



06



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progress & achievements

CHAIRMAN & CEO'S REPORT



Dr Hugh Niall, Chairman

Dear Shareholders

The team at Avexa is proud of the progress made by the Company over the past financial year. During the year, the Company pursued a number of key initiatives that were important building blocks towards growing the Company and building shareholder value. These major achievements in 2005-06 are highlighted as follows:

- initiation of two Phase I studies;
- initiation of the Phase IIb trial for apricitabine;
- preparations for the Phase III trial for apricitabine;
- a \$14.4 million rise in new equity to fund further trials;
- AVX754 was assigned an International Non-proprietary Name (INN) apricitabine by the World Health Organisation;
- a collaboration agreement with the CSIRO;
- a collaboration with MNL Pharma (UK); and
- commencement of animal studies for a new anti-bacterial treatment.

Reflecting the risks we face as a company, there were a few disappointments during the year. The pre-clinical development work on our Hepatitis B compound was slowed following inconclusive results and the Phase IIb trial for apricitabine has not proceeded as quickly as we might have expected due to slow recruitment of patients in Australia. The Company moved quickly to ensure that patient recruitment improved by opening study sites in Argentina. Argentina was chosen for the support and belief by local HIV treating clinicians that apricitabine shows potential as part of the treatment armament against HIV. It should be noted that the majority of patients treated in the Phase IIa trial for apricitabine were recruited in Argentina.

Avexa continues to be buoyed by the progress of apricitabine in the current Phase IIb trial in particular as a number of patients are entering into the open label part of the trial where patients are knowingly taking apricitabine as part of their daily treatment. In



Dr Julian Chick, Chief Executive Officer

the coming 12 months the Company is looking forward to the completion of the Phase IIb trial and progress towards the commencement of Phase III trials for apricitabine. In addition to the Phase IIb trial, the Company is also expecting the results from two supporting Phase I trials for apricitabine.

In April 2006, the Company raised \$14.4 million in new capital from US and Australian based institutions and shareholders. This was a great vote of confidence in our strategies and provided the financial foundation for us to proceed with the next stage in the clinical development of apricitabine.

Whilst apricitabine is our most advanced project, we have other projects in the pipeline. One of our two early stage projects is looking at a treatment for serious bacterial infections typically found in hospitals and known as 'super bugs', and the other is a promising new approach to HIV treatments. During the year, we entered two collaborations, one with the CSIRO and the other with MNL Pharma from the UK. These collaborations are aimed at supporting Avexa's existing discovery programs for the identification of new treatments for infectious diseases. The Company is expecting the earlier stage programs to reach significant milestones over the next 12 months.

The development of new treatments for infectious diseases is tremendously important and success is only achieved through a team effort involving our management and scientists in both discovery and clinical development. Avexa is privileged to have such a highly experienced team and we all look forward to the challenges and opportunities over the next year.

Yours sincerely

A handwritten signature in dark ink, appearing to read "Hugh Niall".

Dr Hugh Niall
Chairman

A handwritten signature in dark ink, appearing to read "Julian Chick".

Dr Julian Chick
Chief Executive Officer



research & development

R&D REPORT

Apricitabine: A Treatment for Drug-resistant HIV Infections

Although there are a number of different treatments available now on the market for people infected with HIV, there is still a need for new, improved therapies which have less side effects, that are easier to take, and are more effective against drug-resistant virus. Many HIV sufferers need to change their medication as the virus develops resistance to existing treatment, or because the side effects are too troublesome. For advanced patients who have tried all the currently available drugs, new drugs are sometimes their only hope to regain control of their infection.

Currently, HIV drugs are available in four classes: Nucleoside Reverse Transcriptase Inhibitors (NRTIs), Protease Inhibitors (PIs), Non-Nucleoside Reverse Transcriptase Inhibitors (NNRTIs) and Fusion Inhibitors (FIs). These classes of drugs hit different viral targets: the Reverse Transcriptase (NRTI and NNRTI), the Protease (PI), and the envelope protein (FI). Two new classes which hit new targets are also in clinical development. Integrase Inhibitors target the viral Integrase, whilst Entry Inhibitors target the co-receptor (location for viral entry into the host cell) for the virus.

NRTIs are the oldest and best known class of drugs, and form the backbone of the most commonly used therapies for HIV. Most patients are treated with at least two NRTIs, plus one or more drugs from the other classes (which in the future may be expanded to include the new drug classes under development). 3TC (lamivudine®) and FTC (emtricitabine®) are the most commonly used NRTIs. Both are effective at first, and well tolerated, but the virus easily develops high level resistance by just a single change in the Reverse Transcriptase (called M184V).

Apricitabine (ATC) is a new drug belonging to the Nucleoside Reverse Transcriptase Inhibitor (NRTI) class of HIV drugs. In the laboratory, it shows potent antiviral activity against HIV which is resistant to currently available NRTIs, as well as a low likelihood of toxicity (side effects). In particular, ATC shows activity against virus which is resistant to 3TC and FTC (M184V virus).

ATC has also shown very good antiviral activity in a Phase IIa study where first time HIV patients took the drug for 10 days.

ATC is now being tested in a clinical trial in patients who have failed treatment with 3TC. The trial is taking place in Argentina and Australia. Patients receive either ATC or 3TC for 24 weeks in a blinded fashion – neither the patients nor the clinical team know which one they are actually taking. After this period, they enter an open label period, where they knowingly receive ATC for a further

IN THE LABORATORY,
APRICITABINE SHOWS POTENT
ANTIVIRAL ACTIVITY AGAINST
HIV WHICH IS RESISTANT TO
CURRENTLY AVAILABLE NRTIs.

24 weeks as part of their daily treatment. As of July 2006 five of the first patients enrolled have passed the first 24 week blinded part and are now taking ATC as part of their daily medication. Thus far, very few side effects related to ATC have been seen, which is encouraging considering that these patients have now been treated with ATC for many months. Further long term information will be forthcoming from an extension to the current Phase IIb trial for patients after 48 weeks of treatment may continue to be treated with ATC as part of their daily treatment. Avexa is keen to ensure that these patients can continue to receive ATC as a valuable part of their HIV treatment.

The current Phase IIb trial is part of a global development program for ATC, which will take ATC towards global registration and the market. This includes Phase III trials, which Avexa is currently designing. Other aspects of the development program (such as manufacture of drug stocks for Phase III trials) are already underway, so that we can move forward as quickly as possible. Also Avexa has now completed enrollment in two Phase I trials: a cardiac safety trial and a tipranavir co-dosing trial. These two trials have been requested by regulatory authorities prior to entering Phase III trials. They are being undertaken now in preparation for Phase III development. Many planning and other activities are also taking place to ensure that we are fully prepared to move forward as effectively and efficiently as possible as soon as the current Phase IIb trial is concluded.

R&D REPORT CONTINUED

HIV Infection

Currently there are approximately 40 million people worldwide infected with HIV. Approximately four million more are infected each year, and with no vaccine available in the foreseeable future, 'antiretroviral medicines' are the only way to manage this disease.

Once infected with HIV, the overwhelming majority of people progress to AIDS although this can be slowed or even prevented by daily dosing of a combination of antiretroviral drugs. These drugs prevent virus replication however their success relies on near total adherence to the dosing schedule over what appears at present to be for the rest of the patient's life. If full adherence is not maintained the risk of developing viruses resistant to the drugs increases significantly.

It is estimated that approximately 75 per cent of patients who fail anti retroviral drugs have developed resistance to more than one therapeutic class thereby limiting the options available for a second line therapy. Therefore to combat the issue of resistance and offer new front line therapeutic strategies there is a need for inhibitors that target other parts of the life cycle of the virus.

To date the most successful antiretrovirals have targeted two of the three essential HIV enzymes, Reverse Transcriptase and Protease. A new target to which no drugs are yet available on the market is the third HIV encoded enzyme, Integrase. The function of this enzyme is to insert the virus genome into the human cell genome enabling the virus to replicate.

Currently only two HIV inhibitors are known to be in clinical trials, a compound known as MK-0518 from Merck and Co and one co-developed by Gilead and Japan Tobacco called GS-9137. These compounds have shown good antiviral effects and have offered proof of concept that inhibitors of integrase will block HIV replication.

So far, reports on these compounds have indicated possible metabolism issues, with the compound GS-9137 being dosed with ritonavir a drug metabolism blocker.

Avexa's HIV Integrase Program

Avexa is developing its own class of integrase inhibitors and has submitted three patents to cover the class. Avexa's inhibitors are significantly different from those inhibitors in trials and whilst their mode of action is similar, they are thought to act by a different mechanism.

Avexa's Discovery group utilises both biochemical and virology techniques in conjunction with molecular modelling and protein-drug crystallography approaches to design and assess the activity of its compounds. Findings from these approaches assist Avexa's

medicinal chemistry group and its resources at the Shanghai Institute of Organic Chemistry in China in the rapid synthesis and optimisation of lead compounds.

During the discovery program lead compounds are also analysed for their in vitro and ex vivo absorption, distribution, metabolism and excretion (ADME) and their pharmacokinetic properties to ensure Avexa's lead compounds are developed with favourable drug like properties.

In addition to its international resources, Avexa is also working closely with one of Australia's premier scientific organisations, CSIRO, to identify and develop new lead inhibitors.

Avexa's goal is to complete a proof of concept animal model of its lead inhibitor series in the first half of 2007. On successful completion of this study, the compounds will proceed into preclinical development and then progress into clinical trials. As part of its other programs Avexa has established a clinical development group with experience in the development of HIV antiretrovirals.

Antibacterial for the Treatment of Antibiotic-resistant Bacterial Infections

Penicillin was the first antibiotic to be discovered. Identified nearly 80 years ago it became a widely used medicine that could treat infections that had previously proved very serious and often lethal. However, in less than four years after the drug started being mass-produced, resistance to penicillin was found in one of the most common bacteria to infect humans, *Staphylococcus aureus*. Methicillin is a type of penicillin and methicillin-resistant *Staphylococcus aureus* (MRSA) was first confirmed in the UK in 1961 and is now relatively common in hospitals throughout the world. In 1999 for example MRSA was responsible for nearly 40 per cent of fatal cases of blood poisoning in the UK. Half of all *Staphylococcus aureus* infections in the USA are believed to be resistant to penicillin, methicillin, tetracycline and erythromycin.

Vancomycin, another antibiotic, is often used as a 'medicine of last resort' to treat infections caused by these multi-drug resistant bacteria. Unfortunately, while it took many years for *Staphylococcus aureus* to become resistant to this antibiotic, Vancomycin-resistant *Staphylococcus aureus* (VISA) was first identified in Japan in 1997, and has since been found in hospitals in the UK, Europe and the USA.

Antibiotic resistance is recognised as a key health concern by leading authorities (including the WHO, CDC and the European community) because of the impact it has on the management of bacterial infections. These include increased length and severity of illness, longer period of infectiousness, higher potential for adverse reactions following the use of second-choice therapies, longer in-patient stays, and increased costs.



The market for antibiotics is predominated by the sales of four types of antibiotic, (namely the cephalosporins, fluoroquinolones, macrolides and penicillins). However, the market for antibiotics is huge, with about US\$20 billion in sales in the seven major markets of USA, Japan, Italy, France, Germany, Spain and the UK.

Avexa's Antibacterial Program

Avexa has used knowledge of the architecture of the bacterial cell wall and its molecular make-up to rationally design a series of compounds that target not only antibiotic-resistant bacterial cell walls, but also antibiotic-sensitive bacterial cell walls. These compounds are highly effective at killing the target bacteria, and do not rapidly select for resistance.

The compounds also have activity against vancomycin-resistant and vancomycin-intermediate sensitive strains of *Staphylococcus aureus*. Over the last year Avexa has been systematically synthesizing and testing these compounds in models that will identify compounds with particular drug-like characteristics. These compounds have been synthesised in collaboration with University of Wollongong, New South Wales. The collaboration with the University of Wollongong has been and remains supported by several Australian Research Council and National Health and Medical Research Council grants.

The most important outcome from this year's work is two series of compounds, one with the properties expected for a topically applied antibacterial agent, while a separate series has the properties of a systemically dosed antibacterial agent. An

AVEXA HAS DESIGNED AND SYNTHESIZED A NUMBER OF COMPOUNDS THAT HAVE POTENT ANTI-BACTERIAL ACTIVITY AGAINST METHICILLIN-SENSITIVE AND METHICILLIN-RESISTANT STRAINS OF *STAPHYLOCOCCUS AUREUS*.

optimum compound from each series has been identified as the series lead, and each compound is being tested in models to demonstrate their drug-likeness, and suitability for development as a topical and a systemic medicine for the treatment of antibiotic-resistant bacterial infections.



practices & policies

CORPORATE GOVERNANCE STATEMENT

The Board of Directors of Avexa Limited recognises the important role that effective corporate governance practices can play in the management of the business of a company and the creation of value for the Company's shareholders. As a result, Avexa and the Board are committed to achieving and maintaining a high standard of corporate governance that is tailored to suit, among other matters, the size of the Company and its business and the characteristics of the industry of which it is a part.

A description of the Company's main corporate governance practices and policies is set out in this statement. In certain instances, the Company's approach has been to address the objectives underlying the Australian Stock Exchange Corporate Governance Council's – Principles of Good Corporate Governance and Best Practice Recommendations (the ASX Recommendations) without strictly complying with the letter of the recommendations. Accordingly, while Avexa has largely adopted the ASX recommendations, the instances in which the Company's practices depart from the ASX recommendations are described and explained in this statement.

The Board will continue to review and assess the Company's corporate governance practices and policies as the Company's business evolves and grows over time.

The Board of Directors

The Avexa Board is responsible for, and has the authority to determine, all matters relating to the strategic direction, policies and practices of Avexa. Part of the Board's role in this regard is to establish goals for Senior Management and for the operation of the Company.

In defining its roles and responsibilities, the Board has not adopted a formal charter, but instead has had regard to the Constitution of Avexa and to the categories of matters that are commonly understood to be within the province of a company board. The Board's specific responsibilities and functions include:

- oversight of the Company, including its control and accountability systems;
- appointing, removing and approving remuneration for the Chief Executive Officer;
- input into and final approval of the corporate strategy, business plans, budgets and performance objectives developed by Senior Management;
- monitoring Senior Management's performance and implementation of strategy, and ensuring appropriate resources are available;
- approving and monitoring the progress of major capital expenditure, capital management, budgeting, operations and acquisitions and divestitures;
- approving communications with shareholders and announcements to the Australian Stock Exchange;

- reviewing and ratifying systems of risk management, internal compliance and control and legal compliance; and
- approving and monitoring financial and other statutory reporting and compliance matters.

The Board has approved a formal delegation to the Chief Executive Officer and other Senior Management of day to day authority over the operations of Avexa's business.

Board Composition

The Board currently consists of four Directors:

- Dr Hugh Niall (Chairman);
- Dr Julian Chick;
- Dr Errol Malta; and
- Mr Stephen Cooper.

Details of each Director's relevant skills, experience and expertise and term of office, in each case as at the date of this Annual Report, are set out later in the Directors' Report. As is noted in the Directors' Report, Dr Chick is the Chief Executive Officer of Avexa.

The Board has considered the independence of each of the Avexa Directors within the framework of the guidance set out in Box 2.1 of the ASX Recommendations, and has classified Dr Niall, Dr Malta and Mr Cooper as independent. At the time of Avexa's last Annual General Meeting, Avexa had only one independent Director, Dr Niall. Since that time, Avexa has been able to secure two additional independent Directors, both of whom add important experience and expertise to the composition of the Board. Consequently, since late in the first half of the reporting period, with the appointment of Dr Malta and Mr Cooper, the majority of the Board has consisted of independent Directors, including the Chairman of the Board.

The Board believes that Dr Chick, the only Executive Director, brings qualities to the Board that greatly enhance its effectiveness. Dr Chick has an intimate knowledge of both the history and the current operations of the Company by virtue of his former position at Amrad (now named Zenyth Therapeutics) as a senior business development executive and his current position as the Company's Chief Executive Officer.

The Board is of the view that its current composition now reflects an appropriate mix of expertise, knowledge of Avexa's operations and independence. The size of the Board is also optimal, as a small board facilitates efficient decision making and is appropriate for a company of Avexa's size. The Board will continue to assess its composition as opportunities arise from time to time to adjust the mix of skills, experience and perspectives represented on the Board.

CORPORATE GOVERNANCE STATEMENT

CONTINUED

Each Director of Avexa has the right to seek independent professional advice at the Company's expense with the approval of the Chairman. Each Director is also indemnified under the Company's Constitution and under separate deeds of indemnity.

Board Remuneration and Performance Evaluations

The Company Constitution and the ASX Listing Rules require the total amount of remuneration payable to Non-Executive Directors to be approved by shareholders by ordinary resolution at a general meeting. At the Company's 2005 inaugural Annual General Meeting, the Company's shareholders approved \$350,000 as the maximum aggregate amount of remuneration payable to Directors.

The Board currently consists of four Directors, one of whom (Dr Chick) is an Executive Director.

Non-Executive Directors are paid their fees out of the maximum aggregate amount approved by shareholders for the remuneration of Non-Executive Directors. Non-Executive Directors do not receive performance based bonuses and do not participate in equity-based incentive plans of the Company. Non-Executive Directors are entitled to statutory superannuation.

The details of the remuneration received by all of the Company's Directors are contained in the Remuneration Report.

In keeping with the previously announced intentions of Avexa's significant shareholder Zenyth Therapeutics (formerly Amrad Corporation), and as specified in Avexa's 2004 Information Memorandum published at the time of the Company's demerger from Amrad, Ms Helen Cameron resigned from the Board in December 2005. As a result of the significant and relatively recent changes in the composition of the Board, the Board has chosen to defer the conduct of a formal performance evaluation of itself or its members until after the reporting period.

The Board has carefully considered its composition and the mix of skills, experience and perspectives of its members during the year, resulting in the appointments of Dr Malta and Mr Cooper. The Board is committed to future annual reviews of its performance, both individually and collectively, against both measurable and qualitative factors.

Board Committees

The Board has established an Audit and Risk Committee, which in general is responsible for any matters relating to the assets and financial affairs of Avexa and to the Company's external or internal audit functions. The Audit and Risk Committee's specific responsibilities include:

- monitoring and reviewing the integrity of financial statements and the effectiveness of internal financial controls;

- making recommendations to the Board in relation to the appointment of external auditors and approving the remuneration and terms of their engagement;
- reviewing risk management and internal compliance and control systems; and
- monitoring and reviewing the independence, objectivity and competency of internal and external auditors.

The Audit and Risk Committee's charter is posted on the corporate governance section of Avexa's website.

The members of the Audit and Risk Committee are:

- Mr Stephen Cooper (Chairman);
- Dr Hugh Niall; and
- Dr Errol Malta.

All of the members of the Audit and Risk Committee are independent Directors. Details of Mr Cooper's, Dr Niall's and Dr Malta's qualifications and attendance at Audit and Risk Committee meetings are set out in the Directors' Report. Dr Chick is entitled to attend meetings of the Audit and Risk Committee in an ex-officio capacity only.

The Board requires the Chief Executive Officer of Avexa and the contracted chief financial officer to provide written assurances to the Board in respect of the accuracy and compliance of Company financial reports and of the integrity of the risk management and internal compliance and control systems as part of the management sign-off process for Avexa's half year and full year financial statements.

The Board does not have a nomination committee or a remuneration committee, as the Board does not consider formal committees to be necessary in these areas in light of the small size of the Board. All matters in relation to potential new Directors or remuneration are considered by the full Board (except that Dr Chick does not participate in any deliberations in respect of his own remuneration).

Other Corporate Governance Practices and Policies

Avexa has written policies and procedures in respect of trading in the Company's securities and compliance with the Company's continuous disclosure obligations. These policies and procedures are posted on the corporate governance section of Avexa's website. Avexa's securities trading policy prohibits the trading of Company securities by Directors and employees while in possession of price sensitive information.

The Company does not have any formal code of conduct governing unethical practices or compliance matters, or any formal policies on risk oversight and management. Instead, the Company has individual policies covering matters such as confidentiality, conflicts of interest, fraud risks, information technology use and employee discrimination and harassment. Avexa employees, contractors and consultants are made aware of these policies through the employees' policies and procedures manual.

External Auditors

KPMG has been Avexa's external auditor since the Company's incorporation in April 2004. KPMG meets with the Audit and Risk Committee at least four times each year. KPMG will be requested to attend the Annual General Meeting and to be available to answer shareholder questions about its audit of the Company's financial statements.

Information on procedures for the selection and appointment of the Company's external auditor is posted on the corporate section of the Company's website.

Shareholder Communications

The Board is committed to keeping shareholders fully informed of Avexa's activities through regular and timely communications with all shareholders. As part of this commitment, the Company distributes a quarterly news report to shareholders, and posts various information, including company announcements, media briefings, details of general meetings, press releases and financial reports, on the Company's website. Avexa also communicates with its shareholders through its Annual Report, which will be issued to all shareholders and posted on the Company's website.

Executive Remuneration

Company remuneration policies and practices, including details of options issued under Avexa's Employee Share Option Plan, are set out in the Remuneration Report. A copy of the Employee Share Option Plan is posted on the corporate section of the Company's website.

The Company is committed to remunerating its Senior Executives in a manner that is market-competitive and consistent with best practice as well as supporting the interests of shareholders. By remunerating Senior Executives through performance and long term incentive plans in addition to their fixed remuneration, the Company aims to align the interests of Senior Executives with those of shareholders and increase Company performance. The objective behind using this remuneration structure is to drive improved Company performance and thereby increase shareholder value as well as aligning the interests of Executives and shareholders.

THE BOARD WILL CONTINUE TO REVIEW AND ASSESS THE COMPANY'S CORPORATE GOVERNANCE PRACTICES AND POLICIES AS THE BUSINESS EVOLVES AND GROWS OVER TIME.

Corporate and individual performance targets have been established by the Board for Avexa's Chief Executive Officer, Dr Chick, as part of his remuneration arrangements. Accordingly, shareholder approval will also be sought at the 2006 Annual General Meeting for the proposed further issue of a total of 300,000 options to Dr Chick under the Employee Share Option Plan in connection with the performance targets achieved during the financial year ending 30 June 2006 by Dr Chick in his role as the Company's Chief Executive Officer. The exercise price for these options will be 20 per cent above the weighted average trading price of an Avexa share on the first five business days of the financial year ending 30 June 2007. The options will vest progressively as follows: 50 per cent on 1 July 2007 and the remaining 50 per cent on 1 July 2008. The options will expire on 30 June 2011.

If shareholders do not approve the issue of these options to Dr Chick, Avexa is required to ensure that Dr Chick is provided with alternative benefits of an equivalent after-tax value to him.

Particulars of the remuneration of the Chief Executive Officer, Dr Chick, and Senior Management for the period 1 July 2005 to 30 June 2006, including all monetary and non-monetary components, are set out in the Remuneration Report.

AVEXA BOARD



Dr Hugh Niall MB, BS, MD (Melb.) FRACP
Chairman and Non-Executive Director

Dr Niall became Chairman and a Non-Executive Director of Avexa on 23 September 2004. Dr Niall has many years experience in the biotechnology industry in Australia and the United States. From 2003 to 2006 he was Chief Executive Officer of the Australian Stem Cell Centre Limited (ASCC) and from 1995 to 2002 was the Chief Executive Officer of Biota Holdings Limited, a publicly listed company based in Melbourne, whose focus is the discovery and development of new human antiviral pharmaceuticals.

After completing his medical degree and obtaining post-graduate qualifications in medicine at the University of Melbourne, Dr Niall worked overseas at the National Institutes of Health, Bethesda, Maryland, USA and at Harvard University, where he was an Associate Professor of Medicine. Dr Niall has also held senior appointments with the Howard Florey Institute of Experimental Physiology and with Genentech Inc, a major biotechnology company in South San Francisco where he was Vice President of Research Discovery and an Officer of the Company.

Dr Niall is the Chair of the Investment Committee of the Genesis Fund of GBS Venture Partners Limited, Chair of the Diabetes Vaccine Development Centre, a Director of Ausgenics Pty Ltd and a Fellow of the Royal Australasian College of Physicians.



Dr Julian Chick BSc (Hons), PhD (La Trobe)
Chief Executive Officer and Executive Director

Dr Chick was appointed as Chief Executive Officer and Executive Director of Avexa on 7 September 2004. He graduated with a PhD in Muscle Physiology from La Trobe University in 1998 and joined Zenyth Therapeutics Limited (formerly Amrad Corporation Limited) as a Senior Business Development Manager in April 2002. Prior to joining Amrad, Dr Chick had five years experience as an investment adviser and financial consultant with Prudential-Bache Securities, BNP Paribas and Salomon Smith Barney. Dr Chick also spent time working for Foursight Associates as the 'principal analyst' reviewing investment opportunities for private equity investors and venture capitalists.



Dr Errol Malta PhD (Melb.), FAICD

Non-Executive Director

Dr Malta is currently a Director of Australian biotechnology company Alchemia Ltd and has held previous directorships in two small unlisted Australian biotechnology companies. Over the last 17 years Dr Malta has been employed in the pharmaceutical/biotechnology industry in drug development. In eight of his 10 years with Amgen at their head office in the United States he was Product Development Team Leader responsible for global drug development and commercialisation for a number of different molecules. During that time Dr Malta was responsible for five successful new-molecule IND submissions to FDA and other regulatory agencies, subsequent Phase I/II programs and a number of Phase III and IV trials.

Dr Malta holds a PhD from the University of Melbourne and is a Fellow of the Australian Institute of Company Directors. Prior to his industry experience, Dr Malta spent 13 years in academia as Senior Lecturer and Researcher in Pharmacology at the Victorian College of Pharmacy where he published over 50 scientific papers.



Mr Stephen Cooper B Com (Hons), CA

Non-Executive Director

Mr Cooper is a Director of Grant Samuel, a leading independent Australasian investment house, where he provides corporate finance advice to small and large companies across a range of industry sectors. Prior to that, he was Senior Manager for KPMG Peat Marwick, Melbourne, in the area of strategic planning and business development.

Mr Cooper holds a Bachelor of Commerce (Hons) from the University of Cape Town and is an Associate of the Institute of Chartered Accountants (Aust) and Associate of the Chartered Institute of Management Accountants (UK).

SENIOR MANAGEMENT



Dr Jonathan Coates BSc (Hons), PhD (Glasgow)
Chief Scientific Officer

Dr Coates obtained his PhD from Glasgow University and has more than 24 years experience in antiviral drug discovery in the pharmaceutical industry. He spent 15 years in the UK at Glaxo Group Research and later Glaxo-Wellcome, where he filled various senior research roles and was one of the inventors of the anti-viral drug 3TC (Epivir® for HIV and Zeffix® for HBV). Dr Coates has extensive experience in leading program teams towards successful milestones, including clinical trials and three marketed drugs. Dr Coates joined Amrad Corporation Limited in 1996 to establish a team to develop treatments for infectious diseases. Dr Coates now holds the position of Avexa's Chief Scientific Officer.



Dr Susan Cox BSc (Hons), PhD (Stockholm), GAICD
Head of Development

Dr Cox graduated with a PhD in Virology from the Karolinska Institute Stockholm in 1991, and became an associate professor in 1994. She has 15 years experience in antiviral drug discovery. Dr Cox worked on the anti-CMV drug Foscavir® at Astra, and was Program Director at Medivir, where she led antiviral research programs from discovery up to and including Phase II studies. Dr Cox joined Amrad Corporation Limited in 1998 and helped establish Avexa, where she currently holds the position of Head of Development and is responsible for the later stage projects. She has recently been appointed to the Board of the International Society of Antiviral Research (ISAR) and is a graduate of the Australian Institute of Company Directors.



Dr John Deadman BSc, PhD (London)

Head of Chemistry

Dr Deadman obtained his PhD in 1989 from the Institute of Cancer Research, London. Dr Deadman has more than 12 years experience in medicinal chemistry, drug design, and formulation/manufacturing aspects, first at the Thrombosis Research Institute (UK) and then as Head of Chemistry at Trigen, where he directed a program from discovery through to Phase II clinical trials. He is the author of more than 30 research papers and five patents.



Dr David Rhodes BSc (Hons), PhD (La Trobe)

Head of Discovery

Dr Rhodes graduated with a PhD in Biochemistry from La Trobe University in 1994 and has more than 10 years experience in HIV research. Dr Rhodes took up a post doctoral fellowship at the Fox Chase Cancer Center in the US from 1994 to 1995. In 1995, he returned to Australia to the Macfarlane Burnet Centre for Medical Research where he was previously Senior Research Officer. Dr Rhodes joined Amrad Corporation Limited in 2000 and presently holds the position of Head of Discovery at Avexa.

CONCISE FINANCIAL REPORT

FOR THE YEAR ENDED 30 JUNE 2006

The financial statements and other specific disclosures have been derived from the Avexa Limited full financial report for the financial year ended 30 June 2006. Other information included in the concise financial report is consistent with the Company's full financial report.

The concise financial report does not, and cannot be expected to, provide as full an understanding of the financial performance, financial position and financing and investing activities of the Company as the full financial report.

A copy of the Company's 2006 Annual Financial Report, including the Independent Audit Report, is available to all shareholders, and will be sent to shareholders without charge upon request. The 2006 Annual Financial Report can be requested by telephone (Australia: (03) 9208 4300; Overseas: (613) 9208 4300) and by email (avexa@avexa.com.au).

DIRECTORS' REPORT

The Directors present their report together with the financial report of Avexa Limited (the Company) for the year ended 30 June 2006 and the auditor's report thereon.

Principal Activities

The principal activity of the Company during the course of the financial year was the development and commercialisation of anti-infective pharmaceutical programs and projects.

Avexa Limited is a Melbourne-based biotechnology company with a focus on research and development of anti-infectives. The Company is developing drugs for the treatment of infectious diseases which have a significant unmet medical need. Avexa has dedicated resources and funding for key projects including antiviral drugs for HIV/AIDS and an antibiotic alternative for antibiotic-resistant bacterial infections. The Company's lead program is apricitabine which is currently in Phase IIb clinical trials. The Company also has exciting programs targeting HIV and drug resistant bacterial infections.

The Company is a public company listed on the ASX, incorporated and domiciled in Australia, and with a registered office and principal place of business located at 576 Swan Street, Richmond, Victoria 3121.

Review and Results of Operations

In its second year of operation the Company successfully concluded a capital raising of over \$14.4 million and commenced a Phase IIb trial for its HIV drug AVX754, acquired in January 2005 from Shire Pharmaceuticals Group Plc and since renamed apricitabine.

Apricitabine

Apricitabine continues to be positioned to target those patients that are failing current therapies and recruitment for the Company's Phase IIb study to determine the efficacy of the drug in that particular patient group is expected to be concluded by the end of the fourth quarter of 2006. Five patients in the Phase IIb trial have successfully completed the 24 week blinded stage of treatment and moved into the open label part of the protocol, in which they receive 800 milligrams of apricitabine, twice daily as part of their therapy. Several of these patients have already been in the open label period for 10 weeks or longer. As per the trial protocol, patients will continue treatment for up to 24 weeks unless their therapy ceases to be effective in controlling viral load, or adverse effects preclude continued dosing with apricitabine. Avexa remains encouraged as it appears that the therapy is well tolerated and continues to be effective in these particular treatment resistant patients.

The FDA expects that all prospective antiretroviral drug candidates undergo cardiac safety studies. Avexa's Phase I cardiac safety study has completed enrollment and is expected to be finished on time in the second half of 2006 and on budget. The Phase I co-dosing trial with tipranavir has also completed enrolment with the result due in the second half of 2006. Tipranavir is a promising new protease inhibitor, and the co-dosing of tipranavir and apricitabine has the potential to expand clinicians' HIV armamentarium. This study is expected to be completed by the end of the fourth quarter of 2006.

Avexa had AUD \$20 million in cash at 30 June 2006, which is sufficient funding to deliver the results from the Phase IIb, both Phase I trials and commence preparations for Phase III.

Initial feedback from regulatory authorities indicates that it may be possible for the Company to file for approval after 24 weeks dosing in the Phase III trial rather than the usual 48 week dosing period. This benefit stems from apricitabine's potential ability to target a broader range of HIV drug-resistant strains. Moving forward, the Company will be consulting with international regulatory authorities to determine the appropriate strategy to complete apricitabine's clinical development. As part of the Phase III preparation process, Avexa is planning for the manufacture of the requisite quantities of apricitabine and the acquisition of likely comparator drugs that may be required in the blinded trial.

A significant capital raising was undertaken during the financial year primarily to fund the costs of the AVX754 Phase IIb extension studies Phase I safety studies and commencement of preparations for Phase III. The capital raising comprised the issue of 20.4 million shares to Sophisticated Investors and 39.5 million shares under a Prospectus dated 3 April 2006. All shares were offered at an issue price of 24 cents and total net proceeds of \$13.5 million were raised, thereby creating an issued share capital at year end of 197,854,554 shares.

DIRECTORS' REPORT CONTINUED

HIV Integrase

Avexa is developing its own class of HIV integrase inhibitors and has submitted three patents to cover the class. Avexa's integrase inhibitors, whilst their mode of action is similar to those of Merck and Gilead currently in trials, are thought to act by a different mechanism. The possibility also exists that they will act on viruses resistant to the two integrase inhibitors currently in trials.

In its discovery and development of inhibitors to the preclinical stage Avexa's Discovery group is utilising both biochemical and virology techniques in conjunction with molecular modelling and protein-drug crystallography approaches to design and assess the activity of its compounds. Findings from these approaches are fed into Avexa's medicinal chemistry group and its dedicated resources at the Shanghai Institute of Organic Chemistry in China to facilitate the rapid synthesis and optimisation of lead compounds.

During the discovery program lead compounds are also analysed for their drug like properties including in vitro and ex vivo absorption, distribution, metabolism and excretion (ADME) and their pharmacokinetic properties to ensure Avexa's lead compounds are developed with favourable drug like properties.

In addition to its international resources, Avexa is also working closely with one of Australia's premier scientific organisations, CSIRO, to identify and develop new lead inhibitors.

Avexa is on target to complete a proof of concept animal model of its lead inhibitor series in the first half of 2007. On successful completion of this study, the compounds will proceed into preclinical development then progress into clinical trials. As part of its other programs Avexa has established a clinical development group with experience in the development of HIV antiretrovirals.

Vancomycin Resistant Infections

Avexa has used knowledge of the architecture of the bacterial cell wall and its molecular make-up to rationally design a series of compounds that target not only antibiotic-resistant bacterial cell walls, but also antibiotic-sensitive bacterial cell walls. These compounds are highly effective at killing the target bacteria, and do not rapidly select for resistance.

Avexa has designed and synthesised a number of compounds that have potent anti-bacterial activity against methicillin-sensitive and methicillin-resistant strains of *Staphylococcus aureus*. The compounds also have activity against vancomycin-resistant and vancomycin-intermediate sensitive strains of *Staphylococcus aureus*. Over the last year Avexa has been systematically synthesizing and testing these compounds in models that will identify compounds with particular drug-like characteristics. These compounds have been synthesized in collaboration with Wollongong University, NSW. The collaboration with Wollongong University has been and remains supported by several Australian Research Council and National Health and Medical Research Council grants.

The most important outcome from this last year's work is that Avexa has two series of compounds. One series has the properties expected for a topically applied antibacterial agent, while a separate series has the properties of a systemically dosed antibacterial agent. An optimum compound from each series has been identified as the series lead, and each compound has just completed testing in models to demonstrate their drug-likeness, and suitability for development further as a topical and a systemic medicine for the treatment of antibiotic-resistant bacterial infections. The two lead compounds are presently in two independent models of antibacterial activity, to determine in vivo proof of concept and efficacy.

Capital and Corporate Structure

The Company has no subsidiary or associated entity interests. When listed on the Australian Stock Exchange (ASX) on 23 September 2004, there were 80,312,102 fully paid shares on issue. Following a capital raising in the 2005 financial year the number of fully paid ordinary shares issued as at 1 July 2005 was 137,916,452.

Following a placement of 20,408,000 shares to institutional and sophisticated investors at \$0.24 per share in March 2006, the Company under a Prospectus dated 3 April 2006 issued a total of 39,530,102 new shares at \$0.24 per share to raise \$9.5 million before costs by way of a fully underwritten, non-renounceable rights issue. Share capital movements for the year are detailed in Note 5 to the financial statements.

Further information regarding the operations and financial position of the Company and its prospects for future financial years is required by section 299A of the Corporations Act 2001 and is set out in the Chairman and Chief Executive Officer's report.

Unissued Shares Under Option

During the financial year 280,000 (2005: 450,000) options to acquire ordinary shares were issued to staff, 480,000 (2005: 1,050,000) were issued to Executive Officers and 1,100,000 (2005: nil) were issued to the CEO. Terms and conditions of options issued are provided in the Remuneration Report. There were no options exercised during or since the end of the financial year up to the date of this report. 100,000 options lapsed upon the termination of certain employees' employment during the financial year. Options issued after reporting date have been disclosed under the heading "Post reporting date option movements" on page 29 of this report. As at the date of this report unissued ordinary shares of the Company under option are:

| Number of Options Granted | Exercise Price | Expiry Date |
|---------------------------|----------------|---------------|
| 1,400,000 | \$0.40 | 30 June 2009 |
| 600,000 | \$0.40 | 30 June 2010 |
| 500,000 | \$0.19 | 30 June 2010 |
| 100,000 | \$0.40 | 30 June 2010 |
| 1,235,000 | \$0.30 | 30 June 2011 |
| 660,000 | \$0.19 | 25 Sept 2010 |
| 50,000 | \$0.40 | 25 Sept 2010 |
| 50,000 | \$0.40 | 21 March 2011 |
| 500,000 | \$0.40 | 30 June 2011 |
| 4,000,000 | See below | See below |
| 9,095,000 | | |

The exercise price of the 4,000,000 options issued to Shire Biochem Inc. will be equal to the volume weighted average price of Avexa shares over the period commencing 30 business days before and ending 30 business days after the ASX trading day on which the results of the Company's Phase IIb study in respect of the compound AVX754 are announced. The exercise period for these options commences on 17 January 2008 and expires on the earlier of 17 January 2012 or the termination of the Shire Licence Agreement. At the present time, neither the exercise price nor consequently the dilutive factor are therefore capable of reliable measurement.

Directors

The Directors of the Company at any time during or since the end of the financial year are:

| Name, Qualification and Independence Status | Experience and Special Responsibilities |
|---|--|
| Dr H Niall Independent Non-Executive Director and Chairman | Independent Non-Executive Director and Chairman since 7 September 2004. Member of the Avexa Audit Committee. |
| Dr J Chick Executive Director | Chief Executive Officer from 7 September 2004. |
| Dr E Malta Independent Non-Executive Director | Independent Non-Executive Director and member of the Avexa Audit Committee appointed on 1 November 2005. |
| Mr S Cooper Independent Non-Executive Director | Independent Non-Executive Director and member of the Avexa Audit Committee from 18 November 2005; appointed Chair of that committee on 20 December 2005. |

Ms H Cameron was an independent Non-Executive Director and Chair of the Avexa Audit Committee until her resignation on 20 December 2005.

Due to the small number of Non-Executive Directors on the Board all Non-Executive Directors are members of the Audit Committee. The role of the Audit Committee ordinarily is to give the Board of Directors assurance regarding the quality and reliability of financial information prepared for use by the Board in determining policies or for inclusion in the financial report.

DIRECTORS' REPORT CONTINUED

Directors' Interests

The relevant interest of each Director in the share capital of the Company, as notified by the Company to the ASX in accordance with S205G(1) of the Corporations Act 2001, as at the date of this report is as shown following:

| Director | Ordinary Shares Number | Options to Acquire Ordinary Shares Number |
|-------------|---------------------------|--|
| Dr H Niall | 1,125,000 | - |
| Dr J Chick | 625,000 | 1,100,000 |
| Dr E Malta | 102,500 | - |
| Mr S Cooper | 212,500 | - |

Shareholder approval was given on 4 October 2005 to the issue on 5 October 2005 of 600,000 and 500,000 options to CEO Dr Chick with exercise prices of \$0.40 and \$0.19 respectively, a five year term and progressive vesting entitlement.

Shareholder approval will be sought at the 2006 Annual General Meeting of the Company for the issue of 300,000 performance-related options to Dr Chick which will expire on 30 June 2011 and will have an exercise price of \$0.30, based on a 20 per cent premium to the Company's volume weighted average share price for the first five days of share trading in the 2007 financial year. The options will be issued under the Avexa Employee Share Option Plan (ESOP) and will be exercisable 50 per cent on 1 July 2007 and 50 per cent on 1 July 2008.

Directors' Meetings

The number of Directors' meetings (including meetings of committees of Directors) and number of meetings attended by each of the Directors of the Company during the financial year are:

| Director | Board Meetings | | Audit Committee Meetings | |
|--|----------------|-------|--------------------------|-------|
| | Attended | Held* | Attended | Held* |
| Dr H Niall | 12 | 13 | 3 | 4 |
| Dr J Chick | 13 | 13 | 1 | # |
| Dr E Malta (appointed 1 November 2005) | 8 | 9 | 3 | 3 |
| Mr S Cooper (appointed 18 November 2005) | 7 | 9 | 3 | 3 |
| Ms H Cameron (resigned 20 December 2005) | 4 | 6 | 2 | 2 |

* Represents the number of meetings held during the time that the Director held office.

As the Company's sole Executive Director, Dr Chick ordinarily is not present at Audit Committee meetings however Dr Chick attended the August 2005 meeting.

Dividends

The Directors do not recommend a dividend be paid or declared by the Company for the year. No dividend has been paid by the Company since its incorporation on 7 April 2004.

Significant Changes in the State of Affairs

Other than as detailed elsewhere within this financial report, there has been no significant change in the state of affairs of the Company.

Environmental Regulation

The Company's operations are not subject to any significant environmental regulations under either Commonwealth or State legislation. The Directors believe that the Company has adequate systems in place for the management of its environmental requirements and is not aware of any breach of those environmental requirements as they apply to the Company.

Likely Developments

Information about likely developments in the operations of the Company and the expected results of those operations in future financial years has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the Company.

Events Subsequent to Reporting Date

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the Company, the results of those operations, or the state of affairs of the Company in future financial years.

Indemnification and Insurance of Officers

Indemnification

The Company has agreed to indemnify the following current Directors of the Company, Dr H Niall, Dr J Chick, Dr E Malta and Mr S Cooper against liability arising as a result of a Director acting as a Director or other Officer of the Company. The indemnity includes a right to require the Company to maintain Directors and Officers insurance that extends to former Directors. The indemnity provided by the Company is an unlimited and continuing indemnity irrespective of whether a Director ceases to hold any position in the Company.

Insurance Premiums

Since the end of the financial year, the Company has paid an undisclosed premium for Directors' and Officers' Liability insurance, for current and former Directors and Officers including Executive Officers of the Company. The Directors have not contributed to the payment of the policy premium. The Directors' and Officers' Liability insurance policy covers the Directors and Officers of the Company against loss arising from any claims made against them during the period of insurance (including company reimbursement) by reason of any wrongful act committed or alleged to have been committed by them in their capacity as Directors or Officers of the Company and reported to the insurers during the policy period or if exercised, the extended reporting period.

Company Secretary

On 5 July 2006, Mr Alan Boyd was appointed as Company Secretary. Mr Boyd is a Fellow of the Chartered Institute of Company Secretaries of Australia and is also the current Director, Finance and Administration of Zenyth Therapeutics Limited.

Ms R Fry was the Company Secretary of Avexa Limited from the Company's incorporation in April 2004 to her resignation on 5 July 2006. Ms Fry also holds the role of General Counsel and Company Secretary for Zenyth Therapeutics Limited.

Rounding Off

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the financial report and Directors' Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

Lead Auditor's Independence Declaration Under Section 307C of the Corporations Act 2001

The lead auditor's independence declaration forms part of the Directors' Report for the year ended 30 June 2006 and is set out on page 30.

DIRECTORS' REPORT CONTINUED

Non-Audit Services

The following non-audit services were provided by the Company's auditor, KPMG, during the financial year. The Directors are satisfied that the provision of non-audit services is compatible with the general standard for independence imposed by the Corporations Act 2001 and with the Company's own Auditor Independence Policy. The nature and scope of each of the non-audit services provided means that auditor independence was not compromised. KPMG received or is due to receive the following amounts for the provision of the following services:

| | |
|--------------------------|----------|
| Statutory audit services | \$41,000 |
| Tax advisory services | \$7,600 |
| Other advisory services | \$12,182 |
| Total | \$60,782 |

Remuneration Report

This report outlines the remuneration arrangements in place for Directors and Senior Executives of the Company. Sections contained herein have been subject to audit unless otherwise stated.

Dated at Melbourne this 8th day of August, 2006. This report is made with a resolution of the Directors.



Dr J Chick
Executive Director

REMUNERATION REPORT

FOR THE YEAR ENDED 30 JUNE 2006

Directors' and Senior Executives' Remuneration

The Board assumes full responsibility for remuneration policies and packages applicable to Directors and Senior Executives of the Company. The broad remuneration policy is to ensure the remuneration package appropriately reflects the person's duties and responsibilities, and that remuneration levels are competitive in attracting, retaining and motivating people who possess the requisite level of skill and experience. Employees may receive incentive payments remunerated as cash or share options based on the achievement of specific goals related to the performance of the individual and the Company as determined by the Directors. Incentives are provided to senior managers for the achievement of individual and strategic objectives with the broader view of creating value for shareholders.

Fixed Remuneration for Employees

Fixed remuneration consists of a base remuneration package, which includes Fringe Benefits Tax calculated on any salary packaging arrangements and employer contributions to superannuation funds. Fixed remuneration levels for staff are reviewed annually by the senior management group, referred to as the Senior Management Team (SMT), through a process that considers the employee's personal development, achievement of key performance objectives for the year, industry benchmarks wherever possible and CPI data. Remuneration recommendations for staff are given by the SMT to the Chief Executive Officer (CEO) for approval. The CEO conducts the review of the SMT and makes recommendations to the Board for approval.

Key Performance Indicators (KPIs) are individually tailored by the SMT for each employee each year, and reflect an assessment of how that employee can fulfil his or her particular responsibilities in a way that best contributes to Company performance and shareholder wealth in that year. KPIs and remuneration levels are set for the SMT by the CEO and for the CEO by the Board adopting the same process as that adopted for staff, with close alignment to each individual's role and responsibility within the organisation and in conjunction with the strategic objectives of the Company.

Performance-Linked Remuneration

All employees other than Non-Executive Directors may receive incentive payments and/or share options based on the achievement of specific goals related to (i) performance against individual key performance objectives and (ii) the performance of the Company as a whole as determined by the Directors based on a range of factors. These factors include traditional financial considerations such as operating performance, cash consumption and deals concluded and also industry-specific factors relating to the advancement of the project portfolio, introduction of new projects to the portfolio, collaborations and relationships with scientific institutions, third parties and internal employees.

Employment contracts for staff other than management provide for incentive remuneration of up to 10 per cent of their total fixed remuneration package (although higher incentive remuneration payments may be made at the Board's discretion). Typically incentive remuneration is split 50 per cent on personal performance and 50 per cent on Company performance.

The Board at its sole discretion determines the total amount of performance-linked remuneration payable as a percentage of the total annualised salaries for all employees employed as at the end of the financial year (with pro rata reductions to the annualised salary made for any employee not employed for the entire financial year). Once the Board has determined the total performance-linked remuneration payable across the Company, SMT members assess the performance of each individual staff member within their department, relative to that staff member's KPIs, and decide how much performance-linked remuneration should be paid to that person.

The SMT members have full discretion to award individual employees in excess of or less than the performance-linked remuneration percentage determined by the Board, dependent upon their assessment of the employee's performance for the financial year, provided that the overall amount payable within the SMT member's department remains within the stated percentage.

The CEO makes a recommendation annually to the Board in respect of incentive remuneration for the SMT based on the same principles and processes as those adopted for all staff. The Board similarly reviews the performance of the CEO and resolves accordingly on the appropriate level of performance incentive to be paid. Contractual arrangements with the CEO for the financial year ended 30 June 2006 were that the CEO would be entitled to an incentive payment if the Board determined that the KPIs set for the CEO had been met.

Incentive payments are made before the end of August in the year following the financial year performance review period. In respect of 2005 financial year performance, incentive payments of \$14,769 were paid to staff in August 2005 and \$60,000 to the CEO following shareholder approval in October 2005. An amount of \$123,014 has been accrued during the 2006 financial year by way of an employee benefit provision in respect of performance for the 2006 financial year. \$12,700 was approved and paid after year end in respect of incentive payments to staff and \$40,000 to the CEO and this will be reflected in future remuneration tables as remuneration received in the year ended 30 June 2007.

REMUNERATION REPORT CONTINUED

The CEO has the discretion to recommend the offer of options to acquire ordinary shares to any member of staff in recognition of exemplary performance. Such options are likely to vest immediately upon issue given that they are issued as a reward for past performance rather than as a long term incentive. Any issue of options proposed as incentive remuneration requires approval by the Board and is subject to the option limits imposed by the Corporations Act.

Performance Management and Development System – Unaudited

The Company has established a Performance Management and Development System (PMDS) the objectives of which are to:

- improve the quality of work, efficiency and productivity of all staff through continual skills improvement and through gaining new skills and knowledge;
- recognise current skills held against identified core competencies;
- develop and implement training plans relevant to Avexa's business needs;
- identify career streams for all employees, outlining their progression from current skills levels as training and on-the-job learning is implemented; and
- develop a training/development process that provides mobility of skills that supports sound succession planning processes.

At the beginning of each financial year, individual and team performance for the previous year is assessed for every employee by their line manager and new objectives set for the forthcoming year. These objectives include department and project specific objectives together with individual stretch objectives, challenging, realistic and personal development objectives tailored to the employee's role within the organisation. Measurement, management support, target dates and training course requirements are all set. Progress against the objectives is reviewed during the year and percentage achievement concluded at the end of the year, whereupon the cycle recommences. The outputs of this process form the basis of the assessment of the individual's personal incentive remuneration.

Contractual Arrangements

All Avexa Executive Officers, comprising the SMT, are employed under contracts with the following common terms and conditions:

- no fixed term;
- no termination payment prescribed;
- terminable by either party on the giving of three months notice in writing; and
- the Company may terminate any contract for Cause as defined.

These clauses are the same for the CEO's contract except that a six month notice period remains in place at all times.

Long Term Incentive

From time to time Board approval may be sought for the issue of options to acquire ordinary shares to staff and the SMT as a means of providing a long term incentive for performance and loyalty. Any such options are issued under the ESOP.

In order to give the incentive a medium to long term impact, the options issued in 2006 have an approximate five year life and a vesting profile as follows:

| Issues in 2006 | 600,000 to CEO | 500,000 to CEO | 180,000 to Staff | 480,000 to SMT | 100,000 to Staff |
|----------------|--|--|---|---|---|
| Exercise price | \$0.40 | \$0.19 | \$0.19 | \$0.19 | \$0.40 |
| Vesting | 40% on issue; 20% on each of 5 October 2007, 5 October 2008 and 5 October 2009 | 50% on each of 1 July 2006 and 1 July 2007 | 75% on 26 September 2006; 25% on 26 September 2007 | 50% on each of 26 September 2006 and 26 September 2007 | 37,500 on each of 26 September 2006 and 21 March 2007; 12,500 on each of 26 September 2007 and 21 March 2008 |

With an exercise price of \$0.40 the 600,000 options to the CEO and 100,000 to two members of staff were issued effectively as a catch up from the prior year issue of options.

For the offers of 500,000 options to the CEO, to staff and Executive Officers, the exercise price of \$0.19 was set at a premium of 20 per cent to the Company's volume weighted average closing share price for the first five days of trading in the 2006 financial year. The Company has adopted this mechanism as a policy for the determination of option exercise prices in the future.

Other Benefits

In addition to the fixed and at-risk remuneration, the Company provides salary continuance cover for its permanent employees engaged in more than 20 hours work per week and pays the administration fees for employees participating in the Aon Master Trust superannuation fund.

The value for 'Non-cash Benefits' in the remuneration table represents the value of motor vehicle costs salary packaged by an Executive.

Director Remuneration

The Constitution and the ASX Listing Rules specify that the aggregate remuneration of Non-Executive Directors shall be determined from time to time by a general meeting. An amount not exceeding the amount approved by shareholders is then divided between the Directors as agreed by the Board. An amount of \$350,000 was approved at the Company's inaugural Annual General Meeting held on 4 October 2005.

Non-Executive Directors do not receive performance related remuneration and the structure of Non-Executive Director and Senior Management remuneration is separate and distinct. Non-Executive Directors do not have contracts of employment but are required to evidence their understanding and compliance with the Board policies of Avexa Limited. These Board policies do not prescribe how remuneration levels for Non-Executive Directors are modified from year to year. Remuneration levels are to be reviewed by the Board each year taking into account cost of living changes, changes to the scope of the roles of the Directors, and any changes required to meet the principles of the overall Board policies.

Directors' base fees since incorporation have been and are currently \$40,000 per annum with \$80,000 for the role of Chairman, inclusive of superannuation and of duties associated with participation in the Avexa Audit Committee.

Directors' and Executive Officers' Remuneration Table

Details of the nature and amount of each major element of the remuneration of each Director of the Company and each of the named Officers of the Company receiving the highest remuneration for the period that the Director or officer held that position during the current financial year are disclosed in accordance with Accounting Standard AASB 1046 Director and Executive Disclosures by Disclosing Entities and with the Corporations Act 2001 in the following table.

There has been no exercise of options during the financial year. There is no component of the values recorded in the following table under the heading 'Shares and Options issued' that relates to options that have lapsed during the financial year.

Details of the Company's policy in relation to the proportion of remuneration that is performance related are provided earlier in this report. For the individuals named in the Directors' and Executive Officers' remuneration tables, details of their service contracts are provided under the heading of 'Contractual arrangements' earlier in this report. Figures in brackets represent the value of options as a percentage of remuneration. No termination or retirement benefits were awarded in either of the 2005 or 2006 financial years. The Company operated throughout the 2005 and 2006 financial years with an Executive management team comprising the CEO and three other persons.

In the following tables, the fair value of the options granted to Executive Officers has been calculated based on the value at the date of grant using a valuation model that takes into account the performance hurdles and vesting period related to those options. The value as disclosed is the portion of the fair value of the options allocated to this reporting period.

REMUNERATION REPORT CONTINUED

| 2006 | Primary | | | Post Employment Superannuation Contributions | Share-Based Payments: Shares and Options Issued | Total Remuneration |
|---|---|----------------------|------------------------|---|--|-----------------------|
| | Base Remuneration (Salary and Fees) | Non-cash Benefits | Bonuses/ Incentives | | | |
| | \$ | \$ | \$ | \$ | \$ | \$ |
| Directors | | | | | | |
| <i>Non-Executive</i> | | | | | | |
| Dr H Niall | 67,278 | - | - | 12,722 | - | 80,000 |
| Dr E Malta (appointed 1 November 2005) | 24,465 | - | - | 2,202 | - | 26,667 |
| Mr S Cooper (appointed 18 November 2005) | 22,677 | - | - | 2,041 | - | 24,718 |
| Ms H Cameron (resigned 20 Dec 2005) | 5,034 | - | - | 13,786 | - | 18,820 |
| <i>Executive</i> | | | | | | |
| Dr J Chick | 190,995 | 28,339 | 60,000 | 40,560 | (11%) 39,479 | 359,373 |
| Total compensation | 310,449 | 28,339 | 60,000 | 71,311 | 39,479 | 509,578 |
| Executive Officers (Excluding Directors) | | | | | | |
| <i>Current – Key Management Personnel</i> | | | | | | |
| Dr J Coates | 184,325 | 21,430 | - | 12,150 | (10%) 24,027 | 241,932 |
| Dr S Cox | 132,929 | 23,770 | - | 11,992 | (12%) 22,861 | 191,552 |
| Dr J Deadman | 117,332 | 22,589 | - | 10,561 | (9%) 14,823 | 165,305 |
| Total compensation | 434,586 | 67,789 | - | 34,703 | 61,711 | 598,788 |

For Key Management Personnel titles refer to the table on page 28 of this report.

The Company's Director, Finance and Administration, Mr A Boyd, was remunerated by his employer Zenyth Therapeutics Limited (Zenyth) and provided these services by way of a service agreement between Zenyth and the Company.

| 2005 | Primary | | | Post Employment Superannuation Contributions | Share-Based Payments: Shares and Options Issued | Total Remuneration |
|---|---|----------------------|------------------------|---|--|-----------------------|
| | Base Remuneration (Salary and Fees) | Non-cash Benefits | Bonuses/ Incentives | | | |
| | \$ | \$ | \$ | \$ | \$ | \$ |
| Directors | | | | | | |
| <i>Non-Executive</i> | | | | | | |
| Dr H Niall | 60,127 | - | - | 5,412 | - | 65,539 |
| Ms H Cameron | - | - | - | 47,279 | - | 47,279 |
| Mr A Boyd | - | - | - | - | - | - |
| Ms R Fry | - | - | - | - | - | - |
| <i>Executive</i> | | | | | | |
| Dr J Chick ⁽ⁱ⁾ | 142,918 | 20,094 | - | 21,490 | - | 184,502 |
| Dr P Smith | - | - | - | - | - | - |
| Total compensation | 203,045 | 20,094 | - | 74,181 | - | 297,320 |
| Executive Officers (Excluding Directors) | | | | | | |
| <i>Current – Key Management Personnel</i> | | | | | | |
| Dr J Chick ⁽ⁱ⁾ | 20,442 | 4,434 | - | 2,239 | - | 27,115 |
| Dr J Coates | 177,965 | 19,170 | - | 12,000 | (7.2%) 16,252 | 225,387 |
| Dr S Cox | 120,333 | 22,659 | - | 11,340 | (9.5%) 16,252 | 170,584 |
| Dr J Deadman | 93,661 | 22,589 | - | 8,669 | (7.5%) 10,158 | 135,077 |
| Total compensation | 412,401 | 68,852 | - | 34,248 | 42,662 | 558,163 |

(i) Dr J Chick was an Executive Officer until his appointment as Executive Director and CEO on 7 September 2004. Remuneration for the period prior to Dr Chick's appointment as a Director has been reflected under the Executive Officer heading and the remainder of Dr Chick's remuneration for the year has been reflected as Executive Director remuneration.

Grants, Modifications and Exercise of Options and Rights over Equity Instruments Granted as Compensation – Unaudited

Details of the vesting profile of the options granted as remuneration during the financial year to each applicable person in the Directors' and Executive Officers' remuneration tables is detailed on the following page. There were no options forfeited or exercised during the financial year nor were there any alterations or modifications to existing terms and conditions.

REMUNERATION REPORT CONTINUED

| Executives and Title | Options Granted | | Number and Percentage Vested in Year | Forfeited in Year | Financial Years in Which Grant Vests [#] | Value Yet to Vest in \$ |
|---|-----------------|-------------------|--------------------------------------|-------------------|---|-------------------------|
| | Number | Date | | | | |
| Executive Director | | | | | | |
| Dr J Chick (CEO) | 600,000 | 5 October 2005 | (40%) 240,000 | - | 2006-2010 ⁽ⁱ⁾ | 48,627 |
| | 500,000 | 5 October 2005 | Nil | - | 2007-2008 ⁽ⁱⁱ⁾ | 46,540 |
| Executive Director | 1,100,000 | | | | | 95,167 |
| Company Executives | | | | | | |
| Dr J Coates (Chief Scientific Officer) | 180,000 | 26 September 2005 | Nil | - | 2007-2008 ⁽ⁱⁱⁱ⁾ | 13,996 |
| | 20,000 | 26 September 2005 | Nil | - | 2007-2008 ^(iv) | 1,555 |
| Dr S Cox (Head of Development) | 150,000 | 26 September 2005 | Nil | - | 2007-2008 ⁽ⁱⁱⁱ⁾ | 11,663 |
| | 20,000 | 26 September 2005 | Nil | - | 2007-2008 ^(iv) | 1,555 |
| Dr J Deadman (Head of Chemistry) | 100,000 | 26 September 2005 | Nil | - | 2007-2008 ⁽ⁱⁱⁱ⁾ | 7,775 |
| | 20,000 | 26 September 2005 | Nil | - | 2007-2008 ^(iv) | 1,555 |
| Company Executives | 490,000 | | | | | 38,099 |

The vesting profile for options issued during 2006 is as follows:

- (i) 40 per cent on issue and 20 per cent on each of 5 October 2007, 5 October 2008 and 5 October 2009.
- (ii) 50 per cent on 1 July 2006 and 50 per cent on 1 July 2007.
- (iii) 50 per cent on each of 26 September 2006 and 26 September 2007.
- (iv) 75 per cent on 26 September 2006 and 25 per cent on 26 September 2007.

The fair value of options issued has been apportioned evenly over the vesting profile of the option giving rise to a fair value remuneration for the 2006 financial year. The options do not entitle the holder to participate in any share issue of the Company or any other body corporate.

Analysis of Bonuses and Incentive Payments – Unaudited

Incentive payments (relating to performance in the 2005 financial year) of \$14,769 to staff and \$60,000 to the CEO were made during the year under the Company's PMDS. Accruals for payments of \$12,700 to staff and \$40,000 to the CEO have been included in the 2006 result in respect of the 2006 performance year. All amounts are fully vested.

Fair Value of Options

The fair values of the options granted to Executive Directors and Officers in the above tables have been calculated at grant date using a binomial valuation model that takes into account the performance hurdles and vesting period related to those options. The value as disclosed is the portion of the fair value of the options allocated to this reporting period. The following factors and assumptions have been used in determining the fair value on grant date. Comparative information has not been restated as market conditions were already included in the prior year valuation. A zero dividend yield assumption has been adopted in every valuation.

| Number and Recipients of Options | Grant Date | Expiry Date | Fair Value Per Option | Exercise Price | Price of Shares on Value Date | Risk Free Interest Rate | Estimated Volatility |
|----------------------------------|--------------|--------------|-----------------------|----------------|-------------------------------|-------------------------|----------------------|
| 600,000 to CEO | 5 Oct 2005 | 30 June 2010 | \$0.108 | \$0.40 | \$0.21 | 5.38% | 76.78% |
| 500,000 to CEO | 5 Oct 2005 | 30 June 2010 | \$0.140 | \$0.19 | \$0.21 | 5.38% | 76.78% |
| 180,000 to Staff | 26 Sept 2005 | 25 Sept 2010 | \$0.117 | \$0.19 | \$0.18 | 5.25% | 76.78% |
| 480,000 to SMT | 26 Sept 2005 | 25 Sept 2010 | \$0.117 | \$0.19 | \$0.18 | 5.25% | 76.78% |
| 50,000 to Staff | 26 Sept 2005 | 25 Sept 2010 | \$0.009 | \$0.40 | \$0.18 | 5.25% | 76.78% |
| 50,000 to Staff | 21 Mar 2006 | 21 Mar 2011 | \$0.168 | \$0.40 | \$0.28 | 5.67% | 79.10% |

Post Reporting Date Option Movements

There has been no cancellation of options from the balance date to the date of this report.

As part of the performance-linked remuneration strategy since reporting date the Company's Board has passed the following resolutions:

- (i) to offer 710,000 options to staff at an exercise price of \$0.30 based on a 20 per cent premium to the Company's volume weighted average share price for the first five days of share trading in the 2007 financial year. The options will be exercisable 50 per cent on 1 July 2007 and 50 per cent on 1 July 2008; and
- (ii) to offer 300,000 options to Dr Chick subject to shareholder approval at the Company's 2006 Annual General Meeting. The options will expire on 30 June 2011 and will have an exercise price of \$0.30 based on a 20 per cent premium to the Company's volume weighted average share price for the first five days of share trading in the 2007 financial year. The options will be exercisable 50 per cent on 1 July 2007 and 50 per cent on 1 July 2008.

As part of the Company's long term incentive strategy, subsequent to reporting date, the Company's Board of Directors has also approved the offer and issue of:

- (i) 525,000 options to all staff other than the CEO (including Executive Officers) at an exercise price of \$0.30 based on a 20 per cent premium to the Company's volume weighted average share price for the first five days of share trading in the 2007 financial year. The options will be exercisable 50 per cent on 1 July 2007 and 50 per cent on 1 July 2008; and
- (ii) 500,000 options to 10 members of staff yet to receive an initial allocation of 50,000 options and 100,000 to one staff member upon employment by the Company set at the \$0.40 exercise price adopted at the 1 July 2004 commencement of the Company's operations. The 500,000 options vest 40 per cent on 1 July 2007 and a further 20 per cent on each 1 July anniversary thereafter whilst the vesting profile for the 100,000 options is accelerated by one year. The 500,000 options expire on 30 June 2011 and the 100,000 on 30 June 2010.

Shares Issued on Exercise of Options

During or since the end of the financial year up to the date of this report the Company did not issue any shares upon exercise of options.

Alteration to Option Terms

There has been no alteration to option terms and conditions during or since the end of the financial year up to the date of this report.

Consequences of Performance on Shareholder Wealth – Unaudited

In considering the Company's performance and how best to generate shareholder value, the Board has regard to a broad range of factors, some of which are financial and others of which relate to the scientific progress on the Company's projects, relationship building with research institutions, projects introduced, staff development etc. The Board has some but not absolute regard to the Company's result and cash consumption for the year. It does not utilise earnings per share as a performance measure nor does it contemplate consideration of any dividends in the short to medium term given that all efforts are currently being expended to build the business and establish self-sustaining revenue streams. The Company is of the view that any adverse movement in the Company's share price should not be taken into account in assessing the performance of employees other than the CEO, for whom the Company's share price is included within the overall measure of performance against individual objectives.

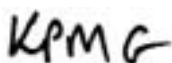
LEAD AUDITOR'S INDEPENDENCE DECLARATION

UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

To the Directors of Avexa Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 30 June 2006, there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the audit.



KPMG



B W Szentirmay

Melbourne

8 August 2006

DISCUSSION AND ANALYSIS OF THE CONCISE FINANCIAL REPORT FOR THE YEAR ENDED 30 JUNE 2006

Discussion and Analysis of the Income Statement

The Company's revenue for the period comprised bank interest of \$738,000 (2005: \$669,000) generated from the operating account and from investment of surplus funds in capital stable, bank term deposits.

Included within operating expenses for the period are the following significant items:

(i) Amortisation of Intellectual Property

The Company has amortised the full \$12 million cost of its intellectual property on a straight line basis over the first 24 months of operations of the Company, giving rise to an amortisation charge for the year of \$6 million (2005: \$6 million). The intellectual property of \$12 million acquired at the commencement of the Company's operations on 1 July 2004 has now been fully amortised as at 30 June 2006.

(ii) Contract Research and Development Costs

The increase in costs incurred for the year to \$6.6 million (2005: \$4.6 million) reflects the commencement of the Phase IIb trial for Avexa's anti-HIV drug AVX754, given the International Non-proprietary Name of apricitabine by the World Health Organisation.

(iii) Employee Expenses

The increase in employee expenses from \$1.5 million to \$2.5 million reflects the effective increase in staff numbers from 16 to 22 as the Company has expanded both its chemistry capability to advance earlier stage projects and development capability to manage the Phase IIb and later stage trials.

Discussion and Analysis of the Balance Sheet

(i) Cash Position

The Company conducted a capital raising in March and April 2006, and consequently issued approximately 60 million shares at 24 cents per share for net proceeds of \$13.5 million. These proceeds contributed towards a closing cash position of \$20.2 million. Operational cash outflows of \$8.9 million have been recorded together with investing outflows of \$0.1 million to acquire plant and equipment.

(ii) Contributed Equity

The March and April 2006 capital raising comprised a placement to sophisticated investors of 20,408,000 shares and a rights issue of 39,530,102 shares, both offered at 24 cents per share. Total transaction costs of \$0.9 million have been deducted from the issue proceeds to generate issued capital of \$13.5 million.

(iii) Tax Benefits

Given the uncertainties associated with their recovery, the Company has not recognised any tax benefits relating to income tax losses recorded for the current or prior financial year.

Discussion and Analysis of the Statement of Cash Flows

(i) Proceeds from Issue of Share Capital

The net proceeds from issue of share capital reflects the above issues of equity.

(ii) Property, Plant and Equipment

The Company has renewed its two year operating lease covering most of its operational asset requirements such that only \$148,000 of capital acquisitions was capitalised during the financial year, against which depreciation of \$52,000 has been recorded.

INCOME STATEMENT

FOR THE YEAR ENDED 30 JUNE 2006

| | Note | Company | |
|---|----------|-----------------|-----------------|
| | | 2006 \$'000 | 2005 \$'000 |
| Other revenues from ordinary activities | | 738 | 669 |
| Total revenue from ordinary activities | | 738 | 669 |
| Contract research and development costs | 2(a) | (6,576) | (4,654) |
| Employee expenses | | (2,533) | (1,482) |
| Share-based payment expense | | (122) | (61) |
| Depreciation | | (52) | (12) |
| Amortisation of intellectual property | | (6,000) | (6,000) |
| Occupancy costs | | (332) | (210) |
| Consulting costs | | (592) | (215) |
| Professional services | | (497) | (355) |
| Travel and accommodation | | (405) | (244) |
| Raw materials and consumables used | | (424) | (199) |
| Asset management expenses | | (282) | (318) |
| Insurance | | (169) | (150) |
| Other expenses from ordinary activities | 2(c) | (584) | (366) |
| Profit/(loss) from ordinary activities before related income tax expense | | (17,830) | (13,597) |
| Income tax expense relating to ordinary activities | | - | - |
| Net profit/(loss) for the year | 4 | (17,830) | (13,597) |
| Basic earnings per share (ordinary shares) | | (12.1) | (14.4) |
| Diluted earnings per share (ordinary shares) | | (11.8) | (14.4) |

The income statement is to be read in conjunction with the discussion and analysis on page 31 and notes to the financial statements set out on pages 36 to 39.

STATEMENT OF CHANGES IN EQUITY

For the Year Ended 30 June 2006

| | Issued Capital \$'000 | Accumulated Losses \$'000 | Total Equity \$'000 |
|--|--------------------------|------------------------------|------------------------|
| Opening balance as at 1 July 2005 | 34,648 | (13,536) | 21,112 |
| Non-profit items recognised directly in equity: | | | |
| Placement to sophisticated investors | 4,898 | - | 4,898 |
| Shares offered under 3 April 2006 Prospectus | 9,487 | - | 9,487 |
| Transactions costs relating to placement and Prospectus shares | (869) | - | (869) |
| Total non-profit items recognised directly in equity | 13,516 | - | 13,516 |
| Loss for the period | - | (17,830) | (17,830) |
| Total recognised income and expense for the period | - | (17,830) | (17,830) |
| Equity settled share-based payment transactions | - | 122 | 122 |
| Closing balance as at 30 June 2006 | 48,164 | (31,244) | 16,920 |

For the Year Ended 30 June 2005

| | Issued Capital \$'000 | Accumulated Losses \$'000 | Total Equity \$'000 |
|--|--------------------------|------------------------------|------------------------|
| Opening balance as at 1 July 2004 | - | - | - |
| Non-profit items recognised directly in equity: | | | |
| Consideration for acquisition of intellectual property | 12,000 | - | 12,000 |
| Share capital issue | 12,000 | - | 12,000 |
| Placement to sophisticated investors | 2,400 | - | 2,400 |
| Shares offered under 15 February 2005 Prospectus | 5,600 | - | 5,600 |
| Priority Offer shares issued under 15 February 2005 Prospectus | 1,521 | - | 1,521 |
| Placement of shares to Shire under Shire Licence Agreement | 2,000 | - | 2,000 |
| Transaction costs relating to Placements and Prospectus offers | (873) | - | (873) |
| Total non-profit items recognised directly in equity | 34,648 | - | 34,648 |
| Loss for the period | - | (13,597) | (13,597) |
| Total recognised income and expense for the period | - | (13,597) | (13,597) |
| Equity settled share-based payment transactions | - | 61 | 61 |
| Closing balance as at 30 June 2005 | 34,648 | (13,536) | 21,112 |

Amounts disclosed in the statement of changes in equity are stated net of tax.

The statement of changes in equity is to be read in conjunction with the discussion and analysis on page 31 and notes to the financial statements set out on pages 36 to 39.

BALANCE SHEET

AS AT 30 JUNE 2006

| | Note | Company | |
|--------------------------------------|------|----------------|----------------|
| | | 2006 \$'000 | 2005 \$'000 |
| Current assets | | | |
| Cash assets | | 20,228 | 15,727 |
| Receivables | | 34 | 64 |
| Other | | 106 | 81 |
| Total current assets | | 20,368 | 15,872 |
| Non-current assets | | | |
| Intangibles | | - | 6,000 |
| Property, plant and equipment | | 217 | 121 |
| Total non-current assets | | 217 | 6,121 |
| Total assets | | 20,585 | 21,993 |
| Current liabilities | | | |
| Payables | | 3,357 | 687 |
| Provisions | | 280 | 154 |
| Total current liabilities | | 3,637 | 841 |
| Non-current liabilities | | | |
| Provisions | | 28 | 40 |
| Total non-current liabilities | | 28 | 40 |
| Total liabilities | | 3,665 | 881 |
| Net assets | | 16,920 | 21,112 |
| Equity | | | |
| Contributed equity | 5 | 48,164 | 34,648 |
| Accumulated losses | 4 | (31,244) | (13,536) |
| Total equity | | 16,920 | 21,112 |

The balance sheet is to be read in conjunction with the discussion and analysis on page 31 and notes to the financial statements set out on pages 36 to 39.

STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 30 JUNE 2006

| | Company | |
|---|----------------|----------------|
| | 2006 \$'000 | 2005 \$'000 |
| Cash flows from operating activities | | |
| Cash receipts in the course of operations | 783 | 261 |
| Cash payments in the course of operations | (10,209) | (7,760) |
| Interest received | 535 | 625 |
| Income taxes paid | - | - |
| Net cash used in operating activities | (8,891) | (6,874) |
| Cash flows from investing activities | | |
| Payments for property, plant and equipment | (144) | (133) |
| Net cash used in investing activities | (144) | (133) |
| Cash flows from financing activities | | |
| Proceeds from issue of share capital | 14,385 | 23,521 |
| Costs of raising share capital | (849) | (873) |
| Consideration for taking on employee entitlements | - | 86 |
| Net cash provided by financing activities | 13,536 | 22,734 |
| Net increase in cash held | 4,501 | 15,727 |
| Cash at the beginning of the financial year | 15,727 | - |
| Cash at the end of the financial year | 20,228 | 15,727 |

The statement of cash flows is to be read in conjunction with the discussion and analysis on page 31 and notes to the financial statements set out on pages 36 to 39.

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30 JUNE 2006

1. Basis of Preparation of Concise Financial Report

The concise financial report has been prepared in accordance with the Corporations Act 2001, Accounting Standard AASB 1039 Concise Financial Reports and applicable Urgent Issues Group Consensus Views. The financial statements and specific disclosures required by AASB 1039 have been derived from the Company's full financial report for the financial year. Other information included in the concise financial report is consistent with the Company's full financial report. The concise financial report does not, and cannot be expected to, provide as full an understanding of the financial performance, financial position and financing and investing activities of the Company as the full financial report.

The concise financial report has been prepared on the basis of historical costs and except where stated, does not take into account changing money values or fair values of non-current assets.

These accounting policies have been consistently applied by the Company throughout the financial year. A full description of the accounting policies adopted by the Company may be found in the Company's full financial report. The presentation currency is Australian dollars. Management has discussed with the Audit Committee the development, selection and disclosure of the Company's critical accounting policies and estimates and the application of these policies and estimates.

2. Profit Before Related Income Tax Expense

(a) Individually material items included in Profit Before Related Income Tax Expense

| | Company | |
|---|----------------|----------------|
| | 2006 \$'000 | 2005 \$'000 |
| Contract research and development expenditure | 6,576 | 4,654 |
| Direct research and development expenditure | 3,721 | 1,980 |
| Research and Development | 10,297 | 6,634 |

(b) Profit Before Related Income Tax Expense has been arrived at after charging the following items

| | | |
|---|-------|-------|
| Depreciation of plant and equipment | 52 | 12 |
| Amortisation of intellectual property | 6,000 | 6,000 |
| Amounts transferred to provisions for employee entitlements | 278 | 155 |
| Operating lease rental expense | 120 | 120 |

(c) Other Expenses

From operating activities

| | | |
|--|-----|-----|
| Corporate administration | 87 | 109 |
| Intellectual property management | 62 | 72 |
| Advertising and promotion | 214 | 75 |
| Workplace administration | 120 | 62 |
| Finance expenses | 5 | 6 |
| Other expenses | 96 | 42 |
| Other expenses from operating activities | 584 | 366 |

3. Segment Reporting

The Company comprises a single business segment comprising anti-infective research and development and in a single geographical segment being that of Australia. Therefore the segment details are fully reflected in the results and balances reported in the income statement and balance sheet.

4. Accumulated Losses

| | Company | |
|---|----------------|----------------|
| | 2006 \$'000 | 2005 \$'000 |
| Accumulated losses at the beginning of the financial year | (13,536) | - |
| Net loss attributable to members of the Company | (17,830) | (13,597) |
| Share-based payment expense | 122 | 61 |
| Accumulated losses at the end of the financial year | (31,244) | (13,536) |

5. Issued Capital

Issued and Paid Up Capital

| | 2006 | | 2005 | |
|--|--------|-------------|--------|-------------|
| | \$'000 | Number | \$'000 | Number |
| 197,854,554 (2005: 137,916,452) ordinary shares, fully paid | 48,164 | 197,854,554 | 34,648 | 137,916,452 |
| Movements during the year were as follows: | | | | |
| Balance at the beginning of the financial year | 34,648 | 137,916,452 | - | 2 |
| Consideration for acquisition of intellectual property | - | - | 12,000 | 40,156,000 |
| Share capital issue | - | - | 12,000 | 40,156,000 |
| Shares issued upon demerger as part of rounding up of Zenyth shareholder entitlement | - | - | - | 100 |
| Placement to Sophisticated Investors | 4,898 | 20,408,000 | 2,400 | 12,000,000 |
| Shares offered under 3 April 2006 (2005: 15 February 2005) Prospectus | 9,487 | 39,530,102 | 5,600 | 28,000,000 |
| Priority Offer shares issued under 15 February 2005 Prospectus | - | - | 1,521 | 7,604,350 |
| Placement of shares to Shire under Shire Licence Agreement | - | - | 2,000 | 10,000,000 |
| Transaction costs relating to placements and prospectus offers | (869) | - | (873) | - |
| Share capital at the end of the financial year | 48,164 | 197,854,554 | 34,648 | 137,916,452 |

Terms and Conditions of Ordinary Shares

Holders of ordinary shares are entitled to one vote per share at shareholders' meetings and to receive any dividends as may be declared. In the event of winding up of the Company, ordinary shareholders rank after all creditors and are fully entitled to any proceeds of liquidation.

Options to Acquire Ordinary Shares

During the financial year 1,860,000 (2005: 1,500,000) options were issued to employees under the Avexa Employee Share Option Plan as summarised in the following table:

| Issues in 2006 | 600,000 to CEO | 500,000 to CEO | 180,000 to Staff | 480,000 to SMT | 100,000 to Staff |
|----------------|--|--|---|---|---|
| Exercise price | \$0.40 | \$0.19 | \$0.19 | \$0.19 | \$0.40 |
| Vesting | 40% on issue; 20% on each of 5 October 2007, 5 October 2008 and 5 October 2009 | 50% on each of 1 July 2006 and 1 July 2007 | 75% on 26 September 2006; 25% on 26 September 2007 | 50% on each of 26 September 2006 and 26 September 2007 | 37,500 on each of 26 September 2006 and 21 March 2007; 12,500 on each of 26 September 2007 and 21 March 2008 |

Options to Acquire Ordinary Shares

4,000,000 options were issued to Shire Biochem Inc. (Shire) during the 2005 financial year in accordance with the Shire Agreement referred to in the 15 February 2005 Prospectus. In addition to the 10 million ordinary shares already held, Shire has the option to acquire a further 4 million shares in Avexa through the exercise of its options. Pricing of the option is set by reference to the Avexa share price 30 Business Days either side of the ASX announcement of the Phase IIb study results relating to the AVX754 compound. Shire may exercise the option at any time between 17 January 2008 and 17 January 2012. The Option terminates if the licence agreement between the Company and Shire is terminated.

NOTES TO THE FINANCIAL STATEMENTS

CONTINUED

6. Dividends

No dividends were paid or proposed in the current or prior financial years.

7. Contingencies

Details of contingent liabilities and contingent assets where the probability of future payments/receipts is not considered remote are set out below, as well as details of contingent liabilities and contingent assets, which although considered remote, the Directors consider should be disclosed. The Directors are of the opinion that no provisions are required in respect of these matters, as it is not probable that a future sacrifice of economic benefits will be required or the amount is not capable of reliable measurement.

Contingent Liabilities and Assets not Considered/Considered Remote

The Company is not aware of any contingent liabilities or assets capable of having a material impact on the Company.

8. Events Subsequent to Reporting Date

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors of the Company, to affect significantly the operations of the Company, the results of those operations, or the state of affairs of the Company in future financial years.

9. Explanation of Transition to AIFRS

This is the Company's first financial report prepared in accordance with AIFRS. The accounting policies set out in the significant accounting policies section of the Company's full financial report have been applied in preparing the financial statements for the year ended 30 June 2006, the comparative information presented in this financial report for the year ended 30 June 2005 and in the preparation of an opening AIFRS balance sheet as at 1 July 2004, the Company's date of transition.

In preparing its opening AIFRS balance sheet, the Company has adjusted amounts reported previously in financial reports prepared in accordance with its old basis of accounting (previously Australian Generally Accepted Accounting Principles or AGAAP). An explanation of how the transition from previous AGAAP to AIFRS has affected the Company's financial position, financial performance and cash flows is set out in the following table and the notes that accompany the table.

(i) Financial Position

Net assets are unaffected by the transition from previous AGAAP to AIFRS and therefore no commentary or analysis is required.

(ii) Financial Performance

The only expense or revenue item in the income statement that has been affected by the transition is the 'Employee expense' item, which has been increased to reflect the fair value of equity-settled share-based payments by \$61,000 for the full financial year ended 30 June 2005. The share-based payment expense for the 2006 financial year is \$122,264.

On the basis that no revenue item or any other expense items are affected by the transition, an abridged version of the income statement is therefore reflected in the following table.

(iii) Cash Flows

There are no adjustments required between the statement of cash flows prepared under AIFRS and previous AGAAP.

(iv) Equity

Set out below are the quantitative impacts of the changes on total equity as at the 1 July 2004 date of transition and at 30 June 2005 and on net profit for the year ended 30 June 2005.

(a) Reconciliation of Equity as Presented Under Previous AGAAP to that Under AIFRS

| | 30 June 2005 \$'000 | 1 July 2004 \$'000 |
|---|------------------------|-----------------------|
| Total equity under AGAAP | 21,112 | - |
| Adjustments to accumulated losses (net of tax): | | |
| Recognition of share-based payment expense | (61) | - |
| | 21,051 | - |
| Adjustments to accumulated losses (net of tax) | | |
| Recognition of share-based payment expense | 61 | - |
| Total equity under AIFRS | 21,112 | - |

(b) Reconciliation of Results as Presented Under AGAAP to that Under AIFRS

| | 2005 \$'000 |
|----------------------------------|----------------|
| Net loss as reported under AGAAP | 13,536 |
| Share-based payment expense | 61 |
| Net loss under AIFRS | 13,597 |

Under AASB 2 Share Based Payments, the Company recognises the fair value of options granted to employees at grant date as an expense on a pro-rata basis over the vesting period in the income statement, with a corresponding adjustment to equity. Share-based payments costs were not recognised under previous AGAAP.

(c) Reconciliation of Cash Flows as Presented Under AGAAP to that Under AIFRS

There are no material impacts on the Company's reported cash flows presented under previous AGAAP arising from the adoption of AIFRS.

Other Accounting Impact

Impairment

Under previous AGAAP the carrying amounts of non-current assets were reviewed at reporting date to determine whether they were in excess of their recoverable amount. If the carrying amount exceeded the recoverable amount, then the asset was written down to its recoverable amount, with the write down recognised as an expense in the income statement in the period in which it occurred.

Under AIFRS, the carrying amounts of non-current assets are reviewed each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset is tested for impairment by comparing its recoverable amount to its carrying amount. An impairment loss will be recognised whenever the carrying amount of the asset exceeds its recoverable amount. Impairment losses will be recognised in the income statement unless they relate to a revalued asset, where the impairment loss will be treated in the same as a revaluation decrease.

Under previous AGAAP, the recoverable amount of non-current assets was assessed at the entity level using undiscounted cash flows. Under AIFRS, the recoverable amount of non-current assets is required to be assessed using estimated future cash flows discounted to their present value using a pre-tax discount rate that reflects the current market assessment of the risks specific to the asset.

On the basis that the non-current assets of the Company are utilised to facilitate the development and commercialisation of scientific projects to generate sustainable royalty and other revenue streams in the long term, a review of the Company's non-current assets at reporting date did not reveal any indication of impairment.

DIRECTORS' DECLARATION

FOR THE YEAR ENDED 30 JUNE 2006

In the opinion of the Directors of Avexa Limited (the Company), the accompanying concise financial report and the audited remuneration disclosures of the Remuneration Report in the Directors' Report, of the Company for the year ended 30 June 2006, set out on pages 31 to 39:

- (a) has been derived from or is consistent with the full financial report for the financial year; and
- (b) complies with Australian Accounting Standard AASB 1039 Concise Financial Reports.

Dated at Melbourne this 8th day of August, 2006.

Signed in accordance with a resolution of the Directors.



Dr J Chick
Executive Director

INDEPENDENT AUDIT REPORT ON CONCISE FINANCIAL REPORT TO THE MEMBERS OF AVEXA LIMITED

Scope

The Financial Report, Remuneration Disclosures and Directors' Responsibility

The concise financial report comprises the income statement, statement of changes in equity, balance sheet, statement of cash flows, accompanying notes 1 to 9, and the accompanying discussion and analysis on the income statement, statement of changes in equity, balance sheet and statement of cash flows, and the Directors' declaration on pages 31 to 39 for Avexa Limited (the Company) for the year ended 30 June 2006.

As permitted by the Corporations Regulations 2001, the Company has disclosed information about the remuneration of Directors and Executives (remuneration disclosures) required by Australian Accounting Standard AASB 124 Related Party Disclosures, under the heading 'Remuneration Report' in the audited sections of the Directors' Report and not in the concise financial report.

The Remuneration Report also contains unaudited information not required by Australian Accounting Standard AASB 124 which is not subject to our audit.

The Directors of the Company are responsible for the preparation of the concise financial report and the Remuneration Report in accordance with Australian Accounting Standard AASB 1039 Concise Financial Reports. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the concise financial report. The Directors are also responsible for the remuneration disclosures contained in the Directors' Report.

Audit Approach

We conducted an independent audit in order to express an opinion to the members of the Company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the concise financial report is free of material misstatement and that the remuneration disclosures comply with AASB 124. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected. We have also performed an independent audit of the full financial report and the remuneration disclosures of the Company for the year ended 30 June 2006. Our audit report on the full financial report and the remuneration disclosures was signed on 8 August 2006, and was not subject to any qualification.

We performed procedures in respect of the audit of the concise financial report to assess whether, in all material respects, the concise financial report is presented fairly in accordance with Australian Accounting Standard AASB 1039 Concise Financial Reports.

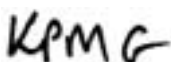
We formed our audit opinion on the basis of these procedures, which included:

- testing that the information in the concise financial report is consistent with the full financial report; and
- examining, on a test basis, information to provide evidence supporting the amounts, discussion and analysis, and other disclosures, which were not directly derived from the full financial report.

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

Audit Opinion

In our opinion, the concise financial report of Avexa Limited for the year ended 30 June 2006 complies with Australian Accounting Standard AASB 1039 Concise Financial Reports.



KPMG



B W Szentirmay
Partner
Melbourne
8 August 2006

SHAREHOLDER INFORMATION

FOR THE YEAR ENDED 30 JUNE 2006

Share Capital

As at 15 August 2006, the share capital of the Company was:
 Issued and paid up capital: 197,854,554 ordinary shares

| | Number |
|--|-------------|
| Number of shares quoted on The Australian Stock Exchange Limited | 197,557,956 |

Avexa Limited ordinary shares have been traded on The Australian Stock Exchange Limited since 23 September 2004 and trade under the ASX code AVX. Melbourne is the Home Exchange. The Company's securities are not quoted on any other stock exchange.

Twenty Largest Shareholders as at 15 August 2006

| Name | Ordinary Share Held | % of Total Shareholding |
|---|---------------------|-------------------------|
| Fibre Optics (Aust) Pty Ltd | 23,915,365 | 12.09 |
| Zenyth Therapeutics Limited | 21,062,000 | 10.65 |
| Westpac Custodian Nominees | 18,620,612 | 9.41 |
| National Nominees Limited | 14,615,165 | 7.39 |
| Shire BioChem Inc | 12,500,000 | 6.32 |
| State Trustees Limited | 9,871,797 | 4.99 |
| Jagen Pty Ltd | 5,175,008 | 2.62 |
| ANZ Nominees Limited | 3,585,814 | 1.81 |
| Invia Custodian Pty Limited | 2,935,778 | 1.48 |
| Powers Pty Ltd | 2,754,635 | 1.39 |
| Merck Sharp & Dohme | 1,818,182 | 0.92 |
| Asia Union Investments | 1,459,000 | 0.74 |
| Willben Pty Ltd | 1,200,000 | 0.61 |
| Oaktel Investments Pty Ltd | 1,174,375 | 0.59 |
| Warbont Nominees Pty Ltd | 1,109,416 | 0.56 |
| Warragai Investments Pty Ltd | 1,000,640 | 0.51 |
| The Walter and Eliza Hall Institute of Medical Research | 1,000,000 | 0.51 |
| R J Custodians Pty Ltd | 965,322 | 0.49 |
| Sandhurst Trustees Ltd | 939,000 | 0.47 |
| Mirrabooka Investments Limited | 937,500 | 0.47 |

Substantial Shareholders

The following information is extracted from substantial shareholding notices given to the Company as at 15 August 2006 by shareholders who hold relevant interests in more than 5 per cent of the Company's voting shares.

| Name | Ordinary Share Held | % of Total Shareholding |
|-----------------------------|---------------------|-------------------------|
| Fibre Optics (Aust) Pty Ltd | 23,915,365 | 12.09 |
| Zenyth Therapeutics Limited | 21,062,000 | 10.65 |
| Passport Management, LLC | 14,385,000 | 7.27 |

Distribution of Shareholders as at 15 August 2006

| Range | Holders | Ordinary Shares Held | % of Total Shareholding |
|--------------------|---------|----------------------|-------------------------|
| 1 – 1,000 | 1,937 | 1,174,726 | 0.59 |
| 1,001 – 5,000 | 1,784 | 4,273,647 | 2.16 |
| 5,001 – 10,000 | 403 | 3,169,528 | 1.60 |
| 10,001 – 100,000 | 1,033 | 31,848,938 | 16.10 |
| 100,001 and over | 152 | 157,387,715 | 79.55 |
| Total shareholders | 5,309 | 197,854,554 | 100.00 |

The number of shareholders as at 15 August 2006 with less than a marketable parcel of \$500 worth of shares, based on the market price as at the above date, was 2,128.

Shares and Voting Rights

As at 15 August 2006, there were 5,309 holders of ordinary shares of the Company.

The voting rights attached to ordinary shares are set out in Rules 5(f) and 40 of the Company's Constitution. In broad summary, but without prejudice to the provisions of those Rules, each shareholder present at a general meeting in person or by a duly appointed representative, proxy or attorney:

- on a show of hands, has one vote except if a shareholder has appointed more than one person as a representative, proxy or attorney, in which case none of those persons is entitled to vote or if a person is entitled to vote in more than one capacity, that person is entitled to only one vote; and
- on a poll, has one vote for each fully paid share held and for each other share held, has a vote in respect of the share equivalent to the proportion which the amount paid on that share is of the total amounts paid and payable on that share at the time a poll is taken but no amount paid on a share in advance of calls shall be treated as paid on that share.

As at 15 August 2006, there were options over 5,095,000 unissued ordinary shares granted to employees under the Key Employee Share Option Plan. There are a further 4,000,000 options over unissued ordinary shares issued to Shire Biochem Inc on terms approved by shareholders at the Company's General Meeting held on 22 March 2005. There are no voting rights attached to either the options or the underlying unissued ordinary shares.

Officers

Chief Executive Officer: Dr Julian Chick BSc (Hons) PhD (La Trobe)
Company Secretary: Mr Alan Boyd

Registered Office

Avexa Limited
576 Swan Street
Richmond Victoria 3121 Australia
Telephone 61 3 9208 4300
Facsimile 61 3 9208 4004

Share Registry

Computershare Investor Services Pty Limited
Yarra Falls
452 Johnston Street
Abbotsford Victoria 3067 Australia
Telephone 1300 850 505 or 61 3 9415 4000
Facsimile 61 3 9473 2500
Website www.computershare.com
Email web.enquiries@computershare.com.au

Facsimile for receipt of 24 October 2006 Annual General Meeting correspondence only: 61 3 9473 2555

SHAREHOLDER INFORMATION CONTINUED

Securityholder Information

You can gain access to your Securityholding information in a number of ways. The details are managed via the Company's registrar, Computershare Investor Services and can be accessed as outlined below. Please note your Securityholder Reference Number (SRN) or Holder Identification Number (HIN) is required for access.

Investor Phone Access

Provides telephone access 24 hours a day 7 days a week.

Step 1: Call 1300 850 505

Step 2: Enter the first five letters of the Company name – e.g. Avexa (touch tone 28392#).

Step 3: Enter your Security Reference Number (SRN) or Holder Identification Number (HIN).

Step 4: Follow the prompts to gain secure, immediate access to your holding details, registration details or payment information.

Internet Account Access

Securityholders can access their details via the Internet. Computershare provides two levels of access: Read only and online portfolio updating capability.

View Securityholding (read only access)

Step 1: Go to www.computershare.com/au/investors

Step 2: Select Securityholding and enter AVX or Avexa Limited.

Step 3: Enter Securityholder Reference Number (SRN) or Holder Identification Number (HIN).

Step 4: Read only access to account balance, transaction history, payment instructions, payment history and sign up for electronic securityholder communications.

Investor Centre (online portfolio updating capability)

Step 1: Go to www.computershare.com/au/investors

Step 2: Enter User ID and PIN or access the 'Register Here' button.

Step 3: Follow the prompts to register. For security purposes, Computershare will generate a PIN and mail it to your registered address.

Step 4: View, evaluate and manage your portfolio.

Changing Shareholder Details

Changes to your name or address must be advised in writing to Computershare Investor Services Pty Limited. If you are sponsored by a broker, your notice in writing must be sent to your sponsoring broker.

Avexa Publications Mailing List

The Annual Report is a major source of information about the Company. Shareholders who do not wish to receive this publication can assist the Company to reduce costs by advising Computershare Investor Services Pty Limited in writing. Shareholders will continue to receive all other shareholder information, including the Notice of Annual General Meeting and Proxy. The Annual Report, other releases and general Company information are also available on the Company's website at www.avexa.com.au

Annual General Meeting

11am on Tuesday 24 October 2006

Computershare Conference Centre

Yarra Falls

452 Johnston Street

Abbotsford Victoria 3067 Australia

Investor Relations

If you have any questions or issues regarding your shareholding or require hard copies of any information posted on Avexa's website, please contact the Company's Company Secretary, Mr Alan Boyd on 61 3 9208 4300.



A V E X A

Avexa Limited
ABN 53 108 150 750

576 Swan Street Richmond
Victoria 3121 Australia

Telephone 61 3 9208 4300
Facsimile 61 3 9208 4004
www.avexa.com.au