PolyNovo

Annual Report
2016

Contents

PolyNovo is a Melbourne-based medical device company that designs, develops and manufactures solutions for standalone and combination devices using its NovoSorb™ biodegradable polymer technology.

PolyNovo's current focus is on the development and commercialisation of innovative medical devices using its NovoSorb™ technology in the treatment of burns, surgical wounds and Negative Pressure Wound Therapy.

Chairman and Chief Executive Officer's Report

> "Apart from building the business and our clinical data, the focus over the second half of the year was on the commercialisation of NovoSorb™ BTM by prioritising entry into the US, South Africa and New Zealand markets."

Dear Shareholder,

The year past has been one of building a team and a business to take our technology to the world.

We significantly expanded the resources within the Company with additional staff in regulatory, finance, clinical and business development. We expect further hires to be made in the near future to build a first class team. We also added a new Board Director, Mr. Leon Hoare ex Smith&Nephew.

Our corporate structure was consolidated with the acquisition of the minority interests in NovoSkin™/ NovoWound™. This provides PolyNovo with full control of the entities and flexibility to negotiate commercial agreements. The roll-up made Professor Greenwood and Mr Burton significant shareholders in PolyNovo and more closely aligns their contribution to developing our technology.

To fund this, we raised $8.47m from institutional investors and a further $4.37m from a Share Purchase Plan. This broadened the shareholder base and improved the liquidity of the shares. Our share price over the year has gone from 9 cents to 28 cents.

Obtaining US FDA 510(k) approval for the use of NovoSorb™ BTM in surgical wounds now enables sales into the US and several other markets. We expect to announce our market entry strategy for the US before the AGM.

The Royal Adelaide Hospital (RAH) initial patient trial concluded. This trial provided valuable data which informs clinical applications of the BTM and enabled us to establish a new and larger clinical trial. Post the RAH trial, Professor John Greenwood and Dr Marcus Wagstaff continue to use the BTM under the TGA Prescribers Exemption Scheme. Dr Wagstaff from RAH was appointed PolyNovo's Clinical Director advising on the CE and BARDA trial programs.

The CE Mark trials have been slow to recruit patients, but we have accelerated patient recruitment by modifying the Protocol. We are also in the process of enrolling three additional Australian sites. This will accelerate our recruitment and we expect completing patient enrolment by January 2017.

Our BARDA funded feasibility trial has formally commenced now the US FDA has approved the Protocol. Patient recruitment will begin in August 2016. The feasibility trial is anticipated to conclude before June 2017. Concurrent with this trial, BARDA exercised their option to award PolyNovo a non-clinical trial contract to investigate the full bio-reabsorption of the polymer. The data from this study will add considerable weight to our safety and toxicity data for further regulatory submissions.

Apart from building the business and our clinical data, the focus over the second half of the year was on the commercialisation of NovoSorb™ BTM by prioritising entry into the US, South Africa and New Zealand markets. We had a strong presence at the American Burn Association meeting and received enthusiastic interest from surgeons and distributors, from the US and many other countries. We are currently in the process of detailing our US market entry plan and expect to announce this before the AGM.

Our divestment of Metabolic to Lateral Pharma Pty Ltd required Lateral to invest $1m in the development of the compound. We are pleased to inform shareholders that Lateral has met the investment requirement. The sale preserved some upside for us if Lateral is successful.

At the same time, we have pursued the development of new products for Hernia and Breast reconstructions. These products have reached the early prototype stage. Development of these products will continue and will include engagement with key opinion leaders to refine the final products. Regulatory and commercialisation phases of these products are scheduled to commence in 2017.

David Williams
Chairman

Paul Brennan
Chief Executive Officer

The Directors of PolyNovo Limited (PolyNovo) present the Directors' Report, together with the Financial Report, of the Company and its controlled entities (the Group) for the year ended 30 June 2016 and the related Auditor's Report.

Board of Directors and Senior Management

The details of Directors and Senior Management during the year and until the date of this report are set out below. Directors were in office for the entire period unless otherwise stated.

Mr David Williams

B.Ec (Hons), M.Ec, FAICD

Non-executive Chairman

Mr Williams was appointed as a Non-executive Director on 28 February 2014 and Chairman on 13 March 2014. Mr Williams is an experienced Director and investment banker with a proven track record in business development and strategy, as well as in corporate initiatives specialising in mergers and acquisitions and capital raising. He possesses 30 years' experience working with and advising ASX-listed companies in the food, medical device and pharmaceutical sectors. Mr Williams was previously the Managing Director of Challenger Corporate Finance, Head of Mergers & Acquisitions – Melbourne, Société Générale Hambros, Head of Mergers & Acquisitions at ANZ McCaughan, and Australian Head of Mergers & Acquisitions Arthur Andersen & Co. He has been Chairman of Tassal Group Ltd and Austin Group Ltd and held numerous other Directorships including with Amcal Ltd and Select Harvests Ltd. Mr Williams is currently Chairman of ASX-listed Medical Developments International Ltd (ASX: MVP), and is Managing Director of corporate advisory firm Kidder Williams Ltd. Mr Williams resigned as Non-executive Director of IDT (ASX: IDT) on 19 May 2015.

Dr David McQuillan

PhD

Non-executive Director

Dr McQuillan was appointed a Director of PolyNovo on 6 August 2012. He has extensive technical, medical, scientific and regulatory knowledge, as well as merger and acquisition expertise. Dr McQuillan was with LifeCell Inc/Kinetic Concepts Inc (KCI) for 12 years, holding a number of senior roles, including Vice President for Research and Development at LifeCell and Senior Vice President of Advanced Research and Technology at KCI. He was Chief Science Officer for TELA Bio, a VC-funded development-stage biotechnology company from 2013 to 2015.

Mr Bruce Rathie

BComm, LLB, MBA, FAIM, FAICD

Non-executive Director

Mr Rathie is an experienced Company Director and lawyer. He practised as a partner in a large legal firm and acted as Senior In-house Counsel to Bell Resources Limited from 1980 to 1985. He studied for his MBA in Geneva and embarked on his investment banking career in 1986. He was Head of the Industrial Franchise Group at Salomon Smith Barney in the late 1990s and led Salomon's roles in the Federal Government's privatisation of Qantas, Commonwealth Bank (CBA3) and Telstra (T1). He has over 15 years' experience as a professional Non-executive Company Director. He is currently Chairman of DataDot Technology Limited (ASX: DDT), Vice Chairman of Capricorn Society Limited and Chairman of Capricorn Mutual Limited. In the medical device space, he was previously Chairman of Anteo Diagnostics Limited and a Director of Compumedics Limited and USCOM Limited. He has been a Non-executive Director of PolyNovo since February 2010.

Mr Max Johnston

Non-executive Director

Mr Johnston was appointed a Director of PolyNovo on 13 May 2014. Mr Johnston held the position of President and Chief Executive Officer of Johnson & Johnson Pacific, a division of the world's largest medical, pharmaceutical and consumer healthcare company for 11 years. Prior to joining Johnson & Johnson, Mr Johnston's career also included senior roles with Diageo and Unilever in Europe. Mr Johnston has also held several prominent industry roles as a past President of ACCORD Australasia Limited, a former Vice Chairman of the Australian Food and Grocery Council and a former member of the board of ASMI. Mr Johnston has had extensive overseas experience during his career in leading businesses in both Western and Central-Eastern Europe and Africa as well as the Asia-Pacific region. Mr Johnston is currently a Non-executive Director of Medical Developments International Ltd (ASX: MVP) and Enero Group Limited (ASX: EGG), and Non-executive Chairman of Probiotec Ltd (ASX: PBP).

Mr Philip Powell

BComm (Hons), ACA, F.Fin, MAICD

Non-executive Director

Mr Powell was appointed a Director of PolyNovo on 13 May 2014 and was Acting Managing Director from 15 July 2014 to 13 February 2015. Mr Powell has many years' experience in investment banking specialising in capital raisings, Initial Public Offerings (IPOs), mergers and acquisitions and other successful corporate finance assignments across a diverse range of sectors including utilities, IT, pharma, financial services, food and agriculture. He spent 10 years in senior financial roles at OAMPS Ltd, a former ASX-listed financial services group, and 10 years in audit with Arthur Andersen & Co in Melbourne, Sydney and Los Angeles. Mr Powell is currently a Non-executive Director of Medical Developments International Ltd (ASX: MVP).

Mr Leon Hoare

Non-executive Director

Mr Hoare was appointed a Director of PolyNovo on 27 January 2016. Mr Hoare is also Managing Director of Lohmann & Rauscher (Australia and New Zealand), a privately owned, multinational medical device company. Previously Mr Hoare was Managing Director of Smith & Nephew (Aus/NZ) until the end of 2015, one of Smith & Nephew's largest global subsidiaries outside the US. He served as President of Smith & Nephew's Asia-Pacific Advanced Wound Management (AWM) business for five years and was a member of the Global Executive Management for the AWM Division. In his 24 years with Smith & Nephew, he also held roles in marketing, divisional and general management. Mr Hoare's career also includes a senior role at Bristol-Myers Squibb in surgical products, and Vice Chair of Australia's peak medical device body, Medical Technology Association of Australia. Mr Hoare is currently a Non-executive Director of Medical Developments International Ltd (ASX: MVP).

Mr Paul Brennan

MBA, BSc (Nursing) RN, RM

Chief Executive Officer

Mr Brennan was appointed Chief Executive Officer (CEO) of PolyNovo Ltd on 13 February 2015. Mr Brennan has extensive knowledge, exposure and understanding of the health system through his clinical background and commercial exposure with various multinational companies. He has co-ordinated the marketing, global strategy development, new product development and regulatory processes for the Asia-Pacific region for industry-leading organisations in relation to medical products and devices. Mr Brennan has an intimate knowledge of the manufacturing and production processes. Previously he was Marketing Director Australia and New Zealand and Sales Director New Zealand for Smith & Nephew Healthcare from 2008 to his commencement with PolyNovo in February 2015. Mr Brennan holds a MBA from Swinburne University, a Bachelor of Science (Nursing) from the University of New England in NSW, Certificate in Midwifery Central Coast Area Health Service NSW, and General Nursing certificate from St Vincent's Hospital Darlinghurst NSW.

Ms Andrea Goldie

CPA ACA CTA GIA (Cert)

CFO and Company Secretary

Ms Goldie was appointed as Chief Financial Officer (CFO) and Company Secretary on 28 October 2015. Ms Goldie has over 14 year's corporate governance experience with multinational companies within the pharmaceutical and healthcare industries. Her areas of expertise include financial accounting, statutory reporting, auditing, tax compliance, management reporting and corporate governance. These skills have been applied across a number of geographic regions including Europe, the Middle East, Africa, the Asia-Pacific region and North America. Ms Goldie is a Chartered Accountant, a Chartered Tax Adviser and a certificated member of the Governance Institute Australia. Ms Goldie holds a Bachelor of Economics (Accounting) and an MBA (Finance).

Corporate and Organisational Structure

PolyNovo Limited, the ultimate parent entity of the PolyNovo Group, is a public company listed on the Australian Securities Exchange. As at 30 June 2016, PolyNovo Limited had three wholly owned subsidiaries: PolyNovo Biomaterials Pty Limited, NovoSkin Pty Ltd and NovoWound Pty Ltd. All three subsidiary companies are Australian proprietary companies.

Subsidiaries: acquisition of non-controlling interests

On 24 November 2015, the Company entered into an agreement with the owners of the 20% non-controlling interests in PolyNovo's subsidiary companies, NovoSkin Pty Ltd and NovoWound Pty Ltd, to acquire those interests. The acquisition received shareholder approval at the 2015 AGM and the acquisition was completed on 22 December 2015. The advantages of the acquisition were significant and included:

- gaining full control over marketing of the BTM and other NovoPore™ products;
- entitlement to 100% of all revenues;
- meeting the requirements of BARDA and other parties, that wish to deal with the head company;
- simplifying the corporate and reporting structure; and
- improving the ability to utilise tax losses from trials and product development.

Capital injection

During the period, the Company raised capital to fund its ongoing and future operations. On 28 November 2015, $8,474,816 was raised from private placement to sophisticated investors and institutions, and on 23 December 2015 $4,373,000 was raised via the Company's Share Purchase Plan (SPP) offer. Funds raised have been used and will be used to:

- fund a 22 patient trial for full thickness burns at The Alfred Hospital in Melbourne and at St Anne Hospital in Toulon, France. Successful completion of this trial will help PolyNovo to achieve CE Mark certification in Europe, South East Asia, Australia and New Zealand, and to sell in these markets;
- support activities for trials for full thickness burns in the US. These activities may include manufacturing scale-up and any required consulting expenses not covered by our BARDA funding;
- increase the depth and breadth of the organisational structure. Staff numbers and costs will increase as PolyNovo progresses towards commercialisation and increases development of product outside the BTM;
- settle the cash component for the purchase of the non-controlling interest shareholders in NovoSkin™ and NovoWound™;
- meet regulatory requirements, such as the filing of the CE Mark in Europe, Australia, South East Asia, and scope possible filing of regulatory submissions in new regions such as South Africa, UAE, Indonesia, New Zealand and India;
- meet the cost of accelerating the progress of products and associated trials in respect to pelvic floor repair and hernia and breast reconstruction; and
- satisfy general working capital requirements.

Principal Activities and Operations

PolyNovo's principal activity is the development of innovative medical devices for a number of medical applications, utilising the patented biodegradable polymer technology NovoSorb™.

NovoSorb™ is a family of proprietary medical grade polymers that can be utilised to manufacture novel medical devices designed to support tissue repair and which then degrade in a defined fashion in-situ to harmless by-products. NovoSorb™ has significant advantages over competitor biodegradable polymers in terms of its design flexibility. PolyNovo is able to manufacture NovoSorb™ polymer devices with a range of mechanical properties and flexible degradation times from months to years that are suitable for many different medical applications.

Key attributes of the NovoSorb™ technology include an unparalleled range of mechanical properties and degradation times, excellent biocompatibility and safety profile and harmless degradation. The technology can be utilised as a foam, coating or a thermoplastic structure, with the potential to deliver drugs, biological agents, antimicrobials and cells. In addition, the technology is scalable in terms of manufacturing and processing.

A summary of PolyNovo's lead projects is set out below:

BTM surgical wounds

NovoSorb™ BTM is used in a fully debrided clean surgical wound to physiologically 'close the wound". With the BTM scaffold in place, the dermal layer is regenerated within the scaffold. Once fully integrated, the outer layer is delaminated and the wound closes through secondary intention (smaller wounds) or through application of a split skin graft. The BTM has been demonstrated in human use for closure of free flap deficits and full thickness burns. Several publications relating to these applications can be found on our website: www.polynovo.com.au.

In December 2015, our polymer was awarded US FDA 510(k) approval for use in surgical wound repair. This opens the North American market to PolyNovo for commercial sales.

PolyNovo now seeks to commercialise NovoSorb™ through different channels including:

- direct market entry where the investment and return are attractive;
- licensing with specialist external distributors;
- partnering with groups that have complementary skills and expertise; and
- entering into joint ventures to develop products internally.

PolyNovo is in the process of gaining commercial entry to markets in the US, New Zealand and South Africa. Other geographic markets will follow as the Group establishes distribution agreements or its own sales teams.

Key attributes of the NovoSorb™ technology include an unparalleled range of mechanical properties and degradation times, excellent biocompatibility and safety profile and harmless degradation. The technology can be utilised as a foam, coating or a thermoplastic structure, with the potential to deliver drugs, biological agents, antimicrobials and cells.

BTM for full thickness burns

This BTM is an innovative treatment for full thickness burns as distinct from surgical wounds.

The pathway for US regulatory approval of the BTM requires extensive clinical trials to support a Premarket Approval (PMA) application. An outline of the clinical trial process in set out below.

BARDA

Our BARDA contract, funded by the US Department of Health and Human Services (Office of the Assistant Secretary for Preparedness and Response), commenced on 28 September 2015. This is a non-dilutive contract that supports a projected five-year clinical pathway, which will lead to a PMA application with the US FDA and the use of our polymer in full thickness acute burns. The contract is a cost-plus-fixed-fee contract and it will progress in specific stages that cover the base work and two optional segments. The total cost is US$28m, through to July 2021.

The first of the trials is a feasibility trial, currently in progress, and the first patients are expected to enrol in September/October 2016. In addition, PolyNovo announced on 31 May 2016 that BARDA is funding a concurrent swine study looking at mapping the full degradation pathway of the BTM. This will provide valuable data to support our PMA application.

Principal Activities and Operations continued

CE Mark certification

PolyNovo is also conducting CE Mark clinical trials in burns. The sites are St Anne's Hospital, Toulon (France) and The Alfred Hospital, Melbourne (Australia). The recruitment of patients has been slower than anticipated. To accelerate recruitment we have expanded the inclusion criteria from patients with burns to 20–50% of total body surface area (TBSA) to 10–70% TBSA. The Company is adding further Australian sites to the program.

Professor John Greenwood has completed a five patient BTM burn trial at the Royal Adelaide Hospital. The clinical outcomes of these five patients have been outstanding and there are several related publications available on our website, including an online peer review journal, *ePlasty*. The information gained in this trial has informed our current clinical program. Publication of the results will occur after October 2016 which will mark 12 months post BTM implementation on the last patient.

Hernia repair and breast sling development

PolyNovo has developed a new fabric utilising our patented polymer. This will form the basis of the prototypes that will be assessed by key opinion leaders in the field of application. We anticipate moving to laboratory testing in the coming months followed by non-clinical assessment. Our goal is to have these products ready for US FDA 510(k) submission by 2018.

Topical Negative Pressure Wound Therapy (tNPWT)

tNPWT is the application of a wound interface under suction from a mechanical pump. This creates a negative pressure, thereby exerting positive pressure on the wound to stimulate angiogenesis while evacuating excess wound exudate. This process encourages new tissue growth and increases blood supply while providing a mechanical means of contracting the wound. PolyNovo has developed NovoPore™ foam, which can act as the wound/pump interface. The market opportunity is as a component supplier of foam to a tNPWT distributor within its wound kits. PolyNovo views access to this market segment as largely opportunistic.

Bone void filler

Whilst PolyNovo has an agreement with Smith & Nephew for the use of the bone void filler in orthopaedic applications, this has not progressed in the past year. Smith & Nephew remains interested in developing the product within the orthopaedic applications and PolyNovo will pursue advancement of this licence.

Other

The range of applications for our polymer technology is considerable; however, we are focused on commercialisation of the applications outlined above in the near term.

Metabolic

On 30 May 2015, PolyNovo completed the sale of Metabolic Pharmaceuticals Pty Ltd to Lateral Pharma Pty Ltd. Terms of the sale included that Lateral Pharma must subsequently meet certain obligations within an agreed timeframe. Lateral Pharma has met these obligations. PolyNovo retains its right to a percentage of Metabolic's future licensing revenues and royalties which may be converted to equity in the event of a future IPO of Metabolic; or, alternatively a share of the proceeds from any sale of the Metabolic business.

Capital investment

PolyNovo completed validation of the expanded cleanroom factory and invested in equipment in the 2016 financial year. This means that production can be scaled up as demand increases and further automation of the process is possible over time.

Significant Changes in the State of Affairs

Except as otherwise set out in this report, the Directors are unaware of any significant changes in the state of affairs or principal activities of PolyNovo during the year ended 30 June 2016.

Strategic Overview and Likely Developments

PolyNovo's focus over the next 12 months will be to:

- finalise details of our US market entry plan that we expect to announce before the AGM;
- finalise commercial partnerships for the BTM product in markets where the US FDA 510(k) is recognised, such as New Zealand, South Africa, United Arab Emirates (UAE), the Middle East, Hong Kong and India;
- continue the CE Mark trial being conducted at The Alfred Hospital and St Anne Hospital in Toulon (France);
- pursue a commercial supply arrangement for NovoPore™ in the tNPWT market;
- develop advanced hernia prototypes for non-clinical and clinical trials;
- develop advanced breast sling prototypes for non-clinical and clinical trials;
- continue our bone void filler agreement with Smith & Nephew towards a commercial application;
- pursue strategies for the expansion of applications or development of other new fields of NovoSorb™; and
- continue the BARDA trial and progress to pivotal period.

Significant Events After the Balance Date

The Directors are not aware of any other matters or circumstances since the end of the financial year other than those described above, nor otherwise dealt with in this report, which have significantly affected, or may significantly affect, the operations of the Group, the results of those operations or the state of affairs of the Group in subsequent financial years.

Financial Results

PolyNovo reported a net loss after tax of $3,355,594 for the 2016 financial year, compared to the prior year loss of $1,414,321. This represents an increased loss of $1,941,273. A number of factors contributed to the increased loss in 2016 as follows:

- The result for the 2015 financial year includes non-recurring income of $1.5m in relation to the sale of a subsidiary.
- Research and development (R&D) and corporate, administrative and overhead expenses increased by $1,659,887 and $1,140,900 respectively in 2016. The increases are predominantly attributable to the Company's BARDA activities, R&D activities and growth in headcount.

- Revenue earned from the Company's contract with BARDA commenced in September 2015. A total of $3,274,927 was recognised as BARDA revenue for the 2016 financial year.
- Interest income increased in 2016 as a result of increased levels of cash, following the capital raisings in November and December 2015.
- Employee-related expenses have increased by 45% year on year. Headcount has increased from 8 to 15 full time employees during the year in order to meet the resource requirements of the BARDA contract and to prepare for commercial manufacturing and sales of the FDA-approved BTM surgical wound product.

R&D tax incentives

During the 2016 financial year, the Company submitted an application for the Research and Development Tax Incentive scheme managed by AusIndustry and the Australian Taxation Office (ATO). In October 2015, the Company applied to claim eligible 2015 R&D expenditure and in November 2015 received a 45% refundable tax offset of $885,180 (cash). PolyNovo is now in the process of preparing its application for submission to claim eligible expenditure for 2016 R&D activities, as disclosed in the notes to the financial statements.

PolyNovo's share price was $0.09 as at 1 July 2015 and $0.28 as at 30 June 2016.

Loss Per Share

In Australian dollars $	Cents
Basic loss per share	(0.62)
Diluted loss per share	(0.62)

As the Group made a loss for the year ended 30 June 2016, potential ordinary shares, being options or performance rights to acquire ordinary shares, are considered non-dilutive and therefore not included in the diluted earnings per share calculation.

Dividends

No amounts have been recommended by the Directors to be paid by way of dividends during the current financial year. No cash dividends have been paid or declared by PolyNovo since the beginning of the financial year.

Indemnification and Insurance of Directors and Officers

During the year ended 30 June 2016, the Company indemnified its Directors, Company Secretary and Executive Officers in respect of any acts or omissions giving rise to a liability to another person (other than the Company or a related party) unless the liability arose out of conduct involving a lack of good faith. In addition, the Company indemnified the Directors and the Company Secretary against any liability incurred by them in their capacity as Directors or Company Secretary in successfully defending civil or criminal proceedings in relation to the Company. No monetary restriction was placed on this indemnity.

The Company has insured its Directors, Company Secretary and Executive Officers for the period under review. Under the Company's Directors' and Officers' Liability Insurance Policy, the Company shall not release to any third party or otherwise publish details of the nature of the liabilities insured by the policy or the amount of the premium. Accordingly, the Company relies on section 300(9) of the *Corporations Act 2001* to exempt it from the requirement to disclose the nature of the liability insured against and the premium amount of the relevant policy.

Inherent Risks of Investment in Biotechnology Companies

There are many inherent risks associated with the development of pharmaceutical and medical products to a marketable stage. The clinical trial process is designed to assess the safety and efficacy of a drug or medical device prior to commercialisation and a significant proportion of drugs and medical devices fail one or both of these criteria. Other risks include uncertainty of patent protection and proprietary rights, whether patent applications and issued patents will offer adequate protection to enable product development, the obtaining of necessary regulatory authority approvals and difficulties caused by the rapid advancements in technology.

Companies such as PolyNovo are dependent on the success of their research projects and their ability to attract funding to support these activities. Investment in research and development projects cannot be assessed on the same fundamentals as other trading enterprises and access to capital and funding for the Group and its projects going forward cannot be guaranteed. Investment in companies specialising in research projects, such as PolyNovo, should be regarded as highly speculative. PolyNovo strongly recommends that professional investment advice be sought prior to individuals making such investments.

Forward-looking statements

Certain statements in this Annual Report contain forward-looking statements regarding the Company's business and the therapeutic and commercial potential of its technologies and products in development. Any statement describing the Company's goals, expectations, intentions or beliefs is a forward-looking statement and should be considered an at-risk statement. Such statements are subject to certain risks and uncertainties, particularly those risks or uncertainties inherent in the process of discovering, developing and commercialising drugs and medical devices that can be proven to be safe and effective for use in humans, and in the endeavour of building a business around such products and services. PolyNovo undertakes no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise. Actual results could differ materially from those discussed in this Annual Report. As a result, readers of this report are cautioned not to rely on forward-looking statements.

Environmental Regulation

PolyNovo is not subject to significant environmental regulations.

Board Monitoring

The Board monitors PolyNovo's overall performance, from the implementation of its strategic plan through to the performance of the Group against operating plans and financial budgets. For further details regarding PolyNovo's Board and Committees, refer to the Corporate Governance Statement on the Company's website.

Directors' Report continued

Board and Committee Meetings

Details of the number of meetings of the Board of Directors and Board Committees, and Director's attendance at those meetings, during the year under review are set out in the table below.

	Full Board		Audit and Risk Committee		Remuneration Committee[1]	
Directors	**Meetings attended**	**Meetings eligible to attend**	**Meetings attended**	**Meetings eligible to attend**	**Meetings attended**	**Meetings eligible to attend**
Total number of meetings held	11		3		1	
Mr David Williams	11	11	–	–	1	1
Mr Bruce Rathie	11	11	3	3	1	1
Dr David McQuillan	11	11	–	–	1	1
Mr Philip Powell	11	11	3	3	1	1
Mr Max Johnston	11	11	3	3	1	1
Mr Leon Hoare[2]	5	5	–	–	–	–

1. PolyNovo does not have an established Remuneration Committee. Due to the small size of the business the Board acts as the Remuneration Committee and addresses such issues during the year as they arise.
2. Mr Leon Hoare was appointed a Non-executive Director on 27 January 2016.

Directors' Shareholdings and Declared Interests

At 30 June 2016, the Directors of PolyNovo collectively hold 10,651,310 shares in the Company.

As at the date of this report, the interests of the Directors in the Company's shares are:

Name	Shares held directly	Shares held indirectly
Directors		
Mr David Williams	–	7,727,038
Mr Bruce Rathie	–	1,841,882
Dr David McQuillan	500,000	–
Mr Max Johnston	–	261,112
Mr Philip Powell	–	211,112
Mr Leon Hoare	–	110,166
Total	**500,000**	**10,151,310**

As at 30 June 2016 and as at the date of this report, no Director has an interest in any contract or proposed contract with PolyNovo other than as disclosed below or in the Group's 2016 Annual Report. Further details of the equity interests of Directors can be found in the Remuneration Report.

Kidder Williams Limited, an advisory firm specialising in capital raising, assisted PolyNovo during the process of capital raising in November and December 2015 when PolyNovo raised a total of $12.4m from a placement to sophisticated investors, followed by a Share Purchase Plan. PolyNovo paid a flat fee of $100,000 plus GST to Kidder Williams for its services. Kidder Williams Limited is a company associated with the Chairman of the Board of PolyNovo, Mr David Williams, as Mr David Williams is the owner and Managing Director of Kidder Williams Limited.

Auditor

Ernst & Young (EY) continues in office in accordance with section 327b(2) of the *Corporations Act 2001*.

Non-audit Services

During the year ended 30 June 2016, the amount received or due and receivable for non-audit services provided by PolyNovo's auditor, Ernst & Young, were:

Tax compliance services	$12,500
Research and development tax benefit application	$23,250

The Directors are satisfied that the provision of non-audit services during the current period is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

Auditor's Independence Declaration

The auditor has provided a written declaration that no professional engagement for the Group has been carried out during the financial year that would impair EY's independence as auditor. This declaration is set out on page 20.

Corporate Governance

Overview

The Board of PolyNovo is responsible for the corporate governance of the Group and guides and monitors the business on behalf of its shareholders. The Board has strived to reach a balance between industry best practice and appropriate policies for PolyNovo in terms of its size, stage of development and role in the biotechnology industry. PolyNovo performed a review of its Board policies and governance practices with reference to the eight Principles of Good Corporate Governance (Principles) and the Best Practice Recommendations (Recommendations) established by the ASX Corporate Governance Council. The Recommendations are not mandatory and cannot, in themselves, prevent corporate failure or poor corporate decision-making. They are intended to provide a reference point for companies regarding their corporate governance structures and practices.

The Directors have considered each of the core Principles and Recommendations applicable for the year ended 30 June 2016. There are instances where the Group would not benefit from compliance with the Recommendations, and in some instances the Group has not had the resources to comply. The Recommendations that were not adopted are discussed in the Corporate Governance Statement located on the Company's website.

PolyNovo's Corporate Governance Statement, which summarises the Group's corporate governance practices and incorporates the disclosures required by the ASX Principles, can be viewed on the Company's website at http://www.polynovo.com.au/about/corporate-governance

Remuneration Report

The Directors of PolyNovo present the Remuneration Report prepared in accordance with section 300A of the *Corporations Act 2001* for the Company and its controlled entities (the Group) for the year ended 30 June 2016. This Remuneration Report is audited.

This Remuneration Report forms part of the Directors' Report and includes details of the Group's remuneration strategy and arrangements for the 2016 financial year.

This report outlines the compensation arrangements for the key management personnel of PolyNovo and explains how these arrangements are linked to Company performance.

Key Management Personnel

Key management personnel are those persons who are responsible for planning, directing and controlling the activities of the Group. The Board has determined that the key management personnel of the Group are the Non-executive Directors and Senior Managers (Executives) of PolyNovo, whose details are set out below.

Non-executive Directors

- Mr David Williams – Non-executive Chairman (*appointed as Non-executive Director on 28 February 2014 and Non-executive Chairman on 13 March 2014*)
- Mr Bruce Rathie – *Non-executive Director (appointed 18 February 2010)*
- Dr David McQuillan – *Non-executive Director (appointed 6 August 2012)*
- Mr Max Johnston – *Non-executive Director (appointed 13 May 2014)*
- Mr Philip Powell – *Non-executive Director (appointed 13 May 2014)*
- Mr Leon Hoare – *Non-executive Director (appointed 27 January 2016)*

Senior Managers

- Mr Paul Brennan – *Chief Executive Officer (appointed 13 February 2015)*
- Mr Christopher Mews – *Chief Financial Officer/Company Secretary (resigned 28 October 2015)*
- Ms Andrea Goldie – *Chief Financial Officer/Company Secretary (appointed 28 October 2015)*

Remuneration Strategy

PolyNovo has designed its compensation policies to ensure significant linkage between rewards and specific achievements that are intended to improve shareholder wealth. In assessing the link between Group performance and compensation policy, it must be recognised that biotechnology companies generally do not make a profit until a drug or device is licensed or commercialised, either of which takes a number of years.

Furthermore, the biotechnology sector as a whole is highly volatile, significantly driven by market sentiment and inherently high risk. Therefore, the direct correlation of compensation policy and key financial performance measures such as total shareholder return (TSR), net earnings per share or Company earnings, in the view of the Board, are inappropriate. As an alternative, key milestones are a more meaningful measure of performance to correlate levels of compensation. These milestones are discrete achievements that can be used to evaluate PolyNovo's progress towards commercialising its various projects.

PolyNovo's annual expenditure is predominantly impacted by research and development expenses. The Group has not made a profit and therefore no dividends have been declared, nor has there been a return of capital. The Group's performance is based on its key milestones, such as progress towards clinical trials, securing funding and licensing deals. Such milestones are directly linked to performance conditions set within the short-term incentives that form a significant proportion of Senior Management compensation. The Board continues to review the Group's compensation policy to ensure competitive and appropriate rewards that endeavour to result in greater shareholder wealth.

PolyNovo's compensation policy for key management personnel is designed to provide competitive and appropriate rewards that are transparent and fully aligned to shareholder interests. In accordance with corporate governance best practice, the Company has a compensation policy for Non-executive Directors and a separate policy for Senior Managers.

Non-executive Director Remuneration

The compensation of Non-executive Directors is based on market practice, Directors' duties and the level of Director accountability. The compensation policy is designed to attract and retain competent and suitably qualified Non-executive Directors and aims to align Directors' interests with the interests of shareholders. Non-executive Directors are paid a set fee plus statutory superannuation, where appropriate, and are reimbursed for out-of-pocket expenses. In addition, as medium and long-term incentives, Non-executive Directors may be invited to participate in the PolyNovo Employee Share Option Plan (the Plan). Non-executive Directors are encouraged to own shares in PolyNovo.

Non-executive Directors' fees are determined within an aggregate Directors' fee pool limit, which is approved by shareholders. This limit has been set at $300,000.

Total Non-executive Directors' fees (including superannuation) for the year ended 30 June 2016 were $295,481. The Directors' fees are considered within the average range for similar sized companies in the biotechnology industry and are reviewed periodically.

Executive Remuneration

PolyNovo's compensation policy for its Senior Managers is determined by the Board and is designed to link performance and retention strategies to ensure that:

- the balance between fixed and variable (performance) components for each position is appropriate in light of internal and external factors;
- the objectives set for each person will result in sustainable beneficial outcomes for PolyNovo;
- all variable (performance) components are appropriately linked to measurable personal, business unit or Company outcomes; and
- total compensation (the sum of fixed and variable components) for each Senior Manager is fair, reasonable and market competitive.

Generally, there are two components of Senior Management compensation, as follows:

1. Fixed annual compensation comprising salary and benefits, superannuation and non-monetary benefits.
2. Medium and long-term incentives, through participation in the Plan with share price thresholds to be achieved.

Fixed Annual Compensation

Senior Managers are offered a market competitive base salary, which reflects their competencies and job description as well as the size of the Group. Base salaries are reviewed against market data for comparable positions. Adjustments to base salary are made based on significant role responsibility changes, pay relativities to market and relative performance in the role.

Medium and Long-term Incentives

PolyNovo's medium and long-term incentive policy for Senior Managers encourages high-quality performance and long-term retention. Carefully designed and performance-linked equity incentive plans are widely recognised as an effective way of providing performance incentives.

Service Contracts

Chief Executive Officer – PolyNovo Limited

Mr Paul Brennan was appointed Chief Executive Officer of PolyNovo Limited on 13 February 2015.

The key terms of his contract are as follows:

- Salary of $270,000 per annum inclusive of superannuation.
- Short-term incentive bonus of up to 20% of total package upon achieving set key performance indicators (KPIs). To achieve this bonus Mr Brennan must meet value-creating targets for the financial year, which may include:
  - Develop and implement a three to five year corporate and product strategy;
  - Align clinical strategy with regulatory and commercial outcomes;
  - Commercialisation of wounds and burns products; and
  - Advance the use of NovoSorb™ in other areas.
- Long-term incentive plan in the form of equity interest. Details of the options package and the fair value of options and other compensation are included in the CEO Performance Incentives section of the Remuneration Report and in Tables A, B, C and D below.
- No fixed employment term.
- Termination payment of three months' salary; three-month period of notice.

Company Secretary and Chief Financial Officer

Ms Andrea Goldie was appointed Company Secretary and CFO on 28 October 2015. Terms of her contract are as follows:

- Salary of $175,000 per annum.
- Superannuation of 9.50%.
- No fixed employment term.
- Termination payment of three months' salary; six-month period of notice.

CEO Performance Incentives

The performance evaluation of the Chief Executive Officer is conducted by the Board.

On 6 August 2015, PolyNovo issued an options package compromising three tranches of 4,185,095 share options (a total of 12,555,285 options), to the CEO, Mr Paul Brennan.

The vesting hurdle for the options is linked to the PolyNovo volume weighted average market price. The vesting hurdles for each tranche are as follows:

- $0.18 per share for tranche 1;
- $0.25 per share for tranche 2; and
- $0.35 per share for tranche 3.

The share price must be sustained over a period of at least 90 consecutive calendar days. Any vested options are exercisable at 9 cents and may be exercised within 90 days of vesting. The options package will expire on 5 August 2018.

The first tranche of options vested and were exercised in April 2016, when the volume weighted average share price of PolyNovo was above $0.18 for more than 90 consecutive calendar days. The second and third tranches of options had not vested as at 30 June 2016.

All shares issued under the incentive scheme are escrowed for a period of 12 months commencing on the date of issue. The expense relating to the incentive scheme shares during the financial year was $308,602.

Remuneration of Key Management Personnel

Details of the remuneration for key management personnel for the years ended 30 June 2016 and 30 June 2015 are set out in Table A below.

		Short-term			Post employment	Long-term		Share-based payments		
Table A		**Cash salary and fees**	**Cash bonus**	**Consulting fees**	**Superannuation**	**Long service leave**	**Termination benefits**	**Options and performance rights**	**Total**	**% Performance based**
Directors										
Mr David Williams (Chairman/Non-executive Director)	2016	75,000	–	–	7,125	–	–	–	82,125	–
	2015	75,000	–	–	7,125	–	–	–	82,125	–
Mr Bruce Rathie (Non-executive Director)	2016	45,000	–	–	4,275	–	–	–	49,275	–
	2015	45,000	–	–	4,275	–	–	21,436	70,711	30%
Dr David McQuillan (Non-executive Director)	2016	45,000	–	–	–	–	–	–	45,000	–
	2015	53,125	–	–	–	–	–	21,436	74,561	29%
Dr Roger Aston	2016	–	–	–	–	–	–	–	–	–
	2015	8,884	–	–	844	–	–	–	9,728	–
Mr Max Johnston (Non-executive Director)	2016	45,000	–	–	4,275	–	–	–	49,275	–
	2015	45,000	–	–	4,275	–	–	48,372	97,647	50%
Mr Philip Powell (Non-executive Director)	2016	45,000	–	–	4,275	–	–	–	49,275	–
	2015	132,019	–	–	12,541	–	–	48,372	192,932	25%
Mr Leon Hoare (Non-executive Director)	2016	18,750	–	–	1,781	–	–	–	20,531	–
	2015	–	–	–	–	–	–	–	–	–
Subtotal compensation for Directors	2016	273,750	–	–	21,731	–	–	–	295,481	–
	2015	359,028	–	–	29,060	–	–	139,616	527,704	26%
Key management personnel										
Mr Paul Brennan (CEO)	2016	246,575	–	–	23,425	4,132	–	308,602	582,734	53%
	2015	91,788	–	–	8,719	1,538	–	–	102,045	–
Mr Christopher Mews	2016	93,280	10,000	–	13,447	–	53,815	–	170,542	–
	2015	186,558	10,000	–	17,723	3,397	–	–	217,678	–
Mr David Kenley	2016	–	–	–	–	–	–	–	–	–
	2015	–	–	239,528	–	–	–	–	239,528	–
Mr Laurent Fossaert	2016	–	–	–	–	–	–	–	–	–
	2015	140,460	–	–	20,464	28,801	128,661	–	318,386	–
Ms Andrea Goldie (CFO/Company Secretary)	2016	117,340	–	–	11,147	1,972	–	–	130,459	–
	2015	–	–	–	–	–	–	–	–	–
Subtotal compensation for other key management personnel	2016	457,195	10,000	–	48,019	6,104	53,815	308,602	883,735	35%
	2015	418,806	10,000	239,528	46,906	33,736	128,661	–	877,637	–
Total compensation for all key management personnel	2016	730,945	10,000	–	69,750	6,104	53,815	308,602	1,179,216	27%
	2015	777,834	10,000	239,528	75,966	33,736	128,661	139,616	1,405,341	10%

Options Granted as Part of Remuneration

During the year ended 30 June 2016, 12,555,285 options (2015: 3,000,000) were granted, no options were cancelled (2015: nil), and no options were forfeited (2015: nil). These options were issued pursuant to the PolyNovo Employee Share Option Plan.

Details of the share-based payment component included in total remuneration in Table A are set out below.

Table B

2016 financial year	Grant date	Grant number	Average fair value per option at grant date	Fair value of options granted during the year	Value of options forfeited/ lapsed during the year	Value of options exercised during the year	Number of shares issued upon exercise of options	Value of shares received upon exercise of options	Value of options yet to be expensed	Fair value of options included in remuneration during the year	% Compensation consisting of options during the year
Mr David Williams											
Options	19-May-14	2,500,000	$0.03300	–	–	–	–	–	–	–	–
Options	19-May-14	7,500,000	$0.05300	–	–	$397,500	7,500,000	$2,100,000	–	–	–
Mr Bruce Rathie											
Options	20-Nov-12	500,000	$0.01730	–	–	$8,650	500,000	$80,000	–	–	–
Options	17-Nov-14	500,000	$0.04300	–	–	–	–	–	–	–	–
Dr David McQuillan											
Options	20-Nov-12	500,000	$0.01730	–	–	$8,650	500,000	$95,000	–	–	–
Options	17-Nov-14	500,000	$0.04300	–	–	–	–	–	–	–	–
Mr Philip Powell											
Options	17-Nov-14	500,000	$0.04300	–	–	–	–	–	–	–	–
Options	17-Nov-14	500,000	$0.05400	–	–	–	–	–	–	–	–
Mr Max Johnston											
Options	17-Nov-14	500,000	$0.04300	–	–	–	–	–	–	–	–
Options	17-Nov-14	500,000	$0.05400	–	–	–	–	–	–	–	–
Mr Paul Brennan											
Options	6-Aug-15	4,185,095	$0.04944	$206,070	–	$206,070	4,185,095	$1,234,603	–	$206,070	35%
Options	6-Aug-15	4,185,095	$0.04326	$181,028	–	–	–	–	$125,714	$55,314	10%
Options	6-Aug-15	4,185,095	$0.03692	$154,532	–	–	–	–	$107,314	$47,218	8%
Total		**27,055,285**		**$541,630**	**–**	**–**	**–**	**–**	**–**	**$308,602**	**53%**

The fair value of options granted during the year, as included in Table B, was determined using a Monte Carlo simulation based model. A Monte Carlo simulation based model simulates the path of the share price according to a probability distribution assumption. After a large number of simulations, the arithmetic average of the outcomes, discounted to the valuation date, is calculated to represent the option value. This model can accommodate complex exercise conditions when the number of options exercised depends on some function of the whole path followed by the share price.

Each tranche of options has an expiry date of three months after vesting, and the options package will expire on 5 August 2018. Shares issued upon exercise of options are escrowed for a period of 12 months from issue. The option-pricing model values each of the vesting portions separately. Accordingly the amortised share-based compensation disclosed in Table A includes the apportioned value of the options during the year. A breakdown of the fair value of each grant of option included in key management personnel share-based compensation is set out in Table B.

Key Management Personnel Disclosures

Movements in shares of the Company

The movement during the reporting period in the number of shares in the Company held either directly or indirectly by each of the key management personnel, including their related parties, is set out in the table below:

Table C	Balance at 1 July 2015	Granted as compen-sation	On exercise of options	Net change other	Balance at 30 June 2016	Balance at end of year – directly held	Balance at end of year – indirectly held
Directors							
Mr David Williams	2,190,000	–	7,500,000	(1,962,962)	7,727,038	–	7,727,038
Mr David Franklyn*	980,050	–	500,000	(1,477,850)	2,200	–	2,200
Mr Bruce Rathie	1,230,770	–	500,000	111,112	1,841,882	–	1,841,882
Dr David McQuillan	–	–	500,000	–	500,000	500,000	–
Mr Max Johnston	150,000	–	–	111,112	261,112	–	261,112
Mr Philip Powell	100,000	–	–	111,112	211,112	–	211,112
Mr Leon Hoare	–	–	–	110,166	110,166	–	110,166
Other key management personnel							
Mr Paul Brennan	244,929	–	4,185,095	22,223	4,452,247	162,577	4,289,670
Mr Christopher Mews	1,618,680	–	–	(189,049)	1,429,631	1,429,631	–
Ms Andrea Goldie	–	–	–	225,905	225,905	–	225,905

Options and performance rights of key management personnel

The option holdings of key management personnel for the year ended 30 June 2016 is set out in the following table. No performance rights were granted during the year.

Table D	Balance at 1 July 2015	Granted as compen-sation	Options exercised	Net change other	Balance at 30 June 2016	Total vested at end of year	Total exercisable at end of year	Total not exercisable at end of year	Total vested during year
Directors									
Mr David Williams	10,000,000	–	7,500,000	–	2,500,000	–	2,500,000	–	–
Mr David Franklyn*	500,000	–	500,000	–	–	–	–	–	–
Mr Bruce Rathie	1,000,000	–	500,000	–	500,000	–	500,000	–	–
Dr David McQuillan	1,000,000	–	500,000	–	500,000	–	500,000	–	–
Mr Max Johnston	1,000,000	–	–	–	1,000,000	–	1,000,000	–	–
Mr Philip Powell	1,000,000	–	–	–	1,000,000	–	1,000,000	–	–
Mr Leon Hoare	–	–	–	–	–	–	–	–	–
Other key management personnel									
Mr Paul Brennan	–	12,555,285	4,185,095	–	8,370,190	4,185,095	–	8,370,190	4,185,095
Mr Christopher Mews	–	–	–	–	–	–	–	–	–
Ms Andrea Goldie	–	–	–	–	–	–	–	–	–
Total	**14,500,000**	**12,555,285**	**13,185,095**	**–**	**13,870,190**	**4,185,095**	**5,500,000**	**8,370,190**	**4,185,095**

* Mr David Franklyn is former Chairman of the Company who retired in 2013.

Loans to Key Management Personnel

No loans have been made to Directors of PolyNovo or to any other key management personnel, including their personally related entities.

Other Key Management Personnel Transactions

Kidder Williams Limited, an advisory firm specialising in capital raising, assisted PolyNovo during the process of capital raising in November and December 2015 when PolyNovo raised a total of $12.4m from a placement to sophisticated investors followed by a Share Purchase Plan. PolyNovo paid a flat fee of $100,000 plus GST to Kidder Williams for its services. Kidder Williams Limited is a company associated with the Chairman of the Board of PolyNovo, Mr David Williams, as Mr David Williams is the owner and Managing Director of Kidder Williams Limited.

During 2015, Lateral Innovations Pty Ltd, of which David Kenley is a Director, was engaged by PolyNovo Limited to provide consulting services to Metabolic Pharmaceuticals Pty Ltd. Consulting and Director fees of $239,528 (2014: $237,455) were paid by PolyNovo during the 2015 financial year.

This Directors' Report, incorporating the Corporate Governance Statement and Remuneration Report, has been signed in accordance with a resolution of the Directors made on 22 August 2016.

Mr David Williams
Chairman
22 August 2016

Auditor's Independence Declaration

Ernst & Young
8 Exhibition Street
Melbourne VIC 3000 Australia
GPO Box 67 Melbourne VIC 3001

Tel: +61 3 9288 8000
Fax: +61 3 8650 7777
ey.com/au

Auditor's Independence Declaration to the Directors of PolyNovo Limited

As lead auditor for the audit of PolyNovo Limited for the financial year ended 30 June 2016, I declare to the best of my knowledge and belief, there have been:

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

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

This declaration is in respect of PolyNovo Limited and the entities it controlled during the financial year.

Ernst + Young

Ernst & Young

J Lonergan

Joanne Lonergan
Partner
22 August 2016

Consolidated Statement of Comprehensive Income

for the year ended 30 June 2016

	Notes	30 June 2016 $	30 June 2015 $
Revenue			
Interest income/finance revenue	4(A)	193,366	118,382
BARDA revenue	4(B)	3,274,927	–
Sale of materials		2,112	3,000
Royalty revenue		165	19,339
Total revenue		3,470,570	**140,721**
Other operating income			
Government grant income	4(C)	–	75,000
Other income		2,002	10,144
Research and development tax benefit	4(H)	846,818	819,282
Profit on sale of available-for-sale and other assets		78,925	38,715
Profit on sale of subsidiary		–	1,500,000
Operating leases	4(F)	(352,966)	(305,143)
Employee related expenses	4(D)	(2,604,262)	(1,789,123)
Research and development expenses		(2,698,557)	(1,038,670)
Depreciation and amortisation expense	4(E)	(219,685)	(205,159)
Corporate administrative and overhead expenses	4(G)	(1,774,689)	(633,789)
Loss on revaluation of available-for-sale assets		–	(3,750)
Impairment of fixed assets		–	(22,550)
Net loss before income tax		(3,251,844)	**(1,414,321)**
Income tax benefit	5	–	–
Net loss for the period		(3,251,844)	**(1,414,321)**
Other comprehensive income that may be reclassified subsequently to profit and loss			
Net fair value gains on available-for-sale assets	11	45,000	–
Reclassification to profit and loss	11	(148,750)	–
Total comprehensive income/(loss) for the period		(3,355,594)	**(1,414,321)**
Loss for the period is attributable to:			
Non-controlling interest	17	(189,970)	(111,875)
Owners of the parent		(3,061,874)	(1,302,446)
		(3,251,844)	**(1,414,321)**
Total comprehensive income/(loss) for the period is attributable to:			
Non-controlling interest	17	(189,970)	(111,875)
Owners of the parent		(3,165,624)	(1,302,446)
		(3,355,594)	**(1,414,321)**
Basic loss per share (cents per share)	7	(0.62) cents	(0.33) cents
Diluted loss per share (cents per share)	7	(0.62) cents	(0.33) cents

The accompanying notes form part of these financial statements.

Consolidated Statement of Financial Position

as at 30 June 2016

	Note	30 June 2016 $	30 June 2015 $
Current assets			
Cash and cash equivalents	8	10,746,691	3,460,454
Receivables	9	1,556,275	850,872
Prepayments		38,665	11,061
Other financial asset	23	50,000	60,000
Total current assets		12,391,631	**4,382,387**
Non-current assets			
Available-for-sale financial assets	11	–	98,750
Property, plant and equipment	12	992,676	1,007,723
Intangible assets	13	2,519,788	2,519,788
Other assets	10	120,774	117,142
Total non-current assets		3,633,238	**3,743,403**
Total assets		16,024,869	**8,125,790**
Current liabilities			
Trade and other payables	14	590,614	417,513
Provisions	15(A)	115,219	71,565
Total current liabilities		705,833	**489,078**
Non-current liabilities			
Provisions	15(B)	16,016	30,150
Deferred rent liability		191,294	213,256
Total non-current liabilities		207,310	**243,406**
Total liabilities		913,143	**732,484**
Net assets		15,111,726	**7,393,306**
Equity			
Contributed equity	16(A)	114,099,712	94,870,080
Reserves	16(B)	(6,698,911)	1,912,597
Retained earnings/(accumulated losses)	16(C)	(92,289,075)	(89,227,201)
Parent interests		15,111,726	**7,555,476**
Non-controlling interest	17	–	**(162,170)**
Total equity		15,111,726	**7,393,306**

The accompanying notes form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 30 June 2016

	Contributed equity $	Gains/ (losses) on available-for-sale financial assets $	Other reserves $	Acquisition of non-controlling interest Reserve $	Retained earnings $	Owners of the parent $	Non-controlling interest $	Total $
As at 30 June 2014	**94,870,080**	**103,750**	**2,146,827**	**(477,596)**	**(87,924,755)**	**8,718,306**	**(50,295)**	**8,668,011**
Loss for the period	–	–	–	–	(1,302,446)	(1,302,446)	(111,875)	(1,414,321)
Other comprehensive income	–	–	–	–	–	–	–	–
Total comprehensive income for the period	–	–	–	–	(1,302,446)	(1,302,446)	(111,875)	(1,414,321)
Share-based payments	–	–	139,616	–	–	139,616	–	139,616
As at 30 June 2015	**94,870,080**	**103,750**	**2,286,443**	**(477,596)**	**(89,227,201)**	**7,555,476**	**(162,170)**	**7,393,306**
Loss for the period	–	–	–	–	(3,061,874)	(3,061,874)	(189,970)	(3,251,844)
Other comprehensive income	–	(103,750)	–	–	–	(103,750)	–	(103,750)
Total comprehensive income for the period	–	(103,750)	–	–	(3,061,874)	(3,165,624)	(189,970)	(3,355,594)
Issue of shares	12,092,973	–	–	–	–	12,092,973	–	12,092,973
Issue of shares on exercise of options	1,216,659	–	–	–	–	1,216,659	–	1,216,659
Issue of shares on acquisition of non-controlling interest	5,920,000	–	–	–	–	5,920,000	–	5,920,000
Acquisition of non-controlling interest	–	–	–	(8,816,360)	–	(8,816,360)	352,140	(8,464,220)
Share-based payments	–	–	308,602	–	–	308,602	–	308,602
As at 30 June 2016	**114,099,712**	**–**	**2,595,045**	**(9,293,956)**	**(92,289,075)**	**15,111,726**	**–**	**15,111,726**

The accompanying notes form part of these financial statements.

Consolidated Cash Flow Statement

for the year ended 30 June 2016

	Note	30 June 2016 $	30 June 2015 $
Payments to suppliers and employees		(7,000,582)	(3,615,321)
Receipt of government grants		–	82,500
Income from sale of materials		2,323	2,992
Receipts from research and development tax benefit		885,180	939,461
Receipts from BARDA reimbursements		2,552,442	–
Receipts from royalty revenue		4,218	23,087
Net cash outflows from operating activities	8	**(3,556,419)**	**(2,567,281)**
Interest received		189,734	127,389
Payments for purchase of property, plant and equipment		(204,689)	(317,429)
Proceeds from sales of available-for-sale financial assets		73,925	–
Proceeds from the sale of fixed assets		–	41,415
Term deposits now classified as cash and cash equivalents		10,000	–
Sale of investment in Metabolic Pharmaceuticals Pty Ltd		–	1,510,000
Net cash inflows/(outflows) from investing activities		**68,970**	**1,361,375**
Proceeds from the issue of shares (net of costs)		12,092,973	–
Payments for acquisition of non-controlling interest (including associated costs)		(2,544,221)	
Proceeds from exercise of options		1,216,659	–
Cash flows from financing activities		**10,765,411**	**–**
Net increase/(decrease) in cash and cash equivalents		7,277,962	(1,205,906)
Cash and cash equivalents at beginning of period		**3,460,454**	**4,666,360**
Effects of foreign exchange rate changes		8,275	–
Cash and cash equivalents at end of period	8	**10,746,691**	**3,460,454**

The accompanying notes form part of these financial statements

Notes to the Financial Statements

for the year ended 30 June 2016

1. Corporate Information

The Financial Report of PolyNovo Limited (the Company) and its controlled entities (the Group) for the year ended 30 June 2016 was authorised for issue in accordance with a resolution of the Directors on 22 August 2016.

PolyNovo Limited, a for-profit entity, is a Company incorporated in Australia, whose shares are publicly traded on ASX Limited (ASX code: PNV).

The Company operates predominantly in one industry and one geographical segment, being the medical device and healthcare industry and Australia respectively.

2. Summary of Significant Accounting Policies

(a) Basis of preparation

The Financial Report is a general-purpose financial report, which has been prepared in accordance with the requirements of the *Corporations Act 2001*, applicable Accounting Standards and other mandatory professional reporting requirements.

The Financial Report has been prepared on a historical cost basis, except for available-for-sale financial assets, which have been measured at fair value.

The financial statements have been prepared in compliance with Class Order Instrument 2016/191 'ASIC Corporations (Rounding in Financial/Directors' Reports)'.

The Financial Report is presented in Australian dollars.

The financial statements of the Group have been prepared on a going concern basis. The Group's operations are subject to major risks due primarily to the nature of the research, development and commercialisation to be undertaken. These risks may materially impact the financial performance and position of the Group, including the value of recorded assets and the future value of its shares, options and performance rights. The financial statements take no account of the consequences, if any, of the inability of the Company to obtain adequate funding or of the effects of unsuccessful research, development and commercialisation of the Group's projects.

(b) Statement of compliance

The Financial Report complies with Australian Accounting Standards as issued by the Australian Accounting Standards Board (AASB) and International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board.

The Group has adopted all applicable new and amended Australian Accounting Standards and AASB Interpretations that apply as of 1 July 2015. Those Australian Accounting Standards and Interpretations that have recently been issued or amended but are not yet effective have not been adopted. Details of the new and amended Standards adopted, along with a summary of the new and amended Standards that are not yet effective, are set out below.

(c) Changes in accounting policy, disclosures, Standards and Interpretations

The Group has adopted the following new and amended Australian Accounting Standards and AASB Interpretations as of 1 July 2015.

- AASB 2012-3 Amendments to Australian Accounting Standards – Offsetting Financial Assets and Financial Liabilities
- AASB 2013-4 Amendments to Australian Accounting Standards – Novation of Derivatives and Continuation of Hedge Accounting (AASB 139)
- AASB 1031 Materiality
- AASB 2013-9 Amendments to Australian Accounting Standards – Conceptual Framework, Materiality and Financial Instruments
- AASB 2014-1 Part A – Annual Improvements 2010–2012 Cycle
- AASB 2014-1 Part A – Annual Improvements 2011–2013 Cycle
- AASB CF 2013-1 Amendments to the Australian Conceptual Framework

The above new and amended Australian Accounting Standards and AASB Interpretation did not have any material impact on the accounting policies, financial position or performance of the Group.

2. Summary of Significant Accounting Policies continued

(c) Changes in accounting policy, disclosures, Standards and Interpretations continued

The following new Australian Accounting Standards have been issued by the AASB but are not yet effective for the period ended 30 June 2016. They have not been adopted by the Group for the year ended 30 June 2016.

- AASB 9 Financial Instruments: this replaces AASB 139. AASB 9 is effective for annual periods beginning on or after 1 January 2018.
- AASB 15 Revenue from Contracts with Customers: this replaces the existing revenue recognition standards. AASB 15 is effective for annual reporting periods commencing on or after 1 January 2018.
- AASB 16 Leases: supersedes AASB 117. AASB 16 will be effective for annual periods beginning on or after 1 January 2019.
- AASB 2015-3 Amendments to Australian Accounting Standards arising from the Withdrawal of AASB 1031 Materiality.

The potential effects of adoption of the above Standards are currently being assessed. The Company has not decided whether to early adopt any or all of these Standards at this point in time.

In addition, the following amendments to existing Standards (issued but not yet effective) are not expected to result in significant changes to the Company's accounting policies in the future:

- AASB 2014-4 Clarification of Acceptable Methods of Depreciation and Amortisation
- AASB 2015-1 Amendments to Australian Accounting Standards – Annual Improvements to Australian Accounting Standards 2012–2014 Cycle
- AASB 2015-2 Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 101
- AASB 2015-5 Amendments to Australian Accounting Standards – Investment Entities: Applying the Consolidation Exception
- AASB 2015-9 Amendments to Australian Accounting Standards – Scope and Application Paragraphs [AASB 8, AASB 133 & AASB 1057]
- AASB 2016-1 Amendments to Australian Accounting Standards – Recognition of Deferred Tax Assets for Unrealised Losses
- AASB 2016-2 Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 107

(d) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Group and its subsidiaries as at 30 June 2016. The Group controls an investee if and only if the Group has:

- power over the investee (i.e. rights that give it the ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- the contractual arrangement with the other vote holders of the investee;
- rights arising from other contractual arrangements; or
- the Group's voting rights and potential voting rights.

The Group reassesses whether or not it controls an investee if facts and circumstances indicate a change in one or more of the three elements of control. Consolidation of a subsidiary commences when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. The assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the Statement of Comprehensive Income from the date the Group gains control until the date the Group ceases to control the subsidiary.

Items of profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the parent Company and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation. A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If the Group loses control over a subsidiary, it:

- derecognises the assets (including goodwill) and liabilities of the subsidiary;
- derecognises the carrying amount of any non-controlling interests;
- derecognises the cumulative translation differences recorded in equity;
- recognises the fair value of the consideration received;
- recognises the fair value of any investment retained;
- recognises any surplus or deficit in profit or loss; and
- reclassifies the parent's share of components previously recognised in OCI to profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

(e) Business combination

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred measured at acquisition date fair value and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

If the business combination is achieved in stages, any previously held equity interest is remeasured at its acquisition date fair value and any resulting gain or loss is recognised in profit or loss. It is then considered in the determination of goodwill.

(f) Intangible assets

Intangible assets acquired separately or in a business combination are initially measured at cost. The cost of an intangible asset acquired in a business combination is its fair value as at the date of acquisition. The intangible assets carried by the Group, being intellectual property assets, have an indefinite useful life and are subject to annual impairment testing (see Note 2(F) for methodology). Following initial recognition, intangible assets are carried at cost less any impairment losses.

Internally generated intangible assets are not capitalised and expenditure is recognised in the Statement of Comprehensive Income (profit or loss) in the year in which the expenditure is incurred.

(g) Impairment of intangible and other assets

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

The Group conducts an annual internal review of asset values, which is used as a source of information to assess for any indicators of impairment. External factors, such as changes in expected future processes, technology and economic conditions, are also monitored to assess for indicators of impairment. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated.

(h) Share-based payments

The Company provides benefits to employees in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares.

The PolyNovo Employee Share Option Plan was in place for the year ended 30 June 2016. Information relating to this Plan is set out in Note 6 and in the Remuneration Report section of the Directors' Report.

The cost of share-based payments under the terms of the Share Option Plan is measured by reference to the fair value of options at the date at which they are granted. The fair value of options granted is determined by using the Monte Carlo simulation or the binomial option valuation model. The assumptions and models used for estimating fair value for share-based payment transactions are disclosed in the Remuneration Report.

The fair value of options is recognised as an employee benefit expense with a corresponding increase in equity. The fair value is measured at grant date and recognised over the period during which the employee becomes conditionally entitled to the option. At each reporting date, the number of options that are expected to vest is revisited. The employee benefit expense recognised each period takes into account the most recent estimate of the number of options that are expected to vest.

2. Summary of Significant Accounting Policies continued

(i) Plant and equipment

Plant and equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

Office equipment	3 to 10 years
Laboratory plant and equipment	3 to 13.33 years
Leasehold improvements	12 years

(j) Plant and equipment impairment

Impairment

The carrying values of plant and equipment are reviewed for impairment at each reporting date, when events or changes in circumstances indicate that the carrying value may be impaired. An asset is impaired when its carrying value exceeds its estimated recoverable amount. In this instance, the asset is written down to its recoverable amount and the impairment loss recognised in the Statement of Comprehensive Income.

For impairment testing purposes, the recoverable amount of an asset is estimated as the higher of its fair value less cost of disposal and its 'value-in-use'. Value-in-use is calculated by discounting the estimated future cash flows derived from use of the asset, using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Disposal

Plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is recognised in the Statement of Comprehensive Income.

(k) Research and development costs

Research and patent costs are expensed as incurred. An intangible asset arising from development expenditure on an individual project is recognised only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available-for-use or sale. No development expenditure has been capitalised.

(l) Investments

Available-for-sale investments

After initial recognition, investments classified as available-for-sale are measured at fair value. For investments that are actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on balance date. Gains or losses on available-for-sale investments are recognised as a separate component of equity until the investment is disposed of. At this point, the cumulative gain or loss previously reported in other comprehensive income (equity) is included in the Statement of Comprehensive Income (profit and loss).

The Group had no available-for-sale investments as at 30 June 2016.

(m) Cash and cash equivalents

Cash at bank and short-term deposits mature in three months or less and are stated at nominal value.

(n) Employee leave benefits

Liabilities for wages, salaries and annual leave expected to be settled within 12 months of the reporting date and pro-rata long service leave for employees with over seven years of service are recognised in current liabilities. Wages, salaries, annual leave and long service leave are measured at the amounts expected to be paid when the liabilities are settled.

Liabilities for pro-rata long service leave for employees with less than seven years of service are recognised in non-current liabilities and are measured as the present value of the expected future payments to be made.

(o) Operating leases

The minimum lease payments of operating leases, where the lessor retains substantially all of the risks and benefits of ownership of the leased items, are recognised as an expense in the Statement of Comprehensive Income on a straight-line basis over the lease term.

(p) Revenue recognition

Revenue is recognised when it is probable that future economic benefits will flow to the entity and the revenue can be reliably measured.

The amount of revenue arising on the BARDA contract is determined by the BARDA agreement between PolyNovo and BARDA. Revenue is measured in accordance with the criteria set out in the contract and is assessed based on employee timesheets, sub-contractor invoices, direct BARDA expenses and other indirect rates as defined in the contract or otherwise agreed with BARDA. The BARDA contract is a cost-plus-fixed-fee contract of a reimbursement nature and has a pre-agreed contract period and contract value. The customer, being the US Government, has low or no credit risk.

Interest revenue is recognised when the Group has the right to receive the interest payment. Interest receivable and GST recoverable are recorded at amortised cost. Due to the short-term nature of these receivables, amortised cost equates to face value.

Sales of materials are recognised when they are shipped to suppliers.

(q) Government grants

Government grants are recognised at their fair value when the grant is received and all attaching conditions have been complied with.

Research and development tax benefit revenue is recognised when there is reasonable assurance of receipt.

(r) Trade and other payables

Trade and other payables are carried at amortised cost. They represent liabilities for goods and services provided to the Group prior to the end of the financial year that are unpaid. The amounts are unsecured and are normally settled on 30-day terms. Due to the short-term nature of these payables amortised cost equates to fair value.

(s) Income tax

Deferred income tax is provided on all temporary differences at balance date, calculated as the difference between the tax cost base of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. The same criteria apply for recognition of tax assets relating to unused tax losses.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) effective at balance date.

Income taxes relating to items recognised directly in equity are recognised in other comprehensive income (equity) and not in the Statement of Comprehensive Income (profit and loss).

(t) Significant accounting, estimates and assumptions

Deferred tax liability

The deferred tax liability (DTL) arising from the carrying value of PolyNovo's intangible assets is offset by deferred tax assets (DTAs) recognised for unused tax losses, where the continuity of ownership test is satisfied. Significant management judgement is required to determine the amount of the DTA that can be used to offset the impact of the DTL. Further details on deferred taxes are disclosed in Note 5.

Share-based payments

Estimating fair value for share-based payment transactions requires selection of the most appropriate valuation model, which in turn is dependent on the terms and conditions of the share-based payment granted. Determination of the most appropriate inputs to the valuation model, including the expected life of the share option, volatility and dividend yield, is also required. The models and related assumptions used for estimating the fair value of share-based payment transactions are disclosed in Note 6 and in the Remuneration Report.

Impairment of intangibles

Impairment exists when the carrying value of an asset exceeds its recoverable amount. PolyNovo determines the recoverable amount of an intangible asset by assigning a value to each project in the pipeline, using a probability adjusted net present value method. The key assumptions used to determine the recoverable amount for the different assets is further explained in Note 13.

2. Summary of Significant Accounting Policies continued

(u) Goods and services tax (GST)

Revenues, expenses and assets are recognised net of GST except:

- Where the GST incurred on purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable.
- Receivables and payables are stated with the amount of GST (if any) included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the Statement of Financial Position. Cash flows are included in the Statement of Cash Flows on a gross basis (i.e. including GST) and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority is classified as operating cash flows. Commitments and contingencies are disclosed exclusive of the amount of GST recoverable from, or payable to, the taxation authority.

(v) Earnings per share (EPS)

Basic EPS is calculated as the net profit/(loss) attributable to shareholders, adjusted to exclude costs of servicing equity (other than dividends), divided by the weighted average number of ordinary shares.

Diluted EPS is calculated as the net profit/(loss) attributable to members, adjusted for:

- the costs of servicing equity (other than dividends);
- the after-tax effect of dividends and interest associated with dilutive potential ordinary shares that have been recognised as expenses; and
- other non-discretionary changes in revenues or expenses during the period that would result from the dilution of potential ordinary shares.

The resultant net profit/(loss) is divided by the weighted average number of ordinary shares and dilutive potential ordinary shares.

As the Group incurred a loss for the period under review and in the prior year, potential ordinary shares, being options and performance rights to acquire ordinary shares, are considered non-dilutive and therefore not included in the diluted earnings per share calculation.

(w) Contributed equity

Ordinary shares are classified as equity and recognised at the fair value of the consideration received by the Company. Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received.

(x) Foreign currency translation

The functional currency of each of the entities in the Group is Australian dollars as it reflects the primary economic environment in which the entity operates.

Foreign currency items are translated to Australian currency on the following basis:

- Transactions are converted at exchange rates approximating those in effect at the date of the transaction.
- Foreign currency monetary items that are outstanding at the reporting date are translated using the spot rate at the end of the financial year.

Exchange differences relating to monetary items are included in the Statement of Comprehensive Income (profit and loss).

(y) Comparatives

Where necessary, comparatives have been reclassified and repositioned for consistency with current year disclosures.

(z) Security deposits

Security deposits are recorded at amortised cost in the Statement of Financial Position.

3. Segment Information

Business segment

PolyNovo has only one business segment, being the development of the NovoSorb™ technology for use in a range of biodegradable medical devices.

The chief operating decision-maker from 13 February 2015 onwards has been the Chief Executive Officer. The chief operating decision maker was previously the Joint Acting Managing Directors and the Chairman.

The chief operating decision-maker reviews the results of the business on a single entity basis. For financial results refer to the Statement of Comprehensive Income and Statement of Financial Position.

The Board monitors the operating results of the Group for the purpose of making decisions about resource allocation to each project. Projects are evaluated based on progressing the PolyNovo technology in accordance with budgeted Company expenditure. For a description of PolyNovo's current projects, refer to the Directors Report.

Geographical areas

The Group operated in only one geographical area during the years ended 30 June 2015 and 2016.

4. Revenues and Expenses

(a) Interest income/finance revenue

	30 June 2016 $	30 June 2015 $
Term deposit interest	174,785	111,661
Bank account interest	14,949	6,721
Interest income – other	3,632	–
	193,366	**118,382**

(b) BARDA revenue

Revenue from contract with BARDA	3,274,927	**–**

During the 2016 financial year, PolyNovo recognised $3,274,927 revenue from its contract with BARDA. The contract is a cost plus fixed fee reimbursement contract that was awarded on 28 September 2015. The contract is to fund the full cycle of clinical trial activities relating to commercialisation of the Company's BTM in deep tissue burns.

(c) Government grant income

Government grants	–	**75,000**

In the 2015 financial year, PolyNovo received $75,000 from the Victorian State Government to fund a feasibility study at The Alfred Hospital. The Group did not benefit directly from any other forms of government assistance in either 2016 or 2015.

Notes to the Financial Statements continued

for the year ended 30 June 2016

4. Revenues and Expenses continued

(d) Employee related expenses

	30 June 2016 $	30 June 2015 $
Wages and salaries	(1,464,853)	(957,815)
Superannuation	(169,538)	(120,738)
Share-based payments (expense) (see Note 6)	(308,602)	(139,616)
Directors' fees	(295,481)	(272,289)
Severance payments (including superannuation)	(53,815)	(128,661)
Long service leave provision	(1,895)	(15,111)
Annual leave provision	(27,625)	(14,346)
Payroll taxes and administration	(66,639)	(70,983)
Employee welfare	(14,846)	(2,378)
Recruitment fees	(200,968)	(67,186)
	(2,604,262)	**(1,789,123)**

(e) Depreciation and amortisation expense

Depreciation – office equipment	(24,326)	(15,415)
Depreciation – laboratory equipment	(62,949)	(77,152)
Depreciation – leasehold improvements	(132,410)	(112,592)
	(219,685)	**(205,159)**

(f) Rental expense relating to operating leases

Rental expense and outgoings – laboratory and administration	(352,966)	(305,143)
	(352,966)	**(305,143)**

(g) Corporate administrative and overhead expenses

Insurances	(59,411)	(67,939)
Accounting and audit fees	(167,706)	(129,640)
Investor relations and share registry expenses	(114,570)	(48,605)
Legal fees	(140,753)	(121,031)
Consultants and contractors	(877,882)	(33,889)
Travel	(129,003)	(63,957)
Communication expenses	(42,034)	(23,304)
Other	(243,330)	(145,424)
	(1,774,689)	**(633,789)**

The increase in Consultant and contractor costs are predominantly attributable to the Company's BARDA activities that started in September 2015.

(h) Research and development tax benefit

Research and development tax benefit income of $846,818 (2015:$819,282) was recognised as income in the Statement of Comprehensive Income. $783,308 is receivable, as recognised in the Statement of Financial Position, with respect to the year ended 30 June 2016.

5. Income Tax

(a) Income tax benefit/(income tax expense)

	30 June 2016 $	30 June 2015 $
Current income tax		
Current income tax charge	–	–
Deferred income tax		
Relating to origination and reversal of temporary differences	–	–
Income tax benefit/(income tax expense)	–	–
Income tax recognised directly in equity		
Deferred tax expense	–	–
Available-for-sale asset	–	–
Reconciliation of income tax expense to prima facie tax payable		
Net loss before income tax expense	3,251,844	1,414,321
Prima facie tax calculated at 30% (2015: 30%)	(975,553)	(424,295)
Tax effect of amounts that are not included in accounting loss:		
Research and development	522,205	546,188
Non-assessable rental deposit	(1,090)	(3,043)
Non-assessable grant income	(234,992)	(245,785)
Tax effect of amounts that are not deductible:		
Share-based payments	92,581	41,885
Other	–	978
	(596,850)	(84,072)
Current year tax losses not brought to account	786,555	249,984
Current year temporary differences not brought to account	(189,705)	(165,912)
Income tax benefit/(income tax expense)	–	–

5. Income Tax continued

(b) Deferred tax assets and liabilities

	30 June 2016 $	30 June 2015 $
Deferred tax assets	987,631	761,967
Deferred tax liabilities	(987,631)	(761,967)
Net deferred tax assets/(liabilities)	–	–
Deferred tax balances reflects temporary differences attributable to:		
Amounts recognised in profit and loss		
Recognised tax losses	867,320	653,602
Recognised on temporary differences	120,311	108,365
Interest receivable	(231,695)	(6,030)
Amount recognised due to acquisition of PolyNovo	(755,936)	(755,936)
Net deferred tax assets/(liabilities)	–	–
Movement in temporary differences during the year:		
Balance as of 1 July	–	–
Credit to profit and loss	–	–
Charged to equity	–	–
Net deferred tax assets/(liabilities) as 30 June	–	–

(c) Deferred tax assets not brought to account

Unrecognised, unconfirmed tax losses for which no deferred tax asset has been recognised	82,521,187	80,037,015
Deductible temporary differences – no deferred tax asset has been recognised	189,705	212,402
	82,710,892	80,249,418
Potential tax benefit at 30%	24,813,268	24,074,825

The availability of the tax losses in future periods is uncertain and will be dependent on the Group satisfying strict requirements with respect to continuity of ownership and the same business test, imposed by income tax legislation. The recoupment of available tax losses as at 30 June 2016 is contingent upon the following:

- the Group deriving future assessable income of a nature and of an amount sufficient to enable the benefit from the losses to be realised;
- the conditions for deductibility imposed by tax legislation continuing to be complied with; and
- there being no changes in tax legislation that would adversely affect the Group from realising the benefit from the losses.

Given the Group's history of recent losses (with the exceptions of the benefit noted in (D) below), the Group has not recognised a deferred tax asset with regard to unused tax losses, as it has not been determined that the Group will generate sufficient taxable profit against which the unused tax losses can be utilised.

In the prior year, consideration was given to PolyNovo's ability to satisfy the tax loss recoupment tests for losses incurred in 2003 and earlier income years. Based on reassessment, tax losses of approximately $26m were forfeited.

(d) Income tax benefit

The income tax benefit arises due to the recording of deferred tax assets that are available in the current year to offset against deferred tax liabilities from temporary differences.

6. Share-based Payments

(a) Employee share-based payment plans

The Company provides benefits to employees and Non-executive Directors in the form of share-based payment transactions, whereby employees and Non-executive Directors render services in exchange for shares or rights over shares.

The expense recognised in the Statement of Comprehensive Income for the years ended 30 June 2016 and 30 June 2015 were $308,602 and $139,616, respectively.

(b) Share-based payments for the year ended 30 June 2016

During the 2016 financial year, on 6 August 2015 an options package compromising three tranches of 4,185,095 share options (a total of 12,555,285 options) were granted to the CEO, Mr Paul Brennan, pursuant to the terms of the PolyNovo Employee Share Option Plan.

The vesting hurdle for the options is linked to the PolyNovo volume weighted average market price. The vesting hurdles for each tranche are as follows:

- $0.18 per share for tranche 1;
- $0.25 per share for tranche 2; and
- $0.35 per share for tranche 3.

The share price must be sustained over a period of at least 90 consecutive calendar days. Any vested options are exercisable at 9 cents and may be exercised within 90 days of vesting. The options package will expire on 5 August 2018.

The first tranche of options vested and were exercised in April 2016, when the volume weighted average share price of PolyNovo was above $0.18 for more than 90 consecutive calendar days. The second and third tranches of options had not vested as at 30 June 2016. All shares issued under the incentive scheme are escrowed for a period of 12 months commencing on the date of issue. The expense relating to the incentive scheme shares during the 2016 financial year was $308,602.

2016	Balance at 1 July 2015	Granted as compensation	Options exercised	Net change other (forfeited, lapsed, expired)	Balance at 30 June 2016	Total vested at end of year	Total exercisable at end of year	Total not exercisable at end of year	Total vested during year	Share-based payments expense
Other key management personnel										
Mr Paul Brennan	–	12,555,285	4,185,095	–	8,370,190	4,185,095	–	8,370,190	4,185,095	308,602

The fair value of options granted during the year, as included in the above table, was determined using a Monte Carlo simulation based model. A Monte Carlo simulation based model simulates the path of the share price according to a probability distribution assumption. After a large number of simulations, the arithmetic average of the outcomes, discounted to the valuation date, is calculated to represent the option value. This model can accommodate complex exercise conditions when the number of options exercised depends on some function of the whole path followed by the share price.

6. Share-based Payments continued

(c) Share-based payments for the year ended 30 June 2015

During the 2015 financial year, on 17 November 2014 3,000,000 options were issued to certain Directors of the Company. These options vested immediately. 1,000,000 options had an exercise price of $0.14 and an expiry of 17 November 2017, and 2,000,000 options had an exercise price of $0.20 and an expiry date of 17 November 2017. The expense recognised in the Statement of Comprehensive Income during the 2015 financial year was $139,616.

2015	Balance at 1 July 2014	Granted as compensation	Options exercised	Net change other (forfeited, lapsed, expired)	Balance at 30 June 2015	Total vested at end of year	Total exercisable at end of year	Total not exercisable at end of year	Total vested during year	Share-based payments expense
Directors										
Mr Bruce Rathie	500,000	500,000	–	–	1,000,000	500,000	1,000,000	–	500,000	21,436
Dr David McQuillan	500,000	500,000	–	–	1,000,000	500,000	1,000,000	–	500,000	21,436
Mr Max Johnston	–	1,000,000	–	–	1,000,000	1,000,000	1,000,000	–	1,000,000	48,372
Mr Philip Powell	–	1,000,000	–	–	1,000,000	1,000,000	1,000,000	–	1,000,000	48,372
Total	**1,000,000**	**3,000,000**	**–**	**–**	**4,000,000**	**3,000,000**	**4,000,000**	**–**	**3,000,000**	**139,616**

During the 2016 financial year, 1,000,000 options were exercised of the total 3,000,000 options granted during the 2015 financial year.

The weighted average share price during the 2016 reporting period was $0.23 (2015: $0.09).

7. Earnings Per Share (EPS)

Basic EPS amounts are calculated by dividing the net loss for the year by the weighted average number of ordinary shares outstanding during the year.

Diluted EPS amounts are calculated by dividing the net loss for the year by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

Basic EPS:

30 June 2016	(0.62) cents per share
30 June 2015	(0.33) cents per share

Diluted EPS:

30 June 2016	(0.62) cents per share
30 June 2015	(0.33) cents per share

	30 June 2016	30 June 2015
The following reflects the income and share data used in the calculation of basic and diluted EPS:		
Net loss used in calculating basic and diluted EPS attributable to equity holders of the parent entity	($3,061,874)	($1,302,446)
Weighted average number of ordinary shares on issue used in the calculation of basic EPS	493,258,179	418,509,426
Potential ordinary shares that are not dilutive and are excluded from the calculation of diluted EPS	–	–

There were no transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

8. Cash and Cash Equivalents

Reconciliation of cash at the end of the year

	30 June 2016 $	30 June 2015 $
Cash at bank and in hand[i]	3,246,691	260,454
Short-term deposits[ii]	7,500,000	3,200,000
	10,746,691	3,460,454
Cash and cash equivalents are denominated in:		
Australian dollars	9,269,572	3,460,454
US dollars	1,477,119	–
	10,746,691	3,460,454

Notes:
(i) Cash at bank earns interest at floating rates based on daily bank deposit rates.
(ii) Short-term deposits with varying maturity terms and interest rates at 2.92% to 2.98% (2015: short-term deposit maturing within three months and interest rate at 2.87%).

For the purpose of the Cash Flow Statement, cash and cash equivalents comprises cash at bank and investments in short-term deposits as listed above. The Group has no borrowings.

Reconciliation of net loss after income tax to net cash flow from operating activities

	30 June 2016 $	30 June 2015 $
Net loss	(3,251,844)	(1,414,321)
Adjustments for non-cash items:		
Depreciation/amortisation	219,685	205,159
Share-based payment expense	308,602	139,616
Interest	(3,632)	(118,382)
Revaluation of available-for-sale assets	–	3,750
Gain on disposal of available-for-sale assets	(78,925)	–
Unrealised foreign exchange rate differences	(7,949)	–
Change in assets and liabilities during the financial year:		
Profit on sale of assets	–	(38,715)
Impairment of assets	–	22,550
Sale of Metabolic Pharmaceuticals Pty Ltd	–	(1,500,000)
(Increase)/decrease in prepayments	(27,605)	478
(Increase)/decrease in receivables	(693,576)	145,951
(Increase)/decrease in other assets	(201,535)	(10,148)
Increase/(decrease) in payables	368,398	41,751
Increase/(decrease) in provisions	29,520	(41,882)
Increase/(decrease) in other liabilities	(217,558)	(3,088)
Net cash outflows from operating activities	(3,556,419)	(2,567,281)

9. Receivables (Current)

	30 June 2016 $	30 June 2015 $
Accrued income – BARDA	697,058	–
Research and development tax concession	783,308	822,298
Interest receivable	74,238	13,590
GST recoverable	–	7,755
Royalty revenue receivable	1,019	6,511
Sundry receivables	652	718
	1,556,275	850,872

Accrued income relates to PolyNovo's BARDA project and represents unbilled labour and subcontractor expenses incurred in June 2016.

10. Other Assets (Non-current)

Non-current

	30 June 2016 $	30 June 2015 $
Security deposit	120,774	117,142

The non-current security deposit relates to PolyNovo's long-term lease of premises in Port Melbourne.

11. Available-for-sale Financial Asset – Investment in Shares

	30 June 2016 $	30 June 2015 $
Balance at beginning of year	98,750	102,500
Gain/(impairment) of available-for-sale financial asset	45,000	(3,750)
Sale of financial assets	(143,750)	–
Balance at end of year	–	98,750

The Company's available-for-sale financial asset comprised fully paid ordinary shares held in Neuren Pharmaceuticals Limited (Neuren) a company listed on the Australian Securities Exchange.

On 8 June 2016, PolyNovo sold all ordinary shares in Neuren for net proceeds of $73,925. The cumulative balance of other comprehensive income previously recognised in equity was transferred to profit and loss on disposal.

12. Plant and Equipment

Office equipment

	30 June 2016 $	30 June 2015 $
(i) Cost		
Opening balance	209,640	180,242
Reclassification	44,825	–
Additions	27,514	29,398
Disposals and write-off of equipment	–	–
Closing balance	281,979	209,640
(ii) Accumulated depreciation		
Opening balance	(152,000)	(136,585)
Reclassification	(44,823)	–
Depreciation for the year	(24,395)	(15,415)
Closing balance	(221,218)	(152,000)
Net book value – office equipment	60,761	**57,640**

Laboratory plant and equipment

	30 June 2016 $	30 June 2015 $
(i) Cost		
Opening balance	784,414	685,231
Reclassification	313,502	–
Additions	177,174	121,733
Impairment	–	(22,550)
Closing balance	1,275,090	784,414
(ii) Accumulated depreciation		
Opening balance	(588,102)	(510,950)
Reclassification	(304,666)	–
Depreciation for the year	(62,930)	(77,152)
Closing balance	(955,698)	(588,102)
Net book value – laboratory plant and equipment	319,392	**196,312**

12. Plant and Equipment continued

Leasehold improvements

	30 June 2016 $	30 June 2015 $
(i) Cost		
Opening balance	1,461,848	1,327,257
Additions	–	134,591
Closing balance	1,461,848	1,461,848
(ii) Accumulated depreciation		
Opening balance	(708,077)	(595,485)
Reclassification	(8,838)	
Depreciation for the year	(132,410)	(112,592)
Closing balance	(849,325)	(708,077)
Net book value – leasehold improvements	**612,523**	**753,771**
Net book value – plant and equipment	**992,676**	**1,007,723**

During the year, a number of reclassification entries were recorded in order to correctly represent the nature of assets. The net effect of reclassification entries is nil.

13. Intangible assets

	30 June 2016 $	30 June 2015 $
Intangible assets	2,519,788	2,519,788

Intangible assets, comprising intellectual property, were acquired through the business combination with PolyNovo Biomaterials Pty Ltd on 17 December 2008. These assets are indefinite lived and are subject to impairment testing on an annual basis or whenever there is an indication of impairment.

The impairment assessment at 30 June 2016 and 30 June 2015 was based on a valuation report prepared by an independent third party.

The valuation report was prepared by assigning a value to projects in the Group's pipeline on a probability-weighted basis, based on future cash flows. In arriving at a valuation for each project, assumptions were made on a project-by-project basis. The assumptions used for each project are outlined below:

	30 June 2016	30 June 2015
Growth rate	2%	3%
Valuation date	30 June 2016	30 June 2014
After tax discount rate	20%	not applicable
Pre-tax discount rate	not applicable	28.57%
Royalty on sales	5% to 8%	4%
Market penetration	5% to 7.5%	5% to 10%

Growth rate: derived from published data on growth prospects and historical growth of products being sold into those conditions.

Royalty on sales: based on available industry data.

Market penetration: a best estimate, taking into consideration the quality of proposed products relative to competitive offerings, where competitors exist, number of competitive products and what commercial partners would expect to justify further investment in development.

Consideration was also given to recent transactions in the field of each project and the market capitalisation of ASX-listed companies with similar technology. The report concluded that the value of the intellectual property is in excess of its current carrying value.

No reasonable possible changes in the assumptions were identified that could cause an impairment of the identified intangible assets except for a failure in clinical trials. Due to the nature of the business, the cash flows were assessed on a short-term 12-month basis with assumptions applied to future models to assess the recoverable amount of identified intangibles.

The recoverable amount has been determined using a value-in-use method.

The Directors considered this valuation report and it is the opinion of the Directors that PolyNovo's intangible assets are not impaired as at 30 June 2016.

14. Trade and Other Payables

	30 June 2016 $	30 June 2015 $
Trade creditors and payables	406,311	133,197
Other payables	184,303	284,316
Total trade and other payables	590,614	417,513

Trade payables are non-interest bearing and are normally settled on 30-day terms.

15. Provisions

(a) Current provisions

	30 June 2016 $	30 June 2015 $
Annual leave	69,737	42,112
Long service leave	45,482	29,453
Total current provisions	115,219	**71,565**

(b) Non-current provisions

Long service leave	16,016	30,150
Total non-current provisions	16,016	**30,150**

16. Contributed Equity and Reserves

(a) Movement in contributed equity

	30 June 2016 $	30 June 2015 $
Contributed equity at beginning of year	94,870,080	94,870,080
Shares issued: capital raising	12,847,816	–
Costs of share issue	(754,843)	–
Shares issued on acquisition of non-controlling interest	5,920,000	–
Exercise of options	1,216,659	–
Contributed equity at end of year	114,099,712	94,870,080

	Number of shares	
On issue at start of year	418,509,426	418,509,426
Shares issued: capital raising	95,169,394	–
Shares issued on acquisition of non-controlling interest	32,000,000	–
Exercise of options	13,185,095	–
On issue at end of year	558,863,915	418,509,426

(b) Reserves

	30 June 2016 $	30 June 2015 $
Share-based payments reserve (i)	2,595,045	2,286,443
Gains/(losses) on available-for-sale financial assets (ii)	–	103,750
Acquisition of non-controlling interest reserve (iii)	(9,293,956)	(477,596)
Balance at end of period	(6,698,911)	1,912,597

(i) Share-based Payments Reserve

Balance at beginning of period	2,286,443	2,146,827
Share-based payments movement	308,602	139,616
Balance at end of period	2,595,045	2,286,443

This reserve represents the nominal consideration paid for subscriber or employee options and the fair value of options and performance rights.

	30 June 2016 $	30 June 2015 $
(ii) Gains/(losses) on available-for-sale financial assets reserve		
Opening balance	103,750	103,750
Unrealised gain/(loss) on available-for-sale financial assets	45,000	–
Reclassification to profit and loss on disposal of assets	(148,750)	
Balance at end of period	–	103,750

Refer Note 11 for details of the purpose of this reserve account.

(iii) Acquisition of non-controlling interest reserve		
Opening balance	(477,596)	(477,596)
Acquisition of non-controlling interest	(8,816,360)	–
Balance at end of year	(9,293,956)	(477,596)

This reserve represents the premium paid by PolyNovo Limited for the non-controlling interest in subsidiary entities PolyNovo Biomaterials Pty Ltd, NovoSkin Pty Ltd and NovoWound Pty Ltd.

(c) Accumulated losses

	30 June 2016 $	30 June 2015 $
Accumulated losses at beginning of year	(89,227,201)	(87,924,755)
Net loss attributable to members of the parent	(3,061,874)	(1,302,446)
Accumulated losses at end of financial year	(92,289,075)	(89,227,201)

17. Non-controlling Interests

	30 June 2016 $	30 June 2015 $
Opening balance	(162,170)	(50,295)
Current year share of accumulated losses	(189,970)	(111,875)
Acquisition of non-controlling interest	352,140	–
Balance at end of year	–	(162,170)

During the financial year ended 30 June 2016, the Group acquired the non-controlling interest in subsidiary entities NovoSkin Pty Ltd and NovoWound Pty Ltd. The PolyNovo Group, as at 30 June 2016, is a wholly owned group of companies.

18. Commitments and Contingencies

Operating lease commitments

The Group has entered into a commercial office and laboratory lease. This lease has an initial term of 12 years, from 2008 to 2020, with a further five-year option. Future minimum rentals payable under the non-cancellable operating lease is as follows:

	30 June 2016 $	30 June 2015 $
Not later than one year	275,539	264,065
Later than one year, but not later than five years	841,158	1,139,510
	1,116,697	1,403,575

Contingencies

The Directors are not aware of any other contingent liabilities or contingent assets at 30 June 2016. There has been no change in this assessment up to the date of this report.

19. Related Party Disclosures

As set out in the disclosures under key management personnel (Note 24), transactions with related parties during the year were as follows:

- Kidder Williams Ltd, an entity associated with Mr David Williams, received payments in the amount of $110,000 (2015: nil). These payments were in respect to consulting services provided to PolyNovo Limited in relation to the capital raising.

Other than as noted above, there were no transactions with related parties during the year ended 30 June 2016.

20. Events After the Balance Sheet Date

The Directors are not aware of any other matters or circumstances since the end of the financial year other than those described above, nor otherwise dealt with in this report, which have significantly affected, or may significantly affect, the operations of the Group, the results of those operations or the state of affairs of the Group in subsequent financial years.

21. Auditor's Remuneration

The auditor of PolyNovo Limited is Ernst & Young. The amounts received or due and receivable by Ernst & Young for audit and other services were as follows:

	30 June 2016 $	30 June 2015 $
An audit or review of the Financial Reports of the entity:		
– Half-year and full-year audits	93,000	87,000
Other services in relation to the entity:		
– Tax compliance services	12,500	12,500
– Preparation and lodgement of research and development tax benefit application, AusIndustry review and overseas applications	23,250	22,500
Total auditor's remuneration	128,750	122,000

The Directors are satisfied that the provision of non-audit services during the current period is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The nature and scope of each type of non-audit service provided means that auditor independence was not compromised.

22. Parent Entity Information

	30 June 2016 $	30 June 2015 $
Current assets	21,443,043	3,748,358
Total assets	27,492,777	15,259,362
Current liabilities	86,322	167,097
Total liabilities	86,322	181,701
Issued capital	114,099,711	94,870,080
Retained earnings	(83,324,082)	(82,182,612)
Total reserves	(3,369,175)	2,390,193
Total shareholders' equity	27,406,455	15,077,661
Profit/(loss) of the parent entity	(1,141,714)	(1,799,424)
Total comprehensive income/(loss) of the parent entity	(1,245,464)	(1,799,424)

Details of operating leases entered into by PolyNovo Limited are provided in Note 18.

23. Financial Risk Management Objectives and Policies

(a) Financial instruments

The Group's financial instruments comprise cash and cash equivalents, trade and other receivables, trade and other payables, other financial assets and available-for-sale financial assets.

	30 June 2016 $	30 June 2015 $
Cash and cash equivalents	10,746,691	3,460,454
Trade and other receivables	1,556,275	850,872
Other financial assets (classified as held to maturity)[1]	50,000	60,000
Trade and other payables	590,614	417,513

1. At 30 June 2016 and 30 June 2015, the carrying value of these held-to-maturity assets approximated fair value.

(b) Available-for-sale financial assets – investment in shares

Available-for-sale financial assets	–	98,750

The Group's available-for-sale financial assets at 30 June 2015 comprised 1,250,000 fully paid ordinary shares in Neuren Pharmaceuticals Limited (Neuren), a company listed on the Australian Securities Exchange. The Company sold all its shares in Neuren in June 2016.

(c) Risk Management Policy

The Group has a formal Risk Management Policy and framework. The Group's approach to risk management involves identifying, assessing and managing risk, including consideration of identified risks, in the context of the Group's values, objectives and strategies. The Board is responsible for overseeing the implementation of the risk management system and reviews and assesses the effectiveness of the Group's implementation of that system.

The Group seeks to ensure that its exposure to risks that are likely to impact its financial performance, continued growth and survival are minimised in a cost-effective manner.

23. Financial Risk Management Objectives and Policies continued

(d) Significant accounting policies

Details of the significant accounting policies and methodologies adopted in respect of each class of financial asset, financial liability and equity instrument are disclosed in Note 2.

Details in relation to interest revenue earned on holdings of cash and cash equivalents are disclosed in Note 4.

(e) Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern and to maintain an optimal capital structure so as to maximise shareholder value. In order to maintain an optimal capital structure, the Group may issue new shares or reduce its capital, subject to the provisions of the Company's Constitution and any relevant regulatory requirements. The capital structure of the Group consists of equity attributed to equity holders of the Group comprising contributed equity, reserves and accumulated losses as disclosed in Note 16. The Board monitors the need to raise additional equity from the equity markets based on its ongoing review of PolyNovo's actual and forecast cash flows, which are provided by management.

(f) Financial risk management

The key financial risks the Group is exposed to through its operations are:

- Interest rate risk
- Credit risk
- Liquidity risk
- Foreign currency risk
- Other price risk.

Interest rate risk

Interest rate risk arises when the value of a financial instrument fluctuates as a result of changes in market interest rates.

The Group is exposed to interest rate risks in relation to its holdings in cash and cash equivalents. The objective of managing interest rate risk is to minimise the Group's exposure to fluctuations in interest rates. To manage this risk, the Group locks a portion of the Group's cash and cash equivalents into term deposits. The required maturity period of term deposits is determined based on the Group's cash flow forecast. In addition, the Group considers the lower interest rate received on cash held in the Group's operating account compared to placing funds on term deposit. Account is also taken of the costs associated with early withdrawal of a term deposit should access to cash and cash equivalents be required.

The Group's exposure to interest rate risk and the weighted average interest rates on the Group's financial assets and financial liabilities as at 30 June 2016, along with prior year comparatives, was as follows:

2016	Weighted average effective interest rate	Floating interest rate $	Fixed interest rate 0–90 days $	Fixed interest rate 91–365 days $	Fixed interest rate 1–5 years $	Fixed interest rate over 5 years $	Non-interest bearing $	Total $
Financial assets								
Cash and cash equivalents	2.05%	3,246,691	1,000,000	6,500,000	–	–	–	10,746,691
Other financial assets	2.94%	–	–	50,000	–	–	–	50,000
Receivables	–	–	–	–	–	–	1,556,275	1,556,275
Total financial assets		3,246,691	1,000,000	6,550,000	–	–	1,556,275	12,352,966
Financial liabilities								
Trade and other payables	–	–	–	–	–	–	590,614	590,614
Total financial liabilities	–	–	–	–	–	–	590,614	590,614

2015	Weighted average effective interest rate	Floating interest rate $	Fixed interest rate 0–90 days $	Fixed interest rate 91–365 days $	Fixed interest rate 1–5 years $	Fixed interest rate over 5 years $	Non-interest bearing $	Total $
Financial assets								
Cash and cash equivalents	2.87%	260,454	3,200,000	–	–	–	–	3,460,454
Other financial assets	2.35%	–	–	60,000	–	–	–	60,000
Receivables	–	–	–	–	–	–	850,872	850,872
Total financial assets		**260,454**	**3,200,000**	**60,000**	**–**	**–**	**850,872**	**4,371,326**
Financial liabilities								
Trade and other payables	–	–	–	–	–	–	382,513	382,513
Total financial liabilities		**–**	**–**	**–**	**–**	**–**	**382,513**	**382,513**

23. Financial Risk Management Objectives and Policies continued

(f) Financial risk management continued

Interest rate risk continued

There has been no change to the Group's exposure to interest rate risk, other than the fact that cash holdings are higher than at the previous year end. As noted above, cash is invested in term deposits of varying maturity terms to maximise interest income as well as meet operational cash flow requirements. All term deposits are with the National Australia Bank, to ensure market interest rates are achieved without compromising the security of funds on deposit.

The analysis below details the impact on the Group's loss after tax and equity if the interest rate associated with financial assets was to fluctuate by the margins below, assuming all other variables had remained constant:

	Loss (higher)/lower equity higher/(lower) 2016 $	Loss (higher)/lower equity higher/(lower) 2015 $
+ 1% (100 basis points)	107,967	35,204
- 1% (100 basis points)	(107,967)	(35,204)

Credit risk

Credit risk arises when a counterparty defaults on its contractual obligations, resulting in a financial loss to the Group.

The Group is exposed to credit risk via its cash and cash equivalents and receivables. To reduce risk exposure in relation to its holdings of cash and cash equivalents, they are placed on deposit with the Group's main bankers, the National Australia Bank (S&P Rating AA/A-1+, Moody's rating Aa1/P-1). A change to the Group's bankers requires Board approval.

In previous years the Group has had minimal trade and other receivables, with the majority of its cash being provided via shareholder investment.

In 2016, with the commencement of the Company's contract with BARDA, the receivables balance at 30 June 2016 includes accrued income of $697,058 from this agency in relation to services provided. BARDA is contractually obliged to reimburse the Company for these services. BARDA, being a US government agency, is considered to be a low credit risk customer.

The ageing analysis of trade and other receivables is as follows.

2016	0–30 days $	30–60 days $	60–90 days $	90+ days $	Total $
Trade and other receivables	697,984	10,041	–	64,942	772,967
2015					
Trade and other receivables	21,305	7,269	–	–	**28,574**

Liquidity risk

Liquidity risk arises if the Group encounters difficulty in raising funds to meet its financial liabilities.

The Group is exposed to liquidity risk via its trade and other payables. Responsibility for managing liquidity risk rests with the Board, which regularly reviews liquidity risk by monitoring the undiscounted cash flow forecasts and actual cash flows provided to it by management. This process is undertaken to ensure that the Group continues to be able to meet its debts as and when they fall due. Contracts are not entered into unless the Board is satisfied that there is sufficient cash flow to fund the additional commitment. The Board determines when reviewing the undiscounted cash flow forecasts whether the Group needs to raise additional working capital from its existing shareholders, the equity capital markets or any other available sources.

A maturity analysis of trade and other payables, based on contractual terms, is set out below:

2016	0–30 days $	30–60 days $	60–90 days $	90+ days $	Total $
Trade and other payables	513,147	64,967	12,500	–	590,614

2015					
Trade and other payables	99,147	318,366	–	–	**417,513**

Foreign currency risk

Foreign currency risk arises when foreign currency exchange rates fluctuate against the Australian dollar, resulting in a foreign currency exchange loss or gain to the Group.

The Group is exposed to foreign currency risk via its cash and cash equivalents, trade receivables and trade payables as part of its normal business.

The Group incurs foreign currency expenses predominantly in USD and EUR. To reduce foreign currency risk exposure, the Group maintains an amount of cash and cash equivalents in USD. The Group receives payment from its overseas customer (BARDA) in USD and pays USD trade payables from its USD funds. EUR denominated payable balances carry some foreign currency risk; however, these payable balances are typically low in value (nil balance at 30 June 2016) and are therefore considered to expose the Group to minimal risk.

The holdings of cash and cash equivalents, trade receivables and trade payables analysed by nominated currency at 30 June 2016, along with prior year comparatives, were as follows.

2016	Denominated in AUD $	Denominated in USD $	Denominated in EUR $	Total $
Financial assets				
Cash and cash equivalents	9,269,572	1,477,119	–	10,746,691
Receivables	859,217	697,058	–	1,556,275
Total financial assets	10,128,789	2,174,177	–	12,302,966
Financial liabilities				
Trade and other payables	173,474	417,140	–	590,614
Total financial liabilities	173,474	417,140	–	590,614

A hypothetical 10% strengthening in the exchange rate of the Australian dollar against the US dollar with all other variables held constant would have $175,704 favourable effect on the loss and equity for the 2016 financial year.

2015	Denominated in AUD $	Denominated in USD $	Denominated in EUR $	Total $
Financial assets				
Cash and cash equivalents	3,460,454	–	–	3,460,454
Receivables	850,872	–	–	850,872
Total financial assets	**4,311,326**	**–**	**–**	**4,311,326**
Financial liabilities				
Trade and other payables	417,513	–	–	417,513
Total financial liabilities	**417,513**	**–**	**–**	**417,513**

Notes to the Financial Statements continued

for the year ended 30 June 2016

23. Financial Risk Management Objectives and Policies continued

(f) Financial risk management continued

Other price risk – available-for-sale financial asset

The Group's available-for-sale financial asset at 30 June 2015 consisted of 1,250,000 fully paid ordinary shares held in Neuren Pharmaceuticals Limited (Neuren), a company listed on the Australian Securities Exchange (ASX Code: NEU). This investment was subject to price risk associated with fluctuations in the market price of the Neuren shares.

The Company sold all shares in Neuren Pharmaceuticals Limited in June 2016, therefore the price risk associated with the fluctuations in the market price of the shares has been eliminated.

24. Key Management Personnel Disclosures

The key management personnel compensation disclosures required by the *Corporations Act 2001* are provided in the Remuneration Report in the Directors' Report.

(a) Details of key management personnel

The key management personnel of the Group are those persons having the authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, during the 2016 and 2015 financial years. Unless otherwise indicated, they were key management personnel during the whole of the financial years.

Poloynovo's key management personnel are its Directors and members of the senior management team. Details of each Director and Senior Executive, who are classified as key management personnel, are provided in the Remuneration Report.

(b) Compensation by category: key management personnel

	30 June 2016 $	30 June 2015 $
Short-term	740,944	1,027,362
Post-employment – superannuation	69,750	75,966
Long-term	6,104	33,736
Share-based payments	308,602	139,616
Termination benefits	53,815	128,661
	1,179,216	1,405,341

(c) Interests held by key management personnel

Share options held by key management personnel to purchase ordinary shares have the following expiry dates and exercise prices:

Issue date	Expiry date	Exercise price	2016 number outstanding	2015 number outstanding
2012	20/11/15	$0.110	–	1,500,000
2014	03/07/17	$0.090	–	7,500,000
2014	03/07/17	$0.200	2,500,000	2,500,000
2014	17/11/17	$0.140	1,000,000	1,000,000
2014	17/11/17	$0.20	2,000,000	2,000,000
2015	05/08/18	$0.09	8,370,190	–
			13,870,190	14,500,000

(d) Loans to key management personnel

No loans have been made to Directors of PolyNovo or to any other key management personnel, including their related entities.

(e) Other transactions with Directors

Details of other transactions with Directors have been provided as part of the key management personnel disclosures in the Remuneration Report.

25. Controlled Entities

The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policy in Note 2:

	Country of incorporation	Percentage owned 2016 %	2015 %
Company:			
PolyNovo Limited	Australia		
Subsidiaries of PolyNovo Limited:			
PolyNovo Biomaterials Pty Ltd	Australia	100	100
NovoSkin Pty Ltd	Australia	100	80
NovoWound Pty Ltd	Australia	100	80

PolyNovo completed the acquisition of non-controlling interests in subsidiary companies NovoSkin Pty Ltd and NovoWound Pty Ltd on 22 December 2015.

Consideration for the acquisition comprised 32,000,000 PolyNovo shares, which remained in escrow until 31 May 2016, and cash payments as follows: $500,000 at settlement, $1,000,000 payable on 1 March 2016, $500,000 payable on 31 May 2016 and $500,000 payable on 29 June 2016. The attributed value of consideration paid in shares, based on the closing share price on the 22 December 2015, was $5,920,000.

Corporate Directory

ABN 96 083 866 862

Non-executive Chairman

Mr David Williams

Non-executive Directors

Mr Bruce Rathie
Dr David McQuillan
Mr Philip Powell
Mr Max Johnston
Mr Leon Hoare

Chief Executive Officer

Mr Paul Brennan

Company Secretary

Ms Andrea Goldie

Registered office

Unit 2/320 Lorimer Street
Port Melbourne
Victoria Australia 3207

T (03) 8681 4050
F (03) 8681 4099

Share registry

Computershare Investor Services Pty Ltd
Yarra Falls
452 Johnston Street
Abbotsford
Victoria Australia 3067

T 1300 850 505

Auditors

Ernst & Young
8 Exhibition St
Melbourne Victoria 3000

Website

www.polynovo.com.au

Australian Securities Exchange

PolyNovo shares are quoted on ASX Limited
(ASX Code: PNV)

PolyNovo

2/320 Lorimer Street
Port Melbourne
Victoria Australia 3207

T +613 8681 4050
F +613 8681 4099

polynovo.com.au

PolyNovo Limited (ABN 96 083 866 862)

Directors' Declaration

for the year ended 30 June 2016

In accordance with a resolution of the Directors of PolyNovo Limited, I state that:

1. In the opinion of the Directors:

   (a) The Financial Report and the Remuneration Report included in the Directors' Report, of the Company and of the Group are in accordance with the *Corporations Act 2001*, including:

      (i) giving a true and fair view of the Company and the Group's financial position as at 30 June 2016 and of their performance for the year ended on that date;

      (ii) complying with Australian Accounting Standards and *Corporations Regulations 2001*; and

      (iii) complying with International Financial Reporting Standards as issued by the International Accounting Standards Board.

   (b) There are reasonable grounds to believe that the Company and the Group will be able to pay their debts as and when they become due and payable.

2. This declaration has been made after receiving the declarations required to be made to Directors in accordance with section 295A of the *Corporations Act 2001* for the financial period ended 30 June 2016.

On behalf of the Board,

Mr David Williams
Chairman
22 August 2016

Ernst & Young
8 Exhibition Street
Melbourne VIC 3000 Australia
GPO Box 67 Melbourne VIC 3001

Tel: +61 3 9288 8000
Fax: +61 3 8650 7777
ey.com/au

Independent auditor's report to the members of PolyNovo Limited

Report on the financial report

We have audited the accompanying financial report of PolyNovo Limited, which comprises the consolidated statement of financial position as at 30 June 2016, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal controls as the directors determine are necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 2, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards*.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

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

Independence

In conducting our audit we have complied with the independence requirements of the *Corporations Act 2001*. We have given to the directors of the company a written Auditor's Independence Declaration, a copy of which is included in the directors' report.

Opinion

In our opinion:

a. the financial report of PolyNovo Limited is in accordance with the *Corporations Act 2001*, including:

   i giving a true and fair view of the consolidated entity's financial position as at 30 June 2016 and of its performance for the year ended on that date; and

   ii complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and

b. the financial report also complies with *International Financial Reporting Standards* as disclosed in Note 2.

Report on the remuneration report

We have audited the Remuneration Report included in pages 13 to 19 of the directors' report for the year ended 30 June 2016. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Opinion

In our opinion, the Remuneration Report of PolyNovo Limited for the year ended 30 June 2016, complies with section 300A of the *Corporations Act 2001*.

Ernst + Young

Ernst & Young

Joanne Lonergan
Partner
Melbourne
22 August 2016

Additional Information Required by ASX

for the year ended 30 June 2016

Additional information required by the Australian Securities Exchange is as follows:

Ordinary Shares

As at 17 August 2016, there were 558,863,915 ordinary shares on issue held by 5,828 shareholders. Each ordinary share carries one vote per share.

Top 20 holders as at 17 August 2016

Shareholder	No. of shares	%
The Trust Company (Australia) Limited <MOF A/C>	69,012,099	12.35
HSBC Custody Nominees (Australia) Limited	17,963,413	3.21
Mr John Edward Greenwood <The Greenwood Family A/C>	16,000,000	2.86
J A B Investments (SA) Pty Ltd <J A B A/C>	16,000,000	2.86
Citicorp Nominees Pty Limited	15,470,654	2.77
Lateral Innovations Pty Ltd <Trust A/C>	12,228,548	2.19
Monash Investment Holdings Pty Ltd	9,607,520	1.72
National Nominees Limited	8,980,724	1.61
Mr Anthony Shane Kittel + Mrs Michele Therese Kittel <Kittel Family Super A/C>	7,798,620	1.40
Moggs Creek Pty Ltd <Superannuation Fund A/C>	7,500,000	1.34
UBS Nominees Pty Ltd	6,540,423	1.17
Mrs Suzanne Kenley	5,350,000	0.96
Mr Laurent Fossaert	5,135,139	0.92
Dr Gavin James Shepherd + Mrs Catherine Jane Shepherd <Shepherd Investment A/C>	4,761,451	0.85
ABN Amro Clearing Sydney Nominees Pty Ltd <Custodian A/C>	4,282,888	0.77
Simone Maree Beks	4,185,095	0.75
CSIRO	4,081,250	0.73
Mr Paul James Lappin + Ms Siobhan Catherine Lyons <Lappin Super Fund A/C>	4,049,076	0.72
Mr David Kenley	3,700,000	0.66
Semblance Pty Ltd <Graeme Mutton Retire S/Fund>	3,670,000	0.66
Total	**226,316,900**	**40.50**

Additional Information Required by ASX continued

for the year ended 30 June 2016

Unquoted Securities

Options over unissued shares

As at 22 August 2016, a total of 13,870,190 options over ordinary shares are on issue held by six individual holders.

There are 5,500,000 options on issue to Directors as at the date of this report. Options do not carry a right to vote.

On 6 August 2015, PolyNovo issued an options package to the CEO, compromising three tranches of 4,185,095 options exercisable at 9 cents upon satisfaction of share price-based vesting hurdles. Details of the options package and the fair value of options and compensation during the year are included in the Remuneration Report at Tables A, C and E.

The range of shareholders based on number of shares held as at 22 August 2016 is as follows.

Range of units	No. of holders	No. of shares
1 – 1,000	742	453,723
1,001 – 5,000	1,652	4,945,308
5,001 – 10,000	873	7,155,390
10,001 – 100,000	1,946	69,380,070
100,001 and over	650	476,929,424
Number of holders with less than a marketable parcel	1,018	841,522

Voting Rights

Clauses 45 to 54 of the Company's Constitution stipulate the voting rights of members. In summary but without prejudice to the provisions of the Constitution, every member present in person or by representative, proxy or attorney shall have one vote on a show of hands and on a poll have one vote for each share held by the member.

Substantial Shareholders

Name of shareholding	No. of shares
The Trust Company (Australia) Limited <MOF Account>	69,012,099
Mr David Kenley	27,440,625

Quotation of the Company's Shares

PolyNovo has been granted official quotation for its shares on the Australian Securities Exchange (ASX Code: PNV).

Corporate Directory

ABN 96 083 866 862

Non-executive Chairman

Mr David Williams

Non-executive Directors

Mr Bruce Rathie
Dr David McQuillan
Mr Philip Powell
Mr Max Johnston
Mr Leon Hoare

Chief Executive Officer

Mr Paul Brennan

Company Secretary

Ms Andrea Goldie

Registered office

Unit 2/320 Lorimer Street
Port Melbourne
Victoria Australia 3207

T (03) 8681 4050
F (03) 8681 4099

Share registry

Computershare Investor Services Pty Ltd
Yarra Falls
452 Johnston Street
Abbotsford
Victoria Australia 3067

T 1300 850 505

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Melbourne Victoria 3000

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