Mesoblast Limited ABN: 68-109 431 870
and Controlled Entity (Mesoblast Group)

Financial Report for the Half-Year Ended 31 December 2010

This report is to be read in conjunction with the financial report for the year ended 30 June 2010.

Contents

Directors' Report

The Board of Directors of Mesoblast Group has resolved to submit the following half-year report of the Group for the half-year ended 31 December 2010. In order to comply with the provisions of the *Corporations Act 2001*, the directors report the following information:

Directors

The following persons were Directors of Mesoblast Group during the whole of the half-year and up to the date of this report (unless specified):

Mr Brian Jamieson (Chairman)

Professor Silviu Itescu (Executive Director)

Mr Donal O'Dwyer

Mr Michael Spooner

Mr Kevin Buchi (elected to the Board on 30 December 2010)

Mr Byron McAllister (resigned 29 November 2010)

Review of Operations

The half-year ended 31 December 2010 saw the company achieve significant commercial, strategic, and clinical accomplishments. During December 2010 Mesoblast completed the acquisition of United States company Angioblast Systems Inc. and established a strategic alliance with global pharmaceutical company Cephalon Inc.

Together, these transactions have enabled Mesoblast to now be in a position of considerable strength both financially and strategically. At 31 December 2010, Mesoblast had $140.6 million in funds available. On 14 February 2011, Mesoblast announced that these funds had nearly doubled to $279 million following the placement of shares to Cephalon bringing its stake to 19.99 per cent.

Mesoblast has significantly reduced execution risk by forming a strategic alliance with a major partner in order to complete product registration and drive sales/distribution of its lead products for the cardiovascular and central nervous systems, as well as for bone marrow regeneration in cancer patients.

Under the terms of the Development and Commercialization Agreement between the companies, in exchange for exclusive worldwide rights to commercialize specific products based on Mesoblast's proprietary adult stem cell technology platform, Cephalon provided an upfront payment to Mesoblast of US$130 million and will make additional clinical and regulatory milestone payments of up to US$1.7 billion. Cephalon is funding all late stage clinical development costs worldwide for the specific products in the alliance, as well as all sales and marketing costs. Mesoblast retains all manufacturing rights and has a significant share of all product revenues.

As a result of these significant payment schedules and issue of new equity, Mesoblast now has sufficient capital to bring to market directly a wide range of existing and new products to which it has gained access through its strategic acquisition of Angioblast. Additional products the company can now develop due to its broader technology access and additional capital resources include products for treating diabetes and for treating various inflammatory/immunologic conditions such as rheumatoid arthritis and lung diseases.

As 2011 progresses, the company will derive new value based on three clear pillars for its clinical product pipeline:

- Firstly, the Cephalon alliance will draw on Cephalon's proven execution capability and experienced clinical and regulatory team to deliver on near-term clinical and commercial outcomes for Mesoblast's lead cardiovascular and bone marrow regeneration products.
- Seondly, Mesoblast's enhanced financial position will enable the company to move into new clinical programs for an intravenously-delivered adult stem cell product which will be used to treat a range of new and highly visible clinical indications. This product will target very lucrative markets, first and foremost of which will be diabetes. Additional markets will include various inflammatory and immunologic conditions of joints, lungs and other tissues.
- Our third pillar is our orthopedic pipeline. We will continue to focus on our spinal franchise, with our Phase 2 intervertebral disc repair clinical program expected to commence shortly. Our existing bone repair products for conditions such as lumbar and cervical spinal fusion will progress towards Phase 3, and several new products will target long bone fractures, stress fractures, and vertebral fractures. Our osteoarthritis product will progress in both clinical and manufacturing development towards late stage clinical trials.

Since Mesoblast has retained all manufacturing rights for its stem cell products, a major additional focus of the company in the coming period is to lock in and derisk its long-term commercial manufacturing strategy. Mesoblast intends to do this in conjunction with best of breed partners and contract organizations, incentives from governmental authorities in appropriate jurisdictions, and strengthened internal resources. Your directors expect that a well-positioned manufacturing strategy will underpin significant value growth for the company going forward.

Mesoblast-Cephalon Alliance

Cardiovascular products

The Mesoblast - Cephalon development programs for cardiovascular diseases are focussing on treatments for congestive heart failure (CHF) and heart attacks, or acute myocardial infarction (AMI).

Mesoblast has developed its cell therapy product Revascor™ to treat moderate to severe congestive heart failure, the number one cause of mortality and hospitalization in the Western world. Indeed, more than 6 million people in the United States alone suffer from heart failure with an additional 670,000 new cases diagnosed each year.

An interim analysis was performed in December 2010 of Mesoblast's 60-patient Phase 2 trial comparing outcomes in patients receiving either a single injection of Revascor™ or standard-of-care. Analyses of hard efficacy endpoints after each group had been followed for a mean of approx. 18 months showed that a single injection of Revascor™

significantly reduced the number of patients who developed any severe adverse cardiac events from 93.3% in the control group to 44.4% in the treated patients (p=0.001). Revascor™ also significantly reduced the number of patients who developed any major adverse cardiac events (MACE, defined as the composite of cardiac death, heart attack, or coronary revascularization procedures) from 40% to 6.7% (p=0.005). A single injection of Revascor™ reduced the overall monthly event rate of a MACE by 84% compared with controls (p=0.01). Death from cardiac causes was reduced from 13.3% to 0% over this period (p=0.059) and the overall monthly rate of cardiac- related hospitalizations was reduced by 48% (p=0.07).

Your directors are very pleased with these interim results that show for the first time that our proprietary technology can impact both quality of life and survival. If these long-term beneficial outcomes from a single dose of our adult stem cells are sustained they will translate into significant improvements to the quality of life and longevity of patients who are struggling with debilitating congestive heart failure.

At the other end of the disease spectrum, Mesoblast and Cephalon are aiming to develop a stem cell therapeutic to prevent the onset of heart failure after heart attack. The initial target for Revascor™ is the approximately 50 per cent of the annually 880,000 surviving heart attack patients with the poorest prognosis.

Revascor™ has been shown to induce sustainable blood vessel formation and protect heart muscle against progression to heart failure. A successful protocol has been developed to infuse Revascor™ directly into the affected coronary artery after removing an initial obstruction.

It is envisaged that coronary artery infusion of Revascor™ by a standard catheter immediately after angioplasty and stent implantation could become a routine procedure to improve cardiac function, enhance quality of life, and reduce the likelihood of heart failure following a heart attack.

Bone marrow regeneration product

Mesoblast's MPCs are currently being trialed under a United States FDA Orphan Drug Designation to expand hematopoietic stem and progenitor cell numbers in patients with hematologic malignancies.

In the first 25 patients who received cord blood expanded ex vivo by Mesoblast's MPCs, the numbers of hematopoietic progenitors and stem cells in the cord blood product had been expanded by 40-44 fold following ex vivo culture. After transplantation with the expanded cord, the median time to neutrophil recovery was 15 days and to platelet recovery was approximately 54 days, compared with approximately 30 days and over 90-120 days, respectively, in published reports of patients transplanted with a single unexpanded cord.

In these patients, 80% successfully achieved the key composite endpoint at 100 days of survival with sustained engraftment of both neutrophils and platelets. This is significantly higher than the rate of 38 per cent for this composite endpoint achieved after transplantation with two non-expanded cords in the United States registry of 300 patients collected by the Center for International Blood and Marrow Transplant Research. Preliminary results showed that only 16% receiving expanded cord blood had developed severe GVHD.

Together, these results indicate that transplantation of allogeneic MPC-expanded cord blood is a promising strategy for effective bone marrow engraftment without the high risk of GVHD seen with adult allogeneic marrow.

Mesoblast plans to commence a Phase 3 program this year for this product, and expects that it will be the first of its products to receive FDA approval, and to be marketed and distributed by Cephalon.

Orthopedic Products

Spinal Franchise

Mesoblast has made solid progress in the development of its spinal franchise. The bone repair product NeoFuse™ continues to demonstrate superior results in terms of safety or effectiveness for spinal fusion over both hip bone grafting and other biologicals. This will enable the company to target the entire autograft and biological markets for lumbar and cervical spinal fusion. Phase 2 trials of NeoFuse™ for these indications are continuing to progress well and are expected to be completed this year.

Adding to our suite of products for spinal fusion, the potential of our cells to address the much larger potential market of chronic low back pain due to disc degeneration will crystallize shortly with the commencement of Phase 2 trials. If these clinical trials show that a simple, non-invasive injection can reverse the degenerative process, this would represent a major product breakthrough into an unmet market segment that is conservatively estimated at more than $US 2 billion per year.

Osteoarthritis products

Mesoblast intends to develop its cartilage regenerative adult stem cell product RepliCart™ for both prevention and reversal of established osteoarthritis, a degenerative disease characterised by the loss of cartilage and the leading cause of joint pain and disability among the elderly. In the United States alone, more than 15 million people suffer from osteoarthritis of the knee.

Our ongoing clinical trial of RepliCart™ for prevention of early knee osteoarthritis after Anterior Cruciate Ligament (ACL) injury has made solid progress, with no cell-related adverse events recorded. In the United States, osteoarthritis after a single acute traumatic incident comprises approximately 12% of all osteoarthritis cases with up to 300,000 new cases each year.

Intravenously Administered Products

Mesoblast's strengthened cash position will fund our plans to develop new products delivered by intravenous injection. These products will target large markets which have the potential of being highly profitable, and will aim to treat a range of new and highly visible clinical indications. The first of these markets will be diabetes. Additional products will target various inflammatory and immunologic conditions, including rheumatoid arthritis and lung diseases.

Diabetes product

In a preclinical model, Mesoblast has shown that its proprietary adult stem cells could be an effective treatment for diabetes. In the study, a single dose of the patented human MPCs injected into mice with diabetes resulted in a significant increase in blood insulin levels and sustained reduction in blood glucose levels for the entire three week period of follow-up. This was due to restoration in the damaged pancreas of the balance between insulin-producing beta cells which reduce blood glucose, and glucagon-producing alpha cells which increase blood glucose.

These trial results suggest that the MPCs enhanced endogenous pancreatic beta cell regeneration, resulting in sustained augmentation of insulin secretion and reduction in blood glucose levels.

Mesoblast is currently extending these studies in non-human primates, and if results of these trials demonstrate similar levels of efficacy, the company intends to move towards human trials in diabetic patients this year. Given the epidemic proportions at which this disease is evolving, diabetes represents a huge potential global market opportunity for the company.

Eye disease products

Mesoblast is developing adult stem cell-based products for the treatment of eye conditions including age-related macular degeneration (AMD), the cause of more than 50 per cent of blindness in developed nations, and diabetic macular edema (DME) which complicates underlying diabetic eye disease and is the most common cause of visual loss in diabetics.

In the United States alone, there are about 2 million people suffering from the wet form of AMD associated with abnormal blood vessels. The prevalence of DME among United States diabetics is nearly 30 per cent in adults who have had diabetes for 20 years or more.

Current treatments for these conditons include anti-VEGF therapy which is beneficial in approximately 40% of patients with AMD. The lead anti-VEGF ophthalmic product is an antibody fragment with United States sales of US$875 million in 2008. Patients may require intra-ocular injections as often as once a month for six to 24 months at a cost of approximately US$2,000 per injection.

Preclinical trials have shown that a single injection of Mesoblast's proprietary stem cells is highly effective for the treatment of leaky blood vessels in the eye, the major cause of vision loss in patients with wet age-related macular degeneration and diabetic retinopathy. Moreover, a single injection of Mesoblast's adult stem cell technology appears to be synergistic with anti-VEGF treatment. The synergistic effects seen in non-human primates are particularly exciting if they are seen to translate in clinical trials into synergistic effects on eyesight improvement.

The one time administration of Mesoblast's cells holds the promise for delivering a sustained effect and superior outcome to standard of care anti-VEGF therapies alone with reduced intra-ocular treatment administration, a major market advantage. Mesoblast expects to progress these therapies into clinical trials this year.

2011... the year ahead

We remain very excited about the extraordinary potential of your company to deliver further strong capital returns for shareholders.

Mesoblast has a clear sense of the necessary path it needs to take in the coming year in order to realize and unlock further value from our unique platform technology.

Specific objectives and upcoming highlights include:

- commencement of Phase 3 cord blood expansion trial;
- successful completion of Phase 2 heart failure trial and progression to Phase 3 pivotal trial;
- commencement of intra-coronary heart attack Phase 2 trial;
- successful completion of spinal fusion Phase 2 trials;
- commencement of disc repair Phase 2 trial;
- moving diabetes and eye diseases into Phase 2 trials
- new product opportunities targeting immunologic/ inflammatory conditions.

Your directors are confident that Mesoblast will remain focused on highly strategic and wise use of capital, and that by advancing commercialization of these various products your company will continue to deliver significant shareholder value.

Financial Results

Operating results

The net profit for Group for the half-year was $93,107,780 (31 December 2009 *(parent)*: net loss $6,216,065). The net increase is due to the gain on revaluation of the Group's previously held equity investment in Angioblast Systems, Inc. ("Angioblast") of $86,737,561 that has arisen on the acquisition of Angioblast as a wholly owned subsidiary. The Group's share of losses that had arisen as a result of applying equity accounting to its previous ownership of Angioblast (prior to it becoming a subsidiary) have also been reversed resulting in a profit for the Group of $14,873,899.

Income

Revenue from continuing operations for the Group during the period was $2,334,664 (31 December 2009 *(parent)*: $287,416). The increase is due to revenue recognised of $1,416,904 as a result of receiving US$100m as an upfront payment from Cephalon, Inc. ("Cephalon") in accordance with the terms of the Development and Commercialisation Agreement ("Agreement"). The remaining revenue related to this payment will be recognised over the development term of the Agreement. Interest revenue has also increased by $630,344 as a result of increased cash balances throughout this half year compared with the corresponding prior period.

Other income for the Group during the period was $101,617,776 (31 December 2009 *(parent)*: $nil). Other income consists of $101,611,460 of gains recognised on consolidation in accordance with applicable Australian Accounting Standards as result of the acquisition of Angioblast.

Expenditure

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 yet demonstrate all the factors required in order to capitalise development expenditure. The research and development expenditure for the Group for the period was $3,605,073 (31 December 2009 *(parent)*: $3,456,248).

Share of losses of equity accounted associates for the period of $1,505,345 (31 December 2009 *(parent)*: $1,478,110) represent 38.4% of the Angioblast net losses for the period from 1 July 2010 through to 12 November 2010, from which date Angioblast is fully consolidated. These losses are consistent with the corresponding prior period.

Cash flows

Net cash inflow from operations for the period was $87,962,399 (31 December 2009 *(parent)*: outflow $4,448,358). This increase is largely related to the US$100m cash payment received as an upfront payment from Cephalon in accordance with the terms of the Agreement.

Net cash inflow from investing activities for the period was $4,517,762 (31 December 2009 *(parent)*: $245,545). The increase relates to the cash balance acquired on the acquisition of Angioblast of $3,448,299 plus an increase of interest received on bank balances of $646,659.

During the period under review the Group raised a further $16,659,441 (31 December 2009 *(parent)*: $2,326,400) from Institution and Sophisticated Investors approved by shareholders on 22 September 2010. The corresponding period relates solely to proceeds received from the exercise of options by seed capital investors.

Investment in associates

During the reporting period ended 31 December 2010 (reporting date), Mesoblast Limited acquired the remaining 67.7% of the issued securities of Angioblast Systems, Inc., a researcher and developer of the Mesenchymal Precursor Cell (MPC) platform technology for use in non-orthopaedic applications.

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

Events Occuring After the Reporting Date

On 9 February 2011, shareholders of Mesoblast Ltd approved an issue of 24,702,056 ordinary shares to global biopharmaceutical company Cephalon Inc. The Group received an additional cash injection of $139,000,000 payable in accordance with the terms and conditions of the Development and Commercialisation Agreement and Subscription Deed. The Group has approximately $280,000,000 cash reserves as at the date of this report.

There have not been any events subsequent to the balance date, not otherwise disclosed in this report, which significantly affected or may significantly affect the operations of the Group, the results of its operations or the state of affairs of the Group in subsequent financial periods.

Auditor's Independence Declaration

A copy of the auditor's declaration as required under Section 307C of the Corporations Act 2001 is included on page 5 of this report.

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

Mr. Brian Jamieson

28 February 2011

Chairman

Melbourne

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Auditor's Independence Declaration

As lead auditor for the review of Mesoblast Limited for the half year ended 31 December 2010, I declare that to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the review; and

b) no contraventions of any applicable code of professional conduct in relation to the review.

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

Anton Linschoten

Melbourne
28 February 2011

Partner
PricewaterhouseCoopers

Consolidated Statement of Comprehensive Income for the Half-Year Ended 31 December 2010

	Consolidated Half-Year 31 December 2010 $	*Parent* Half-Year 31 December 2009 $
Revenue from continuing operations		
Commercialisation revenue	1,416,904	-
Interest revenue	917,760	287,416
	2,334,664	287,416
Other income		
Gain on revaluation of investment to fair value	86,737,561	-
Writeback of share of losses of equity accounted associates on acquisition	14,873,899	-
Other income	6,316	-
	101,617,776	-
	103,952,440	287,416
Expenses from continuing operations		
Research and development	(3,605,073)	(3,456,248)
Management and administration	(5,734,149)	(1,569,123)
Interest expense	(93)	-
Share of losses of equity accounted associates	(1,505,345)	(1,478,110)
	(10,844,660)	(6,503,481)
Profit/(loss) before income tax expense	93,107,780	(6,216,065)
Income tax	-	-
Profit/(loss) after related income tax from continuing operations	93,107,780	(6,216,065)
Other comprehensive income		
Exchange differences on translation of foreign operations	(420,004)	897,100
Income tax relating to components of other comprehensive income	-	-
Other comprehensive (loss)/income for the period (net of tax)	(420,004)	897,100
Total comprehensive income/(loss) for the period	92,687,772	(5,318,965)

Earnings/(losses) per share from continuing operations attributable to the ordinary equity holders of the Group:	**Cents**	**Cents**
Basic – cents per share	57.92	(4.52)
Diluted – cents per share	55.43	(4.25)

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

Consolidated Balance Sheet as at 31 December 2010

	Note	*Consolidated* 31 December 2010 $	*Parent* 30 June 2010 $
CURRENT ASSETS			
Cash and cash equivalents		140,603,985	32,049,327
Trade and other receivables		455,389	1,375,679
Prepayments		247,327	93,284
TOTAL CURRENT ASSETS		141,306,701	33,518,290
NON-CURRENT ASSETS			
Property, plant and equipment		246,848	223,695
Deferred tax asset		10,775,756	-
Investments accounted for using the equity method	3	-	5,334,241
Intangible assets	4	504,050,285	438,544
TOTAL NON-CURRENT ASSETS		515,072,889	5,996,480
TOTAL ASSETS		656,379,590	39,514,770
CURRENT LIABILITIES			
Trade and other payables		7,347,663	1,595,510
Deferred revenue	5	21,910,000	-
TOTAL CURRENT LIABILITIES		29,257,663	1,595,510
NON-CURRENT LIABILITIES			
Deferred revenue	5	75,069,239	-
Deferred tax liability		135,716,003	-
TOTAL NON-CURRENT LIABILITIES		210,785,242	-
TOTAL LIABILITIES		240,042,905	1,595,510
NET ASSETS		416,336,685	37,919,260
EQUITY			
Issued capital	6	366,853,098	87,949,316
Reserves		12,001,627	5,595,764
Retained earnings/(accumulated losses)		37,481,960	(55,625,820)
TOTAL EQUITY		416,336,685	37,919,260

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

Consolidated Statement of Changes in Equity for the Half-Year Ended 31 December 2010

	Issued Capital $	Share Option Reserve $	Foreign Currency Translation Reserve $	Retained Earnings $	Total $
Parent					
Balance at 1 July 2009	62,460,236	4,156,507	18,144	(40,844,925)	25,789,962
Total comprehensive profit/(loss) for the period	**-**	**-**	**897,100**	**(6,216,065)**	**(5,318,965)**
Contributions of equity net of transaction costs	2,326,400	-	-	-	2,326,400
Fair value of share based payment	-	294,162	-	-	294,162
Balance at 31 December 2009	**64,786,636**	**4,450,669**	**915,244**	**(47,060,990)**	**23,091,559**
Consolidated					
Balance at 1 July 2010	87,949,316	5,175,760	420,004	(55,625,820)	37,919,260
Total comprehensive profit/(loss) for the period	**2,691,422**	**(2,691,422)**	**(420,004)**	**93,107,780**	**92,687,776**
Contributions of equity net of transaction costs	16,659,441	-	-	-	16,659,441
Acquisition of Angioblast Systems, Inc.	259,552,919	8,900,359	-	-	268,453,278
Exchange differences on translation of foreign operations	-	-	(8,995)	-	(8,995)
Fair value of share based payment	-	625,925	-	-	625,925
Balance at 31 December 2010	**366,853,098**	**12,010,622**	**(8,995)**	**37,481,960**	**416,336,685**

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

Consolidated Statement of Cashflows for the Half-Year Ended 31 December 2010

	Consolidated Half-Year 31 December 2010 $	*Parent* Half-Year 31 December 2009 $
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to suppliers and employees	(10,433,744)	(4,448,358)
Commercialisation milestones received	98,396,143	-
Net cash provided by/(used) in operating activities	87,962,399	(4,448,358)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	945,338	298,679
Cash acquired on acquisition of subsidiary	3,448,299	-
Investment in fixed assets	(61,533)	(51,029)
Investment in patents & licenses	(142,767)	-
Costs repaid/(made) to associate company	328,425	(2,105)
Net cash provided by investing activities	4,517,762	245,545
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issue of shares	17,376,647	2,326,400
Payments for share issue costs	(717,206)	-
Net cash provided by financing activities	16,659,441	2,326,400
Net increase/(decrease) in cash and cash equivalents	109,139,602	(1,876,413)
Cash and cash equivalents at beginning of half-year	32,049,328	16,526,278
FX (losses)/gains on the translation of foreign bank accounts	(584,945)	3,189
Cash and cash equivalents at end of half-year	140,603,985	14,653,054

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

Notes to the Financial Statements for the Half-Year Ended 31 December 2010

NOTE 1

Basis of preparation of half-year report

This general purpose financial report for the half-year reporting period ended 31 December 2010 has been prepared in accordance with the *Corporations Act 2001* and AASB 134 Interim Financial Reporting.

This half-year financial report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2010 and any public announcements made by Mesoblast Group during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001.*

The accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period, except as set out below.

Principles of consolidation

Subsidiaries

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Mesoblast Limited ("company" or "parent entity") as at 31 December 2010 and the results of all subsidiaries for the period 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 the parent has the ability to exercise control over its subsidiary, even if it does not hold a shareholding of more than one-half of the voting rights. 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 unrealised gains on transactions between group companies are eliminated. Unrealised 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.

Foreign currency translation

Functional and presentation currency

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

Translations and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the transaction at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised 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 recognised in the statement of comprehensive income 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 included in the fair value reserve in equity.

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 each balance sheets presented are translated at the closing rate at the date of that balance sheets;
- income and expenses for the consolidated statement 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 recognised in other comprehensive income.

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 recognised in other comprehensive income. When a foreign operation is sold or any borrowings forming part of the net investment are repaid, a proportionate share of such exchange difference is reclassified to the statement of comprehensive income, as part of the gain or loss on sale where applicable.

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.

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 recognises 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 recognised for the major business activities as follows:

Commercialisation revenue

Commercialisation revenue refers to upfront and milestone payments received under development and commercialisation agreements. Upfront milestone payments which are typically received upon (or near) the signing of these agreements are recognised as revenue over the development life of the agreement. Milestone payments are recognised on an accruals basis when the development milestone has been reached.

Income tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for 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 company'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 realised or the deferred income tax liability is settled.

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

Deferred tax liabilities and assets are not recognised 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 realise the asset and settle the liability simultaneously.

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

Business combinations

The acquisition method of accounting is used to account for all business combinations, including business combinations involving entities or businesses under common control, regardless of whether equity instruments or other assets are acquired. The consideration transferred for the acquisition of a subsidiary comprises the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. The consideration transferred also includes the fair value of any contingent consideration arrangement and the fair value of any pre-existing equity interest in the subsidiary. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are, with limited exceptions, measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the group recognises 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 the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the subsidiary acquired and the measurement of all amounts has been reviewed, the difference is recognised directly in profit or loss as a bargain purchase.

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

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

Intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is not amortised. Instead, goodwill 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).

Trademarks and licences

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

Intellectual property

Other intellectual property is amortised from the point at which the asset is ready for use on a straight line basis over its useful life.

Impact of standards issued but not yet applied by the entity

In December 2009, the AASB issued AASB 9 *Financial Instruments* which addresses the classification and measurement of financial assets and is likely to affect the group's accounting for its financial assets. The standard is not applicable until 1 January 2013 but is available for early adoption. The group is yet to assess its full impact.

Comparative figures

The comparative information for the half-year report is for the parent entity only, as there were no subsidiaries of the parent for the comparative period.

Notes to the Financial Statements for the Half-Year Ended 31 December 2010 continued

NOTE 2. SEGMENT INFORMATION

(a) Description of segments

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

Two reportable operating segments have been identified, the orthopaedic segment and the non-orthopaedic segment, both having two distinct markets for which the MPC platform technology is currently being developed. Both segments operate primarily in the USA, with some operations also occurring in Australia, Europe and Asia.

(b) Segment information

	Orthopaedic indications	Non-orthopaedic indications*	Total
	$	$	$
Consolidated			
Half-year 2010			
Net profit/(loss) after tax	(3,148,755)	101,073,017	97,924,262
Total segment assets	466,402	503,633,607	504,100,009
Total segment assets include:			
Carrying value of investments accounted for using the equity method	-	-	-
Parent			
Half-year 2009			
Net profit/(loss) after tax	(3,416,347)	(1,478,110)	(4,894,457)
Total segment assets	504,015	8,745,416	9,249,431
Total segment assets include:			
Carrying value of investments accounted for using the equity method	-	8,745,416	8,745,416

* Performed in conjunction with Angioblast, and includes treatments for cardiovascular conditions, eye disease, bone marrow transplantation, diabetes and other non-orthopaedic conditions. Further information can be found in the directors' report.

(c) Segment reconciliation

The following table reconciles total segment net profit/(loss) to the totals reported for the Group in the statement of comprehensive income and balance sheet. These reconciling items are not considered by the Group to be an operating segment as defined in AASB 8 Operating Segments (which was early adopted in the previous financial year) and therefore are not disclosed as such. They are administrative in nature and relate largely to the running of the Mesoblast head office.

	Consolidated 31 December 2010 $	*Parent* 31 December 2009 $
Total segment net profit/(loss)	**97,924,262**	**(4,894,457)**
Interest revenue	917,760	287,416
Administration expenses	(5,108,224)	(1,317,102)
Foreign exchange gain	-	2,240
Interest expense	(93)	-
Share-based payments	(625,925)	(294,162)
Total net profit/(loss) after tax	93,107,780	(6,216,065)

Notes to the Financial Statements for the Half-Year Ended 31 December 2010 continued

NOTE 3. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

	Country of Incorporation	Principal Activity	Ownership Interest	
			Consolidated	*Parent*
			31 December 2010	30 June 2010
			% (undiluted)	% (undiluted)
(a) Carrying amount				
Angioblast Systems, Inc.	USA	Adult stem cell development and commercialisation for non-orthopaedic applications	100	38.4
			% (fully diluted)	% (fully diluted)
			100	32.3
			Consolidated	*Parent*
			31 December 2010	30 June 2010
			$	$
Investment in Angioblast Systems, Inc.			-	18,282,791
Share of equity accounted losses			-	(13,368,554)
Foreign exchange difference on translation			-	420,004
			-	5,334,241

(b) Movement in carrying amount		
Carrying amount at the beginning of the six month period	5,334,241	9,326,428
Share of losses for the period	(1,505,345)	(4,394,047)
Foreign exchange difference on translation	1,704,870	401,860
Writeback of share of losses of equity accounted associates on acquisition	14,873,899	-
Writeback of foreign exchange difference on translation	(2,124,874)	-
Writeback of investment in Angioblast Systems Inc	(18,282,791)	-
Carrying amount at the end of the six month period	-	5,334,241

4. INTANGIBLE ASSETS

	Goodwill $	Patents, trademarks and other intellectual property $	Total $
Consolidated			
31 December 2010			
Gross carrying amount			
Balance at the beginning of the six month period	-	690,000	690,000
Additions	115,873,597	387,760,010	503,633,607
Disposals	-	-	-
Carrying amount at the end of the six month period	115,873,597	388,450,010	504,323,607
Accumulated amortisation			
Balance at the beginning of the six month period	-	(251,456)	(251,456)
Amortisation expense	-	(21,866)	(21,866)
Carrying amount at the end of the six month period	-	(273,322)	(273,322)
Net book value	115,873,597	388,176,688	504,050,285
Parent			
30 June 2010			
Gross carrying amount			
Balance at the beginning of the six month period	-	690,000	690,000
Additions	-	-	-
Disposals	-	-	-
Carrying amount at the end of the six month period	-	690,000	690,000
Accumulated amortisation			
Balance at the beginning of the six month period	-	(207,725)	(207,725)
Amortisation expense	-	(43,731)	(43,731)
Carrying amount at the end of the six month period	-	(251,456)	(251,456)
Net book value	-	438,544	438,544

Notes to the Financial Statements for the Half-Year Ended 31 December 2010 continued

NOTE 5. DEFERRED REVENUE

	Consolidated 31 December 2010 $	*Parent* 30 June 2010 $
Opening Balance	-	-
Commercialisation revenue received during the period	98,396,143	-
Amount recognised in as revenue in the period	(1,416,904)	-
Balance at the end of the period	96,979,239	-
Amount expected to be recognised as revenue:		
• in the next twelve months (current deferred revenue)	21,910,000	-
• beyond twelve months (non current deferred revenue)	75,069,239	-
	96,979,239	-

NOTE 6. EQUITY SECURITIES ISSUED

Date	Details	Number of shares	Issue price	$
Parent				
Half-year 2009				
1 July 2009	Opening balance	136,174,869		62,460,236
Quarter 3 2009	Exercise of share options	2,093,332	$0.55	1,151,333
Quarter 4 2009	Exercise of share options	1,826,668	$0.55	1,004,667
Quarter 4 2009	Exercise of share options	216,000	$0.65	140,400
Quarter 4 2009	Exercise of share options	30,000	$1.00	30,000
	Movement for the six month period	4,166,000		2,326,400
31 December 2009	**Closing Balance**	**140,340,869**		**64,786,636**
Consolidated				
Half-year 2010				
1 July 2010	Opening balance	154,880,556		87,949,316
Quarter 3&4 2010	Share issue to institutions and sophisticated investors	7,061,000	$1.70	12,003,700
Quarter 3&4 2010	Exercise of share options	316,000	$1.00	316,000
Quarter 4 2010	Shares issued on acquisition of Angioblast Systems, Inc.	81,722,752	$2.88	235,361,526
Quarter 4 2010	Exercise of share options	9,091,198	$0.33*	3,018,746
Quarter 4 2010	Exercise of share options	100,000	$1.20	120,000
Quarter 4 2010	Exercise of share options	90,000	$1.58	142,200
Quarter 4 2010	Exercise of share options	15,000	$1.96	29,400
Quarter 4 2010	Exercise of share options	820,000	$2.13	1,746,600
	Movement for the six month period	99,215,950		252,738,172
	Less: Transaction costs arising on share issues			(717,206)
	Add: Transfer of exercised options reserve			26,882,816
31 December 2010	**Closing Balance**	**254,096,506**		**366,853,098**

** rounded*

Notes to the Financial Statements for the Half-Year Ended 31 December 2010 continued

NOTE 7. SHARE OPTIONS

	Consolidated	*Parent*
	31 December 2010	30 June 2010
(a) Movement in share options over ordinary shares	No.	No.
Balance at the beginning of the six month period	6,963,000	5,446,000
Issued on acquisition of Angioblast Systems, Inc.	12,867,191	-
Exercised on acquisition of Angioblast Systems, Inc.	(9,091,198)	-
Granted during the half-year	525,000	2,070,000
Exercised during the half-year	(1,341,000)	(519,334)
Lapsed during the half-year	-	(33,666)
Balance at the end of the six month period	9,922,993	6,963,000

NOTE 8. EVENTS OCCURING AFTER THE REPORTING DATE

On 9 February 2011, shareholders of Mesoblast Ltd approved an issue of 24,702,056 ordinary shares to global biopharmaceutical company Cephalon Inc. The Group received an additional cash injection of $139,000,000 payable in accordance with the terms and conditions of the Development and Commercialisation Agreement and Subscription Deed. The Group has approximately $280,000,000 cash reserves as at the date of this report.

There have not been any events subsequent to the balance date, not otherwise disclosed in this report, which significantly affected or may significantly affect the operations of the Group, the results of its operations or the state of affairs of the Group in subsequent financial periods.

Notes to the Financial Statements for the Half-Year Ended 31 December 2010 continued

NOTE 9. BUSINESS COMBINATION

During the reporting period ending on 31 December 2010, Mesoblast Limited acquired the remaining 67.7% of the issued securities of Angioblast Systems, Inc., a researcher and developer of the Mesenchymal Precursor Cell (MPC) platform technology for use in non-orthopaedic applications, for a consideration of $268,453,278.

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

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

	Preliminary Fair value $
Purchase consideration	
Securities allotment (94,590,000 shares and options)	268,453,278
Fair value of previously held investment	105,020,352
Total purchase consideration	373,473,630
The assets and liabilities recognised as a result of the business combination at fair value are as follows:	
Cash and cash equivalents	3,448,299
Prepayments and other receivables	337,321
Property, plant and equipment	63,909
Intangible assets: intellectual property	387,760,010
Payables	(9,069,259)
Deferred tax assets	10,775,756
Deferred tax liabilities	(135,716,003)
	257,600,033
Add: Goodwill	115,873,597
	373,473,630

The goodwill is attributable to commercialisation, manufacturing and operational synergies as a result of owning 100% of the platform technology. No amount of goodwill is expected to be deducted for tax purposes.

(i) Acquisition-related costs

Directly attributable acquisition-related costs of approximately $500,000 are included in management and administration expenses in the statement of comprehensive income, and are included in the non-orthopaedic operating segment.

(ii) Revenue and profit contribution

Angioblast contributed revenues of $1,434,852 and net loss of $207,521 to the group for the period from 12 November 2010 to 31 December 2010. If the business combination had occurred on 1 July 2010, consolidated revenue and consolidated loss for the half-year ended 31 December 2010 would have been $2,720,399 and $3,520,206 respectively.

(ii) Business combinations achieved in stages

In accordance with AASB 3 (Revised): *Business Combinations,* the Group has remeasured its previously held equity interest (32.3% fully diluted) in Angioblast Systems, Inc. at fair value. This revaluation has resulted in a gain on revaluation of $86,737,561 which has been recognised in "other income", in the Consolidated Statement of Comprehensive Income.

NOTE 10. PARENT ENTITY FINANCIAL INFORMATION

	Parent 31 December 2010 $	*Parent* 30 June 2010 $
Balance Sheet		
Current assets	43,629,743	33,518,290
Total assets	330,971,414	39,514,770
Current liabilities	1,570,820	1,595,510
Total liabilities	1,570,820	1,595,510
Shareholders' equity		
Issued capital	366,853,098	87,949,316
Reserves		
Share options reserve	12,010,622	5,175,760
Foreign currency translation reserve	-	420,004
Accumulated losses	(49,463,126)	(55,625,820)
	329,400,594	37,919,260
Statement of Comprehensive Income		
Profit/(loss) for the period	6,162,693	(6,216,065)
Total comprehensive income/(loss) for the period	4,037,819	(5,318,965)

Directors' Declaration

In accordance with a resolution of directors of the Mesoblast Group,

In the directors' opinion:

(a) the financial statements and notes set out on pages 6 to 20 are in accordance with the *Corporations Act 2001*, including:

  (i) compying 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 31 December 2010 and of its performance for the half-year ended on that date, and

(b) there are reasonable grounds to believe that Mesoblast Limited will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of the Board of Directors

Mr. Brian Jamieson

28 February 2011

Chairman

Melbourne

PRICEWATERHOUSECOOPERS

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Independent auditor's review report to the members of Mesoblast Limited

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Mesoblast Limited, which comprises the balance sheet as at 31 December 2010, and the income statement, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, selected explanatory notes and the directors' declaration for the Mesoblast Limited Group (the consolidated entity). The consolidated entity comprises both Mesoblast Limited (the company) and the entities it controlled during that half-year.

Directors' responsibility for the half-year financial report

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001 and for such control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 Review of an Interim Financial Report Performed by the Independent Auditor of the Entity, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the Corporations Act 2001 including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Regulations 2001. As the auditor of Mesoblast Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. It also includes reading the other information included with the financial report to determine whether it contains any material inconsistencies with the financial report. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

PRICEWATERHOUSECOOPERS

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

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

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

Conclusion
Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Mesoblast Limited is not in accordance with the *Corporations Act 2001* including:

(a) giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and of its performance for the half-year ended on that date; and

(b) complying with Accounting Standard AASB 134 *Interim Financial Reporting and Corporations Regulations 2001*.

PricewaterhouseCoopers

Anton Linschoten

Melbourne
28 February 2011

Partner
PricewaterhouseCoopers