

Innate Immunotherapeutics Limited

Annual Report

For the year ended March 31, 2011



Innate Immunotherapeutics Limited
(formerly Innate Therapeutics Limited)

**Annual Report and Financial Statements
for the year ended 31 March 2011**

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Innate Immunotherapeutics Limited

(formerly Innate Therapeutics Limited)

Company Directory

Company Number	1039166
Date of Incorporation	31 May 2000
Registered Office	4B Walls Road Penrose Auckland
Nature of Business	Biopharmaceutical Product Development
Directors	Gregory J Moyle Simon E Wilkinson Christopher C Collins Elizabeth M Hopkins
Auditors	Grant Thornton New Zealand Audit Partnership 152 Fanshawe Street Auckland

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Annual Report

THE YEAR IN REVIEW

- Clinical trial of MIS416 in patients with progressive Multiple Sclerosis starts in Christchurch
- Clinical trial of MIS416 as a cancer vaccine adjuvant starts in Japan
- Patent protecting the use of MIS416 to treat MS approved and issued in New Zealand
- Share offering to existing shareholders raises \$3.4 million

CLINICAL PROGRAMME

The Company's primary focus over the past 12 months has been to move the microparticle immunomodulator drug candidate, MIS416, into the clinic for appropriately regulated human safety trialing. This was successfully achieved in early October with the commencement of the Christchurch (NZ) based Phase 2A study of MIS416 in patients with progressive Multiple Sclerosis (MS). This study is in two parts; a dose escalation phase, during which 12-15 subjects are treated in small groups weekly for four weeks with the amount of drug used increasing from group to group, followed by a dose confirmation phase during which another 12-15 subjects will be treated in one group weekly for three months using an amount of drug determined by the results of the dose escalation phase.

Notwithstanding the significant earthquake events that have impacted Christchurch and its residents since September 2010, the dose escalation phase of the study has proceeded steadily and is due to complete at the end of October 2011. To date, the drug appears to have been well tolerated by the trial subjects with few unexpected side effects reported. These interim observations will need to be confirmed in the final study report expected in May 2012.

The commencement of the dose confirmation phase is subject to the approval of the New Zealand drug regulator, Medsafe. Medsafe approved the initial dose escalation part of the study in July 2010 and at that time deferred approval of the dose confirmation until such time as the Company completed a six month 'chronic' animal toxicology study. They also required the dose confirmation phase to include a 'control group'. The Company advised Medsafe of its intention to conduct the required animal study in a single species as provided for by the latest international regulatory guidelines. In the absence of any contrary comment from Medsafe, the study was initiated in late August 2010. However, upon submission of the animal study results in June 2011, the Company was asked to further justify why only a single species was used in the study. An independent expert's report was obtained supporting the Company's adoption of the latest animal study guidelines and this has been submitted to Medsafe. The Company has received no further comments from Medsafe concerning the single species study and on that basis, the results appear to have been accepted by Medsafe. The issue of a control group has time and cost implications but more importantly, is not scientifically or ethically justified in the view of the Company and its clinical consultants. Providing this matter can be resolved in a timely fashion, the Company expects the dose confirmation to complete by the end of March 2012.

If the current Phase 2A study is successful, the Company's current intentions are to sponsor a substantive Phase 2B trial in subjects with the secondary progressive form of MS. Such a study would likely take place at sites in both Australia and New Zealand and could potentially start enrolling subjects in late 2012, with a completion in mid 2014.

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In February 2011, academic collaborators in Japan commenced a Phase 1B safety trial of a cancer treatment vaccine in patients with prostate or bladder cancers who had not responded to other treatments. The vaccine candidate they are trialing is composed of Innate Immunotherapeutic's MIS416, as the adjuvant (or immune response 'booster') and their proprietary tumour antigen (or small pieces of the cancer being targeted) as the immune system 'trigger'. This study is being sponsored by the Japanese researchers and their academic institution with the Company's involvement limited to the supply of MIS416, supporting intellectual input, and approval of the study protocol. The study is expected to take approximately two years to enrol subjects and complete treatment and as such, not too much can be shared until the final study report is available sometime in late 2013. The results of the trial will be shared between the parties and to date no commercial rights have been requested or agreed to. The use of MIS416 as a cancer vaccine adjuvant is already claimed in the Company's cancer patent application and as such the results of the study would not constitute new and unprotected intellectual property.

PRE-CLINICAL PROGRAMME

In parallel with the clinical trials of MIS416, a significant amount of preclinical work has been ongoing throughout the period with two separate but important objectives. Firstly, the more that can be discovered about how MIS416 works in patients with MS (the 'mechanism of action') the more the MS development programme is derisked from a potential acquirer's perspective. Secondly, the more evidence (data) that can be generated around the use of MIS416 to treat other diseases or conditions, the more value can be ascribed to the MIS416 asset. Evidence of such other potential uses could also help further derisk the MS programme.

These multiple preclinical programmes are largely being conducted by academic collaborators in both New Zealand and overseas. To date the Company has successfully attracted highly qualified collaborators who are largely carrying out their investigations of MIS416 in their differing experimental models at little or no significant cost to the Company. The supply of MIS416 to these collaborative partners, together with the subsequent results from their experiments, is protected under the terms of signed contracts referred to as 'material transfer agreements'. Such agreements are commonplace within the drug development community and the rights and responsibilities of the parties are well understood.

Currently the Company has initiated academic collaborations with institutions including:

- Victoria University of Wellington
- University of Auckland
- University of Otago
- Roswell Park Cancer Institute, Buffalo, New York
- Purdue University, West Lafayette, Indiana
- University of Melbourne

The Company is indebted to the interest, collegiality, and expertise extended by the scientific investigators at these institutions.

INTELLECTUAL PROPERTY

During the year to 31 March 2011, the Company's patent applications seeking to protect the use of MIS416 to separately treat cancer and certain infections entered national phases in the U.S., Canada, Europe, Japan, China, Australia, and Brazil. The applications in each of these countries, if granted, will all share the same priority date arising out of the original New Zealand filings in 2008.

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With respect to the applications to patent MIS416 for the treatment of MS, the New Zealand patent was granted and issued in December 2010 under patent number 577731. The patent term is for twenty years, expiring June 2030. The MS patent application (number 20100317589) filed in the U.S. in December 2009 was published (opened for public inspection) in December 2010 and awaits examination. An application, based on the N.Z. filing, is in the international phase under the workings of the Patent Cooperation Treaty (PCT number NZ2010/000112) and is due to enter the national phase in selected countries in December 2011. A Written Opinion, issued by the International Preliminary Examining Authority in June 2011, found that the substantive claims in the patent application satisfied the requirements for novelty, inventive step and industrial applicability. While this Opinion is non-binding (on the respective national examining offices) it is nonetheless encouraging to have passed this first test.

The Company has filed all necessary documents to date recording the assignment of the above patents (cancer, infection, and MS) from the named inventors (Drs Gelder and Webster) to the Company.

FINANCIAL PERFORMANCE

The Company started the period with \$1,437,141 (2010: 1,991,534) cash and cash equivalents in hand, and for the 12 months to 31 March 2011 reported an operating deficit of \$3,141,079 (2010: \$5,100,761). The operating deficit included amortisation of intangible assets \$1,637,309 (2010: 1,637,309) and the depreciation and/loss on sale of tangible/leasehold assets of \$77,285 (2010: \$560,951). The Statement of Cash Flows shows net cash inflows of \$1,384,138 (2010: Outflow \$468,947).

During the period the Company raised the following amounts through the issue of fully paid new ordinary shares:

November 2010:	US\$375,000 at US\$0.075 per share by private place to an existing shareholder
December 2010:	NZ\$561,482 at NZ\$0.10 per share from existing N.Z. resident shareholders
January 2011:	US\$1,519,500 at US\$0.075 per share from existing U.S. resident shareholders
March 2011:	NZ\$325,000 at NZ\$0.10 per share by private placement to two new shareholders.

The combined issues raised approximately NZ\$3,439,310 and required the issue of 34,124,853 new ordinary shares. At the end of the period, there were 95,088,425 ordinary shares (2010: 60,771,572) on issue.

In addition to cash inflows from capital raisings, the Company received a one-off R&D cash tax credit of \$418,898, grants and/or awards totalling \$333,890 (2010: \$60,344), and miscellaneous income from the sale of antibody reagents and minor contract research of \$103,259 (2010: \$99,424).

The Company finished the period with \$2,821,279 (2010: \$1,437,141) cash and cash equivalents.

OUTLOOK

The Company's strategy remains unchanged from last year; namely to maximize value around its microparticle technology to position the Company for either major strategic acquisition or IPO. This will be achieved in the following manner:

- Human safety and efficacy data supporting the use of MIS416 to treat patients with secondary progressive MS will be generated in a robust Phase 2 clinical trial programme.

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- In parallel, industry and academic collaborations will be used to generate further animal proof-of-principle data to confirm the extension of MIS416 into unmet areas within the lucrative cancer and antiviral markets.

In line with this strategy, the Company will seek to achieve the following milestones over the next 12 - 18 months:

March 2012: Complete the current Phase 2A trial of MIS416 in patients with progressive MS

June 2012: Complete a pre-Phase 2B funding round of US\$10 million

December 2012: Commence a Phase 2B efficacy trial of MIS416 in patients with SPMS

Providing the current Phase 2A trial shows positive activity in patients similar to what has been seen in the small number of progressive MS compassionate use patients, the Company should be well placed to achieve the above milestones.

BOARD OF DIRECTORS

The Board comprises two non-executive directors, Greg Moyle (Chairman) and Chris Collins (U.S. based), and two executive directors, Simon Wilkinson (CEO) and Elizabeth Hopkins.

Directors Fees and Remuneration to 31 March 2011.

Director	Directors Fees	Other Remuneration
Greg Moyle	Nil	Nil
Chris Collins	Nil	Nil
Simon Wilkinson	Nil	\$185,000
Elizabeth Hopkins	Nil	\$50,000

Other Directors Interests

No Director sold shares nor exercised any options during the period.

Compensation was paid to Greg Moyle during the year of \$30,000 (2010: nil). A trust associated with Greg Moyle participated in the offer to NZ resident shareholders during the year and subscribed for 300,000 new shares at a cost of \$30,000 (2010: 100,000 ordinary shares subscribed at a cost of \$10,000).

During the year Chris Collins (Director) participated in a private placement and offer to US resident shareholders and subscribed for 10,000,000 new ordinary shares at a cost of US\$750,000. At 31 March 2011, Chris Collins held 11,433,334 ordinary shares being approximately 12% of the Company's total number of ordinary shares on issue.

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EMPLOYEES

The number of employees, not being executive directors of the Company, receiving remuneration and benefits above \$100,000 during the period are indicated in the following table:

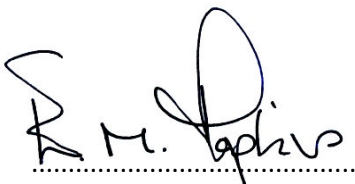
Remuneration and Benefits	Number of Employees	
	2011	2010
Up to \$130,000	1	-
\$130,000 to \$140,000	-	1
\$140,000 to \$170,000	-	-
\$170,000 to \$180,000	-	1
Greater than \$180,000	-	-

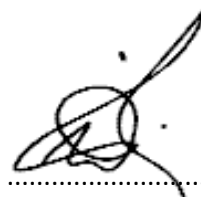
As at 31 March 2011, only one employee, not being an executive director, was receiving remuneration and benefits above \$100,000, this being in the range of \$100,000 to \$130,000.

AUDITORS

The Company's Auditors were Grant Thornton; audit fees payable for the year were \$35,845 (2010: \$33,971). Grant Thornton is willing to continue as the Company's auditors.

For and on behalf of the Board:


.....
Director


.....
Director

Dated this 5th day of October 2011

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Statement of Comprehensive Income for the year ended 31 March 2011

	Note	2011 \$	2010 \$
Other operating income		845,295	164,645
Research and development expenses		(1,243,088)	(1,351,439)
Business development expenses		(418,381)	(292,193)
General expenses		(299,706)	(573,991)
Administrative expenses		<u>(1,555,739)</u>	<u>(2,748,820)</u>
Operating deficit before financing costs		<u>(2,671,619)</u>	<u>(4,910,001)</u>
Financial income		34,449	17,014
Financial expenses		<u>(503,909)</u>	<u>(315,977)</u>
Net financial expense		<u>(469,460)</u>	<u>(298,963)</u>
Operating deficit before taxation	6	(3,141,079)	(5,100,761)
Tax expense	13	<u>-</u>	<u>-</u>
Net deficit after taxation		(3,141,079)	(5,100,761)
Other Comprehensive Income		-	-
Total Comprehensive Loss		<u>(3,141,079)</u>	<u>(5,100,761)</u>

This Statement must be read in conjunction with the notes to the financial statements

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Statement of Changes in Equity for the year ended 31 March 2011

	Share Option reserve \$	Other reserves \$	Share capital \$	Accumulated losses \$	Total equity \$
2011					
Balance at 1 April 2010	2,313,323	706,396	119,220,733	(114,507,253)	7,733,199
Issue of share capital	-	-	3,439,310	-	3,439,310
Expired share options	(1,755,319)	-	-	1,755,319	-
Share based payments	204,479	-	-	-	204,479
Deficit for the year	-	-	-	(3,141,079)	-
Other Comprehensive Income	-	-	-	-	-
Balance at 31 March 2011	762,483	706,396	122,660,043	(115,893,013)	8,235,909
2010					
Balance at 1 April 2009	2,479,733	706,396	117,483,873	(109,601,866)	11,068,136
Issue of share capital	-	-	1,736,860	-	1,736,860
Expired share options	(195,374)	-	-	195,374	-
Share based payments	28,964	-	-	-	28,964
Deficit for the year	-	-	-	(5,100,761)	(5,100,761)
Other Comprehensive Income	-	-	-	-	-
Balance at 31 March 2010	2,313,323	706,396	119,220,733	(114,507,253)	7,733,199

This Statement must be read in conjunction with the notes to the financial statements

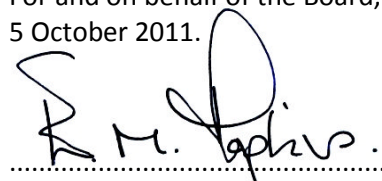
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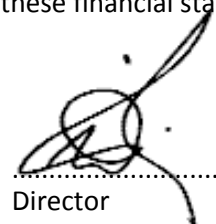
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Statement of Financial Position as at 31 March 2011

	Note	2011 \$	2010 \$
Current Assets			
Cash and cash equivalents	5	2,821,279	1,437,141
Accounts receivable		348,214	14,343
Income tax refund	13	13,548	22,153
Other current assets		64,521	21,375
Total current assets		3,247,562	1,495,012
Non Current Assets			
Property, plant and equipment	8	304,823	381,330
Investments	16	-	7,077
Intangible assets	7	7,095,014	8,732,323
Total non current assets		7,399,837	9,120,730
Total Assets		10,647,399	10,615,742
Current Liabilities			
Accounts payable and accrued liabilities	9	245,802	202,548
Total current liabilities		245,802	202,548
Non current liabilities			
Redeemable preference shares	20	1,276,889	1,037,263
Convertible notes	19	846,240	748,603
Embedded derivative	19	42,559	894,129
Total non current liabilities		2,165,688	2,679,995
Total liabilities		2,411,490	2,882,543
Equity			
Paid-in capital	18	124,128,922	122,240,452
Accumulated losses		(115,893,013)	(114,507,253)
Total equity		8,235,909	7,733,199
Total equity and liabilities		10,647,399	10,615,742

For and on behalf of the Board, who authorised and approved these financial statements for issue on 5 October 2011.


.....
Director


.....
Director

This Statement must be read in conjunction with the notes to the financial statements

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Statement of Cash Flows for the year ended 31 March 2011

	Note	2011 \$	2010 \$
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>			
Receipts from customers		61,223	99,424
Dividends received		348	668
Interest received		34,449	17,014
Grants received		333,890	60,344
Payments to suppliers		(2,384,354)	(1,640,025)
Payments to employees		(534,227)	(1,042,366)
Income tax refunded /(paid)		8,865	(5,707)
Interest paid		(563)	(45,366)
R&D tax credit		418,898	
Net cash outflow from operating activities	17	<u>(2,061,471)</u>	<u>(2,556,014)</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>			
Purchase of property, plant and equipment		(8,302)	(15,299)
Proceeds from sale of property, plant and equipment		7,524	6,069
Purchase of Investments		7,077	-
Net cash outflow from investing activities		<u>6,299</u>	<u>(9,230)</u>
<u>CASH FLOWS FROM FINANCING ACTIVITIES</u>			
Issue of ordinary shares		3,439,310	1,736,860
Issue of convertible promissory notes		-	359,437
Net cash inflow from financing activities		<u>3,439,310</u>	<u>2,096,297</u>
Net increase /(decrease) in cash held		1,384,138	(468,947)
Cash at the beginning of the year		1,437,141	1,991,534
Effect of exchange rate changes on cash		-	(85,446)
Cash at the end of the year		<u><u>2,821,279</u></u>	<u><u>1,437,141</u></u>
<u>CASH BALANCES IN THE STATEMENT OF FINANCIAL POSITION</u>			
Cash and cash equivalents		2,821,279	1,437,141
Closing cash balance		<u><u>2,821,279</u></u>	<u><u>1,437,141</u></u>

This Statement must be read in conjunction with the notes to the financial statements

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Notes to the Financial Statements for the year ended 31 March 2011

1. GENERAL INFORMATION

The financial statements presented are for the entity Innate Immunotherapeutics Limited (formerly Innate Therapeutics Limited) (the "Company"), a profit orientated company incorporated and domiciled in New Zealand and registered under the Companies Act 1993.

The Company is an issuer and reporting entity for the purposes of the Financial Reporting Act 1993 and its financial statements have been prepared in accordance with the Act.

These financial statements have been approved for issue by the Board of Directors on the date on which the Statement of Financial Position was signed.

NATURE OF BUSINESS OPERATIONS

The Company began operations in August 2000 following acquisition of Probe Pharmaceuticals Corporation Limited. At that time the Company acquired a patented platform technology for the treatment of diseases caused by pathogens, and engaged in the research and development of new drugs based on this technology. The Company owns all patent and intellectual property rights to this technology.

Initially the company directed its efforts and resources towards the clinical development of an anti-HIV passive immunotherapeutic drug referred to as PEHRG214. This programme involved Phase 1A & 1B safety trials at the Harvard Medical School (Boston) and Phase 2A safety and efficacy trials at five trials sites in the U.S. The PEHRG214 programme was suspended in late 2008 due to patient recruitment problems and related commercial factors and the programme was closed down altogether in early 2009.

In parallel with the PEHRG214 Phase 2A clinical trial, the Company began the preclinical evaluation of a second drug candidate, an immunomodulator referred to as MIS416. As result of encouraging safety and efficacy results in a number of animal models, the Company commenced a clinical development programme of MIS416 in 2010, initially targeting progressive multiple sclerosis.

To reflect the repositioning of the company around the MIS416 immunomodulator platform, the company's name was changed on 1 April 2009 to Innate Therapeutics Limited and on 1 August 2011 to Innate Immunotherapeutics Limited.

The Company operates within one industry segment in New Zealand.

GOING CONCERN

During the year ended 31 March 2011 the company raised \$886,485 from issues of ordinary shares to New Zealand shareholders and US\$1,924,500 (NZ\$2,552,825 equivalent) from issue of ordinary shares to U.S. shareholders.

During the year ended 31 March 2011 the company spent \$1,243,088 (2010: 1,351,439) on MIS416 research and trial expenses and preclinical investigations, plus operating and financing expenses. Cash on hand at 31 March 2011 was \$2,821,279 (2010: 1,437,141). Over the next 12 months MIS416 Phase 2A trial related expenditure is forecast to be \$1,200,000 and other operating expenses, \$1,647,500. Should the MIS416 Phase 2A trial be successful the Company intends to conduct a Phase

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2B trial, the cost of which is projected to be approximately \$7.2 million. Other operating costs over the coming three year are projected to be approximately \$5.8 million. New funds totalling \$13 million will be sought from the issue of new ordinary shares to both existing and new investors during the first half of 2012. There is no certainty these or other funds will be raised and in this event future operations will need to be curtailed or discontinued.

Furthermore, the Company's ability to continue as a going concern is dependent on the results of the Phase 2A trials being positive.

These matters raise doubt about the Company's ability to continue as a going concern.

2. BASIS OF PREPARATION

Statement of Compliance

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice ("NZ GAAP") and the requirements of the Companies Act 1993 and the Financial Reporting Act 1993. They comply with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS"), and other applicable financial reporting standards as appropriate for profit-oriented entities. The financial statements comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Measurement Base

The financial statements have been prepared on a historical cost basis with the exception of:

- Financial instruments at fair value through profit or loss are measured at fair value.
- Share-based payment arrangements are measured at fair value.

The methods used to measure fair values are discussed further in notes 11 and 19.

The accrual basis of accounting has been used unless otherwise stated and the financial statements have been prepared on a going concern basis.

Functional and Presentation Currency

These financial statements are presented in New Zealand Dollars (\$), which is the Company's functional currency. Numbers presented are rounded to the nearest dollar.

Comparatives

Comparative figures included in the financial statements relate to the financial year ended 31 March 2010. Where necessary, these figures have been reclassified on a basis consistent with the disclosure for the year ended 31 March 2011.

Expense reclassifications were made for some expenses included within Research and Development expense and financial expenses. All other expense classifications are consistent with the prior period.

The expired share options shown in equity has been reclassified from share capital to accumulated losses.

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Presentation of financial statements

The financial statements are presented in accordance with NZ IAS 1 *Presentation of Financial Statements*. The Company has elected to present the Statement of Comprehensive Income in one statement. The Statement of Comprehensive Income discloses the analysis of expenses under the function of expense method. This classifies expenses according to their function as part of cost of sales, distribution or as administration activities.

The Statement of Financial Position presentation discloses assets and liabilities as current or non-current.

Changes in Accounting Policies

The accounting policies adopted are consistent with those of the previous financial year, except that the Company has adopted the following new and amended New Zealand equivalents to IFRS and IFRIC interpretations as at 1 April 2010:

NZ IFRS 2 Group Cash-settled Share-based Payment Transactions (effective from 1 January 2010)

The amendments clarify the scope of NZ IFRS 2 by requiring an entity that receives goods or services in a share-based payment arrangement to account for those goods or services no matter which entity in the group settles the transaction, and no matter whether the transaction is settled in shares or cash. The revised standard did not have an impact on the financial position or performance of the Company.

Improvements to IFRSs

In 2009 the IASB issued an omnibus of amendments to its standards, affecting the financial statements for the year ended 31 March 2010 and 31 March 2011, primarily with a view to removing inconsistencies and clarifying wording. The adoption of the following amendments resulted in changes to accounting policies but did not have any impact on the reported financial position or performance of the Parent and Group:

- **NZ IAS 17 Leases:** The amendment requires that leases of land are classified as finance or operating by applying the general principals of NZ IAS 17. Prior to this amendment, NZ IAS 17 generally required a lease of land to be classified as an operating lease. The Company has reassessed the classification of the land elements of its unexpired leases at 1 April 2010 on the basis of information existing at the inception of those leases and determined that none of its leases require classification.
- **NZ IAS 7 Statement of Cash Flows:** Explicitly states that only expenditure that results in recognizing an asset can be classified as cash flows from investing activities.

The impact of the improvements was limited to additional disclosures and has been applied on a prospective basis.

New NZ IFRS standards and Interpretations issued but not yet adopted

At the date of authorisation of these financial statements, certain new standards and interpretations to existing standards have been published but not yet effective, and have not been adopted early by the Company.

Management anticipates that all pronouncements will be adopted in the first accounting period beginning on or after the effective date of the new standard. Information on new standards, amendments and interpretations that are expected to be relevant to the Company's financial statements is provided below. Certain other new standards and interpretations issued but not yet

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effective, that are not expected to have material impact on the Company's financial statements have not been disclosed.

NZ IFRS 9 – Financial Instruments (effective from 1 January 2013)

The IASB aims to replace IAS 39 Financial Instruments: Recognition and Measurement in its entirety by the end of 2011, with replacement standard (NZ IFRS 9) to be effective for accounting periods beginning on or after 1 Jan 2013. The new standard is being issued in phases, with early adoption available as each phase is issued. To date, the chapters dealing with recognition, classification, measurement and de-recognition of financial assets and financial liabilities have been issued. The chapters dealing with impairment and hedge accounting are still being developed.

Management have yet to assess the impact the standard is likely to have on the recognition and measurement of financial assets and financial liabilities held by the Company. However, they do not expect to implement the amendments until all chapters of NZ IFRS 9 have been published and they can comprehensively assess the impact of all changes.

NZ IAS 24 - Related Party Disclosures (effective for years beginning 1 January 2011)

The amended standard clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The revised standard introduces a partial exemption of disclosure requirements for government-related entities. The revised standard is not expected to have an impact on the reported financial position and performance of the Company.

Recently issued standards (effective for years beginning from 1 January 2013)

In May 2010 the International Accounting Standards Board (IASB) issued the following accounting standards that will be incorporated into NZ IFRS:

- IFRS 10 Consolidated Financial Statements
- IFRS 11 Joint Arrangements
- IFRS 12 Disclosure of Interests in Other Entities
- IFRS 13 Fair Value Measurement

Upon preliminary review, management do not expect these standards to have a material impact on the Company's financial statements. However, a full understanding of the standards has yet to be obtained.

3. SPECIFIC ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

The significant accounting policies used in the preparation of these financial statements are summarised below:

(a) Property, Plant and Equipment

Property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of acquisition.

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Depreciation is calculated on a diminishing value basis to expense the cost of the assets over their estimated useful lives as follows:

Leasehold improvements	4 to 13 years
Plant and equipment	4 to 11 years
Office furniture and fittings	2 to 13 years

Depreciation is charged to profit or loss and disclosed within “administration” expense. The residual value and useful life of property, plant and equipment is reassessed annually.

Repairs and maintenance and gains or losses on sale or disposal of assets are reflected in the Statement of Comprehensive Income as incurred. Major renewals and betterments are capitalised.

(b) Foreign Currencies

Transactions denominated in foreign currencies are converted at the exchange rate current at the transaction date. Monetary assets and liabilities denominated in foreign currencies at the reporting date are converted at exchange rates current at balance date. Foreign exchange gains or losses are included in the Statement of Comprehensive Income.

(c) Research and Development

Research expenses include direct and overhead expenses for drug discovery and research, pre-clinical trials and, more recently, for costs associated with clinical trial activities. Research expenses also include the amortisation of intellectual property (used in research and development activities).

When a project reaches the stage where it is reasonably certain that future expenditure can be recovered through the processes or products produced, development expenditure is recognised as a development asset (other intangible asset).

(d) Intangible assets other than Goodwill

Other intangible assets relate to Intellectual Property acquired for use in research and development activity, as noted in the Research and Development policy.

The Intellectual Property has a finite life and is measured at cost less accumulated amortisation and accumulated impairment losses.

Amortisation is recognised in the Statement of Comprehensive Income on a straight line basis over the estimated useful life from the date available for use as follows:

Intellectual property	15 years
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Amortisation is charged to the Statement of Comprehensive Income and disclosed within Administration expense. The useful life of the intellectual property is reassessed annually.

(e) Share Capital

Ordinary shares are classified as equity. Costs associated with the issue of raising capital are

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recognised in shareholders' equity as a reduction of the amount allocated per share where material. Other expenses such as legal fees are charged to the Statement of Comprehensive Income in the period the expense is incurred.

(f) Goods & Services Tax

The Statement of Comprehensive Income and Statement of Cash Flows have been prepared so that all components are presented exclusive of GST. All items in the Statement of Financial Position are presented net of GST, with the exception of receivables and payables, which include GST invoiced.

(g) Income Tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the Statement of Comprehensive Income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences or unused tax losses can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(h) Other income

Other income is recognised to the extent that it is probable that the economic benefit will flow to the Company and the income can be reliably measured. Where amounts are received in respect of future product deliveries, such amounts are deferred until such time as the criteria above for recognition of revenue are met.

The Company's other income includes grant income, sub-lease rental and other sundry income.

For grant revenue the company recognises it over the period in which the related expenses are incurred.

Income from sub-leased property is recognised in the Statement of Comprehensive Income on a straight line basis over the term of the lease.

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(i) Statement of Cash Flows

The Statement of Cash Flows has been prepared using the direct approach.

Cash and cash equivalents are short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Investing activities are those activities relating to the acquisition, holding and disposal of property, plant and equipment, intangible assets and investments.

Financing activities are those that result in changes in the size and composition of the capital structure. Cash is considered to be cash on hand and current accounts and demand deposits in banks, net of bank overdrafts.

Operating activities are all transactions and events that are not investing or financing activities.

(j) Share-Based Compensation

The Company operates a share option plan for remuneration purposes.

The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted.

The cost of equity settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled (the vesting period), ending on the date on which the relevant employees become fully entitled to the award (the vesting date).

At each subsequent reporting date until vesting, the cumulative charge to the Statement of Comprehensive Income is the product of (i) the grant date fair value of the award; (ii) the current best estimate of the number of awards that will vest, taking in to account such factors as the likelihood of employee turnover during the vesting period; and (iii) the expired portion of the vesting period.

The charge to the Statement of Comprehensive Income for the period is the cumulative amount as calculated above less the amounts already charged in previous periods. There is a corresponding credit to equity.

(k) Impairment

The company assesses at each reporting date whether there is objective evidence that an asset or group of assets is impaired. Where the estimated recoverable amount of the asset is less than its carrying amount, the asset is written down and the impairment loss is recognised in the Statement of Comprehensive Income.

(l) Finance income and expenses

Finance income

Finance income comprises of interest income. Interest income is recognised as it accrues, using the effective interest method.

Finance expenses

Finance expenses comprised of interest expense on borrowings. All borrowing costs are

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recognised in profit and loss using the effective interest method.

(m) Operating expenses

Operating expenses are recognised in the Statement of Comprehensive Income upon utilisation of the service or at the date of their origin.

(m) Operating Leases

Operating leases are leases whereby the lessor retains substantially all the risks and rewards of ownership. The lease payments are recognised as an expense in the periods the amounts are payable.

(n) Investments

Investments are carried at the lower of cost or net realisable value.

(o) Financial Instruments

Financial assets and financial liabilities are recognised when the Company becomes a party to the contractual provisions of the financial instrument.

Financial assets are derecognised when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is derecognised when it is extinguished, discharged, cancelled or expires.

Financial assets and financial liabilities are measured initially at fair value plus transactions costs, except for financial assets and financial liabilities carried at fair value through profit or loss, which are measured initially at fair value.

For financial instruments traded in active markets, the quoted market prices or dealer price quotations are used as a measure of fair value. Where quoted market prices do not exist, fair values are estimated using present value or other market accepted valuation techniques, using methods and assumptions that are based on market conditions and risks existing as at balance date.

Financial assets and liabilities are measured subsequently as described below.

Financial assets

For the purpose of subsequent measurement financial assets other than those designated as hedging instruments are classified into one of the following categories: financial assets at fair value through profit or loss, loans and receivables, held to maturity investments and available for sale financial assets.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include items that are either classified as held for trading or that meet certain conditions and are designated at fair value through profit or loss upon initial recognition. All derivative financial instruments fall into this category, except for those designated and effective as hedging instruments, for which the hedge accounting requirements apply.

The Company does not currently have any financial assets designated into this category.

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Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial recognition, these are measured at amortised cost using the effective interest method, less impairment allowances.

The Company's cash and cash equivalents and trade and other receivables fall into this category of financial instruments.

Trade and other receivables are considered for impairment when there is objective evidence that the Company will not be able to collect all amounts due according to their original terms of the receivables. If there is objective evidence that impairment exists for individual loans and receivables, the impairment loss is calculated as the difference between the carrying amount of the financial assets and the present value of estimated future cash flows using the original effective interest rate. Receivables with a short duration are not discounted.

Held to Maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity other than loans and receivables. Investments are classified as held to-maturity if the Company has the intention and ability to hold them until maturity.

The Company does not currently have any financial assets designated into this category.

Available for Sale Financial Assets

Available-for-sale financial assets are non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets.

The Company does not currently have any financial assets designated into this category.

Financial liabilities

The Company's financial liabilities include trade and other payables. All financial liabilities are measured subsequently at amortised cost using the effective interest method.

Trade and other payables represent liabilities for goods and services provided to the Company prior to the end of the financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

All derivative financial instruments that are not designated and effective as hedging instruments are accounted for at fair value through profit or loss.

Derivative financial instruments

At balance sheet date the company did not undertake any form of hedge accounting.

Compound financial instruments

The Company has issued redeemable preference shares that can be ordinary shares at the option of the holder at a NZ\$ denominated exercise price. The contractual obligation arising from this embedded derivative is an equity instrument (the contract results in a 'fixed for fixed' exchange as required).

The liability portion is valued initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is initially recognised as the difference

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between the fair value of the instrument as a whole and the fair value of the liability portion. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to their initial recognition, the liability portion is measured at amortised cost using the effective interest method. The equity portion is not re-measured subsequent to initial recognition.

Interest, dividends, losses and gains relating to the financial liability are recognised in profit or loss. Distributions to the equity holders are recognised against equity, net of any tax benefit.

Embedded derivatives

The Company has issued convertible promissory notes that can be ordinary shares at the option of the holder at a US\$ denominated exercise price. The functional currency is however NZ\$ therefore the contractual obligation arising from the embedded derivative is not an equity instrument (due to exchange rate volatilities, the contract does not result in a 'fixed for fixed' exchange as required). As such, the derivative component is a derivative liability.

The contractual obligation arising from the debt obligation under each instrument is a financial liability that should be accounted for on an effective interest basis. The note is effectively presented as the net present value of the cash flows assuming a given market yield being the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.

The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

The derivative component is recognised as a liability at issue and then again at period end, with any differences recorded as income or expenditure.

Determination of fair value and fair value hierarchy

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments:

Level 1: Quoted prices in active markets for the same instrument (i.e. without modification or repackaging);

Level 2: Quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data and yield curve information provided by the Company's bankers; and

Level 3: Valuation techniques for which significant inputs are not based on observable market data.

(p) Investment in Joint Venture

The joint venture has been accounted for on an equity basis.

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4. CRITICAL ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in the following notes:

- Note 7 – measurement of the recoverable amounts in cash-generating units
- Note 11 – measurement of share-based payments

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	2011	2010
	\$	\$
Bank	9,628	17,852
Demand Deposits	2,811,651	1,419,289
	<u>2,821,279</u>	<u>1,437,141</u>

6. OPERATING DEFICIT

Operating deficit from continuing activities is stated after crediting and charging:

	2011	2010
	\$	\$
<i>Crediting:</i>		
Interest & Dividend received	34,449	17,014
Dividend received	348	668
Foreign exchange gain	20,150	-
<i>Charging:</i>		
Audit fees to Grant Thornton	35,845	33,971
Tax fees to Grant Thornton	8,642	-
Other fees to Grant Thornton	2,472	4,000
Depreciation - Leasehold improvements	4,214	40,606
- Plant and equipment	64,542	83,599
- Office furniture and fittings	4,333	3,185
Loss on sale of property, plant and equipment	4,196	433,561
Amortisation of intangible assets	1,637,309	1,637,309
Interest expense	221,116	420,214
Rent and leasing expense	99,411	255,682
Foreign exchange loss	-	11,401
Employee benefits	534,227	999,724

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7. INTANGIBLE ASSETS

	2011	2010
	\$	\$
Intellectual property		
Cost	24,559,638	24,559,638
Accumulated amortisation	<u>(17,464,624)</u>	<u>(15,827,315)</u>
Net intangible assets	<u>7,095,014</u>	<u>8,732,323</u>

The Company's intangible assets are comprised of issued patents, patent applications, manufacturing know how, and scientific knowledge and data. Immediately following incorporation in 2000, the Company acquired a family of issued and pending patents relating primarily to the former lead drug candidate PEHRG214. This specific intellectual property was acquired effective August 2000 through the issue of 6,247,662 ordinary shares of the Company and is recorded at cost, amortised over 15 years on a straight line basis, with a remaining life of 4 years. The Company has subsequently developed new intellectual property relating to the current lead drug candidate MIS416. This is represented by issued and pending patents seeking to protect the use of MIS416 to treat certain diseases or conditions. The current value of the MIS416 related intellectual property has not been specifically assessed to date.

The ultimate realisation of the carrying value of intellectual property is dependent on the Company successfully developing its biopharmaceutical products so that it generates sufficient cash flows to recover the carrying value of this asset. The key assumptions when assessing whether there are any indications of impairment of the Company's overall intellectual property are as follows:

- The commercial market for drugs being developed by the Company.
- The reasonable cost of goods versus the likely selling prices of those drugs
- The availability of industry partners to assist with commercialisation.
- The preclinical and clinical data generated to date in support of the drug candidates
- The progress and status of the various patent applications
- The time to revenue verses the remaining life of the patents

On the above basis, the Directors believe that the carrying value of the Company's intangible assets has not been impaired.

The Company's research and development activities involve inherent risks. These risks include, among others; dependence on, and the Company's ability to retain, key personnel; the Company's ability to protect its intellectual property and prevent other companies from using the technology; the Company's business is based on novel and unproven technology; the Company's ability to complete the clinical trial process to obtain regulatory approval and commercialise the products; technological developments by the Company's competitors may render its products obsolete; and future regulation could limit the amount the Company will be able to charge for its products.

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8. PROPERTY, PLANT & EQUIPMENT

	Leasehold Improvements	Plant and Equipment	Office Furniture and Fittings	Total
	\$	\$	\$	\$
Cost or deemed cost				
Balance at 1 April 2009	1,001,404	1,056,410	59,233	2,117,047
Additions	-	8,125	7,174	15,299
Disposals	(884,407)	(52,303)	(10,023)	(946,733)
Balance at 31 March 2010	116,997	1,012,232	56,384	1,185,613
Balance at 1 April 2010	116,997	1,012,232	56,384	1,185,613
Additions	-	7,600	702	8,302
Disposals		(31,546)	(22,786)	(54,332)
Balance at 31 March 2011	116,997	988,286	34,300	1,139,583
Depreciation and impairment losses				
Balance at 1 April 2009	491,914	643,597	48,485	1,183,996
Depreciation for the year	40,606	83,599	3,185	127,390
Disposals	(459,878)	(40,432)	(6,793)	(507,103)
Balance at 31 March 2010	72,642	686,764	44,877	804,283
Balance at 1 April 2010	72,642	686,764	44,877	804,283
Depreciation for the year	4,214	64,542	4,333	73,089
Disposals		(21,026)	(21,586)	(42,612)
Balance at 31 March 2011	76,856	730,280	27,624	834,760
Carrying amounts				
At 1 April 2009	509,490	412,813	10,748	933,051
At 31 March 2010	44,355	325,468	11,507	381,330
At 1 April 2010	44,355	325,468	11,507	381,330
At 31 March 2011	40,141	258,006	6,676	304,823

At balance date no items of property, plant and equipment were held under finance leases (2010: nil).

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9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2011	2010
	\$	\$
Trade accounts payables	61,239	47,052
Employee related payables	16,946	3,490
Other accruals	167,617	152,006
	<u>245,802</u>	<u>202,548</u>

10. RELATED PARTIES

Directors

During the year Elizabeth Hopkins and Simon Wilkinson (Directors) were paid \$50,000 (2010: \$41,667), and \$185,000 (2010: \$140,000) respectively for management services through their associated entities, Hopkins Associates and Dreadnought Management Ltd.

Compensation was also paid to Greg Moyle during the year of \$30,000 (2010: nil).

A trust associated with Greg Moyle (Director) participated in the offer to NZ resident shareholders during the year and subscribed for 300,000 new shares at a cost of \$30,000 (2010: 100,000 ordinary shares subscribed at a cost of \$10,000).

During the year Chris Collins (Director) participated in the offer to US resident shareholders and subscribed for 10,000,000 new ordinary shares at a cost of US\$750,000.

No shares were issued during the year to the directors for their services (2010: nil).

There were no outstanding balances owing at year end (2010: \$nil).

Key Management Personnel

During the year the entity paid the following to non director key management personnel:

	2011	2010
Salaries	101,634	243,721
Share based payments	6,106	26,820

During the year 550,000 employee share options have been granted to key management personnel (2010: 200,000 options).

There were no post-employment benefits, termination benefits and other long-term benefits for key management personnel.

Other related parties

The company paid no expenses during the year (2010: nil which were written off) on behalf of Buckler Biodefense Inc, the entity's joint venture. The remaining balance of the investment in Buckler Biodefense Inc. was written off at the end of the year.

No other related party debts have been written off or forgiven during the year (2010: nil).

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11. SHARE BASED PAYMENTS

The Company has on issue 8,593,375 share options to employees, directors and non-employees as at 31 March 2011 (2010: 6,651,125). Share options may be exercised at any time until the date of their expiry, or in the case of employee share options, at any time until the date of their expiry or the employee failing to complete the specified period of employment.

On 25 January 2001, the Company established the employee share option plan (the "Employee Plan") which will continue until terminated by the board of directors (the "Board"). Under the terms of the Employee Plan, the Board nominates participants in the Employee Plan and in respect of each nomination the Board determines the number of options and class of shares to which they relate, and the option issue and exercise prices. The Employee Plan establishes an Option Limit which is equal to that number of options which when aggregated with the number of shares issued by the Company during the previous five years pursuant to employee share or option plans is equal to 5% of the total number of shares in the Company.

Options granted vest in tranches upon each anniversary of the grant date over the course of three to five years. Options granted are cancelled if not exercised within one month of the termination of the grantee's employment or association with the Company, except in certain situations such as death or disability, or at the discretion of the Board. All options are exercisable into ordinary shares on a one for one basis.

The fair value of options granted is estimated using the Black-Scholes option-pricing model. Unless otherwise stated, all categories of options adopt the same model as follows:

2011	Employees	Directors	Non employees
Share price	\$0.10 - \$1.50	\$1.50	\$0.10 - \$1.50
Exercise price	\$0.20 - \$1.50	\$1.00	\$0.01 - \$8.75
Expected volatility	80%	80%	80%
Option lives (at issue)	5 years	5 years	4-7 years
Expected dividend yield	0%	0%	0%
Risk free interest rate	4.3% - 6.2%	6.0%	6.0% - 6.5%

2010	Employees	Directors	Non employees
Share price	\$0.50 - \$1.50	\$1.50	\$0.65 - \$1.50
Exercise price	\$1.00 - \$1.50	\$1.00	\$1.00 - \$8.75
Expected volatility	80%	80%	80%
Option lives (at issue)	5 years	5 years	4-7 years
Expected dividend yield	0%	0%	0%
Risk free interest rate	4.3% - 6.4%	6.0%	6.0% - 6.5%

Details of option pricing inputs exclude details of contracted terms for 1.5M share options which are exercisable within 30 days of completing an IPO at an exercise price of \$10 per share. Given the low probability of exercise, these options have been attributed nil value.

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11. SHARE BASED PAYMENTS (CONTINUED)

	2011		Restated 2010	
	Number of options	Weighted Average Exercise price	Number of options	Weighted Average Exercise price
Employee Options				
Share options on issue at start of year	782,000	\$1.00	781,750	\$1.23
Share options granted	1,760,000	\$0.20	200,000	\$1.80
Share options forfeited	-	\$0.00	-	\$0.00
Share options exercised	-	\$0.00	-	\$0.00
Share options expired	(542,000)	\$1.00	(199,750)	\$1.03
Share options on issue at end of year	<u>2,000,000</u>	\$0.31	<u>782,000</u>	\$1.00
Share options exercisable at end of year	<u>820,799</u>	\$0.31	<u>682,000</u>	\$1.02
Weighted average remaining contractual life (years)		4.57yrs		1.6yrs
Directors Options				
Share options on issue at start of year	700,000	\$1.00	1,000,000	\$1.00
Share options transferred (non employee scheme)	-	\$0.00	(300,000)	\$1.00
Share options granted	-	\$0.00	-	\$0.00
Share options forfeited	-	\$0.00	-	\$0.00
Share options exercised	-	\$0.00	-	\$0.00
Share options expired	-	\$0.00	-	\$0.00
Share options on issue at end of year	<u>700,000</u>	\$1.00	<u>700,000</u>	\$1.00
Share options exercisable at end of year	<u>700,000</u>	\$1.00	<u>700,000</u>	\$1.00
Weighted average remaining contractual life (years)		0.7yrs		1.7yrs
Non Employee Shareholder Options				
Share options on issue at start of year	5,169,375	\$4.00	5,069,375	\$4.36
Share options transferred (Director scheme)	-	\$0.00	300,000	\$1.00
Share options granted	4,000,000	\$0.01	-	\$0.00
Share options forfeited	-	\$0.00	-	\$0.00
Share options exercised	-	\$0.00	-	\$0.00
Share options expired	(3,276,000)	\$1.61	(200,000)	\$8.75
Share options on issue at end of year	<u>5,893,375</u>	\$2.62	<u>5,169,375</u>	\$4.00
Share options exercisable at end of year	<u>4,393,375</u>	\$0.60	<u>3,669,375</u>	\$1.55
Weighted average remaining contractual life (years)		3.94yrs		1.2yrs

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12. SEGMENT INFORMATION

The Company operates predominantly in one industry segment, being the research and development of drugs based on the Company's patented platform technology. Other than in respect of US capital raising activities all activity occurs, and assets are based, in New Zealand.

The major sources of income included within Other Operating Revenue relates to the grant of \$333,890 (USD equivalent \$247,500) received from Fast Forward and \$418,898 of R&D Tax credit received. Apart from the grant revenue and R&D tax credit received, the Company has no transactions with any single external customer greater than 10% of the Company's total revenues.

13. PROVISION FOR INCOME TAX

In assessing the reliability of deferred tax assets, management considers whether it is probable that all of the deferred tax asset will be realised. The ultimate realisation of deferred tax assets is dependent upon the generation of future taxable income and compliance with continuity of ownership requirements.

Based upon the level of projections for future taxable income over the periods in which the temporary differences are available to reduce income taxes payable, and uncertainties over continuity of ownership having regard to the Company's intention for further equity fund raising, management has established a valuation provision for the full amount of the deferred tax assets related to the net operating loss carried forward.

The provision for income taxes for continuing operations differs from the amount computed by applying the statutory rates to the Company's earnings from continuing operations before taxes as a result of the following differences:

	2011	2010
	\$	\$
Deficit before taxation	(3,141,079)	(5,100,761)
Provision for income taxes at statutory rate	(942,324)	(1,530,228)
Tax effect of permanent differences	329,576	408,147
Valuation provision	612,748	1,122,081
Income tax expense	<u>-</u>	<u>-</u>

The tax effect of temporary differences that give rise to deferred tax assets and liabilities are as follows:

Current assets:

Provision for holiday pay	4,781	937
Provision for site restoration	5,600	-
Other accruals	4,198	-

Non-current assets:

Intellectual property	1,410,300	1,255,188
Goat herd	-	5,542
Net operating loss to carry forward	<u>3,054,971</u>	<u>13,719,902</u>

Total deferred tax assets at 28% (2010: 30%)	4,479,850	14,981,569
Deferred tax not recognised	<u>(4,479,850)</u>	<u>(14,981,569)</u>
Net deferred tax asset	<u>-</u>	<u>-</u>

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As at 31 March 2011 resident withholding tax of \$13,548 (2010: \$19,786) deducted from interest income was due to the Company. There were imputation credits available at year end of \$14,262 (2010: \$20,373).

14. OPERATING LEASES

Minimum non-cancellable lease payments are as follows:

	2011	2010
	\$	\$
Within one year	48,142	86,418
One- two years	-	28,806
Two- five years	-	-
	<u>48,142</u>	<u>115,224</u>

One property is 25% sub-leased for the same period as the original lease with the landlords. The minimum stream of rental income from this sub-lease is as follows:

	2011	2010
	\$	\$
Within one year	8,800	20,750
One- two years	-	6,917
	<u>8,800</u>	<u>27,667</u>

15. COMMITMENTS AND CONTINGENT LIABILITIES

Contingent Liabilities - Royalties

In conjunction with the acquisition of the intellectual property, the Company granted the vendors royalties from the future net revenues which may be derived from the use of the intellectual property. The royalty agreements have a term of 20 years commencing August 2000, and the royalties, which are payable quarterly, amount to 6% (2010: 6%) of net revenues to a maximum aggregate royalty of US\$100 million (2010: US\$100 million).

Collaborations

The Company has not entered into any formal collaborative arrangements that give rise to significant contingencies or capital commitments as at 31 March 2011 (2010: Nil).

16. INVESTMENTS

In December 2005 the Company formed a joint venture company with the owners of Zeptomatrix Corporation (Buffalo, New York) as a 50% shareholder to exploit potential opportunities arising out of Bio-Defence programmes sponsored by various US Government agencies. The joint venture company is called Buckler Biodefense Inc. and is registered in the State of New York.

The original investment made was US\$5,000 (NZ\$7,077) towards the original set up costs. The joint venture has been accounted for on an equity basis but because the cumulative losses of the joint

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venture at 31 March 2011 are greater than the original investment no gain or loss from this investment has been included in the Company's Statement of Comprehensive Income. The joint venture's losses are immaterial to the Company's financial statements.

The investment has been fully written off in the year ended 31 March 2011 as the Joint Venture is no longer trading and is dormant.

17. RECONCILIATION OF NET DEFICIT AFTER TAXATION TO CASH FLOWS FROM OPERATING ACTIVITIES

	2011	2010
	\$	\$
Net Deficit after Tax	(3,141,079)	(5,100,761)
Non Cash Items:		
Depreciation & Property Plant and Equipment written off	73,089	563,603
Amortisation of intangibles	1,637,309	1,637,309
Share-based compensation	-	28,964
Foreign exchange	(98,456)	74,045
Provision for site restoration	20,000	
Income on derivatives	-	15,720
Movement in convertible notes and RPS	(514,307)	-
Loss on sale of assets	4,196	-
Changes in Working Capital:		
Accounts Receivable	(74,082)	11,511
Prepaid Expense	-	80,246
Accounts Payable and Accruals	23,254	139,056
Income taxes payable/(receivable)	8,605	(5,707)
Net Cash Outflow From Operating Activities	<u>(2,061,471)</u>	<u>(2,556,014)</u>

18. SHAREHOLDERS' EQUITY

Ordinary Shares

At 31 March 2011, 95,088,425 ordinary shares (2010: 60,771,572) were issued and fully paid. All ordinary shares rank equally as to voting, dividends and liquidation. There are no reserved shares of the Company. The shares have no par value.

	No. of shares	2011 \$	No. of shares	2010 \$
At start of year	60,771,572	122,240,452	43,218,660	120,670,002
Share based payment	-	204,479	-	28,964
Expired share options	-	(1,755,319)	-	195,374
Shares issued	34,316,853	3,439,310	17,552,912	1,736,860
At end of year	<u>95,088,425</u>	<u>124,128,922</u>	<u>60,771,572</u>	<u>122,240,452</u>

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Shares issued

A total of 34,316,853 new shares were issued during the year with a total value of \$3,439,310. Breakdown of the share movement details are as follow:

- 192,000 new shares were issued on 15 October 2010 for non cash value of \$39,557 (USD\$30,000) in exchange for services provided to the company.
- 5,000,000 new shares were issued on 3 November 2010 for cash value of \$501,002 (US\$375,000) pursuant to the Private Placement Memorandum dated 28 December 2009.
- 5,614,852 new shares were issued on 30 December 2010 for cash value of \$561,485 pursuant to the New Zealand Investment Statement and Prospectus dated 22 November 2010
- 20,260,001 new shares issued on the 10 February 2011 for cash value of \$2,012,266 (US\$1,519,500) pursuant to the US Private Placement Memorandum dated 20 December 2010
- 3,250,000 new shares issued on the 31 March 2011 for cash value of \$325,000 pursuant to the NZ Private Placement Memorandum dated 11 February 2011.

Share based payments

The movement in fair value of employee and non-employee share options of \$204,479 corresponds with the amount recorded in expenses during the period (2010: \$28,964).

Share option reserve

The share option reserve is used to record the fair value of options as at each balance sheet date. The values of options are transferred between equity components as they vest.

Other reserve

Other reserves are used to record the value of compound financial instruments valued as the time of issue.

19. CONVERTIBLE PROMISSORY NOTES

	2011	2010
	\$	\$
At amortised cost	846,240	748,603
Embedded derivative component	42,559	894,129
Issued convertible promissory notes	<u>888,799</u>	<u>1,642,732</u>

No convertible promissory notes have been issued during the year.

In 2010, the Company issued a further 27 US investment units at an issue price of USD\$10,000 per unit resulting in the issue of 243,000 convertible promissory notes with interest compounding at a rate of 8% p.a. for a term of 4 years. The holder of the notes has a right to convert them to shares at the price of US\$0.40 per share.

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20. REDEEMABLE PREFERENCE SHARES

	2011	2010
	\$	\$
At amortised cost	1,276,889	1,037,263
Issued redeemable preference shares	1,276,889	1,037,263

21. FINANCIAL INSTRUMENTS

Categories of Financial Instruments, including Fair Value of Financial Instruments

The classification of each class of financial assets and liabilities, and their fair values are as follows:

	2011		2010	
	Carrying Amounts	Fair Value	Carrying Amounts	Fair Value
	\$	\$	\$	\$
Non derivative financial assets				
Loans and Receivables				
(i) Cash and cash equivalents	2,821,279	2,821,279	1,437,141	1,437,141
(ii) Accounts receivable	348,214	348,214	14,343	14,343
(iii) Other receivables	64,521	64,521	21,375	21,375
Non derivative financial liabilities				
At Amortised Cost				
(ii) Accounts Payables	245,802	245,802	202,548	202,548
Derivative financial liabilities				
(iii) Redeemable preference shares	1,276,889	1,276,889	1,037,263	1,037,263
(iii) Convertible notes	888,799	888,799	1,642,732	1,642,732

Financial Risks

The financial risks associated with the Company's financial assets and liabilities include credit risk, interest rate risk, liquidity risk and currency risk.

Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, investments, loans and receivables. The maximum credit risk as defined by NZ IFRS 7 *Financial Instruments: Disclosures* is the face value of these financial instruments. However, the Company considers the risk of non-recovery of these accounts to be minimal.

Maximum Risk Exposure

The maximum credit risk exposures are the carrying amounts of the financial assets and financial liabilities listed under the "Categories of Financial Instruments, including Fair Value of Financial Instruments" table.

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No financial assets are either past due or impaired. There are no collateral and other credit enhancements for the financial assets.

Currency Risk

Currency risk is the risk of loss to the Company arising from adverse changes in foreign exchange rates. The Company is exposed to currency risk in respect of amounts held in foreign currency bank accounts and demand deposits. At 31 March 2011, the Company held US\$256,208 (NZ\$335,922) (2010 - US\$201,535 (NZ\$283,932)) in foreign currency bank accounts and demand deposits. Should exchange rates strengthen by 10% this would have an impact of \$37,325 (2010 – NZ\$31,548). Should exchange rates weaken by 10% this would have an impact of NZ\$30,538 (2010 – NZ\$25,812).

Interest Rate Risk

Interest rate risk is the risk of loss to the Company arising from adverse changes in interest rates. The Company is exposed to interest rate risk in respect of amounts held in bank current accounts and demand deposits. Interest on Convertible promissory notes and Redeemable preference shares is set at a fixed 8% therefore does not pose any interest rate risk to the entity.

The amounts are minimal with interest received in the year of \$34,449 and interest paid of \$563 (2010 - \$17,014 and interest paid of \$761).

Interest rate sensitivity analysis

The sensitivity analysis below have been determined based on the exposure to interest rates for both derivative and non-derivative instruments at the balance sheet date. For floating rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the balance sheet date was outstanding for the whole year. A 50 basis point (0.5%) increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

For each interest rate movement of 50 basis points higher/lower, assuming all other variables were held constant, the Company's loss for the year would increase/decrease by \$14,058 (2010: \$7,187).

Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds at short notice to meet commitments associated with financial instruments. This risk is distinct from the Going Concern risk (see note 1).

Analysis for the undiscounted cash flows of financial liabilities showing the remaining contractual maturities is as follows:

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The Company's non-derivative and derivative financial liabilities have contractual maturities as summarised below:

2011	Contractual cash flow maturities					
	Carrying amount	Contractual cash flows	Within 6 months	6 to 12 months	1 to 5 years	Later than 5 years
Trade Payables and accrued expenses	245,802	245,802	225,802	20,000	-	-
Redeemable preference shares	1,276,889	1,514,126	-	-	1,514,126	-
Convertible notes	888,799	1,162,220	-	-	1,162,220	-
	2,411,490	2,922,148	225,802	20,000	2,676,346	-

2010	Contractual cash flow maturities					
	Carrying amount	Contractual cash flows	Within 6 months	6 to 12 months	1 to 5 years	Later than 5 years
Trade Payables and accrued expenses	202,548	202,548	182,548	20,000	-	-
Redeemable preference shares	1,037,263	1,514,126	-	-	1,514,126	-
Convertible notes	1,642,732	1,260,389	-	-	1,260,389	-
	2,882,543	2,977,063	182,548	20,000	2,774,515	-

The above maturities analysis is based on the scenario that all convertible note holders do not convert their Notes liabilities into shares. However, the company expects the majority of Note holders to convert their Notes to company shares.

The Company is unable to reliably estimate how many Note holders will convert their Notes to shares.

24. SUBSEQUENT EVENTS

Events subsequent to 31 March 2011 comprise:

- The Company has negotiated a new lease for the premises it occupies at 4B Walls Road. The lease provided for an initial term of one year, two rights of renewal of two years each, and a final right of renewal for one year. The annual rental of the first one year terms is \$96,780 + GST. The Company has negotiated a new sub-lease with the existing tenant upstairs at Walls Rd for the same terms and rights of renewal. The sub-tenants pays 25% of the overall annual rental for the premises plus a share of outgoings.
- The Company has changed its name to Innate Immunotherapeutics Limited effective from 1 August 2011.

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- The Company has entered into an Agreement for Services with The Research Trust of Victoria University of Wellington that provides for the parties to collaboratively conduct studies into the possible mechanism(s) of action of the Company's drug candidate MIS416. The Agreement provides for the Company to pay approximately \$60,000 towards the costs of these studies with all data concerning MIS416 becoming the exclusive property of the Company.

25. CAPITAL MANAGEMENT

When managing capital, management's objective is to ensure that the Company has sufficient cash to continue as a going concern. Until such time as the Company produces revenues from sales or out-licensing, cash principally comes from the issue of new securities (shares, redeemable shares and convertible promissory notes) to new and/or existing shareholders. When pricing such new share issues, the Board takes into account multiple factors including:

- Market conditions for high risk investments;
- Estimation of current market value of the Company's IP;
- The dilution effect of new issues on existing shareholders; and
- Whether or not the new issue is restricted to existing shareholders.

The Company plans to attract new funds of approximately NZ\$13 million during the first half of 2012 to conduct a Phase 2B safety and efficacy trial of MIS416 and to also provide for operational expenses over a three year period.

The Redeemable Preference Shares (RPS) and Convertible Promissory Notes (Note) issued in late 2008 and early 2009 respectively are due for repayment at the end of 2012 and in early 2013. The holders of these instruments have the right to convert the amounts due (including dividends or interest) into ordinary shares at conversation prices of \$0.65 and US\$0.40 respectively. If the additional fund raising in early 2012 is successful and the Phase 2B trial of MIS416 commences during the second half of 2012, Management believes that the majority of RPS and Note holders will convert their securities into ordinary shares.

Management has no plans to pay a dividend to the holders of ordinary shares until, at the earliest, such time as the Company produces revenues.

The Company is not subject to externally imposed capital requirements.

Independent Auditor's Report

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To the Shareholders of Innate Immunotherapeutics Limited**Report on the Financial Statements**

We have audited the financial statements of Innate Immunotherapeutics on pages 7 to 34, which comprise the statement of financial position as at 31 March 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibilities

The Directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the presentation of the financial statements.

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

Other than in our capacity as auditor we have no relationship with, or interests in Innate Immunotherapeutics Limited.

Fundamental Uncertainty

In forming our unqualified opinion we have considered the adequacy of the disclosures made in the financial statements concerning the Company's ability to continue as a going concern. The going concern of the Company is dependent on the success of the Phase 2A trials as well as the Company's ability to raise an additional USD/AUD \$10,000,000 to fund the Phase 2B trials if the Phase 2A trials were successful. Full details of the circumstances relating to this fundamental uncertainty are described in note 1. The validity of the going concern assumption on which the financial report is prepared depends on the successful conclusion of these matters. If the company were unable to continue in operational existence for the foreseeable future, adjustments may have to be made to reflect the situation that assets may need to be realised other than in the amounts at which they are currently recorded in the balance sheet. In addition, the company may have to provide for further liabilities that might arise, and to reclassify non-current assets and long term liabilities as current assets and liabilities.

Opinion

In our opinion, the financial statements on pages 7 to 34:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards;
- give a true and fair view of the financial position of Innate Immunotherapeutics Limited as at 31 March 2011 and its financial performance and its cash flows for the year ended on that date.

Report on Other Legal and Regulatory Matters

Per the Financial Reporting Act 1993:

- we have obtained all the information and explanations that we have required;
- in our opinion, proper accounting records have been kept by Innate Immunotherapeutics Limited as far as appears from an examination of those records.



Grant Thornton New Zealand Audit Partnership
Auckland, New Zealand
5 October 2011