

Microbial Defense System Holdings Inc.

(a wholly owned subsidiary of Next Science Limited)

Annual Financial Report

31 December 2017

Microbial Defense System Holdings Inc.

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Microbial Defense System Holdings Inc.

Directors' report

For the financial year ended 31 December 2017

The directors present their report together with the consolidated financial statements of the Group comprising of Microbial Defense System Holdings Inc. (the "Company"), and its subsidiaries for the financial year ended 31 December 2017 and the auditor's report thereon.

1 Directors

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

Directors

Matthew Myntti	Appointed 30 March 2012
Judith Mitchell	Appointed 17 December 2018
Bruce Hancox	Appointed 30 March 2012, resigned 17 December 2018
James Mozley	Appointed 30 March 2012, resigned 17 December 2018

2 Principal activities

The principal activities of the Group during the course of the year is the research, development and distribution of technologies which solve microbacterial biofilm related issues.

3 Review of operations

The loss for the Group for the financial year ended 31 December 2017 after providing for income tax amounted to \$2,442,684 (2016: \$2,523,308).

4 Significant changes in the state of affairs

On 22 December 2017, the Group undertook a restructure whereby all of the issued shares in the Company were sold by shareholders to a new parent entity, Next Science Group Pty Limited (now known as Next Science Limited), in exchange for shares in that company. On 27 December 2017, the Company transferred its shareholding in its subsidiary, Next Science Pty Limited (now known as Next Science Technologies Pty Limited), to Next Science Group Pty Limited. On 27 December 2017, the Company sold its intellectual property to Next Science IP Holdings Pty Limited, an Australian based subsidiary of Next Science Group Pty Limited. There were no other significant changes in the state of affairs of the Group that occurred during the financial year.

5 Environmental regulation

The Group's operations are not subject to significant environmental regulations under both Commonwealth and State legislation. The Board believes that the Group 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 Group during the financial year covered by this report.

6 Government regulations

The Group is subject to varying degrees of governmental regulation in the countries in which operations are conducted, and the general trend is toward increasingly stringent regulation. In the U.S., the drug, device, diagnostics and cosmetic industries have long been subject to regulation by various federal and state agencies, primarily as to product safety, efficiency, manufacturing, advertising, labelling and safety reporting. The exercise of broad regulatory powers by the U.S. Food and Drug Administration (the "FDA") results in increases in the amounts of testing and documentation required for FDA clearance of new drugs and devices and a corresponding increase in the expense of product introduction. Similar trends are also evident in major markets outside of the U.S.

The Group relies on global supply chains, and production and distribution processes, that are complex and are subject to increasing regulatory requirements that may affect sourcing, supply and pricing of materials used in the Group's products, and which are subject to lengthy regulatory approvals.

Microbial Defense System Holdings Inc.

Directors' report (continued)

For the financial year ended 31 December 2017

7 Dividends

No dividends were paid or declared since the commencement of the year and the directors do not recommend the declaration of a dividend.

8 Matters subsequent to the end of the financial year

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 Group, to affect significantly the operations of the Group, the results of those operations, or the state of affairs of the Group, in future financial years.

9 Likely developments and expected results of operations

Further information about likely developments in the operations of the Group 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 Group.

10 Shares under option

As at 31 December 2017, there were 325 options over ordinary shares in the Company's new parent entity, Next Science Group Pty Limited (now known as Next Science Limited), representing 2.0% of its total share capital, granted to employees of the Company under an Equity Incentive Plan. The grant dates, vesting dates and exercise prices vary in accordance with the nature of each employee's employment.

11 Indemnity and insurance of officers and auditors

The Company has indemnified the directors and executives of the Company for costs incurred, in their capacity as a director or executive, for which they may be held personally liable, except where there is a lack of good faith. During the financial year, the Company paid a premium in respect of a contract to insure the directors and executives of the Company against a liability to the extent permitted. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

The Company has not, during or since the end of the financial year, indemnified or agreed to indemnify the auditor of the Company or any related entity against a liability incurred by the auditor.

12 Lead auditor's independence declaration

The Lead auditor's independence declaration is set out on page 3 and forms part of the Directors' report for the financial year ended 31 December 2017.

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



Judith Mitchell

Director

Dated at Sydney this 14th day of February 2019



Lead Auditor's Independence Declaration

To the Directors of Microbial Defense System Holdings Inc.

I declare that, to the best of my knowledge and belief, in relation to the audit of Microbial Defense System Holdings Inc. for the financial year ended 31 December 2017 there have been no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

Chris Allenby

Partner

Sydney

14 February 2019

Microbial Defense System Holdings Inc.

Consolidated statement of profit or loss and other comprehensive income

For the financial year ended 31 December 2017

<i>In USD</i>	Note	2017	2016
Revenue	4	483,235	88,345
Cost of sales		<u>(123,574)</u>	<u>(160,733)</u>
Gross profit		<u>359,661</u>	<u>(72,388)</u>
Other income	5	3,598,289	1,004,135
Employee expenses	6(a)	(2,329,241)	(1,100,372)
Research and development expenses		(664,275)	(515,687)
Professional fees		(1,546,045)	(747,671)
Marketing expenses		(128,047)	(237,290)
Administration expenses		(523,734)	(222,972)
Depreciation and amortisation expenses	6(b)	(159,349)	(82,820)
Regulatory costs		(347,035)	(244,876)
Other expenses		<u>(710,908)</u>	<u>(294,304)</u>
Results from operating activities		<u>(2,450,684)</u>	<u>(2,514,245)</u>
Net finance income	6(c)	8,000	(9,063)
Loss before income tax		<u>(2,442,684)</u>	<u>(2,523,308)</u>
Income tax expense	13(a)	-	-
Loss for the year		<u>(2,442,684)</u>	<u>(2,523,308)</u>
Other comprehensive income		-	-
Total comprehensive income for the year		<u>(2,442,684)</u>	<u>(2,523,308)</u>

The notes on pages 8 to 30 are an integral part of these financial statements.

Microbial Defense System Holdings Inc.
 Consolidated statement of financial position
As at 31 December 2017

<i>In USD</i>	Note	2017	2016
Assets			
Current assets			
Cash and cash equivalents	7(a)	1,334,929	793,847
Trade and other receivables	8	1,780	19,141
Inventories	9	80,140	65,324
Other current assets	10	279,858	48,024
Total current assets		<u>1,696,707</u>	<u>926,336</u>
Non-current assets			
Trade and other receivables	8	4,722,860	-
Property, plant and equipment	11	439,923	269,353
Intangible assets	12	632,682	401,485
Total non-current assets		<u>5,795,465</u>	<u>670,838</u>
Total assets		<u>7,492,172</u>	<u>1,597,174</u>
Liabilities			
Current liabilities			
Trade and other payables	14	823,013	249,593
Total current liabilities		<u>823,013</u>	<u>249,593</u>
Non-current liabilities			
Total non-current liabilities		<u>-</u>	<u>-</u>
Total liabilities		<u>823,013</u>	<u>249,593</u>
Net assets		<u>6,669,159</u>	<u>1,347,581</u>
Equity			
Share capital	15(a)	17,605,951	11,052,451
Share option reserve		224,734	-
Common control reserve	20	986,028	-
Accumulated losses		(12,147,554)	(9,704,870)
Total equity		<u>6,669,159</u>	<u>1,347,581</u>

The notes on pages 8 to 30 are an integral part of these financial statements.

Microbial Defense System Holdings Inc.

Consolidated statement of changes in equity

For the financial year ended 31 December 2017

<i>In USD</i>	Share capital	Share option reserve	Common control reserve	Accumul- ated losses	Total equity
Balance at 1 January 2016	8,552,451	-	-	(7,181,562)	1,370,889
<i>Comprehensive income</i>					
Loss for the year	-	-	-	(2,523,308)	(2,523,308)
Total comprehensive income for the year	-	-	-	(2,523,308)	(2,523,308)
<i>Transactions with owners, recorded directly in equity</i>					
Issue of ordinary shares	2,500,000	-	-	-	2,500,000
Total transactions with owners	2,500,000	-	-	-	2,500,000
Balance at 31 December 2016	11,052,451	-	-	(9,704,870)	1,347,581
Balance at 1 January 2017	11,052,451	-	-	(9,704,870)	1,347,581
<i>Comprehensive income</i>					
Loss for the year	-	-	-	(2,442,684)	(2,442,684)
Total comprehensive income for the year	-	-	-	(2,442,684)	(2,442,684)
<i>Transactions with owners, recorded directly in equity</i>					
Issue of ordinary shares	6,553,500	-	-	-	6,553,500
Issue of share options	-	224,734	-	-	224,734
Disposal of subsidiary under common control (refer Note 20(a))	-	-	986,028	-	986,028
Total transactions with owners	6,553,500	224,734	986,028	-	7,764,262
Balance at 31 December 2017	17,605,951	224,734	986,028	(12,147,554)	6,669,159

The notes on pages 8 to 30 are an integral part of these financial statements.

Microbial Defense System Holdings Inc.

Consolidated statement of cash flows

For the financial year ended 31 December 2017

In USD

	Note	2017	2016
Cash flows from operating activities			
Receipts from customers		492,214	1,088,345
Payments to suppliers and employees		(5,691,031)	(3,510,440)
Cash generated from operations		<u>(5,198,817)</u>	<u>(2,422,095)</u>
Interest received		7,632	-
Interest paid		(42)	-
Net cash used in operating activities	7(b)	<u>(5,191,227)</u>	<u>(2,422,095)</u>
Cash flows from investing activities			
Payments for property, plant and equipment	11	(325,847)	(133,271)
Payments for intangible assets	12	(248,089)	(148,374)
Transfer of cash on disposal of subsidiary	20(a)	(247,255)	-
Net cash used in investing activities		<u>(821,191)</u>	<u>(281,645)</u>
Cash flows from financing activities			
Proceeds from shares issued	15(a)	6,553,500	2,500,000
Net cash from financing activities		<u>6,553,500</u>	<u>2,500,000</u>
Net increase / (decrease) in cash and cash equivalents		541,082	(203,740)
Cash and cash equivalents at beginning of the year		793,847	997,587
Cash and cash equivalents at end of the year	7(a)	<u>1,334,929</u>	<u>793,847</u>

The notes on pages 8 to 30 are an integral part of these financial statements.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements

For the financial year ended 31 December 2017

1 Corporate information

Microbial Defense System Holdings Inc. (the "Company") is a company domiciled in the United States of America. The registered address of Company is c/o The Corporation Trust Company, 1209 Orange Street, Wilmington, DE 19801. The Group is a for-profit entity and primarily involved in the research, development and distribution of technologies which solve bacterial related issues.

The Company is a wholly owned subsidiary of Next Science Limited (formerly known as Next Science Group Pty Limited), a company domiciled in Australia, from 22 December 2017.

These consolidated financial statements comprise the Company and its subsidiaries (collectively the "Group" and individually "Group companies").

2 Basis of preparation

(a) Statement of compliance

The Group has prepared these general purpose financial statements for the year ended 31 December 2017 for the purpose of meeting the listing requirements of the Australian Securities Exchange ("ASX"). The general purpose financial statements have been prepared in accordance with Australian Accounting Standards ("AASBs") adopted by the Australian Accounting Standards Board ("AASB"). The consolidated financial statements comply with International Financial Reporting Standards ("IFRS") adopted by the International Accounting Standards Board ("IASB").

The financial statements were approved by the Board of Directors and authorised for issue on the date of signing these financial statements.

(b) Basis of measurement

The financial statements have been prepared on a historical cost basis.

(c) Functional and presentation currency

The financial statements are presented in United States Dollars, which is the Group's functional currency and presentation currency.

(d) Use of judgements and estimates

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income, expenses and disclosure of contingent liabilities. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised prospectively.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements

For the financial year ended 31 December 2017

2 Basis of preparation

(e) Going concern

The financial report has been prepared on a going concern basis, which assumes continuity of normal business activities and the realisation of assets and settlement of liabilities in the ordinary course of business for a period of at least twelve months from the date this financial report is approved.

For the financial year ended 31 December 2017, the Group incurred a loss of \$2,442,684 (2016: \$2,523,308) and had net cash outflows from operations of \$5,191,227 (2016: \$2,422,095). For the subsequent financial period, being the year ended 31 December 2018, the Group incurred a further loss of \$7,600,744 and as at that date had a deficiency in net assets of \$1,881,587.

The Group's parent entity, Next Science Limited, is in the process of undertaking a further equity raising process in order to fund the Group. This is expected to raise sufficient equity to fund its operations and activities for a period of at least twelve months from the date of signing this financial report.

However, in the event that the planned equity raising process does not proceed or that funds raised are significantly lower than targeted, the Group will need to manage its cash outflows, including formalising customer contracts on the commercialisation of its products, and develop plans to raise alternative finance. The Directors are confident that there are a range of alternative options available and believe that the Group has a track record of tightly managing costs and raising finance when required. The Directors have developed plans to undertake these activities, though they have not been enacted as the equity raising process is well advanced.

After considering the above, the Directors have concluded that the Group will be able to fulfil all obligations as and when they fall due for the foreseeable future, being at least twelve months from the date of signing this financial report. However, in the event that the planned equity raising process does not proceed, there will be material uncertainty that may cast significant doubt about the Group's ability to continue as a going concern.

No adjustments have been made to the financial statements relating to the recoverability and classification of recorded asset amounts or to the amount and classification of liabilities that might be necessary should the Group not continue as a going concern.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

The Group has consistently applied the following accounting policies to all periods in these financial statements.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

(ii) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated. Unrealised gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(b) Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Group at exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at the reporting date. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated to the functional currency at the exchange rate when the fair value was determined. Foreign currency differences are generally recognised in profit or loss. Non-monetary items that are measured based on historical cost in a foreign currency are not translated.

(ii) Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into the functional currency at the exchange rates at the reporting date. The income and expenses of foreign operations are translated into the functional currency at the average exchange rates for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rates at the dates of the transaction are used.

Foreign currency differences are recognised in other comprehensive income ("OCI") and accumulated in the translation reserve.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

(c) Revenue

Revenue is measured at the fair value of the consideration received or receivable. The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

(i) *Sale of goods*

Revenue from the sale of goods in the course of ordinary activities is measured at the fair value of the consideration received or receivable, net of returns, trade discounts and volume rebates. Revenue is recognised when persuasive evidence exists, usually in the form of an executed sales agreement, that the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably. The timing of the transfers of risk and rewards varies depending on the individual terms of the contract of sale.

(d) Employee benefits

(i) *Short-term employee benefits*

Short-term employee benefits are benefits (other than termination benefits) that are expected to be settled within 12 months of the end of the financial year in which employees render the related service. Short-term employee benefits include salaries and wages plus related on-costs such as payroll tax, superannuation and workers compensation insurance and are measured at the undiscounted amounts expected to be paid when the obligation is settled.

(ii) *Long-term employee benefits*

Long-term employee benefits includes employees' long service leave and annual leave entitlements not expected to be settled within 12 months of the end of the financial year in which employees render the related service. Other long-term employee benefits are measured at the present value of the expected future payments to be made to employees. Expected future payments incorporate anticipated future wage and salary levels, duration of service and employee departures and are discounted at rates determined by reference to market yields at the end of the reporting period on corporate bonds that have maturity dates that approximate the terms of the obligations. Any remeasurements for changes in assumptions of obligations for long-term employee benefits are recognised in profit or loss in the periods in which the changes occur.

(iii) *Share-based payment arrangements*

The grant date fair value of options granted to employees (equity-settled) is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees become entitled to the options. The amount recognised as an expense is adjusted to reflect the number of options for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised is based on the number of options that meet the related service and non-market performance conditions at the vesting date.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

(e) Finance income and finance costs

Finance income comprises interest income, dividend income and foreign currency gains. Interest income is recognised in profit or loss as it accrues using the effective interest method.

Finance costs comprise interest expense on borrowings, foreign currency losses and impairment losses recognised on financial assets. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognised in profit or loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis as either finance income or finance cost depending on whether foreign currency movements are in a net gain or net loss position.

(f) Income tax

Income tax expense comprises current and deferred tax. It is recognised in profit or loss except to the extent that it relates to a business combination, or items recognised directly in equity or in OCI.

(i) Current tax

Current tax comprises the expected tax payable or receivable on the taxable income or loss for the year and any adjustment to tax payable or receivable in respect of previous years. It is measured using tax rates enacted or substantively enacted at the reporting date. Current tax also includes any tax liability arising from dividends.

Current tax assets and liabilities are offset only if certain criteria are met.

(ii) Deferred tax

Deferred tax is recognised in respect of 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 temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, or on taxable temporary differences arising on the initial recognition of goodwill.

Deferred tax assets are recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they 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; such reductions are reversed when the probability of future taxable profits improves.

Unrecognised deferred tax assets are reassessed at each reporting date and recognised to the extent that it has become probable that future taxable profits will be available against which they can be used.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

The measurement of deferred tax reflects the tax consequences that could follow the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset only if certain criteria are met.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

(g) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably and if it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as a finance cost.

(h) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset. If significant parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment. Any gain and loss on disposal of an item of property, plant and equipment is recognised in profit or loss.

(ii) Subsequent expenditure

Subsequent expenditure is capitalised only when it is probable that the future economic benefits associated with the expenditure will flow to the Group.

(iii) Depreciation

Depreciation is calculated based on the cost of property, plant and equipment less their estimated residual values using the straight-line basis over their estimated useful lives, and is generally recognised in profit or loss. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of property, plant and equipment are as follows:

• Leasehold improvements	5 - 15 years
• Plant and equipment	5 years
• Furniture and fittings	5 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

(i) Leases

(i) Determining whether an arrangement contains a lease

At inception of an arrangement, the Group determines whether such an arrangement is or contains a lease.

(ii) Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

(j) Intangible assets

(i) Recognition and measurement

Research and development expenditure

Expenditure on research activities is recognised in profit or loss as incurred. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group intends to and has sufficient resources to complete development and to use or sell the asset. Otherwise it is recognised in profit or loss as incurred. Subsequent to initial recognition, development expenditure is measured at cost less accumulated amortisation and any accumulated impairment losses.

Patents

Expenditure is capitalised in relation to patent application costs and amortised over the remaining life of the base patent as relevant.

Computer software

Computer software comprises computer application system software and licenses. Costs incurred in developing products or systems and costs incurred in acquiring software and licenses that will contribute to future period financial benefits through revenue generation and/or cost reduction are capitalised to computer software. Costs capitalised include external direct costs of materials and services, direct payroll and payroll-related costs.

(ii) Subsequent expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognised in profit or loss as incurred.

(iii) Amortisation

Amortisation is calculated based on the cost of intangible assets less their estimated residual values using the straight-line method over their estimated useful lives, and is generally recognised in profit or loss.

The estimated useful lives of intangible assets are as follows:

- | | |
|------------|------------|
| • Software | 3 years |
| • Patents | 8-15 years |

Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Intangible assets have finite useful lives.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

(k) Financial instruments

The Group classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity financial assets, loans and receivables and available-for-sale financial assets. The Group classifies non-derivative financial liabilities into the other financial liabilities category.

(i) *Non derivative financial assets and financial liabilities – recognition and derecognition*

The Group initially recognises loans and receivables issued on the date that they are originated. All other financial assets and financial liabilities are recognised initially on the trade date.

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or it neither transfers nor retains substantially all of the risks and rewards of ownership and does not retain control over the transferred asset. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

(ii) *Non derivative financial assets – measurement*

Loans and trade receivables

These assets are initially recognised at fair value. Subsequent to initial recognition, they are measured at amortised cost using the effective interest method, less any provision for impairment. Other receivables are recognised at amortised cost, less any provision for impairment.

Cash and cash equivalents

Cash comprises cash on hand and cash equivalents are short-term, highly liquid investments that are readily convertible to known cash amounts of cash and which are subject to an insignificant risk of changes in value. In the statement of cash flows, cash and cash equivalents includes bank overdrafts (if any) that are repayable on demand and form an integral part of the Group's cash management.

(iii) *Non-derivative financial liabilities – measurement*

Non-derivative financial liabilities are initially recognised at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these liabilities are measured at amortised cost using the effective interest rate method.

(iv) *Share capital*

Incremental costs directly attributable to the issue of ordinary shares, net of any tax effects, are recognised as a deduction from equity.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

(I) Impairment

(i) *Non-derivative financial assets*

Financial assets not classified as at fair value through profit or loss are assessed at each reporting date to determine whether there is objective evidence of impairment.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Group on terms that the Group would not consider otherwise, indications that a debtor or issuer will enter bankruptcy or economic conditions that correlate with defaults, adverse changes in the payment status of borrowers or issuers, the disappearance of an active market for a security, or observable data indicating that there is a measurable decrease in the expected cash flows from a group of financial assets.

The Group considers evidence of impairment for receivables at both a specific asset and collective level. All individually significant receivables are assessed for impairment. Those found not to be impaired are then collectively assessed for any impairment that has been incurred but not yet individually identified. Assets that are not individually significant are collectively assessed for impairment. Collective assessment is carried out by grouping together assets with similar risk characteristics. Loans and receivables that are not individually significant are collectively assessed for impairment by grouping together receivables with similar risk characteristics.

In assessing collective impairment the Group uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognised in profit or loss and reflected in an allowance account against loans and receivables. Interest on the impaired asset continues to be recognised. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

(ii) *Non-financial assets*

At each reporting date, the Group reviews the carrying amounts of its non-financial assets (other than deferred tax assets) to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

For impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or cash generating units ("CGUs"). Goodwill arising from a business combination is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the combination.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. Value in use is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

3 Significant accounting policies

(l) Impairment (continued)

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount. Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amount of assets in the CGU on a pro rata basis. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(m) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Operating Decision Maker ("CODM"). The CODM is responsible for allocating resources and assessing performance of the operating segments.

(o) New Standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2017, and have not been applied in preparing these financial statements. Those which may be relevant to the Group are set out below. The Group does not plan to adopt these standards early.

(i) AASB 9 Financial Instruments (2014)

AASB 9, approved in December 2014, replaces the existing guidance in AASB 139 *Financial Instruments: Recognition and Measurement*. AASB 9 includes revised guidance on the classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from AASB 139. AASB 9 is effective for annual reporting periods beginning on or after 1 January 2018. The Group has assessed that there is no material impact on its financial statements resulting from the application of AASB 9.

(ii) AASB 15 Revenue from Contracts with Customers

AASB 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including AASB 118 *Revenue*, AASB 111 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*. AASB 15 is effective for annual reporting periods beginning on or after 1 January 2018. The Group has assessed the impact of AASB 15 on the financial statements which will result in a reduction in retained earnings of \$950,000 as at 31 December 2018, due to the deferral of contract revenue previously recorded as revenue in the year ended 31 December 2016.

(iii) AASB 16 Leases

AASB 16 removes the classification of leases as either operating lease or finance leases (for the lessee) effectively treating all lease as finance leases. Short-term leases (less than 12 months) and leases of low-value assets (such as personal computers) are exempt from the lease accounting requirements. There are also changes in accounting over the life of the lease. In particular, companies will not recognise a front-loaded pattern of expenses for most leases, even when they pay constant rentals. AASB 16 is effective from annual reporting periods beginning on or after 1 January 2019, with early adoption permitted for entities that also adopt AASB 15. The Group estimates that on transition to AASB 16 it will recognise additional lease liabilities of \$668,435 and corresponding right of use assets of \$582,300 with the balance being recognised in retained earnings.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

4 Revenue

In USD

	2017	2016
Sale of goods	483,235	88,345
	<u>483,235</u>	<u>88,345</u>

5 Other income

In USD

	Note	2017	2016
Sale of intellectual property to related party	18	3,237,100	-
Other income from related party	18	352,210	-
Contract revenue		-	1,000,000
Other income		8,979	4,135
		<u>3,598,289</u>	<u>1,004,135</u>

6 Expenses

In USD

	Note	2017	2016
(a) Employee expenses			
Salaries and wages		2,083,021	1,073,948
Other employee expenses		246,220	26,424
		<u>2,329,241</u>	<u>1,100,372</u>
(b) Depreciation and amortisation expenses			
Depreciation expense	11	105,688	78,177
Amortisation expense	12	53,661	4,643
		<u>159,349</u>	<u>82,820</u>
(c) Net finance income			
Interest income		16,534	-
Finance income		16,534	-
		<u>16,534</u>	<u>-</u>
Interest expense		(8,534)	(9,063)
Finance costs		(8,534)	(9,063)
Net finance income recognised in profit or loss		<u>8,000</u>	<u>(9,063)</u>

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

7 Cash and cash equivalents

(a) Cash and cash equivalents in statement of cash flows

In USD

	2017	2016
Cash at bank	1,334,929	793,847
	<u>1,334,929</u>	<u>793,847</u>

(b) Reconciliation of cash flows from operating activities

In USD

	Note	2017	2016
Loss for the year		(2,442,684)	(2,523,308)
Adjustments for:			
Depreciation expense	6(b)	105,688	78,177
Amortisation expense	6(b)	53,661	4,643
Sale of intellectual property to related party	5	(3,237,100)	-
Share options granted		224,734	-
Interest expense		42	-
Loss/(gain) on plant and equipment		12,410	(35,137)
Operating loss before changes in working capital and provisions		<u>(5,283,249)</u>	<u>(2,475,625)</u>
Change in trade and other receivables		17,284	(19,141)
Change in other current assets		(231,834)	(344)
Change in inventories		(14,816)	(65,324)
Change in trade and other payables		321,388	138,339
Net cash used in operating activities		<u>(5,191,227)</u>	<u>(2,422,095)</u>

8 Trade and other receivables

In USD

	Note	2017	2016
Current			
Trade and other receivables		1,780	19,141
		<u>1,780</u>	<u>19,141</u>
Non-current			
Loan receivable from related parties	18	4,722,860	-
		<u>4,722,860</u>	<u>-</u>

The carrying value of receivables is considered a reasonable approximation of fair value due to the short-term nature of the balances.

9 Inventories

In USD

	2017	2016
Finished goods - at cost	80,140	65,324
	<u>80,140</u>	<u>65,324</u>

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

10 Other current assets

In USD

Current

Prepayments and other assets

2017 **2016**

279,858	48,024
<u>279,858</u>	<u>48,024</u>

11 Property, plant and equipment

In USD

Cost

Balance at 1 January 2016

Additions

Balance at 31 December 2016

	Leasehold improvements	Plant and equipment	Furniture and fittings	Total
-	351,283	18,299	369,582	
1,000	82,034	50,237	133,271	
<u>1,000</u>	<u>433,317</u>	<u>68,536</u>	<u>502,853</u>	

Accumulated depreciation

Balance at 1 January 2016

Depreciation

Balance at 31 December 2016

-	138,776	16,547	155,323
117	70,563	7,497	78,177
<u>117</u>	<u>209,339</u>	<u>24,044</u>	<u>233,498</u>

Cost

Balance at 1 January 2017

Additions

Disposals

Impairment

Transfer to intangible assets

Balance at 31 December 2017

1,000	433,317	68,536	502,853
159,015	93,945	72,887	325,847
-	(7,261)	-	(7,261)
-	(5,559)	-	(5,559)
-	(48,103)	-	(48,103)
<u>160,015</u>	<u>466,339</u>	<u>141,423</u>	<u>767,777</u>

Accumulated depreciation

Balance at 1 January 2017

Depreciation

Transfer to intangible assets

Balance at 31 December 2017

117	209,339	24,043	233,499
5,475	84,711	15,502	105,688
-	(11,333)	-	(11,333)
<u>5,592</u>	<u>282,717</u>	<u>39,545</u>	<u>327,854</u>

Carrying amounts

At 1 January 2017

At 31 December 2017

883	223,978	44,492	269,353
<u>154,423</u>	<u>183,622</u>	<u>101,878</u>	<u>439,923</u>

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

12 Intangible assets

In USD

	Software	Patents	Total
Cost			
Balance at 1 January 2016	-	313,552	313,552
Additions	-	148,375	148,375
Balance at 31 December 2016	-	461,927	461,927
Accumulated amortisation			
Balance at 1 January 2016	-	55,799	55,799
Amortisation	-	4,643	4,643
Balance at 31 December 2016	-	60,442	60,442
Cost			
Balance at 1 January 2017	-	461,927	461,927
Additions	8,772	239,317	248,089
Transfer from property, plant and equipment	48,103	-	48,103
Balance at 31 December 2017	56,875	701,244	758,119
Accumulated amortisation			
Balance at 1 January 2017	-	60,442	60,442
Amortisation	16,313	37,348	53,661
Transfer from property, plant and equipment	11,333	-	11,333
Balance at 31 December 2017	27,646	97,790	125,437
Carrying amounts			
At 1 January 2017	-	401,485	401,485
At 31 December 2017	29,229	603,454	632,682

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

13 Income tax

(a) Income tax expense

Income tax expense comprises current and deferred tax expense and is recognised in profit or loss, except to the extent that it relates to a business combination or items recognised directly in equity or other comprehensive income. The components of tax expense comprise:

The prima facie tax on profit before income tax is reconciled to the income tax expense as follows:

	2017	2016
<i>In USD</i>		
Loss before income tax	(2,442,684)	(2,523,308)
Tax using the Company's tax rate of 21% (US)	(512,964)	(529,895)
Tax losses not brought to account	512,964	529,895
Total income tax expense	-	-

(b) Deferred taxes

The Group has not recognised the tax effect of unused tax losses or temporary differences as deferred tax assets as it is not yet probable that sufficient taxable profits will be earned in future years.

14 Trade and other payables

In USD

	Note	2017	2016
Current			
Trade payables		379,234	174,552
Other payables and accrued expenses		36,162	75,041
Loan payable to related parties	18	407,617	-
		823,013	249,593

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

15 Capital and reserves

(a) Share capital

	Number	\$
<i>In number of shares / USD</i>		
Shares issued in March 2012 (incorporation)	5,818	52,451
Shares issued in March 2012	1,902	2,000,000
Shares issued in March 2013	429	-
Shares issued in March 2013	1,851	2,000,000
Shares issued in April 2014	500	1,000,000
Shares issued in August 2014	500	1,000,000
Shares issued in May 2015	500	1,000,000
Shares issued in October 2015	750	1,500,000
Balance at 31 December 2015	12,250	8,552,451
Shares issued in March 2016	250	500,000
Shares issued in July 2016	500	1,000,000
Shares issued in September 2016	500	1,000,000
Shares issued in November 2016 (partly paid)	100	-
Total shares issued during the 2016 financial year	1,350	2,500,000
Balance at 31 December 2016	13,600	11,052,451
Shares issued in January 2017	500	1,000,000
Shares issued in March 2017	500	1,000,000
Shares issued in June 2017	580	1,160,000
Shares issued in August 2017	370	1,017,500
Shares issued in October 2017	500	1,375,000
Total shares issued in 2017 prior to Group restructure *	2,450	5,552,500
Total shares issued prior to Group restructure *	16,050	16,604,951
Shares issued in December 2017	364	1,001,000
Balance at 31 December 2017	16,414	17,605,951

Ordinary shares participate in dividends and the proceeds on winding up of the Company in proportion to the number of shares held. At shareholders' meetings, each ordinary share is entitled to one vote when a poll is called.

* On 22 December 2017, all of the issued shares in the Company were sold by shareholders to a new parent entity, Next Science Group Pty Limited (now known as Next Science Limited), in exchange for shares in that company.

(b) Dividends

No dividends were paid or declared by the Company during the year.

(c) Capital management

The Group's objectives when managing capital are to safeguard its ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders, maintain sufficient financial flexibility to pursue its growth objectives and maintain an optimal capital structure to reduce the cost of capital.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

16 Parent entity information

As at, and throughout, the financial year the parent entity of the Group was Microbial Defense System Holdings Inc.

Statement of profit or loss and other comprehensive income

In USD

	2017	2016
Loss after income tax	(2,442,684)	(2,523,308)
Other comprehensive income	-	-
Total comprehensive income	(2,442,684)	(2,523,308)

Statement of financial position

In USD

Assets

Total current assets	77	77
Total non-current assets	6,669,082	1,347,504
Total assets	6,669,159	1,347,581

Liabilities

Total current liabilities	-	-
Total non-current liabilities	-	-
Total liabilities	-	-
Total net assets	6,669,159	1,347,581

Equity

Share capital	17,605,951	11,052,451
Share option reserve	224,734	-
Common control reserve	986,028	-
Accumulated losses	(12,147,554)	(9,704,870)
Total equity	6,669,159	1,347,581

The parent entity did not have any contingent liabilities or capital commitments as at 31 December 2017. The parent entity had not entered into a deed of cross guarantee as at 31 December 2017.

17 Group entities

Set out below is a list of subsidiaries of the Group.

	Country of incorporation	Ownership interest	
		2017	2016
Parent entity			
Microbial Defense System Holdings Inc.	United States		
Subsidiaries			
Next Science Technologies Pty Limited	Australia	-	100%
Next Science, LLC	United States	100%	100%
Next Science Health Care, LLC	United States	100%	100%
Next Science Manufacturing, LLC	United States	100%	100%

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

18 Related parties

(a) Key management personnel compensation

Key management personnel ("KMP") are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly and indirectly, and include the Directors, executive and non-executive, as well as certain other senior executives. The totals of remuneration of the KMP of the Group included within employee expenses are as follows:

	2017	2016
<i>In USD</i>		
Short term employee benefits	540,522	220,000
Total KMP remuneration	<u>540,522</u>	<u>220,000</u>

Short term employee benefits

Short term employee benefits include fees and benefits paid to the executive directors and other KMP as well as all salary, fringe benefits and cash bonuses awarded to the non-executive directors.

(b) Key management personnel transactions

Directors of the Company represent 2.2% of the controlling interest in the shares of the ultimate parent entity as at 31 December 2017.

(c) Other related party transactions

On 27 December 2017, the Company sold 100% of the shares and voting interest in Next Science Pty Limited (now known as Next Science Technologies Pty Limited) to Next Science Group Pty Limited (now known as Next Science Limited), which became the Company's ultimate parent entity on the same date, for no consideration, as described in Note 20(a). Next Science Group Pty Limited had common shareholders and directors with the Company.

Other related party transactions and balances outstanding at year-end are:

	2017	2016
<i>Transactions (refer to Note 5)</i>		
Sale of intellectual property to Next Science IP Holdings Pty Limited	3,237,100	-
Other income earned from Next Science Pty Limited	352,133	-
Other income earned from Next Science Group Pty Limited	77	-
	<u>3,589,310</u>	<u>-</u>
<i>Balances outstanding at year-end (refer to Note 8)</i>		
Loan receivable from Next Science IP Holdings Pty Limited	3,237,510	-
Loan receivable from Next Science Pty Limited	1,485,350	-
	<u>4,722,860</u>	<u>-</u>
Loan payable to Next Science Pty Limited (refer to Note 14)	<u>407,617</u>	<u>-</u>

(d) Ultimate parent entity

The ultimate parent entity of the Company is Next Science Limited (formerly known as Next Science Group Pty Limited), a company incorporated in Australia, which acquired 100% of the share capital on 22 December 2017.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

19 Share-based payment arrangements

Equity Incentive Plan (equity-settled)

The Group has established an Equity Incentive Plan. The purpose of the Plan is to attract and retain the types of employees, consultants and directors who will contribute to the Company's long term success; provide incentives that align the interests of employees, consultants and directors with those of the shareholders of the Company; and promote the success of the Company's business.

As at 31 December 2017, there were 325 options over ordinary shares in the Company's new parent entity, Next Science Group Pty Limited (now known as Next Science Limited), representing 2.0% of its total share capital, granted to the employees of the Company. The grant dates, vesting dates and exercise prices vary in accordance with the nature of each employee's employment and are as follows:

Grant date	Number of options	Vesting conditions	Contractual life	Exercise price	Spot Price
9-Nov-16	87	1 yr service from grant date	3 years	\$2,000	\$2,000
9-Nov-16	88	2 yrs service from grant date	4 years	\$2,000	\$2,000
1-Mar-17	50	1 yr service from grant date	3 years	\$2,000	\$2,000
1-Mar-17	50	2 yrs service from grant date	4 years	\$2,000	\$2,000
1-Sep-17	25	1 yr service from grant date	3 years	\$2,750	\$2,750
1-Sep-17	25	2 yrs service from grant date	4 years	\$2,750	\$2,750
	325				

The fair value has been measured using the Black-Scholes formula. Service and non-market performance conditions attached to the arrangements were not taken into account in measuring fair value.

The inputs used in the measurement of the fair values at grant date and measurement date are:

	2017
Expected volatility	91%
Expected life	3-4 years
Risk-free interest rate (based on government bonds)	1.81%

The number of share options under the Equity Incentive Plan were as follows:

	Granted	Vested	Balance at 31 Dec 2017
On 9 November 2016	175	87	175
On 1 March 2017	100	-	100
On 1 September 2017	50	-	50
	325	87	325

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

20 Sale of subsidiaries

(a) Sale of Next Science Pty Limited - common control transaction

Summary

On 27 December 2017, the Group sold 100% of the issued shares and voting interest in Next Science Pty Limited (now known as Next Science Technologies Pty Limited) to Next Science Group Pty Limited (now known as Next Science Limited).

Consideration transferred

No consideration was transferred to the selling shareholders on 27 December 2017.

Identifiable assets acquired and liabilities assumed

The sale of Next Science Pty Limited was accounted for as a common control transaction and as such the requirements of AASB 3 *Business Combinations* did not apply to this transaction. As a common control transaction, the assets and liabilities acquired are recorded at their book value at the date of acquisition, as described in Note 3(a)(i).

The following table summarises the recognised amounts of assets acquired and liabilities disposed by the Group at the date of the disposal.

In USD

Cash and cash equivalents	247,255
Trade and other receivables	11,237
Net intercompany liabilities	(1,077,656)
Trade and other payables	(139,724)
Provisions	(12,987)
Total identifiable net assets of Next Science Pty Limited disposed	<u>(971,875)</u>

Common control reserve

Common control reserve arising from the disposal has been recognised as follows:

In USD

Consideration transferred	-
Less: Book value of identifiable net assets	(971,875)
Add: Foreign exchange translation	(14,153)
Common control reserve	<u>(986,028)</u>

Sale consideration - cash inflow

Receipts from the disposal of Next Science Pty Limited are reconciled to the Statement of Cash Flows as follows:

In USD

Inflow of cash from Next Science Group Pty Limited	-
Less: Cash and cash equivalents acquired	(247,255)
Payments for disposal of Next Science Pty Limited, net of cash acquired	<u>(247,255)</u>

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

21 Commitments and contingencies

(a) Lease as lessee

At 31 December 2017, the future minimum lease payments under non-cancellable leases were payable as follows.

<i>In USD</i>	2017	2016
Within one year	158,195	81,521
Later than one year but not later than five years	621,899	48,810
	<u>780,094</u>	<u>130,331</u>

Operating leases relate to rented premise. Leases have various terms, including some options to extend the terms.

22 Events after the reporting period

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 Group, to affect significantly the operations of the Group, the results of those operations, or the state of affairs of the Group, in future financial years.

23 Operating segments

The Group's activities are within the medical sector. The Group's activities are located throughout the United States. The financial results from this segment are consistent with the financial statements for the Group as a whole.

The Group's Chief Executive Officer ("CEO") who is defined as the Chief Operating Decision Maker reviews the internal monthly management reports of the location in assessing performance and in determining the allocation of resources. Performance of each reportable segment is based on segment revenue and segment result profit. Segment result only takes into account directly attributable costs, which management believes is the most relevant approach in evaluating segment performance. The accounting policies adopted for internal reporting to the CEO are consistent with those adopted in the financial statements.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

24 Financial risk management

(a) Overview

The Group's activities expose it to various financial risks: credit risk, liquidity risk and market risk.

This note presents information about the Group's exposure to each of these risks, its objectives, policies and processes for measuring and managing risk.

(b) Risk management framework

The Company's board of directors has overall responsibility for the establishment and oversight of the Group's risk management framework. The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities. The Group, through its standards and procedures, aims to maintain an effective control environment in which all employees understand their roles and obligations.

(c) Credit risk

The Group held cash and cash equivalents at 31 December 2017 of \$1,334,929 (2016: \$793,847). The cash and cash equivalents are held with credit worthy bank and financial institution counterparties.

(d) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Group's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when they are due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The Group manages liquidity risk by monitoring net cash balances, actual and forecast operating cash flows.

The following are the remaining contractual maturities of financial liabilities at the reporting date. The amounts are gross and undiscounted and include estimated interest payments and exclude the impact of netting agreements.

	Less than 6 months	Between 6 and 12 months	Between 1 and 5 years	Total contracted amounts
As at 31 December 2016				
<i>In USD</i>				
Trade and other payables	249,593	-	-	249,593
	<u>249,593</u>	<u>-</u>	<u>-</u>	<u>249,593</u>
As at 31 December 2017				
<i>In USD</i>				
Trade and other payables	823,013	-	-	823,013
	<u>823,013</u>	<u>-</u>	<u>-</u>	<u>823,013</u>

The cash flows in the maturity analysis above are not expected to occur significantly earlier or be for a significantly different amount than contractually disclosed above.

Microbial Defense System Holdings Inc.

Notes to the consolidated financial statements (continued)

For the financial year ended 31 December 2017

24 Financial instruments (continued)

(e) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Interest rate risk

The Group is not exposed to any significant interest rate risk. There is minimal exposure to the impact of adverse changes in benchmark interest rates. The Group is exposed to variable interest rate risks at the reporting date on the cash and short-term deposits. A reasonably possible change of 100 basis points in interest rates at the reporting date would have increased or decreased profit after tax by \$13,349 for 31 December 2017. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

Currency risk

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The source and nature of this risk arise from operations and translation risks.

The Group's reporting currency is United States Dollars.

Microbial Defense System Holdings Inc.

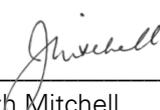
Directors' declaration

In the opinion of the directors of Microbial Defense System Holdings Inc. (the "Company"):

- (a) the consolidated financial statements and notes that are set out on pages 4 to 30:
 - (i) present fairly the financial position of the Group as at 31 December 2017 and of its performance for the the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations); and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- (c) in respect of the year ended 31 December 2017 the Group has:
 - (i) kept such accounting records as correctly record and explain its transactions and financial position;
 - (ii) kept its accounting records that financial statements of the Group that are presented fairly can be prepared from time to time; and
 - (iii) kept its accounting records so that the financial statements of the Group can be conveniently and properly audited.

The directors draw attention to Note 2(a) to the consolidated financial statements, which includes a statement of compliance with International Financial Reporting Standards.

Signed in accordance with a resolution of directors:



Judith Mitchell
Director

Dated at Sydney this 14th day of February 2019



Independent Auditor's Report

To the Directors of Microbial Defense System Holdings Inc.

Opinion

We have audited the **Financial Report** of Microbial Defense System Holdings Inc. (the Company).

In our opinion, the accompanying Financial Report presents fairly, in all material respects, the financial position of *the Group* as at 31 December 2017, and of its financial performance and its cash flows for the year then ended, in accordance with *Australian Accounting Standards*.

The **Financial Report** comprises:

- Consolidated statement of financial position as at 31 December 2017;
- Consolidated statement of profit or loss and other comprehensive income, Consolidated statement of changes in equity, and Consolidated statement of cash flows for the year then ended;
- Notes including a summary of significant accounting policies; and
- Directors' Declaration.

The **Group** consists of the Company and the entities it controlled at the year end or from time to time during the financial year.

Basis for opinion

We conducted our audit in accordance with *Australian Auditing Standards*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

We are independent of the Group in accordance with the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the *Financial Report* in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

Material uncertainty related to going concern

We draw attention to Note 2(e) of the financial statements which describes that the Group incurred a loss of \$2,442,684 and had net cash outflows from operations of \$5,191,227 during the financial year ended 31 December 2017 and requires additional equity or funding. These conditions, along with other matters as set forth in Note 2(e), indicate the existence of a material uncertainty that may cast significant doubt about the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.



Independent auditor's report to the Directors of Microbial Defense System Holdings Inc. (continued)

Restriction on use

The Financial Report has been prepared to assist the Directors of Microbial Defense System Holdings Inc. meet the listing requirements of the Australian Securities Exchange ("ASX").

As a result, the Financial Report and this Auditor's Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Our report is intended solely for the Directors of Microbial Defense System Holdings Inc. and should not be used by parties other than the Directors of Microbial Defense System Holdings Inc. and the ASX. We disclaim any assumption of responsibility for any reliance on this report, or on the Financial Report to which it relates, to any person other than the Directors of Microbial Defense System Holdings Inc. or for any other purpose than that for which it was prepared.

Other Information

Other Information is financial and non-financial information in Microbial Defense System Holdings Inc.'s annual reporting which is provided in addition to the Financial Report and the Auditor's Report. The Directors are responsible for the Other Information. The Other Information we obtained prior to the date of this Auditor's Report was the Directors Report.

Our opinion on the Financial Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the Financial Report, our responsibility is to read the Other Information. In doing so, we consider whether the Other Information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We are required to report if we conclude that there is a material misstatement of this Other Information, and based on the work we have performed on the Other Information that we obtained prior to the date of this Auditor's Report we have nothing to report.

Responsibilities of the Directors for the Financial Report

The Directors are responsible for:

- the preparation and fair presentation of the Financial Report in accordance with the financial reporting requirements of the ASX and have determined that the financial reporting framework is appropriate to meet the needs of the Directors.
- implementing necessary internal control to enable the preparation of a Financial Report that is free from material misstatement, whether due to fraud or error.
- assessing the Group and Company's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Group and Company or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.



Independent auditor's report to the Directors of Microbial Defense System Holdings Inc. (continued)

Auditor's responsibilities for the audit of the Financial Report

Our objective is:

- to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with *Australian Auditing Standards* will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the *Auditing and Assurance Standards Board* website at http://www.auasb.gov.au/auditors_responsibilities/ar3.pdf This description forms part of our Auditor's Report.

KPMG

Chris Allenby

Partner

Sydney

14 February 2019