 10 Consolidated Financial Statements was issued in August 2011 and replaces the guidance on control and consolidation in AASB 127 Consolidated and Separate Financial Statements and in Interpretation 112 Consolidation – Special Purpose Entities.

The Group has reviewed its investments in other entities to assess whether the conclusion to consolidate is different under AASB 10 than under AASB 127. No differences were found and therefore no adjustments to any of the carrying amounts in the financial statements are required as a result of the adoption of AASB 10.

(b) Fair value measurement

AASB 13 Fair Value Measurement aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across Australian Accounting Standards. The standard does not extend the use of fair value accounting but provides guidance on how it should be applied where its use is already required or permitted by other Australian Accounting Standards.

Previously the fair value of financial liabilities (including derivatives) was measured on the basis that the financial liability would be settled or extinguished with the counterparty. The adoption of AASB 13 has clarified that fair value is an exit price notion, and as such, the fair value of financial liabilities should be determined based on a transfer value to a third party market participant. As a result of this change, the fair value of derivative liabilities changed on transition to AASB 13, due to incorporating own credit risk into the valuation.

As required under AASB 13, the change to fair value measurements on adoption of the standard is applied prospectively, in the same way as a change in an accounting estimate. As a consequence, no balances from the current year and previous year have been adjusted due to the change in the standard.

(c) Employee benefits

The adoption of the revised AASB 119 Employee Benefits has not changed the accounting for the Group's annual leave obligations.

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 41 to 91 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 2014 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 22(a) '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
Chairman

Mr Silviu Itescu
Chief Executive Officer

26 August 2014, 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 consolidated balance sheet as at 30 June 2014, the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration for Mesoblast Limited (the consolidated entity). The consolidated entity comprises the company and the entities it controlled at 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 22(a), 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

pwc

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 2014 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 22(a).

Report on the Remuneration Report

We have audited the remuneration report included in pages 22 to 39 of the directors' report for the year ended 30 June 2014. 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 2014 complies with section 300A of the *Corporations Act 2001*.

PricewaterhouseCoopers

John Yeoman
Partner

Melbourne
26 August 2014

Jon Roberts
Partner

Melbourne
26 August 2014