mesoblast

Half-Year Report

For the six months ended 31 December 2014

Mesoblast Limited ABN 68 109 431 870
and Controlled Entities

Contents

Directors' Report

The Board of Directors of Mesoblast Group has resolved to submit the following half-year report of the Company and its subsidiaries for the half-year ended 31 December 2014. In compliance with the provisions of the *Corporations Act 2001*, the Directors report the following information:

Directors

Directors of the Company in office during the whole of the half-year and up to the date of this report were:

Name	Position
Silviu Itescu	Executive Director
Brian Jamieson	Chairman
Donal O'Dwyer	Non-executive Director, Chair of Nomination and Remuneration Committee
Eric Rose	Non-executive Director, Chair of Science and Technology Committee
Michael Spooner	Non-executive Director, Chair of Audit and Risk Committee
William M Burns	Non-executive Director
Ben-Zion Weiner	Non-executive Director

Principal Activities

We aim to leverage our key proprietary technology platform, based on mesenchymal lineage adult stem cells (MLCs), to create new solutions for diseases with major unmet needs, and at the same time deliver long-term growth and value to shareholders.

We have continued to maintain a global leadership position in the field of cell-based regenerative medicine through advancing our late-stage product candidates and through partnerships and strategic alliances.

With five product candidates in the United States that are in active Phase 3 programs or that are Phase 3 ready, and one that has been filed by our partner for regulatory approval in Japan (see chart on next page), we believe we are well positioned to have the first industrially manufactured allogeneic or 'off-the-shelf' stem cell products approved in the United States and Japan.

Our diverse product candidate portfolio is prioritized into tiers based on stage of development, market opportunity, and expected time to market, and we allocate resources based on such prioritization. Our most advanced, or Tier 1, product candidates under development are MPC-150-IM for the treatment of chronic congestive heart failure; MPC-06-ID for the treatment of chronic discogenic low back pain; and MSC-100-IV for the treatment of acute graft versus host disease. We also have a number of advanced Tier 2 product candidates, including MPC-300-IV under development for the treatment of chronic inflammatory conditions, such as biologic-refractory rheumatoid arthritis and diabetic kidney disease, which we intend to elevate to Tier 1 status if Phase 2 clinical results are positive.

Operational Highlights

Product candidate MPC-150-IM for congestive heart failure (CHF):

- Phase 3 trial in patients with CHF is recruiting well across multiple North American sites.
- Phase 3 trial is enriched for patients with advanced heart failure, based on inclusion criteria of high NT-proBNP levels and a heart failure-related hospitalization within the past nine months.
- Patients with advanced heart failure represent the major unmet need in this field, with high rates of heart failure-related major adverse cardiac events (HF-MACE), and are expected to be the optimal target for MPC-150-IM therapy.
- Agreement with the United States National Institutes of Health (NIH) on the conduct of a 120-patient trial using MPC-150-IM in patients with advanced or end-stage CHF requiring mechanical circulatory support.

Product candidate MPC-06-ID for chronic discogenic low back pain (CDLBP):

- Phase 3 clinical program for CDLBP has been initiated.
- 12-month results of Phase 2 CDLBP trial presented at North American Spine Society Annual Meeting showing a single injection of MPC-06-ID resulted in sustained improvement in pain and function compared with controls.
- Key patent granted through 2029 in the United States covering Mesoblast's product candidates for the treatment of degenerated intervertebral discs.

Product candidates MSC-100-IV and JR-031 for acute graft versus host disease (aGVHD):

- Phase 3 registration trial of MSC-100-IV for the treatment of steroid-refractory aGVHD in children has been initiated.

- Our Japanese partner, JCR Pharmaceuticals Co. Ltd (JCR), has filed for Japanese regulatory approval for JR-031 in aGVHD.

Product candidate MPC-300-IV for immune-mediated diseases:

- Phase 2 trial evaluating each of two doses against placebo in patients with biologic-refractory rheumatoid arthritis is ongoing.
- First dose cohort has completed recruitment, six months of follow-up and continues to be evaluated. Second dose cohort continues to actively enroll.
- Phase 2 trial evaluating each of two doses against placebo in patients with diabetic kidney disease has completed recruitment, six months of follow-up and continues patient evaluation.

Scaleable manufacturing:

- We have made substantial advances in the development of 3-D manufacturing processes with greater capacity to improve efficiency and yields.
- We have developed a proprietary serum-free media that has the potential to greatly enhance the yields achieved in manufacturing of product candidates and to eliminate source material constraints.

Key Proprietary Technology Platform

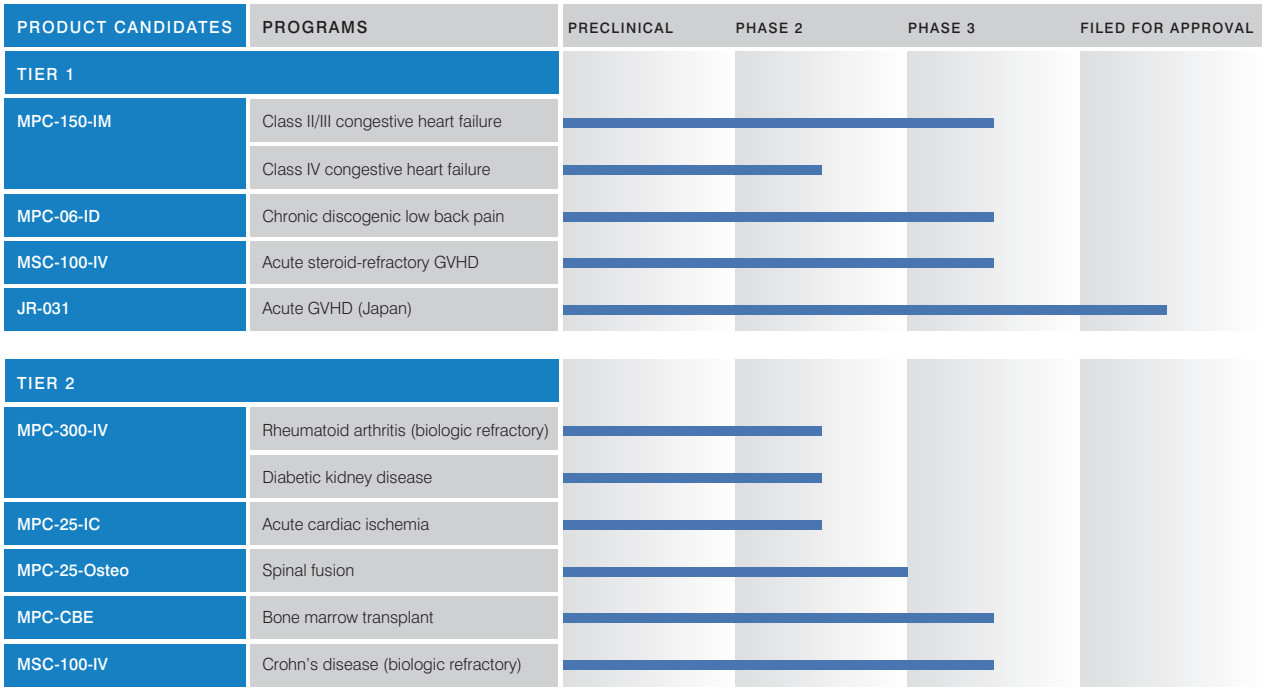
MLCs are present around blood vessels in all tissues, where they can respond to signals associated with tissue damage. This response includes the secretion of a variety of biomolecules that affect various reparative and immunomodulatory mechanisms responsible for maintaining tissue health. Understanding the mechanisms of action by which these biomolecules induce tissue restoration has broad applicability in treating diseases for which current standards of care are inadequate or for which no approved therapy currently exists.

We have developed multiple distinct product candidates derived from our MLC platform by applying an approach that we refer to as 'Product-by-Process', in which we modify the manufacturing, formulation, dosage and route of administration for each product to optimize an MLC-derived product for a specific target condition. This allows for the development of independent, non-interchangeable products, each of which has distinct pricing and strategic partnering opportunities.

Clinical Pipeline Progress

MPC-150-IM is our Phase 3 product candidate partnered with Teva Pharmaceutical Industries Ltd. (Teva), which is being developed as a treatment for CHF.

Teva has initiated a double-blinded Phase 3 trial in Class II/III CHF patients of approximately 1,730 patients. The Phase 3 trial is an event driven trial and is enriched for patients with the greatest clinical need, those with advanced heart



*This chart is figurative and does not purport to show individual trial progress within a clinical program.
For product registration purposes, Phase 3 programs may require more than one trial.

failure and with high rates of HF-MACE, based on inclusion criteria of high NT-proBNP levels and a heart failure-related hospitalization within the past nine months. Patients with advanced heart failure are expected to be the optimal target for MPC-150-IM therapy.

This Phase 3 trial is recruiting well across multiple North American sites, and we expect to complete enrollment of all patients to be evaluated in the first interim analysis during the second quarter of 2015. The results are expected in the first quarter of 2016.

In the completed Phase 2 trial of MPC-150-IM for the treatment of Class II/III CHF, the 150 million dose (currently being evaluated in Phase 3) showed, as compared to control and other dose levels, the greatest positive effects on clinical outcomes, including ventricular remodeling, functional exercise capacity, and prevention of any HF-MACE over three years.

An additional Phase 2b trial of MPC-150-IM in 120 patients with Class IV CHF requiring mechanical support by a left ventricular assist device (LVAD) is expected to be initiated in the first quarter of 2015 by the Cardiothoracic Surgical Trials Network, and funded by the NIH. This trial builds on an earlier Phase 2a clinical trial that demonstrated feasibility and safety, and suggested that a single low-dose injection of our proprietary MPCs may improve cardiac function and may have an early benefit on survival. Results of this new Phase 2b trial are expected in early 2017.

If we receive U.S. regulatory approval for MPC-150-IM, we expect to participate in a market for CHF that in the United States alone has 5.1 million adult patients and 825,000 new diagnoses per year.

MPC-06-ID is our proprietary Phase 3-ready product candidate for the treatment of CDLBP resulting from degenerative disc disease (DDD). In a Phase 2 study, compared to controls, treatment with MPC-06-ID resulted in a significantly greater proportion of patients achieving both reduced back pain and improved back function over 12 months of follow-up. We have initiated a Phase 3 program and we expect top-line data in the second half of 2017. Because current treatments for CDLBP focus only on pain relief rather than addressing the underlying degenerative nature of the disease, we believe MPC-06-ID has the potential to fill an unmet treatment gap for the large population of patients with DDD.

Our third Tier 1 product is MSC-100-IV, an intravenously-delivered product candidate for the treatment of aGVHD following allogeneic bone marrow transplantation. Previously published data from a pediatric Expanded Access Program in the United States, using MSC-100-IV for severe, multiline refractory aGVHD, demonstrated a significant survival benefit at 100 days in those showing a clinical response to treatment, compared to non-responders, in the reviewed set of the first 75 patients. An open-label pediatric Phase 3 trial for MSC-100-IV is actively enrolling in the United States and, if positive, will support filing for U.S. regulatory approval. JCR filed for Japanese regulatory approval for its aGVHD MSC-based product, JR-031, in September 2014.

MPC-300-IV, one of our Tier 2 product candidates, is an intravenously-delivered immunomodulatory product candidate for the treatment of chronic immune-mediated and inflammatory conditions, including biologic-refractory rheumatoid arthritis and diabetic kidney disease.

A Phase 2 trial of MPC-300-IV is ongoing in patients with biologic refractory rheumatoid arthritis, where the first dose cohort has completed recruitment, six months of follow-up and continues to be evaluated. The second dose cohort is actively enrolling. Top-line results are expected in the second half of 2015.

In a Phase 2 trial of MPC-300-IV in patients with poorly-controlled type 2 diabetes but no kidney disease, there was a dose-dependent response on improvement in hemoglobin A1c (HbA1c), the primary measure of glycemic control, a finding suggestive of an immunomodulatory effect on disease pathogenesis. In addition, a Phase 2 trial of MPC-300-IV in patients with diabetic kidney disease has completed recruitment, six months of follow-up and continues patient evaluation. We expect top-line results during the first quarter of 2015.

Financial Summary

Operating results

The net loss after tax for the six months ended 31 December 2014 is $50.8 million, an increase in net loss of $19.9 million compared to $30.9 million for the six months ended 31 December 2013.

The increased loss was driven by an increase in Expenses from continuing operations of $25.0 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013, and a decrease in Revenue from continuing operations of $1.0 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013.

The abovementioned impacts have been partially offset by an increase in Other income of $6.1 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013.

The following sections provide more detail.

Revenue from continuing operations

	Dec 2014 $'000	Dec 2013 $'000	Movement $'000
Commercialization revenue	10,808	8,215	2,593
Interest revenue	2,135	5,705	(3,570)
Total Revenue from continuing operations	**12,943**	**13,920**	**(977)**

The decrease in Revenue from continuing operations of $1.0 million is due to a decrease in Interest revenue of $3.6 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013, due to a decline in market interest rates over the period, and a move towards investing in shorter term deposits. We also held a higher ratio of U.S. dollars to Australian dollars during the six months ended 31 December 2014 compared to 31 December 2013, which decreased revenue as yields on U.S. dollar bank accounts were lower than yields on Australian dollar bank accounts.

The abovementioned decrease is partially offset by an increase in commercialization revenue of $2.6 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013. This increase is due to commercialization revenue from JCR for the completion of a milestone as JCR filed product JR-031 for marketing approval in Japan.

Other income

	Dec 2014 $'000	Dec 2013 $'000	Movement $'000
Research and development tax incentive	3,489	5,795	(2,306)
Rental income	17	–	17
Foreign exchange gains	9,401	1,059	8,342
Total Other income	**12,907**	**6,854**	**6,053**

Research and development tax incentive income decreased by $2.3 million from $5.8 million for the six months ended 31 December 2013 to $3.5 million for the six months ended 31 December 2014. We have recognized incentive income pertaining to the eligible expenditure undertaken in each of these periods. At each period end management estimates the refundable tax offset available to us based on available information at the time. This estimate is also reviewed by external tax advisors.

Of the $3.5 million research and development tax incentive recorded in Other income for the six months ended 31 December 2014, $0.6 million relates to a change in the original estimate of the research and development tax incentive income we estimated we would receive from the Australian Government for the year ended 30 June 2014.

Of the $5.8 million research and development tax incentive recorded in Other income for the six months ended 31 December 2013, $3.5 million relates to a change in the original estimate of the research and development tax incentive income we estimated we would receive from the Australian Government for the year ended 30 June 2013.

The $8.3 million increase in foreign exchange gains to $9.4 million for the six months ended 31 December 2014, from $1.1 million for the six months ended 31 December 2013, is due to the movement in exchange rates as the Australian dollar depreciated against the U.S. dollar during the six month period ended 31 December 2014. We hold certain cash and term deposit balances in U.S. dollars, resulting in foreign exchange gains on the revaluation of foreign currency denominated monetary assets and liabilities. As at 31 December 2014, the total cash and term deposit balance held in U.S. dollars was US$55.8 million.

The overall increase in Other income has been impacted by an increase in rental income for the six months ended 31 December 2014 compared to the six months ended 31 December 2013. We entered into a sublease agreement for a portion of the Melbourne office space in December 2013, resulting in rental income for the six months ended 31 December 2014.

Expenses from continuing operations

The increase in Expenses from continuing operations was $25.0 million for the six months ended 31 December 2014 compared to the six months ended 31 December 2013, the details of which are as follows:

Expenses from continuing operations

	Dec 2014 $'000	Dec 2013 $'000	Movement $'000
Research and development	36,103	25,328	10,775
Manufacturing commercialization	13,232	13,356	(124)
Management and administration	16,572	12,942	3,630
Finance costs	5,422	–	5,422
Other expenses	5,339	–	5,339
Total Expenses from continuing operations	**76,668**	**51,626**	**25,042**

Research and development

Research and development expenses:

	Dec 2014 $'000	Dec 2013 $'000	Movement $'000
Third party costs	16,881	9,916	6,965
Product support costs	17,645	14,302	3,343
Intellectual property support costs	1,577	1,110	467
Total Research and development expenses	**36,103**	**25,328**	**10,775**

Research and development expenses were $36.1 million for the six months ended 31 December 2014, compared to $25.3 million for the six months ended 31 December 2013, an increase of $10.8 million. The $10.8 million net increase in Research and development expenses reflects the continued clinical development of the culture expanded mesenchymal stem cell (ceMSC) assets acquired from Osiris Therapeutics, Inc., the clinical advancement of our mesenchymal precursor cell (MPC) programs as they transition to late-stage development, and our continued investment in resources to execute our clinical programs.

Third party costs have increased by $7.0 million for the six months ended 31 December 2014 compared to the six months ended 31 December 2013. $6.2 million of the increase in third party costs for the period relates to the advancement of our Tier 1 products, and in particular the clinical programs for CDLBP and aGVHD. Third party costs for the MPC-150-IM product for CHF are predominantly funded by our collaborators, Teva (NYHA Class II/III) and the NIH (NYHA Class IV).

Tier 2 and pipeline third party costs increased $0.8 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013, as the ongoing Tier 2 clinical trials and pipeline activities progressed during the period.

Product support costs for the six months ended 31 December 2014 increased by $3.3 million compared to the six months ended 31 December 2013 across all programs primarily reflecting the costs of the additional resources required to run the MSC-100-IV product late-stage programs acquired during FY2014, together with increased development costs for our MPC-06-ID product for CDLBP as we progress to Phase 3 clinical development.

Also included in Research and development expenses are intellectual property support costs, which have risen by $0.5 million in the six months ended 31 December 2014 compared to the six months ended 31 December 2013. This reflects the purchase of ceMSC patent families from Osiris, which we accounted for as a business combination.

Manufacturing commercialization

Manufacturing commercialization expenses were $13.2 million for the six months ended 31 December 2014, compared to $13.4 million for the six months ended 31 December 2013, a decrease of $0.2 million.

There was a net increase of $4.5 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013, attributable to production of MSC-100-IV. The ceMSC assets were not acquired until October 2013 and therefore there was limited expenditure on the MSC-100-IV product in the six month period ended 31 December 2013. In the six months ended 31 December 2014 we incurred Manufacturing commercialization expenses on the MSC-100-IV product development process to enable upcoming clinical and commercial production requirements to be met.

This abovementioned increase was offset by a decrease of $5.1 million on MPC-based Manufacturing commercialization expenses for the six months ended 31 December 2014 compared to the six months ended 31 December 2013. This decrease was due to a reduction in clinical grade production for MPC-based products as we focused on MSC-based products.

Manufacturing commercialization support expenses increased by $0.4 million for the six months ended 31 December 2014, compared to the six months ended 31 December 2013. This increase is attributable to additional costs incurred as a result of the increased head count of 12 staff at 31 December 2014 compared with 7 at 31 December 2013.

Management and administration expenses

Management and administration expenses were $16.5 million for the six months ended 31 December 2014, compared to $12.9 million for the six months ended 31 December 2013, an increase of $3.6 million. This is due to additional costs incurred as a result of the increased head count of 125 staff at 31 December 2014 compared with 92 at 31 December 2013, and increased staff associated costs.

Finance costs

Finance costs of $5.4 million in the six months ended 31 December 2014 represent the change in fair value of contingent consideration financial liabilities pertaining to the acquired ceMSC assets of Osiris. These costs are currently a non-cash item and relate solely to 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. On successful achievement of agreed milestones, the contingent consideration will be payable in cash or shares at our discretion. On successful achievement of commercialization of any ceMSC-based product, product royalties will be funded from the profits generated.

Other expenses

Other expenses were $5.3 million for the six months ended 31 December 2014, no Other expenses were recognized for the six months ended 31 December 2013.

The $5.3 million expense incurred during the six months period ended 31 December 2014 related to the remeasurement of contingent consideration pertaining to the acquisition of assets from Osiris. This remeasurement expense is as a result of changes to the contingent consideration valuation for key assumptions such as market population, market penetration, product pricing and developmental timelines. The net result of changes to the key assumptions was an increase in the valuation of contingent consideration payable to Osiris on royalties from sales and on the achievement of certain pre-determined milestones.

Cash flows

The following table sets forth the significant sources and uses of cash for the periods set forth below:

Consolidated cash flow data

	Dec 2014 $'000	Dec 2013 $'000	Movement $'000
Net cash outflows in operating activities	(56,517)	(48,027)	(8,490)
Net cash outflows in investing activities	(2,891)	(21,209)	18,318
Net cash inflows by financing activities	1,134	1,657	(523)
Net (decrease)/increase in cash and cash equivalents	**(58,274)**	**(67,579)**	**9,305**

Cash flows from operating activities.

Net cash used in operating activities was $56.5 million for the six months ended 31 December 2014, compared to $48.0 million for the six months ended 31 December 2013. The change from 31 December 2013 to 31 December 2014 primarily reflects the increasing clinical development and manufacturing expenditures as we advance our late stage programs, with five Phase 3 or Phase 3 ready programs, and the acquisition of the ceMSC programs acquired from Osiris. This resulted in an increase in payments to suppliers and employees of $6.1 million to $61.1 million in the six months ended 31 December 2014 from $55.0 million in the six months ended 31 December 2013. We received $Nil from the Australian Government's Innovation Australia Research and Development Tax Incentive Program for research and development activities conducted in the six months ended 31 December 2014 compared to $4.3 million in the six months

ended 31 December 2013. Interest received also decreased by $0.5 million to $2.3 million in the six months ended 31 December 2014 from $2.8 million in the six months ended 31 December 2013 due to a decrease in the number of our term deposits maturing during the period. Income tax paid increased by $0.1 million to $0.1 million in the six months ended 31 December 2014 compared to $Nil in the six months ended 31 December 2013. We received $2.3 million of commercialization revenue in the six months ended 31 December 2014 for achievement of a substantive milestone under the JCR Agreement compared to $Nil in the six months ended 31 December 2013.

Cash flows from investing activities.

Net cash used in investing activities was $2.9 million for the six months ended 31 December 2014, compared to $21.2 million for the six months ended 31 December 2013. In the six months ended 31 December 2014, we used $1.9 million for fixed assets primarily for plant and equipment for the progression of our clinical trials and computer equipment for our expanding staff. We used $0.9 million for the payment of financial derivatives and $0.1 million for the payment of licenses and we received a repayment of loans from employees of $0.3 million. In the six months ended 31 December 2013, we used $20.1 million to pay for in-process research & development, and we paid $0.3 million for fixed assets primarily plant and equipment for the progression of our clinical trials and computer equipment. We used $0.3 million for the payment of financial derivatives and $0.8 million in rental deposits as security for the sublease agreement for our New York offices.

Cash flows from financing activities.

Net cash provided by financing activities was $1.1 million for the six months ended 31 December 2014, compared to $1.6 million for the six months ended 31 December 2013. The decrease of $0.5 million was due to a reduction in the number of options exercised.

Events Subsequent to Balance Date

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 company 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 8 of this 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.

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

Mr Brian Jamieson
Chairman

11 February 2015
Melbourne

pwc

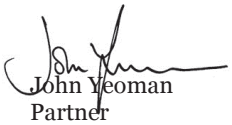
Auditor's Independence Declaration

As lead auditors for the review of Mesoblast Limited for the half-year ended 31 December 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 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.



John Yeoman
Partner
PricewaterhouseCoopers

Melbourne
11 February 2015

Jon Roberts
Partner
PricewaterhouseCoopers

Melbourne
11 February 2015

Consolidated Income Statement for the half-year ended 31 December 2014

	Note	Dec 2014 $'000	Dec 2013 $'000
Revenue from continuing operations	2(a)	12,943	13,920
Other income	2(b)	12,907	6,854
		25,850	**20,774**
Expenses from continuing operations	2(c)		
Research and development		(36,103)	(25,328)
Manufacturing commercialization		(13,232)	(13,356)
Management and administration		(16,572)	(12,942)
Finance costs		(5,422)	–
Other expenses		(5,339)	–
		(76,668)	**(51,626)**
Loss before income tax		**(50,818)**	**(30,852)**
Income tax expense		–	(7)
Loss attributable to the owners of Mesoblast Limited		**(50,818)**	**(30,859)**
Losses per share from continuing operations attributable to the ordinary equity holders of the Group:		Cents	Cents
Basic – losses per share		(16.01)	(9.72)
Diluted – losses per share		(16.01)	(9.72)

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

Consolidated Statement of Comprehensive Income for the half-year ended 31 December 2014

	Note	Dec 2014 $'000	Dec 2013 $'000
Loss for the half-year		**(50,818)**	**(30,859)**
Other comprehensive income			
Items that may be reclassified to profit and loss			
Exchange differences on translation of foreign operations		59,135	13,739
Income tax relating to these items		–	–
Other comprehensive income for the period, net of tax		**59,135**	**13,739**
Total comprehensive income/(loss) attributable to the owners of Mesoblast Limited		**8,317**	**(17,120)**

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

Consolidated Statement of Changes in Equity as at 31 December 2014

	Note	Issued capital $'000	Share option reserve $'000	Foreign currency translation reserve $'000	Retained earnings $'000	Total $'000
Balance as of 1 July 2014		**677,087**	**55,530**	**17,886**	**(178,785)**	**571,718**
Loss for the half-year		–	–	–	(50,818)	(50,818)
Other comprehensive income		–	–	59,135	–	59,135
Total comprehensive income/(loss) for the period		**–**	**–**	**59,135**	**(50,818)**	**8,317**
Transactions with owners in their capacity as owners:						
Contributions of equity net of transaction costs		1,091	–	–	–	1,091
		1,091	**–**	**–**	**–**	**1,091**
Tax effect of options deductible for tax		–	–	–	–	–
Transfer exercised options		49	(49)	–	–	–
Fair value of share-based payments		–	3,748	–	–	3,748
		49	3,699	–	–	3,748
Balance as of 31 December 2014		**678,227**	**59,229**	**77,021**	**(229,603)**	**584,874**
Balance as of 1 July 2013		**654,458**	**49,129**	**24,506**	**(97,827)**	**630,266**
Loss for the half-year		–	–	–	(30,859)	(30,859)
Other comprehensive income		–	–	13,739	–	13,739
Total comprehensive profit/(loss) for the period		**–**	**–**	**13,739**	**(30,859)**	**(17,120)**
Transactions with owners in their capacity as owners:						
Contributions of equity net of transaction costs		19,289	–	–	–	19,289
		19,289	–	–	–	19,289
Tax effect of options deductible for tax		–	–	–	–	–
Transfer exercised options		1,736	(1,736)	–	–	–
Fair value of share-based payments		–	5,321	–	–	5,321
		1,736	**3,585**	**–**	**–**	**5,321**
Balance as of 31 December 2013		**675,483**	**52,714**	**38,245**	**(128,686)**	**637,756**

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

Consolidated Balance Sheet as at 31 December 2014

	Note	Dec 2014 $'000	June 2014 $'000
Assets			
Current assets			
Cash and cash equivalents	3(a)	149,195	196,394
Trade and other receivables	3(b)	9,191	6,098
Prepayments		4,813	1,257
Total current assets		**163,199**	**203,749**
Non-current assets			
Property, plant and equipment		5,532	4,683
Other non-current assets	3	3,279	2,978
Intangible assets	5	792,570	687,904
Total non-current assets		**801,381**	**695,565**
Total assets		**964,580**	**899,314**
Liabilities			
Current liabilities			
Trade and other payables	3(c)	26,100	20,723
Deferred revenue		18,293	15,928
Derivative financial instruments		–	337
Provisions	3(d)	9,071	5,687
Total current liabilities		**53,464**	**42,675**
Non-current liabilities			
Deferred revenue		36,584	39,818
Deferred tax liability		182,134	158,585
Provisions	3(d)	107,524	86,518
Total non-current liabilities		**326,242**	**284,921**
Total liabilities		**379,706**	**327,596**
Net assets		**584,874**	**571,718**
Equity			
Issued capital	8	678,227	677,087
Reserves		136,250	73,416
Accumulated losses		(229,603)	(178,785)
Total equity		**584,874**	**571,718**

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

Consolidated Statement of Cash Flows for the half-year ended 31 December 2014

	Note	Dec 2014 $'000	Dec 2013 $'000
Cash flows from operating activities			
Milestone payment received		2,284	–
Research and development tax incentive received		1	4,304
Payments to suppliers and employees (inclusive of goods and services tax)		(61,085)	(55,109)
Interest received		2,337	2,778
Rent received		21	–
Income taxes (paid)/refunded		(75)	–
Net cash (outflows) in operating activities	6(b)	**(56,517)**	**(48,027)**
Cash flows from investing activities			
Payments for financial derivatives		(939)	(319)
Payments for business combination		–	(19,659)
Payments for licenses		(79)	(469)
Payments for rental deposits		–	(770)
Investment in fixed assets		(1,873)	(312)
Receipts from repayments of loans from employees		–	320
Net cash (outflows) in investing activities		**(2,891)**	**(21,209)**
Cash flows from financing activities			
Proceeds from issue of shares		1,134	1,678
Payments for share issue costs		–	(21)
Net cash inflows by financing activities		**1,134**	**1,657**
Net (decrease) in cash and cash equivalents		(58,274)	(67,579)
Cash and cash equivalents at beginning of year		196,394	315,309
FX gains on the translation of foreign bank accounts		11,075	2,532
Cash and cash equivalents at end of year	6(a)	**149,195**	**250,262**

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

Notes to the Consolidated Financial Statements

Mesoblast Limited (the 'Company') and its subsidiaries (the 'Group') are primarily engaged in the development of regenerative medicine products. The Company's proprietary regenerative medicine technology platform is based on specialized cells known as mesenchymal lineage adult stem cells ('MLCs').

1. Basis of preparation of half-year report

This condensed consolidated interim financial report for the half-year reporting period ended 31 December 2014 has been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*.

This condensed consolidated interim 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 2014 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.

(i) 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 July 1, 2014:

- Amendments to AASB 132 *Financial Instruments Presentation;*
- Amendments to AASB 136 *Impairment of Assets;*
- Amendments to AASB 139 *Financial Instruments Recognition and Measurement;*
- IASB, Annual Improvements to IFRSs 2010–2012 Cycle;
- IASB, Annual Improvements to IFRSs 2011–2013 Cycle; and
- AASB Interpretation 21 *Levies*.

The adoption of the above standards, amendments and interpretation did not result in changes in accounting policies nor an adjustment to the amounts recognized in the interim financial report. They also do not significantly affect the disclosures in the notes to the consolidated financial statements.

(ii) New accounting standards and interpretations

There are no AASB or AASB interpretations that are effective for the first time for the financial year beginning on or after 31 December 2014 that would be expected to have a material impact on the Group.

(iii) Accounting Standards issued but not yet effective

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2014 and 30 June 2015 reporting periods. Initial application of these Standards and Interpretations are not expected to affect any of the amounts recognized in the interim financial report and are not expected to change the disclosures presently made in relation to the Group.

2. Revenue and expenses from continuing operations

	Dec 2014 $'000	Dec 2013 $'000
(a) Revenue from continuing operations		
Commercialization revenue[1]	10,808	8,215
Interest revenue	2,135	5,705
	12,943	**13,920**
(b) Other income		
Research and development tax incentive[2]	3,489	5,795
Rental income	17	–
Foreign exchange gains	9,401	1,059
	12,907	**6,854**
(c) Expenses from continuing operations		
Clinical trial research and development	18,846	10,618
Manufacturing production and development	9,226	11,001
Employee benefits		
Salaries and employee benefits	18,446	13,700
Defined contribution superannuation expenses	256	196
Equity settled share-based payment expense transactions[3]	3,747	5,321
Total employee benefits	**22,449**	**19,217**
Depreciation and amortization of non-current assets		
Plant and equipment depreciation	798	454
Intellectual property amortization	74	54
Total depreciation and amortization of non-current assets	**872**	**508**
Other management and administration expenses		
Overheads & administration	5,917	4,276
Consultancy	3,538	2,482
Legals, patent and other professional fees	3,609	2,475
Intellectual property expenses (excluding the amount amortized above)	1,450	1,049
Total other management and administration expenses	**14,514**	**10,282**
Other expenses		
Remeasurement of contingent consideration	5,339	–
Total other expenses	**5,339**	**–**
Finance costs		
Provisions: unwinding of discount	5,422	–
Total finance costs	**5,422**	**–**
Total expenses from continuing operations	**76,668**	**51,626**

(1) 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. For the half-year ended 31 December 2014 and 31 December 2013, the Group has recognized revenue of $8,524k and $8,215k, respectively, for this payment on the basis that revenue will be earned through-out the life of the development of those products pertaining to that payment.

Additionally, for the half-year ended 31 December 2014 the Group recognized commercialization revenue of $2,284k. This revenue was recognized on achievement of a substantive milestone, being the filing for marketing approval (Japan) for ceMSC product JR-031. No further performance obligations are required of the Group in relation to this revenue.

(2) Research & development tax incentive

The Group's research and development activities are eligible under an Australian Government tax incentive for eligible expenditures from 1 July 2011. Management has assessed these activities and expenditures to determine which are likely to be eligible under the incentive scheme. At each period end management estimates the refundable tax offset available to the Group based on available information at the time. This estimate is also reviewed by external tax advisors. For the half-year ended 31 December 2014 and 31 December 2013, the Group has recognized income of $3,489k and $5,795k, respectively.

Of the $3,489k research and development tax incentive recorded in other income for the half-year ended 31 December 2014, $588k relates to a change in the original estimate of the research and development tax incentive income the Group estimated it would receive from the Australian Government for the year ended 30 June 2014.

Of the $5,795k research and development tax incentive recorded in other income for the half-year ended 31 December 2013, $4,285k relates to a change in the original estimate of the research and development tax incentive income the Group estimated it would receive from the Australian Government for the year ended 30 June 2013.

(3) Equity settled share-based payment transactions

For the half-year ended 31 December 2014 and 2013, equity settled share-based payment transactions have been reflected in the Income Statement functional expense categories as follows: research & development $1,765k and $2,511k, respectively, manufacturing commercialization $416k and $415k, respectively, and management & administration $1,566k and $2,395k, respectively.

3. 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; and
- 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
As of 31 December 2014				
Cash and cash equivalents	3(a)	–	149,195	149,195
Trade and other receivables	3(b)	–	9,191	9,191
Other non-current assets		–	3,279	3,279
			161,665	**161,665**
As of 30 June 2014				
Cash and cash equivalents	3(a)	–	196,394	196,394
Trade and other receivables	3(b)	–	6,098	6,098
Other non-current assets		–	2,978	2,978
		–	**205,470**	**205,470**

Financial liabilities:

	Notes	Liabilities at FVTPL $'000	Liabilities at amortized cost $'000	Total $'000
As of 31 December 2014				
Trade and other payables	3(c)	–	26,100	26,100
Provisions	3(d)(i)	112,580	–	112,580
		112,580	**26,100**	**138,680**
As of 30 June 2014				
Trade and other payables	3(c)	–	20,723	20,723
Provisions	3(d)(i)	86,249	–	86,249
Derivative financial instruments		337	–	337
		86,586	**20,723**	**107,309**

The Group's exposure to various key risks associated with the financial instruments is discussed in Note 3. 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.

Notes to the Consolidated Financial Statements

(a) Cash and cash equivalents

	Dec 2014 $'000	June 2014 $'000
Cash at bank	11,433	3,827
Deposits at call[1]	137,762	192,567
	149,195	**196,394**

(1) As of 31 December 2014 and 30 June 2014, deposits at call include an amount of $6,100k and $6,100k, respectively, held as security against future foreign exchange 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.

(ii) Interest rate risk

The deposits held which derive interest revenue are described in the table below, together with the maximum and minimum interest rates being earned as of 31 December 2014 and 30 June 2014.

	Dec 2014			June 2014		
	Interest rate – low	Interest rate – high	$'000	Interest rate – low	Interest rate – high	$'000
Funds invested – AUD	3.40%	3.57%	76,191	3.41%	3.60%	107,540
Funds invested – USD	0.15%	0.76%	50,500	0.04%	0.27%	81,000

The Group's policy is to invest its cash in A-1+ short-term rated (or better) institutions and products.

(iii) 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 Mesoblast Limited (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 U.S. dollars and Singapore dollars ('SGD'), as well as some smaller amounts in various other currencies. 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 engages professional advice when considering forward foreign exchange contracts.

(b) Trade and other receivables

	Dec 2014 $'000	June 2014 $'000
Other receivables	–	405
Interest receivables	94	296
Sundry debtors	161	11
Income tax and tax incentives recoverable	8,754	5,254
Other recoverable taxes (good and services tax and value-added tax)	182	132
	9,191	**6,098**

(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 as of 31 December 2014 and 30 June 2014.

(ii) Other receivables

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

Notes to the Consolidated Financial Statements

(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 3(a).

(c) Trade and other payables

	Dec 2014 $'000	June 2014 $'000
Trade payables and other payables	26,100	20,723
	26,100	**20,723**

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

(d) Provisions

	Dec 2014			June 2014		
	Current $'000	Non-current $'000	Total $'000	Current $'000	Non-current $'000	Total $'000
Other	–	–	–	796	–	796
Employee benefits	3,757	258	4,015	4,891	269	5,160
Contingent consideration	5,314	107,266	112,580	–	86,249	86,249
	9,071	**107,524**	**116,595**	**5,687**	**86,518**	**92,205**

(i) Movements

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

	Note	Contingent consideration $'000	Other $'000	Total $'000
Carrying amount at start of year – 1 July 2013		–	9,266	9,266
Initial recognition on business combination	7(b)	81,660	–	81,660
Amounts used during the year		–	(5,922)	(5,922)
Charged/(credited) to consolidated income statement				
– Unwinding of discount[1]	4(a)(iii)	4,329	–	4,329
– Unused amounts reversed		–	(2,524)	(2,524)
Foreign exchange difference		260	(24)	236
Carrying amount as of 30 June 2014		86,249	796	87,045
Carrying amount at start of period – 1 July 2014		86,249	796	87,045
Amounts used during the year		–	(914)	(914)
Allocated to goodwill				
– Remeasurement[2][3]	5	2,331	–	2,331
Charged/(credited) to consolidated income statement				
– Unwinding of discount[1]	4(a)(iii)	5,422	–	5,422
– Remeasurement[3]		5,339	–	5,339
Foreign exchange difference		13,239	118	13,357
Carrying amount as of 31 December 2014		112,580	–	112,580

(1) 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.

(2) $2,331k out of period adjustment to goodwill was recognized on finalization of the ceMSC business combination of Osiris.

(3) The total amount of remeasurement of contingent consideration pertaining to the acquired ceMSC assets of Osiris was $7,620k.

4. Fair value measurement of financial instruments

(a) 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 as of 31 December 2014 and 30 June 2014 on a recurring basis, categorized by level according to the significance of the inputs used in making the measurements:

As of 31 December 2014:

Financial liabilities	Note	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Financial liabilities at fair value through profit or loss					
Provisions	3(d)	–	–	112,580	112,580
Total financial liabilities		–	–	112,580	112,580

As of 30 June 2014:

Financial liabilities	Note	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Financial liabilities at fair value through profit or loss					
Derivative financial instruments		–	337	–	337
Provisions	3(d)	–	–	86,249	86,249
Total financial liabilities		–	337	86,249	86,586

There were no transfers between any of the levels 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.

Notes to the Consolidated Financial Statements

(iii) Fair value measurements using significant unobservable inputs (level 3)

The following table presents the changes in level 3 instruments for the half-year ended 31 December 2014 and the year ended 30 June 2014:

	Note	Contingent consideration $'000	Total $'000
Opening balance – 30 June 2013		–	–
Initial recognition	7(b)	81,660	81,660
Charged/(credited) to consolidated income statement			
– Unwinding of discount[1]		4,329	4,329
Exchange difference		260	260
Closing balance – 30 June 2014		86,249	86,249
Opening balance – 30 June 2014		86,249	86,249
Allocated to goodwill			
– Remeasurement[2]		2,331	2,331
Charged/(credited) to consolidated income statement			
– Unwinding of discount[1]		5,422	5,422
– Remeasurement		5,339	5,339
Exchange difference		13,239	13,239
Closing balance – 31 December 2014		112,580	112,580

(1) 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.

(2) $2,331k out of period adjustment to goodwill was recognized on finalization of the ceMSC business combination of Osiris.

(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 as of 31 December 2014 $'000	Valuation technique	Unobservable inputs[1]	Range of inputs (weighted average)	Relationship of unobservable inputs to fair value
Contingent consideration provision	112,580	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 8%

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

(v) Valuation processes

In relation to the contingent consideration recognized in connection with the acquisition of ceMSC assets of Osiris on 11 October, 2013 (the acquisition date), an independent valuation was carried out by an independent valuer as at the date of acquisition.

Since that time the Group has adopted a process to value contingent consideration internally. This valuation has been completed by the Group's internal valuation team and reviewed by the Chief Financial Officer (CFO). The valuation team is responsible for the valuation model. The valuation team also manages a process to continually refine the key assumptions within the model, this is done with input from the relevant business unit. The key assumptions in the model have been clearly defined and the responsibility for refining those assumptions has been assigned to the most relevant business unit(s).

For the six months ended 31 December 2014, the remeasurement charged to the consolidated income statement was a result of changes to key assumptions such as market population, market penetration, product pricing and developmental timelines.

The fair value of contingent consideration

	At 31 December 2014 $'000
Fair value of cash or stock payable, dependent on achievement of future late-stage clinical or regulatory targets	34,408
Fair value of royalty payments from commercialization of the intellectual property acquired	78,172
	112,580

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

Risk adjusted discount rate: The discount rate used in the valuation has been determined based on required rates of returns of listed companies in the biotechnology industry (having regards to their stage of development, their size and number of projects) and the indicative rates of return required by suppliers of venture capital for investments with similar technical and commercial risks.

Expected unit revenues: Expected market sale price based on an independent expert's review of the most comparable products currently available in the market place.

5. Intangible assets

	Goodwill $'000	Acquired licenses to patents $'000	In-process research & development acquired $'000	Total $'000
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
As of 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
Half-year ended 31 December 2014:				
Opening net book value	140,517	2,061	545,326	687,904
Additions[1]	2,331	78	–	2,409
Exchange differences	21,080	271	80,980	102,331
Amortization charge	–	(74)	–	(74)
Impairment charge	–	–	–	–
Closing net book value	163,928	2,336	626,306	792,570
As of 31 December 2014:				
Cost	163,928	3,047	626,306	793,281
Accumulated amortization	–	(711)	–	(711)
Accumulated impairment	–	–	–	–
Net book amount	163,928	2,336	626,306	792,570

(1) An immaterial out of period adjustment to goodwill was recognized on finalization of the ceMSC business combination of Osiris.

6. Cash flow information

(a) Reconciliation of cash and cash equivalents

	Dec 2014 $'000	Dec 2013 $'000
Cash at bank	11,433	11,849
Deposit at call	137,762	238,413
	149,195	**250,262**

(b) Reconciliation of net cash flows used in operations with loss after income tax

Loss for the period	(50,818)	(30,859)
Add/(deduct) net loss items as follows:		
Commercialization revenue	(8,524)	(8,215)
Depreciation and amortization	872	508
Foreign exchange gains	(9,596)	(1,527)
Finance costs	5,422	–
Remeasurement of contingent consideration	5,339	–
Equity settled share-based payment	3,747	5,321
Change in operating assets and liabilities:		
Decrease/(increase) in trade and other receivables	76	(3,213)
(Increase) in prepayments	(3,447)	(87)
(Increase) in tax assets	(3,488)	(1,578)
Increase/(decrease) in trade creditors and accruals	5,870	(10,044)
(Decrease)/increase in provisions	(1,970)	1,667
Net cash outflows used in operations	**(56,517)**	**(48,027)**

7. Business combination

(a) Summary of acquisition

On 11 October 2013, the Group acquired the culture-expanded mesenchymal stem cells business of Osiris.

The acquisition is complementary in its nature with many commercial and strategic benefits. The potential benefits derived from acquiring the approved and late-stage mesenchymal stem cells 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 products;
- ownership of extensive long-term clinical data from over 1,500 patients treated with culture-expanded mesenchymal stem cells, including safety, efficacy and repeat dosing data; and
- acquisition of new intellectual property which is highly complementary to the Group'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 Osiris acquisition date (11 October 2013) $'000
Cash on closing	21,196
Cash payment made on the six month anniversary of the agreement (Fair Value)[1]	15,610
Securities allotment (2,948,729 shares were allotted)[2]	15,873
Contingent consideration[3] (Note 3(d)(i))	81,660
Total purchase consideration	**134,339**

Net assets acquired at fair value

	Fair value at Osiris acquisition date (11 October 2013) $'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**

(1) The cash payment due on the six-month anniversary of the agreement of $15,610k has a USD denominated value of USD 15,000k.

(2) The Company's securities were issued as consideration upon the transfer of assets on 18 December 2013, which had a value of $16,717k on that date.

(3) At acquisition date contingent consideration of $81,660k was recorded as tabled above. Please refer to Note 3(d)(i) for the reconciliation of the subsequent movements of this contingent consideration provision.

The fair value amounts reported above are final.

All assets acquired and purchase consideration amounts are denominated in U.S. dollars. The amounts presented above are in Australian dollars and have been translated at the rate applicable at the acquisition date (11 October 2013) being AUD 1: USD 0.9450. 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 tax base of the asset assumes that the asset is held for use and is therefore $Nil resulting in a deferred tax liability calculated at the tax rate of the jurisdiction where the underlying intangible assets are held.

Refer also to Note 5 for an adjustment relating to goodwill.

(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 Osiris acquisition date (11 October 2013) $'000
Fair value of cash or stock payable, dependent on achievement of future late-stage clinical or regulatory targets[1]	24,507
Fair value of royalty payments from commercialization of the intellectual property acquired[2]	57,153
	81,660

(1) 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 Limited securities 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 USD Nil and a maximum of USD 50,000k.

(2) 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

	Dec 2014 $'000	Dec 2013 $'000
Cash consideration (fair value) owed pursuant to the asset purchase agreement	–	36,806
less: amount paid during the full year ended	–	(1,537)
less: balance owing six months after acquisition date (fair value)	–	(15,610)
Cash outflow reported for the year ended[1]	**–**	**19,659**

(1) Included within cash flows from investing activities within the statement of cash flows.

(d) Revenue and profit contribution

The acquired business contributed revenues of $Nil and net loss of $5,951k 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 $83,298k, respectively. These amounts have been calculated using the Osiris audited financial statements segment information. This has been calculated based on expenditure incurred with external providers to develop programs acquired from Osiris. There were no allocations of internal labour or other internal cost bases.

(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.

8. Issued capital

	Dec 2014 Shares	Dec 2013 Shares	Dec 2014 $'000	Dec 2013 $'000
Opening balance 1 July	**321,640,094**	**316,468,901**	**677,087**	**654,458**
Issues of ordinary shares during the half-year				
Consideration for acquired licenses to patents	–	70,164	–	418
Consideration for in-process research & development acquired	–	2,948,729	–	16,717
Placement of shares under LFSP[1]	1,850,000	1,165,000	–	–
Exercise of share options[2]	710,935	851,000	1,091	2,154
	2,560,935	5,034,893	1,091	19,289
Share options reserve transferred to equity on exercise of options	–	–	49	1,736
Ending balance 31 December	**324,201,029**	**321,503,794**	**678,227**	**675,483**

(1) Shares are issued to employees and consultants in accordance with the Mesoblast Australian Loan Funded Share Plan ('LFSP'). 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.

(2) Options have been issued to employees, directors and consultants in accordance with the Mesoblast Employee Share Option Plan ('ESOP'). The shares issued and share capital received on the exercise of options are recorded above.

9. Events occurring after the reporting period

There are no events that have occurred after 31December 2014 and prior to the signing of this financial report that would likely have a material impact on the financial results presented.

Directors' Declaration

In accordance with a resolution of directors of Mesoblast Group,

In the opinion of the directors:

(a) the financial statements and notes set out on pages 9 to 26 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 31 December 2014 and of its performance for the half-year ended on that date, and

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

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

Mr Brian Jamieson
Chairman

11 February 2015
Melbourne

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 (the Company), which comprises the consolidated balance sheet as at 31 December 2014, the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the half-year ended on that date, selected explanatory notes and the directors' declaration for Mesoblast Limited Group (the consolidated entity). The consolidated entity comprises 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 internal 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 Australian Auditing Standard on Review Engagements ASRE 2410 *Review of a 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 2014 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. 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.

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 2014 and of its performance for the half-year ended on that date;

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

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

PricewaterhouseCoopers

John Yeoman
Partner

Melbourne
11 February 2015

Jon Roberts
Partner

Melbourne
11 February 2015