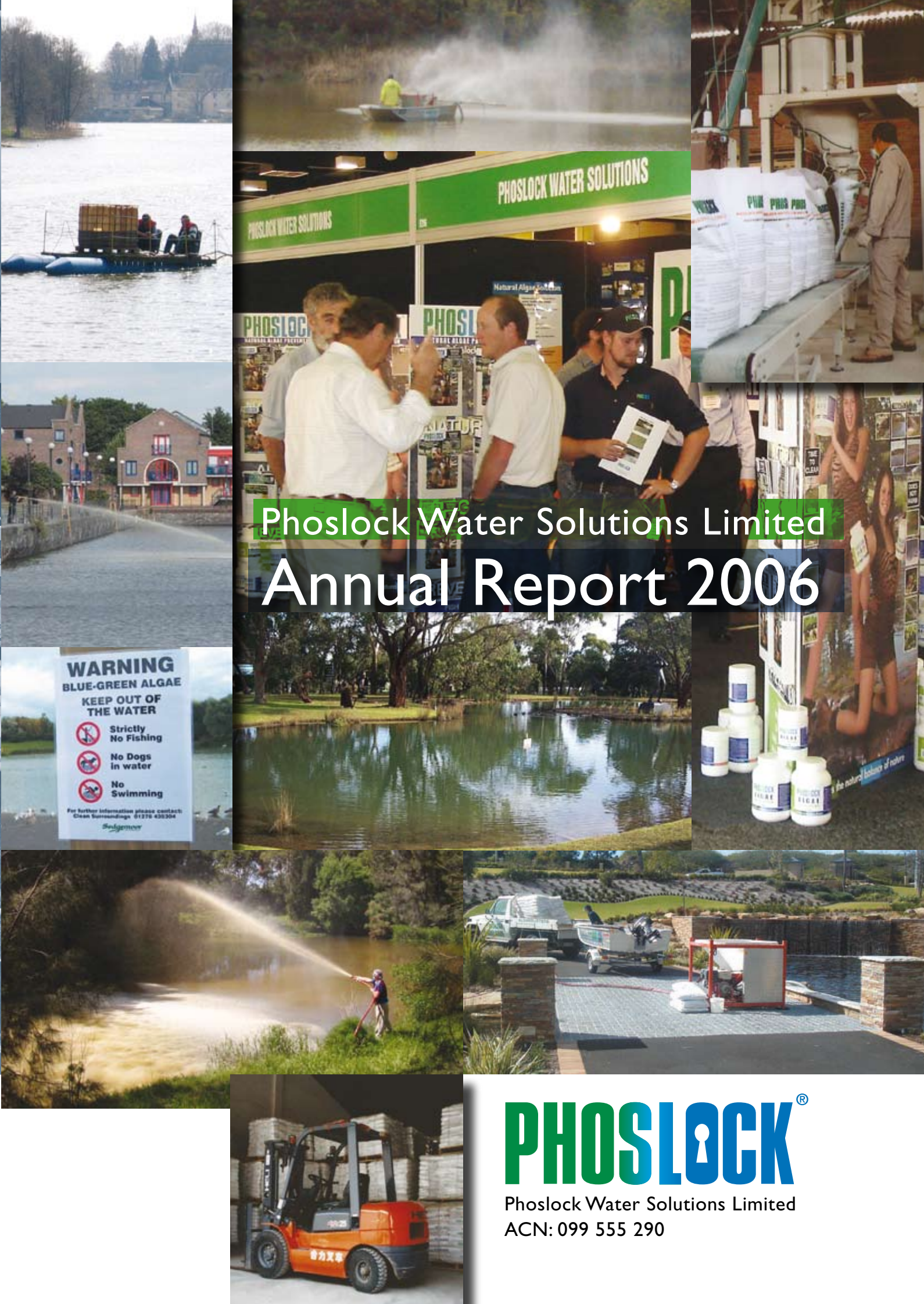

Phoslock Water Solutions Limited

Annual Report 2006

PHOSLOCK®

Phoslock Water Solutions Limited

ACN: 099 555 290

Phoslock Water Solutions Limited

Annual Report 2006

Corporate Directory

Directors

Robert Schuitema
Executive Chairman

Brett Crowley
Managing Director

Dr David Garman
Non Executive Director

Russell Brown
Non Executive Director

Management

Colin Upcroft
Chief Financial Officer & Company Secretary

Hugh Stump
Sales Manager – Australia

Nigel Traill
Sales Manager – Europe and Africa

Phil Adcock
Sales Manager – United Kingdom

Terry Vulles
Sales and Operations Manager – China

Registered Office

Phoslock Water Solutions Limited
116 Rothschild Avenue
Rosebery NSW 2018
Ph: 02 9317 3390 Fax: 02 9317 4437
Email: enquiries@phoslock.com.au

Auditors

William Buck
Level 16, William Buck Centre
120 Edward Street
Brisbane QLD 4000

Share Register

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street
Sydney NSW 2000
Ph: 02 8234 5000 Fax: 02 8234 5050
Email: web.queries@computershare.com.au

Website: www.phoslock.com.au

ASX Listing Code: PHK

Phoslock application – Blenheim Palace Woodstock, Oxfordshire, UK, July 2006

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Phoslock marketing stand – Irrigation Australia Show
Brisbane, Australia, May 2006

Chairman's Report

During the year under review, PWS has made enormous progress in building out its water treatment business. In a relatively short period of time Phoslock has been sold and applied in 18 countries and in projects ranging from large lakes, dams, drinking water reservoirs, golf courses, council water bodies, fish & prawn farms to garden ponds and ornamental water features.

Phoslock is a natural environmentally friendly product which significantly reduces phosphorus and other nutrients in water bodies. The effect of too much phosphorus in a water body is poor water quality, discolored water, algal build up and in some instances, toxic algal blooms. Left untreated, this can lead to a number of adverse public health risks so that water bodies are closed or the water is not usable.

The need for an environmentally friendly product like Phoslock which tackles the phosphorus problem is enormous. There are problems in all parts of the world. The deterioration in water quality over the last decade has been alarming. We have seen a number of lakes and reservoirs which have operated for decades without problems, however in the last 5-10 years have experienced large inflows of phosphorus and nutrients, to the stage where the water body is now closed for public use for some or all of the year. Water management authorities are spending millions of dollars on land based nutrient reduction programs or water treatment projects. In most cases they are unable to see the responses to these until decades after they are completed.

PWS is working with a large number of these type of water body custodians to apply the Phoslock solution. It will however not only restore the aquatic environment it will provide a management tool to assess the most effective application of other control measures, something that has not been possible until now. In many instances the larger lakes will need thousands of tonnes of Phoslock to effectively solve the problem.

Before committing to a large scale treatment, Phoslock is generally trialed in a small part of the water body. These trials have gone exceedingly well and we would expect that this will lead to significant business over the coming years.

The current year under review has been one of establishing Phoslock, a new product, in the market place and applying it on as many water bodies as possible to demonstrate its qualities. Notwithstanding the 10 plus years of product development by the CSIRO and PWS, a myriad of technical reports demonstrating its unique phosphorus absorption and retention capacity, various field studies, and toxicity reports showing that the product falls well below toxicity guidelines for both human, fish and aquatic plants, potential customers want to see for themselves the effectiveness of Phoslock applied under local conditions.

Phoslock sales are closely following a typical pattern for a new treatment type product. Year 1 (which for Phoslock was September 2005 to August 2006) is one of getting the product into the market place, having as many applications undertaken as possible, and using these results to develop sales. It is also a year where we are building out our licencee and distributor network around the world. This entails significant resources to properly train our licencees and distributors to effectively sell and apply the Phoslock product.

We are currently at the beginning of Year 2 (September 2006 to August 2007) in the sales cycle. We are seeing a significant escalation in business activity and we are building up a solid pipeline of future business. A number of our larger applications (over 200 tonnes) have advanced through the approval process and in some instances where necessary, funding submitted. We are spending more time with our licencees and distributors and evaluating their performance and assisting where necessary.

Phoslock application – Bankstown City Council Community Lake, Bankstown, Sydney, Australia, June 2006

We expect a significant sales escalation in Year 3. By this time, Phoslock would have been in the market place for 2 full years, been exhibited at over 50 trade shows around the world (20 trade shows as at the date of this report), profiled in a number of technical publications and applied in many hundreds of water bodies.

Production at PWS's 71% owned IETC joint venture manufacturing facility near Kunming, China is now stable and reliable. During the year a number of modifications were made and additional equipment installed. The manufacturing facility is capable of producing 6,000 – 8,000 tpa of Phoslock products. The company's focus is now on reducing production costs, with a target reduction of 25% over the next 12 months.

Plans are underway to build a second Phoslock manufacturing facility with a capacity of up to 30,000 tpa of Phoslock products. The new facility will be located closer to key raw material providers and export port facilities. This will allow for a significant reduction in production costs.

PWS's business objectives are very clear. Our breakeven production and sales level is approx 3,000 tpa. The company is currently moving towards this rapidly. Our objective past this is to quickly build a company which produces and sells 20,000 – 30,000 tpa of Phoslock products. At this level of sales, PWS will be a very profitable company.

PWS is currently broadening the range of Phoslock products by modifying it to deal with a broader range of problems. This will enable PWS to treat a greater range of water bodies, such as ones with very high phosphorus levels, a large quantity of visible algae or water containing high levels of suspended solids (or dirty or muddy water).

In December, 2005 PWS purchased the Phoslock patent and trade mark from the CSIRO for a mix of shares (3.7m fully paid shares and 2.4m options) plus approx A$0.5m in cash. The CSIRO is PWS's fourth largest shareholder. The transaction cancelled the CSIRO's 3.5% gross revenue royalty payable until 2017. As Phoslock sales increase this royalty would have become a large cash flow cost.

In June, 2006 PWS sold its bentonite leases near Miles in central Queensland for a minimum of A$2.5m (A$1.6m in June 2006, A$0.4m in August 2006 and a minimum of A$0.5m paid as a royalty over the next 5 years).

I would like to thank our hard working team of PWS directors and executives for their significant contribution during the year.

I would also like to thank our long standing shareholders who have remained loyal to the company and welcome the new shareholders who have been attracted to the Phoslock story. We look forward to the 2007 year and beyond with great optimism as the company develops both Phoslock and other water treatment products.

Robert Schuitema
Executive Chairman

IETC Board Members – left to right standing Mr Pang (Operations Manager), Mr Zhu (IETC Director and General Manager) and Dr Sun (IETC Director) at the Kunming Plant.

Dr David Garman – Appointed President of International Water Association (IWA)

PWS is delighted to congratulate Dr David Garman (Non-Executive Director) on his appointment as President of the International Water Association (IWA), effective from September, 2006 for a period of two years.

Dr Garman formally took over Presidency of the IWA at its Bi-Annual conference in Beijing, China in September, 2006.

The IWA, which is London based with over 10,000 members in over 140 countries, is the premier organization of water professionals in the world.

Dr Garman's appointment as President of the IWA provides an excellent opportunity to build on his water industry linkages and advance the professional contacts and leads so important in establishing credibility in new markets.

PWS is a member of the IWA.

Preparation for Phoslock application – Wolfrath Castle Kirkrade, The Netherlands, August 2006

Global Water Organization – IWA

IWA is the leading global water organization focused on assisting water professionals create innovative, pragmatic and sustainable solutions to challenging global water needs. IWA is at the forefront in connecting the broad community of water professionals around the globe – integrating the leading edge of professional thought on research and practice, regulators and the regulated, across national boundaries and across the drinking water, wastewater and stormwater disciplines. IWA was founded in September 1999 by the merger of the International Association of Water Quality (IAWQ) and the International Water Supply Association (IWSA).

Through membership in IWA, water professionals from many specialties benefit from the synergistic gains that result from collaboration across the boundaries of specialties, professions and different parts of the world. Through its network of experts in research, practice, regulation, consulting and manufacturing, IWA can address the unique expressions of global challenges in communities throughout the world to create expanded knowledge and integrated, sustainable solutions.

IWA collaborates with The World Bank, The World Health Organisation as well as the main UN agencies (UNEP, UNDP, UNESCO), dealing with water and sanitation on projects of common interest. IWA is a founder member of the World Water Council and is involved in the Global Water Partnership and the Collaborative Council on Water Supply and Sanitation.

Phoslock application – Shadwell Basin Recreational Water Centre, London, UK, June 2006

Managing Director's Review

I am pleased on behalf of the management team to report on our achievements for the year.

The 2006 period was challenging, being the first year of commercial sales of Phoslock. Although Phoslock has been used and marketed for quite some time, this year was the first that a significant and reliable supply has been available.

Phoslock has now been used in18 countries and in water bodies that include large lakes, drinking water reservoirs, municipal, and council parklands, golf courses, wineries, small private lakes and retail applications.

Of significant importance for generating sales, we are establishing a strong portfolio of completed and successful jobs. This allows us to overcome the biggest hurdle in achieving sales for a new product, that is convincing customers that the product achieves its stated objective. Our developing portfolio allows us to prove to new customers that Phoslock is successful in eliminating algal growth.

Another sales issue is being able to point to evidence that Phoslock is not a temporary solution like many other products, but is a very long term solution. This can only be done over a period of time. One of our first applications, a pond at a Queensland golf course treated in 2001, remains clear of algae. The other connected ponds on the course are all algae affected. Other water bodies treated during the 2006 year will be used as further evidence in the sales process as they remain algae free over time.

Our Strategy

The key to generating sales of Phoslock is "seeing is believing". The starting point for establishing Phoslock in all geographic markets is completing a Phoslock application on a problem water body. Time is then needed for potential customers to assess for themselves its affect. This can sometimes be achieved within a few days and sometimes it can take a number of months. The applications done in 18 countries to date have laid the base for leveraging into significant sales this year.

Australia is the most advanced market. The many treatments completed for water authorities, local councils, golf courses and nurseries have resulted in a strong market profile and awareness. We are now seeing these initial treatments convert into many commercial jobs.

At the time of writing, the arrival of the warmer weather in Australia is triggering algal blooms throughout the country. This is driving enquiries considerably and is expected to result in a significant acceleration of sales.

The same strategy has been implemented in all of the countries in which Phoslock is being used. Water bodies have been treated and the results are becoming apparent. Sales are being driven off these successful results.

Sales

A summary of the status of sales in various countries follows:

Australia

PWS has its direct sales team covering all states of Australia. Phoslock is stocked by close to 100 irrigation supply and water treatment outlets. These outlets sell direct to customers and are generating a number of bulk applications.

Sales are building up with municipal and private lakes, golf course ponds and nurseries providing the majority of sales. We have completed our first treatment of a drinking water dam and arrangements are in process to treat a number of others.

New Zealand

PWS's licencee continues to be successful in using Phoslock to treat the many phosphorus polluted lakes. Lake Okareka has had two applications with the phosphorus loads in the lake being successfully reduced each time.

Success on that lake has resulted in a proposal to commence treatment of another nearby lake.

United Kingdom
PWS commenced its UK business in June 2006.

Many applications have taken place including docklands, fisheries, navigation canals, golf courses and ornamental ponds. A number of pond and irrigation contractors have commenced to sell Phoslock and are treating many of their customers' water bodies.

Algae badly affects the hundreds of fisheries throughout the UK, costing significant revenue from loss of fishing fees. A number of these have been treated and marketing based on the successful results has begun.

Navigation canals throughout the country are badly algae and weed affected. The first has been treated near Manchester and a number of other canals are under negotiation as a result.

Algae in drinking water reservoirs causes significant problems throughout the UK. The main problems are taste and odour, which until now have been remedied at the treatment plant stage at considerable cost. A number of water companies are moving toward treatment at the reservoir stage. Treatment of the first drinking water reservoir with Phoslock has been approved by the required regulatory agencies and the first treatment has been arranged for November. Results of this treatment should be publicly available by February 2007 and use by a number of water companies in the UK should follow soon thereafter.

Europe
Licencees are in place in Germany, Austria, Switzerland, Benelux and Poland.

Two large lakes are being treated in Germany in October. The number of eutrophied lakes throughout Germany alone is vast. The first two lakes to be treated have received considerable media exposure with the local authorities under constant pressure to find a solution. Our German licencee has ensured there will be widespread distribution of the results of the treatment and is very confident of many applications to follow. The licencee has made a considerable investment in personnel and equipment to complete these lakes and to be ready to meet the demand expected to follow.

The first German applications will be viewed by customers from countries including Germany, France, Denmark, Netherlands and others. The prominence of these applications and the resulting publicity will allow us to drive sales throughout Europe.

South Africa
Treatment of part of Hartbeespoort Dam established Phoslock's credentials as a long term solution to eutrophication problems. Sales around South Africa are now commencing on a variety of water bodies.

Asia
Applications have taken place in Japan and Malaysia. The treatment of golf courses starts in Singapore at the end of October. The number of lakes and ponds requiring a Phoslock treatment are huge. These jobs will allow local customers to see the benefits of Phoslock.

The treatment of five prawn farms in Indonesia will commence in November (see further details below).

A golf course in Shanghai will be completed in November.

US and Canada
The US licencee is about to commence treating a section of a large lake in Canada (21 miles long and 15 miles wide). PWS extended the licence to include Canada. A number of lakes and ponds in the US have been treated and the list of customers is growing.

New Developments

Aquatic Weeds
A major problem throughout the world, in addition to algae, is aquatic weeds. These weeds source their nutrients from the water rather than roots growing into the sediments.

Phoslock has been very successful in retarding and eliminating aquatic weeds. In recent Queensland golf course applications, there was a dramatic reduction in the growth of salvinia in the treated lakes. As a result of the success of these treatments, local councils throughout Australia are considering using Phoslock for control of their salvinia problems. To date, the only solutions have been the use of herbicides (largely unsuccessful) and mechanical harvesting (very expensive). Phoslock is being seen as a more successful, less expensive and sustainable solution.

Local councils are in the process of arranging sites around Sydney for Phoslock to be used to deal with salvinia and other weed problems.

In the UK, Phoslock was used in a navigational canal by a borough council near Manchester to control duckweed, a major problem throughout the country. Technical reports are being finalised to document the success of Phoslock and will then be used to market the vast areas where duckweed is a problem.

Aquaculture
In early November, PWS will commence the large scale treatment of prawn farms in Indonesia. By reducing the algal levels, Phoslock will enhance growth, increase yield, reduce mortality rates and avoid taste and odour problems. Phoslock will be used in each of the growing cycles (of which there are normally three annually). Results from these initial treatments will be used to generate sales on the basis of direct economic returns.

Outlook
We have a clear strategy for each of our geographic and industry markets. Our sales in each market are growing as a result of our "seeing is believing" approach, where a water body is treated and the results are used to generate more sales.

The problem of eutrophied water bodies around the world is becoming significantly worse. Phoslock is the only commercially available and environmentally sustainable solution to the problem.

Brett Crowley
Managing Director

Phoslock prawn farm application site, Kuantan, Malaysia, December 2005

Major Uses of Phoslock

Lake Okareka
Rotorua, New Zealand
August 2005 and
June 2006

Canning River
Perth, Australia
January 2000

Fyswick STP
Canberra, Australia
October, 2004

Wessex Water Reservoir
South West England
To be applied in
November, 2006

Hyatt Regency
Coolum Golf Course,
Australia
July, 2006

Chateau Montelena
Winery
Napa Valley,
California, USA
August, 2006

Lechlade Salmon Farm
Swindon, England
July, 2006

Intensive Prawn Farm
Kuantan, Malaysia
December, 2005

Garden Pond
Hornsby, Sydney,
Australia
May, 2006

Lakes & Dams

Phoslock is used on lakes and dams ranging from small council/municipal lakes to very large lakes to reduce phosphorus levels, stop the algal cycle and cap the sediment so that phosphorus will not be released into the water body. These treatments will continue to absorb phosphorus for periods of 5-15 years dependant on new nutrient inflow.

Rivers

Phoslock is used in river systems to absorb phosphorus and cap the sediment. This will significantly reduce the amount of nutrients available for growth of algae and aquatic weeds. By starving the algae and aquatic weeds, Phoslock breaks their growth cycle, eliminating future growth and significantly reducing existing algal and aquatic weed levels. Phoslock is being used by council/municipal authorities, and is beginning to compete with harvesting as a solution to the aquatic weed problems.

Sewage Treatment Plants

Phoslock is being used by STP operators for their settling and polishing ponds to reduce phosphorus to very low levels and stop future algal outbreaks in these ponds.

Drinking Water Reservoirs

Phoslock has recently received EPS and UK drinking water authority approvals to treat a drinking water reservoir for a major UK water utility. This approval is a significant milestone for PWS and opens the door to a worldwide solution for drinking water utilities who are constantly battling algal problems in their reservoirs along with taste and odour issues.

Golf Courses

Lakes and water features are a major part of many of the upmarket golf courses and residential estates located around the course. These water bodies receive the run off from intensive fertilizing of the course hence many have enormous algal problems. In many parts of the world, superintendents can no longer apply environmentally unfriendly and sometime hazardous chemicals, hence are looking at environmental solutions like Phoslock. The golf course along with the residential estate market surrounding them is enormous and very keen to find solutions to their algal problems to have clear looking water bodies.

Wineries

Lakes and dams that form part of wineries receive large run off from intensive fertilizing of the vines. Winery owners are keen to ensure that their lakes and dams are algae free as this often blocks pumps and causes other problems. A number of wineries have meaningful cellar door and accommodation businesses and need to have clear looking water bodies.

Salmon, Trout & Silver Perch Farms

Fresh fish farming is an enormous global industry. The fish need a small amount of phosphorus in the water however too much can affect there growth size, taste and in some instances create fish kills. Fish farmers are beginning to use Phoslock as a product (like fertilizer) to control the amount of phosphorus in the water and prevent conditions which will affect the growth and taste of the end product. Phoslock would be used for each growing cycle, hence fish farmers would apply Phoslock on a regular basis.

Prawn Farms

As with fish farming, prawn growers need to regulate the amount of phosphorus in the water. Prawns are very sensitive to changing water conditions. Phoslock is beginning to be used by prawn growers to better manage growing conditions so that the prawns can remain in the water for as long as possible during the growing cycle, significantly enhancing the value of the prawns harvested.

Garden & Ornamental Ponds

Phoslock is sold in retail containers (1.25kg, 2.5kg and 5kg) in selected markets and over the internet to be used in garden & ornamental ponds. Phoslock is long lasting and is harmless to fish and plant life.

How is Phoslock Applied

Phoslock can be applied to water bodies in a number of different ways. For smaller water bodies Phoslock can be applied from a shore based application machine. The MD1 (as shown in the photo at right) can apply approx 1.4 tonnes per hour.

For larger water bodies application solutions include large barges (which can apply approx 10 tonnes per day) and helicopters refilled from a central filling location (which can apply up to 100 tonnes per day)

For smaller applications

For larger applications

Worldwide Distribution of Phoslock

- (D) Phoslock Authorised Distributor
- (L) Phoslock Licencee
- (P) Phoslock entity operation

Phoslock Promotional Activities

Directors' Report

Your directors present their report on the Company and its controlled entities for the financial year ended 30 June 2006.

Directors

The names of directors in office at any time during or since the end of the year are:

Mr Robert Schuitema

Mr Brett Crowley

Dr David Garman

Mr Russell Brown

Directors have been in office since the start of the financial year to the date of this report unless otherwise stated.

Company Secretary

Mr Colin Upcroft – B Bus, AASA, CPA. Mr Upcroft has been the Chief Financial Officer of Phoslock Water Solutions Limited since April 2001. Mr Upcroft was appointed company secretary on 8 February 2005.

Principal Activities

The principal activities of the economic entity during the financial year were the commercialisation of Phoslock.

There were no significant changes in the nature of the economic entity's principal activities during the financial year.

Operating Results

The consolidated loss of the economic entity after providing for income tax and eliminating outside equity interests amounted to $3,640,320 (2005: ($2,375,542)).

Dividends Paid or Recommended

No dividends have been paid or declared for payment in relation to the financial year ended 30 June 2006.

Review of Operations

Sales and earnings results for the year reflect the provision of resources necessary to support the projected significant revenue growth of the Company. PWS has continued to build its sales and marketing team in Australia, Europe and UK as well as setting up licensees and distributors in New Zealand, United States, South Africa, Asia and Europe.

Major developments in the business segments are detailed below.

The Company has made major advances in the promotion of Phoslock to markets around the world. Phoslock Water Solutions Ltd's (PWS) objective is to establish Phoslock as the preferred method of controlling phosphorus in water bodies and avoiding excessive algal growth.

Production

Manufacture of Phoslock commenced in May 2005 at PWS's Joint Venture manufacturing operation near Kunming, China. A number of modifications at the manufacturing operation have been made over the last 12 months to ensure better reliability of operations and increased production. PWS has a number of employees in China overseeing operations and managing production and shipping.

An inventory of Phoslock has been built up in key locations around the world to support sales initiatives from PWS sales force, licencees, distributors and resellers.

Phoslock bagging operation – Kunming factory, China

Technical
Additional senior resources have been added to the Phoslock technical function. Major projects include improvements to the Phoslock production process, broadening the applicability of Phoslock to a wider range of applications, development of Phoslock non-dispersible pellets and evaluating new water treatment products.

Sales and Marketing
PWS has increased its company employed sales force from two at the beginning of the financial year to nine, in the territories where PWS operates without a licensee – Australia and UK.

Licensees are in place and selling meaningful quantities of product in New Zealand, United States and Canada, South Africa, Germany, Switzerland, Austria, The Netherlands, Belgium, Luxembourg and Poland.

The Company has signed an agreement to form a joint venture entity "Phoslock Africa" to market and sell Phoslock in the African region.

Since Phoslock became commercially available in Q2 2005, the Company, its licensees, distributors and resellers have completed over 50 applications on a range of projects including lakes, rivers, sewage treatment ponds, drinking water reservoirs, golf courses, wineries, prawn farms, community water features, enclosed docks and household ponds. The success of these applications is being used to rapidly expand the Phoslock business.

The Company currently has 10 custom built Phoslock application machines in various locations around the world. The Company is looking to rapidly expand the number of application machines in service over the coming year.

During the year PWS launched a retail product range (Phoslock in 1.25kg, 2.5kg and 5kg containers) which is now available in Australia and being rolled out in New Zealand, UK and South Africa. This product range is targeted towards the household pond, koi and other exotic fish pond markets.

Future Developments, Prospects and Business Strategies
To improve the economic entity's earnings performance and maximise shareholder value, the following developments are intended to be implemented:

i. the proposed construction of a second Phoslock manufacturing plant. Given the expected rapid growth in Phoslock sales, the existing capacity of the company's China plant will be consumed. A second plant will mitigate the risks associated with a single production source.

ii. expansion of sales distribution and global licencee network. The company will focus on rapid expansion of existing sales and marketing resources to support the increased global demand for the Phoslock product particularly in Australia, New Zealand, UK & Europe, South Africa, North America, China and the rest of Asia

iii. evaluation and development of other water treatment products which could be added to PWS's product range.

These developments, together with current strategies, are expected to assist in the achievement of the economic entity's short and long-term goals and development of new business opportunities

Phoslock application – Creightons Creek Bloodstock Stud, Victoria, Australia, June 2006

Financial Position
The net assets of the economic entity have increased by $620,890 from 30 June 2005 to $7,941,604 in 2006. This net increase is a result of share issues and asset sales raising $4.4m, largely offset by increased investment, in working capital and other non current assets.

During the past four financial years the group has invested in the Phoslock technology with the objective of securing its long term success. Strategic investments have been made in associated companies and licencee operations to provide the Company with the necessary management influence and control to ensure business goals and objectives are met. The directors believe the group is in a strong and stable financial position to capitalise on the many opportunities to expand and grow its current operations.

Significant Changes in State of Affairs
The following significant changes in the state of affairs of the parent entity occurred during the financial year:

i. On the 9th December 2005 the Company issued 9,500,000 ordinary shares at $0.14 each to raise $1,330,000 in additional working capital.

ii. On the 16th December 2005 the Company issued 3,700,000 ordinary shares at $0.20 as partial consideration for the purchase of the CSIRO Phoslock technology.

iii. In March 2006 the Company issued 7,394,552 ordinary shares at $0.14 under a shareholder purchase plan to raise a further $1,035,237 in working capital.

Changes in controlled entities and divisions:

i. On the 1st July 2005 the parent entity acquired the 51% shareholding of International Environmental Technology Solutions Pty Ltd (IETS) in the parent entity's China based manufacturing company, IETC Environmental Protection Technology (Kunming) Ltd lifting the parent entity shareholding to a controlling 71% stake. The purchase was satisfied by the issue of 2,071,832 shares in the parent entity and a cash consideration of $100,000.

ii. On the 10 August 2005 Phoslock Pty Ltd, a subsidiary of the parent entity, acquired the 48% minority shareholdings in US Phoslock licencee Purezza Marketing Inc to assume 100% control of the entity. 2,997,915 shares and 2,997,915 options in the parent company were issued as consideration for the purchase.

Information on Directors

Mr Robert Schuitema	Chairman (Executive)
Qualifications	B Com, CA, INFINZ
Experience	Former Managing Director of investment bank Chase Manhattan and later JP MorganChase responsible for the bank's mining & metals and project finance business in Australia and the Asia Pacific region.
Interest in Shares and Options	2,400,000 Ordinary Shares in Phoslock Water Solutions Limited and options to acquire a further 7,000,000 ordinary shares.
Special Responsibilities	Mr Schuitema is a Member of the Audit Committee and Remuneration Committee.
Mr Brett Crowley	Managing Director (Executive)
Qualifications	B Com, Dip Law,CA
Experience	Board member since September 2003, Former partner Ernst & Young Australia and Hong Kong, former Chairman and Director BSA Ltd.
Interest in Shares and Options	459,000 Ordinary Shares in Phoslock Water Solutions Limited and options to acquire a further 7,500,000 ordinary shares.
Special Responsibilities	Mr Crowley is a Member of the Audit Committee and Remuneration Committee.
Dr David Garman	Director (Non-executive)
Qualifications	Ph D (Syd), M. Sc(Syd),B.Sc (Sp Hons) London, MAICD
Experience	Board member since 2001, Non Executive Director Dolomatrix Ltd, Executive Director CRC for Waste Management Ltd and the Environmental Biotechnology CRC, President and Director International Water Association.
Interest in Shares and Options	400,000 Ordinary Shares in Phoslock Water Solutions Limited and options to acquire a further 900,000 ordinary shares.
Special Responsibilities	Dr Garman is a Member of the Audit Committee and Remuneration Committee.
Directorships held in other listed entities	Current director of Dolomatrix Limited (since July 2001).
Mr Russell Brown	Director (Non-executive)
Qualifications	B App Sc (Agri), Post Grad International Marketing (UTS)
Experience	15 years in international marketing of agricultural chemicals. Current Commercial Director, Ospray Pty Ltd.
Interest in Shares and Options	500,000 options to acquire ordinary shares in Phoslock Water Solutions Ltd.

Phoslock marketing display – Sydney Landscaping Show, May 2006

Adoption of Australian Equivalents to IFRS

As a result of the introduction of Australian equivalents to International Financial Reporting Standards (AIFRS), the Company's financial report has been prepared in accordance with those Standards. A reconciliation of adjustments arising on the transition to AIFRS in included in Note 2 to this report.

Environmental Issues

The economic entity's operations are subject to environmental regulation of the territories in which it operates. Details of the economic entity's performance in relation to environmental regulation is as follows:

The Company commits to comply with all regulations governing the use and application of its water technology products both in Australia and internationally. In Australia, the Company's patented water technology product Phoslock has been certified under The National Industrial Chemicals Notification and Assessment Scheme (NICNAS). Guidelines for use of the technology are provided under this certification. The Company is committed to observing these guidelines, including, notification and approval as necessary, prior to use, of State Environmental Agencies and or appropriate regulatory authorities

Internationally, the Company commits to comply with all local regulatory authority requirements.

Remuneration Report

This report details the nature and amount of remuneration for each director and executive of Phoslock Water Solutions Limited.

Remuneration Policy

The remuneration policy of Phoslock Water Solutions Limited has been designed to align director and executive objectives with shareholder and business objectives by providing a fixed remuneration component and offering specific long-term incentives based on key performance areas affecting the economic entity's financial results. The board of Phoslock Water Solutions Limited believes the remuneration policy to be appropriate and effective in its ability to attract and retain the best executives and directors to run and manage the economic entity, as well as create goal congruence between directors, executives and shareholders.

The board's policy for determining the nature and amount of remuneration for board members and senior executives of the economic entity is as follows:

The remuneration policy, setting the terms and conditions for the executive directors and other senior executives, was developed by the remuneration committee. All executives receive a base salary (which is based on factors such as length of service and experience), superannuation, and options. The remuneration committee reviews executive packages annually by reference to the economic entity's performance, executive performance and comparable information from industry sectors and other listed companies in similar industries.

The performance of executives is measured against criteria agreed annually with each executive. At this stage of the Company's development, performance has been based predominantly on achievement of objectives set during the review process. Future reviews will be based on achievement of forecast growth of the economic entity's revenues and profits. All bonuses and incentives will be linked to predetermined performance criteria. The policy is designed to attract the highest calibre of executives and reward them for performance that results in long-term growth in shareholder wealth.

Executives are also entitled to participate in employee option arrangements.

The executive directors and executives receive a superannuation guarantee contribution required by the government, which is currently 9%, and do not receive any other retirement benefits.

All remuneration paid to key management personnel is measured at cost to the company and expensed. Options are valued by reference to the Black Scholes methodology. The Board's policy is to remunerate non-executive directors by reference to market rates for comparable companies for time commitment and responsibilities. The remuneration committee determines payments to non-executive directors and reviews their remuneration annually based on market practice, duties and accountability. The maximum aggregate amount of fees that can be paid to non-executive directors is subject to approval by shareholders at the Annual General Meeting. Fees for non-executive directors are not linked to the performance of the economic entity. However, to align directors' interests with shareholder interests, the directors are encouraged to hold shares in the company and are able to participate in employee option plans.

Performance Based Remuneration

At this stage of the Company's development executive director and executives remuneration packages do not contain a performance-based component. It is the intention of the board and remuneration committee to establish an incentive based component for executives based on performance measured against achievement of key performance indicators (KPIs). The intention of this program is to facilitate goal congruence between directors/executives with that of the business and shareholders. KPIs will be set annually, with a certain level of consultation with directors/executives to ensure buy-in. The measures will be specifically tailored to the areas each director/executive is involved in and has a level of control over. The KPIs target areas the board believes hold greater potential for group expansion and profit, covering financial and non-financial as well as short- and long-term goals. The level set for each KPI will be based on forecast figures for the group and respective industry standards

Performance in relation to the KPIs will be assessed annually, with bonuses being awarded depending on the number and deemed difficulty of the KPIs achieved. Following assessment, the KPIs will be reviewed by the remuneration committee in light of desired and actual outcomes, and their efficiency assessed in relation to the group's goals and shareholder wealth, before KPIs are set for the following year.

Phoslock application – Garden Hut drinking water reservoir Lancefield, Victoria, Australia, September 2006

Details of Remuneration for Year Ended 30 June 2006

The remuneration for each director and each of the executive officers of the consolidated entity during the year was as follows:

	Salary, Fees and Commissions $	Superannuation Contribution $	Cash Bonus $	Other $	Options $	Total $
Directors						
Mr Robert Schuitema	142,500	14,024	-	7,500	130,401	294,425
Mr Brett Crowley	215,000	20,750	-	20,000	117,400	373,150
Dr David Garman	45,000	-	-	-	13,001	58,001
Mr Russell Brown	45,000	-	-	-	13,001	58,001
	447,500	34,774	-	27,500	273,803	783,577

	Salary, Fees and Commissions $	Superannuation $	Cash Bonus $	Other $	Options $	Total $
Specified Executives						
Mr Colin Upcroft	120,000	11,700	-	12,801	26,002	170,503
Mr Nigel Traill	97,500	8,775	-	-	26,002	132,277
Mr Andrew Winks	82,819	6,300	-	13,758	39,003	141,880
	300,319	26,775	-	26,559	91,007	444,660

Performance Income as a Proportion of Total Remuneration

Executive directors and executives remuneration for the year did not contain a performance based component. Executive directors and executives were not paid performance based bonuses during the year. The remuneration committee will consider future bonuses to encourage achievement of specific goals that have been given a high level of importance in relation to the future growth and profitability of the economic entity. The remuneration committee will review performance bonuses to gauge their effectiveness against achievement of the set goals, and adjust future years' incentives as they see fit, to ensure use of the most cost effective and efficient methods.

Options Issued as Part of Remuneration for the Year Ended 30 June 2006

Options were issued to directors and executives as part of their remuneration. The options were not issued based on specific performance criteria, but rather as a reward for past service and performance with the objective of increasing goal congruence between executives, directors and shareholders. Options have been valued by reference to the Black Scholes method.

	Options Granted as Part of Remuneration $	Total Remuneration Represented by Options %	Options Exercised $	Options Lapsed $	Total $
Directors					
Mr Robert Schuitema	130,401	44%	-	-	130,401
Mr Brett Crowley	117,400	31%	-	-	117,400
Dr David Garman	13,001	22%	-	-	13,001
Mr Russell Brown	13,001	22%	-	-	13,001
	273,803		-	-	273,803
Specified Executives					
Mr Colin Upcroft	26,002	15%	-	-	26,002
Mr Nigel Traill	26,002	20%	-	-	26,002
Mr Andrew Winks	39,003	27%	-	-	39,003
	91,007		-	-	91,007

Employment Contracts of Directors and Senior Executives

The employment conditions of the Managing Director, Executive Chairman and executives are formalised in contracts of employment. Other than the Managing Director and Executive Chairman, all executives are permanent employees of Phoslock Water Solutions Ltd. The Managing Director' and Executive Chairman's contracts expire on 30 November 2007.

The employment contracts stipulate a range of one to three-month resignation periods. The Company may terminate a contract of employment without cause by providing written notice or making payment in lieu of notice for a period equivalent to the resignation period. Termination payments are generally not payable on resignation or dismissal for serious misconduct. In the instance of serious misconduct the Company can terminate employment at any time.

Meetings of Directors

During the financial year, eight meetings of directors (including committees of directors) were held. Attendances by each director during the year were:

	Directors' Meetings		Committee Meetings			
			Audit		Remuneration	
	Number eligible to attend	Number attended	Number eligible to attend	Number attended	Number eligible to attend	Number attended
Mr Robert Schuitema	6	6	1	1	1	1
Mr Brett Crowley	6	6	1	1	1	1
Dr David Garman	6	6	1	1	1	1
Mr Russell Brown	6	6	1	1	1	1

Indemnifying Officers or Auditor

During or since the end of the financial year the Company has given an indemnity or entered an agreement to indemnify, or paid or agreed to pay insurance premiums as follows:

The Company has paid premiums to insure all directors and executives against liabilities for costs and expenses incurred by them in defending any legal proceedings arising out of their conduct while acting in the capacity of director or officer of the Company.

Options

Options that were granted over unissued shares or interest during or since the financial year by the Company or controlled entity to directors or executives as part of their remuneration are as follows:

	Number of options granted		Number of options granted
Directors			
Mr Robert Schuitema	7,000,000	Mr Brett Crowley	7,500,000
Dr David Garman	500,000	Mr Russell Brown	500,000
Executives			
Mr Colin Upcroft	500,000	Mr Nigel Traill	500,000
Mr Andrew Winks	500,000		

As at the date of this report the unissued ordinary shares of Phoslock Water Solutions Ltd under options are as follows:

Grant Date	Date of expiry	Exercise price	Number under option
25 November 2004	25 November 2007	$0.227	4,200,000
10 June 2005	30 June 2008	$0.20	2,500,000
10 June 2005	30 November 2008	$0.20	1,500,000
10 August 2005	10 August 2010	$0.22	2,997,915
24 November 2005	30 November 2008	$0.20	7,000,000
24 November 2005	30 June 2008	$0.20	350,000
24 November 2005	30 November 2009	$0.30	4,000,000
24 November 2005	30 November 2010	$0.40	4,000,000
15 December 2005	30 November 2008	$0.20	800,000
15 December 2005	30 November 2009	$0.30	800,000
15 December 2005	30 November 2010	$0.40	800,000
20 March 2006	31 December 2008	$0.20	900,000
31 May 2006	30 June 2008	$0.20	200,000
31 May 2006	30 June 2009	$0.20	100,000
15 August 2006	31 December 2008	$0.20	200,000

These options do not entitle the holder to participate in any share issue of the Company, nor do they carry any voting rights or rights to dividends. Further details regarding these options can be found at Note 6.

Proceedings on Behalf of Company

No person has applied for leave of Court to bring proceedings on behalf of the Company or intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or any part of those proceeding.

The Company was not a party to any such proceedings during the year.

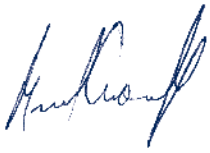
Non-audit Services

No non audit services were provided to the Company by the company's auditors during the reporting period.

Auditor's Independence Declaration

The lead auditor's independence declaration for the year ended 30 June 2006 has been received and can be found on page 18 of the 2006 Annual Report.

Signed in accordance with a resolution of the Board of Directors.



Mr Brett Crowley
Managing Director

Mr Robert Schuitema
Chairman of Directors

Dated this 28th day of September 2006

Auditor's Independence Declaration

Under Section 307C of the Corporations Act 2001

To the Directors of Phoslock Water Solutions Limited and Controlled Entities

I declare that, to the best of my knowledge and belief, during the year ended 30 June 2006 there have been:

(i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and

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

Signed at Brisbane 29th September 2006.

William Buck

WILLIAM BUCK
Chartered Accountants

D W Landon
Partner

William Buck
Business Advisors
Chartered Accountants

Phoslock inventory – Kunming warehouse, China

Typical warning notice on numerous water bodies in Australia and throughout the world

Corporate Governance

Phoslock Water Solutions Ltd (PWS) director's and management are committed to conducting the Company's business ethically and in accordance with high standards of corporate governance.

This statement describes PWS's approach to corporate governance. The Board believes that PWS'S policies and practices comply in all substantial respects with the ASX Corporate Governance Council Principles of Good Corporate Governance.

The Role of the Board & Management

The primary role of the Phoslock Water Solutions Limited Board is the protection and enhancement of long-term shareholder value. The Board is accountable to shareholders for the performance of the Company. It directs and monitors the business and affairs of the Company on behalf of shareholders and is responsible for the Company's overall corporate governance.

Meetings of the Board are normally held monthly and the Board meets on other occasions as the business of the Company may require. Directors receive comprehensive board papers in advance.

Responsibility for managing, directing and promoting the profitable operation and development of the Company, consistent with the primary objective of enhancing long-term shareholder value, is delegated to the Managing Director, who is accountable to the Board.

The Board is responsible for:

- Appointing the Managing Director, setting objectives for the Managing Director and reviewing performance against those objectives, ensuring appropriate policies and procedures are in place for recruitment, training, remuneration and succession planning;
- Setting the strategic direction of the Company and establishing goals to ensure strategic objectives are met;
- Monitoring financial performance including approval of the annual and half-yearly financial reports;
- Ensuring major risks facing the Company and its controlled entities have been identified and appropriate and adequate control, monitoring and reporting mechanisms are in place;
- Receiving detailed briefings from senior management on a regular basis during the year;
- Ensuring the Company complies with relevant laws and conforms to the highest standards of financial and ethical behaviour.

Members of the Board visit the Company's places of business and meet with local management and key customers. These actions enable directors to enhance their knowledge of the Company's activities and assist them in setting performance goals and objectives for senior executives.

Details of the director's as at the date of this report, including their qualifications and experience are set out in the Company's 2006 Annual Report.

The Board considers that its structure, size, focus, experience and use of committees enable it to operate effectively and add value to the Company. Due to the relatively small board of directors the Company does not consider it necessary to have a separate nominations committee. The board as a whole fulfills this function.

The Board currently comprises 4 directors: 2 independent non-executive directors, an executive chairman, and one executive director being the CEO.

The Board does not believe that any director has served on the Board for a period which could materially interfere with the director's ability to act in the best interests of the Company. The Board believes that maintaining flexibility in relation to the appropriate term for each director allows it to attract and retain directors with the best possible relevant skills and expertise.

Appointment to the Board

The director's are conscious of the need to ensure that Board members possess the diversity of skill and experience required to fulfill the obligations of the Board. In considering membership of the Board, directors take into account the appropriate characteristics needed by the Board to maximize its effectiveness and the blend of skills, knowledge and experience necessary for the present and future needs of the Company.

New directors receive a letter of offer, which sets out the terms of their appointment. An induction program is available to directors that includes visits to key business units of the Company and one-on-one sessions with members of the senior management team.

Ethical Business Practices

PWS is committed to be being a socially responsible corporate citizen, using honest and fair business practices, to act in the best interests of clients to achieve the best outcome for shareholders.

The Board has procedures in place for reporting any matters that may give rise to conflict between the interests of a director and those of the Company. These procedures are reviewed as required by the Board. To this end, the Company has adopted a Conflict of Interest Policy that clarifies the processes for directors to determine and disclose when a conflict of interest exists.

Each director is obliged to immediately inform the Company of any fact or circumstance, which may affect the question of the director's independence.

If a conflict of interest arises, the director concerned does not receive the relevant Board papers and is not present at the meeting whilst the item is considered. Directors must keep the Board advised, on an ongoing basis of any interests that could potentially conflict with those of the Company.

The Board encourages non-executive directors to own shares in the Company to further link their interests with the interests of all shareholders. The Board has approved a comprehensive share trading policy for dealing in securities. Directors and employees must not, directly or indirectly buy or sell the Company's shares when in possession of unpublished price sensitive information, which could materially affect the value of those securities.

Any transaction conducted by directors in shares of the Company is notified to the Australian Stock Exchange. Directors enter into an agreement with the Company to provide information to allow the Company to notify the ASX of any transaction within 5 business days.

Safeguard Integrity

The Audit & Compliance Committee, comprises all Board members. The members of the committee contribute a range of financial and accounting skills and commercial experience. The role of the Audit & Compliance Committee is to identify areas of significant business risks and monitor the Company's activities with regard to the following:

- Effective management of financial and other business risks;
- Reliable management reporting;
- Compliance with laws and regulations in respect to financial reporting;
- Maintenance of effective and efficient audits.

In addition the Audit & Compliance Committee is responsible for:

- Meeting with external auditors as circumstances require;
- Providing recommendations to the Board as to the appointment, removal and remuneration of the external auditors, review the auditor's terms of engagement and scope and quality of the audit.

The Audit & Compliance Committee also provides additional assurances regarding the reliability of financial information for inclusion in the financial statements.

Both the Managing Director and Chief Financial Officer are required to state in writing to the Board that the Company's financial report represent a true and fair view, in all material respects, of the group's financial condition and operational results and are in accordance with relevant accounting standards.

The Company's financial accounts are subject to an annual audit by an independent, professional auditor who also reviews the Company's half-yearly financial statements.

The Board recognises that in certain circumstances individual directors may need to seek independent professional advice, at the expense of the Company, on matters arising in the course of their duties. Any advice so received will be made available to other directors.

Communication with Shareholders

The Company seeks to provide relevant and timely information to its shareholders and is committed to fulfilling its obligations to the broader market for continuous disclosure and enabling equal access to material information about the Company.

Communication with shareholders is achieved through the distribution of the following information:

- The Annual Report distributed to all shareholders;
- The Annual General Meeting and other meetings called to obtain shareholder approval for Board action as appropriate;
- Announcements to the Australian Stock Exchange and
- Investor information through the companies internet portal at www.phoslock.com.au.

Phoslock application – McClellands Gallery & Sculptor park pond, (after Phoslock treatment) Langwarrin, Victoria, Australia, May 2006

The Company strives to ensure that Company announcements via the ASX are made, in a timely manner, are factual, do not omit material information and are expressed in a clear and objective manner. The Company Secretary is responsible for communication with the Australian Stock Exchange.

Shareholders' Role

The shareholders of the Company are responsible for voting on the election of directors at the Annual General Meeting in accordance with the constitution. All directors are subject to re-election by rotation, no later than every three years.

The Annual General Meeting provides shareholders with the opportunity to express their views on matters concerning the Company and to vote on other items of business for resolution by shareholders.

A partner of the Company's audit firm, William Buck Chartered Accountants will be present at the Annual General Meeting and be available to answer any questions concerning the audit and the content of the auditors report.

China Operations Manager, Terry Vulles at the Kunming plant, China

Risk Management

The Company's Board is responsible for overseeing the risk management function. The Company believes that it is crucial for all board members to be a part of the process and as such has not established a separate risk management committee.

The Board has begun the process of putting in place integrated risk management programs aimed at ensuring the Company conducts its operations in a manner that allows risks to be formally and systematically identified, assessed and appropriately managed.

The Board is responsible for ensuring risks and also opportunities, are identified on a timely basis and that the Company's objectives and activities are aligned with the risks identified by the Board. The Board has a number of mechanisms in place to ensure management's objectives and activities are aligned with the risks identified by the Board.

These include the following:

- Implementation of board approved operating plans and budgets;
- Board monitoring of progress against these budgets, including the monitoring of key performance indicators of both a financial and non-financial nature; and
- The establishment of working groups to report on specific risk as identified.

Monitoring Performance

The Board and management monitor the performance of the Company through the preparation of monthly management accounts. The monthly management accounts are prepared using accrual accounting techniques. Monthly management accounts are compared to monthly forecasts, which have been set allowing for fluctuations in anticipated revenues and costs. Monitoring of the Company's performance by the Board and management assists in identifying the correct allocation of resources and staff to maximise the overall return to shareholders.

Remuneration

The Board has an established Remuneration Committee comprising all board members. The role of the Remuneration Committee is to review the Company's remuneration plans, policies and practices, including compensation arrangements for the non-executive directors, Managing Director and executives. It is responsible for considering general remuneration policies and practices, recruitment and termination policies and superannuation requirements. There are no retirement schemes or retirements benefits other than statutory benefits for non-executive directors. The Company's remuneration policies are set out in the Company's 2006 Annual Report.

Director's Fees

Total remuneration for non-executive directors is determined by resolution of shareholders. Non-executive directors' fees are determined by the Board within the aggregate amount of $200,000 approved by shareholders at the 2004 Annual General Meeting.

The details of remuneration paid to each non-executive director during the last financial year is set out in the Company's 2006 Annual Report.

Executive Remuneration

The Board believes that executive remuneration should be fair and reasonable, structured effectively to motivate and retain valued executives and designed to produce value for shareholders.

Details of executive's remuneration are also shown in the Company's 2006 Annual Report.

Financial Report for period ended 30 June 2006

Phoslock Water Solutions Limited and Controlled Entities
ABN 88 099 555 290

Income Statement for the period ended 30 June 2006

		Economic Entity		Parent Entity	
	Note	**2006**	2005	**2006**	2005
		$	$	**$**	$
Revenue	3	845,703	214,744	-	-
Cost of Sales		(438,253)	(122,729)	-	-
Gross Profit		407,450	92,015	-	-
Other income	3	488,424	-	-	-
Distribution expenses		(38,086)	(3,577)	-	-
Marketing expenses		(270,636)	(55,718)	-	-
Occupancy expenses		(187,951)	(151,947)	-	-
Administrative expenses		(1,004,126)	(594,443)	(4)	-
Employee benefits expense		(1,547,467)	(1,131,678)	-	-
Depreciation and amortisation		(531,858)	(394,101)	(52,758)	-
Loss on sale of property, plant and equipment		(596,455)	-	-	-
Other expenses		(362,328)	(176,612)	-	(1,949)
Share of net loss of associates and joint ventures		-	(32,969)	-	
Loss before income tax	4	(3,643,033)	(2,449,030)	(52,762)	(1,949)
Income tax revenue/(expense)	5	-	39,859	-	-
Loss for the year		(3,643,033)	(2,409,171)	(52,762)	(1,949)
Loss attributable to minority equity interest		(2,713)	(33,629)	-	-
Loss attributable to members of the parent entity		(3,640,320)	(2,375,542)	(52,762)	(1,949)
Overall Operations					
Basic earnings per share (cents per share)	8	(3.10)	(2.40)		
Diluted earnings per share (cents per share)	8	(3.10)	(2.40)		

The accompanying notes form part of these Financial Statements

Phoslock Water Solutions Limited and Controlled Entities
ABN 88 099 555 290

Balance Sheet as at 30 June 2006

		Economic Entity		Parent Entity	
	Note	**2006**	2005	**2006**	2005
		$	$	**$**	$
Current Assets					
Cash and cash equivalents	9	2,077,697	1,631,192	5,343	-
Trade and other receivables	10	985,149	73,880	-	-
Inventories	11	960,127	38,147	-	-
Other current assets	17	55,862	105,466	-	-
TOTAL CURRENT ASSETS		4,078,835	1,848,685	5,343	-
Non-current Assets					
Trade and other receivables	10	400,000	-	11,376,124	8,817,807
Investments accounted for using the equity method	12	-	119,618	-	-
Financial assets	13	-	1,099	4,647,929	4,247,513
Property, plant and equipment	15	903,002	3,316,622	-	-
Intangible assets	16	3,590,862	2,313,641	1,213,456	-
TOTAL NON-CURRENT ASSETS		4,893,864	5,750,980	17,237,509	13,065,320
TOTAL ASSETS		8,972,699	7,599,665	17,242,852	13,065,320
Current Liabilities					
Trade and other payables	18	866,665	162,280	-	-
Short-term provisions	19	132,373	116,671	-	-
TOTAL CURRENT LIABILITIES		999,038	278,951	-	-
Non-current Liabilities					
Other long-term provisions	19	32,057	-	-	-
TOTAL NON-CURRENT LIABILITIES		32,057	-	-	-
TOTAL LIABILITIES		1,031,095	278,951	-	-
NET ASSETS		7,941,604	7,320,714	17,242,852	13,065,320
Equity					
Issued capital	20	20,572,379	16,773,215	20,572,379	16,773,215
Reserves		745,652	296,065	732,564	301,434
Accumulated losses		(13,567,584)	(9,927,264)	(4,062,091)	(4,009,329)
Parent interest		7,750,447	7,142,016	17,242,852	13,065,320
Minority equity interest		191,157	178,698	-	-
TOTAL EQUITY		7,941,604	7,320,714	17,242,852	13,065,320

The accompanying notes form part of these Financial Statements

Phoslock Water Solutions Limited and Controlled Entities

ABN 88 099 555 290

Statement of Changes in Equity for the period ended 30 June 2006

	Note	Issued Share Capital	Accumulated Losses	Foreign Currency Translation Reserve	Option Reserve	Minority Equity Interests	Total
		$	$	$	$	$	$
Economic Entity							
Balance at 1 July 2004	2	13,876,370	(7,551,722)	1,552	-	-	6,326,200
Loss attributable to members of parent entity		-	(2,375,542)	-	-	-	(2,375,542)
Loss attributable to minority shareholders		-	-	-	-	178,698	178,698
Option reserve on recognition of employee options expense		-	-	-	301,434	-	301,434
Shares issued during the year		2,896,845	-	-	-	-	2,896,845
Adjustments from translation of foreign controlled entities		-	-	(6,921)	-	-	(6,921)
Balance at 30 June 2005		16,773,215	(9,927,264)	(5,369)	301,434	178,698	7,320,714
Shares issued during the year		3,885,318	-	-	-	-	3,885,318
Transaction costs		(86,154)	-	-	-	-	(86,154)
Option reserve on recognition of employee options expense		-	-	-	321,008	-	321,008
Option reserve on recognition of other issue of options		-	-	-	110,122	-	110,122
Loss attributable to members of parent entity		-	(3,640,320)	-	-	-	(3,640,320)
Loss attributable to minority shareholders		-	-	-	-	12,459	12,459
Adjustments from translation of foreign controlled entities		-	-	18,457	-	-	18,457
Balance at 30 June 2006		20,572,379	(13,567,584)	13,088	732,564	191,157	7,941,604

	Note	Issued Share Capital	Accumulated Losses	Foreign Currency Translation	Option Reserve	Minority Equity Interests	Total
		$	$	$	$	$	$
Parent Entity							
Balance at 1 July 2004	2	13,876,370	(4,007,380)	-	-	-	9,868,990
Loss attributable to members of parent entity		-	(1,949)	-	-	-	(1,949)
Shares issued during the year		2,896,845	-	-	-	-	2,896,845
Option reserve on recognition of employee options expense		-	-	-	301,434	-	301,434
Balance at 30 June 2005		16,773,215	(4,009,329)	-	301,434	-	13,065,320
Shares issued during the year		3,885,318	-	-	-	-	3,885,318
Transaction costs		(86,154)	-	-	-	-	(86,154)
Loss attributable to members of parent entity		-	(52,762)	-	-	-	(52,762)
Option reserve on recognition of employee options expense		-	-	-	321,008	-	321,008
Option reserve on recognition of other issue of options		-	-	-	110,122	-	110,122
Balance at 30 June 2006		20,572,379	(4,062,091)	-	732,564	-	17,242,852

The accompanying notes form part of these Financial Statements

Phoslock Water Solutions Limited and Controlled Entities
ABN 88 099 555 290

Cash Flow Statement for the period ended 30 June 2006

	Note	Economic Entity		Parent Entity	
		2006	2005	**2006**	2005
		$	$	**$**	$
Cash Flows from Operating Activities					
Receipts from customers		510,204	117,104	-	-
Interest received		27,044	68,675	-	-
Payments to suppliers and employees		(3,481,416)	(2,226,219)	(4)	-
Other Income		86,713	83,221	-	-
Research and Development Tax offset rebate		-	39,859	-	-
Net cash used in operating activities	25a	(2,857,455)	(1,917,360)	(4)	-
Cash Flows from Investing Activities					
Proceeds from sale of property, plant and equipment		1,597,366	-	-	-
Proceeds from sale of investments		489,785	-	-	-
Purchase of property, plant and equipment		(459,089)	(124,399)	-	-
Purchase of investments		-	-	(2)	(1,448)
Purchase of other non-current assets		(581,459)	(58,299)	(470,000)	-
Payment for subsidiary, net of cash acquired	25b	(50,713)	177,064	(50,713)	-
Net cash provided by (used in) investing activities		995,890	(5,634)	(520,715)	(1,448)
Cash Flows from Financing Activities					
Proceeds from issue of shares		2,365,237	3,000,000	2,365,237	3,000,000
Repayment of borrowings		-	-	(1,749,662)	(2,895,397)
Equity raising costs		(89,513)	(103,155)	(89,513)	(103,155)
Net cash provided by financing activities		2,275,724	2,896,845	526,062	1,448
Net increase in cash held		414,159	973,851	5,343	-
Cash at beginning of financial year		1,631,192	664,469	-	-
Effect of exchange rates on cash holdings in foreign currencies		32,346	(7,128)	-	-
Cash at end of financial year	9	2,077,697	1,631,192	5,343	-

The accompanying notes form part of these Financial Statements

Note 1 Statement of Significant Accounting Policies

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, Urgent Issues Group Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

The financial report covers the economic entity of Phoslock Water Solutions Limited and controlled entities, and Phoslock Water Solutions Limited as an individual parent entity. Phoslock Water Solutions Limited is a listed public company, incorporated and domiciled in Australia.

The financial report of Phoslock Water Solutions Limited and controlled entities, and Phoslock Water Solutions Limited as an individual parent entity comply with all Australian equivalents to International Financial Reporting Standards (AIFRS) in their entirety.

The following is a summary of the material accounting policies adopted by the economic entity in the preparation of the financial report. The accounting policies have been consistently applied, unless otherwise stated

Basis of Preparation

First-time Adoption of Australian Equivalents to International Financial Reporting Standards

Phoslock Water Solutions Limited and controlled entities, and Phoslock Water Solutions Limited as an individual parent entity have prepared financial statements in accordance with the Australian equivalents to International Financial Reporting Standards (AIFRS) from 1 July 2005.

In accordance with the requirements of AASB 1: First-time Adoption of Australian Equivalents to International Financial Reporting Standards, adjustments to the parent entity and consolidated entity accounts resulting from the introduction of AIFRS have been applied retrospectively to 2005 comparative figures excluding cases where optional exemptions available under AASB 1 have been applied. These consolidated accounts are the first financial statements of Phoslock Water Solutions Limited and controlled entities to be prepared in accordance with Australian equivalents to IFRS.

The accounting policies set out below have been consistently applied to all years presented. The parent and consolidated entities have however elected to adopt the exemptions available under AASB 1 relating to AASB 132: Financial Instruments: Disclosure and Presentation, and AASB 139: Financial Instruments: Recognition and Measurement. Refer to Note 29 for further details on changes in accounting policy.

Reconciliations of the transition from previous Australian GAAP to AIFRS have been included in Note 2 to this report.

Reporting Basis and Conventions

The financial report has been prepared on an accruals basis and is based on historical costs modified by the revaluation of selected non-current assets, financial assets and financial liabilities for which the fair value basis of accounting has been applied.

Accounting Policies

a. Principles of Consolidation

A controlled entity is any entity Phoslock Water Solutions Limited has the power to control the financial and operating policies so as to obtain benefits from its activities.

A list of controlled entities is contained in Note 14 to the financial statements. All controlled entities have a June financial year-end with the exception of IETC Environmental Protection Technology (Kunming) Ltd which has a 31 December year-end.

All inter-company balances and transactions between entities in the economic entity, including any unrealised profits or losses, have been eliminated on consolidation. Accounting policies of subsidiaries have been changed where necessary to ensure consistencies with those policies applied by the parent entity.

Where controlled entities have entered or left the economic entity during the year, their operating results have been included/excluded from the date control was obtained or until the date control ceased.

Minority equity interests in the equity and results of the entities that are controlled are shown as a separate item in the consolidated financial report.

b. Income Tax

The charge for current income tax expense is based on the profit for the year adjusted for any non-assessable or disallowed items. It is calculated using the tax rates that have been enacted or are substantially enacted by the balance date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred income tax assets are recognised to the extent that it is probable that future tax profits will be available against which deductible temporary differences can be utilised.

The amount of benefits brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

Phoslock Water Solutions Limited and its wholly-owned Australian subsidiaries have formed an income tax consolidated group under the tax consolidation regime. Each entity in the group recognises its own current and deferred tax liabilities, except for any deferred tax liabilities resulting from unused tax losses and tax credits which are immediately assumed by the parent entity. The current tax liability of each group entity is then subsequently assumed by the parent entity. The group notified the Australian Taxation Office that it had formed an income tax consolidated group to apply from 1 July 2004. The tax consolidated group has entered a tax sharing agreement whereby each company in the group contributes to the income tax payable in proportion to their contribution to the net profit before tax of the tax consolidated group.

c. Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of manufactured products includes direct materials, direct labour and an appropriate portion of variable and fixed overheads. Overheads are applied on the basis of normal operating capacity. Costs are assigned on the basis of weighted average costs.

d. Property Plant and Equipment

Each class of property, plant and equipment is carried at cost or fair value less, where applicable, any accumulated depreciation and impairment losses.

Plant and equipment

Plant and equipment are measured on the cost basis. The carrying amount of plant and equipment is reviewed annually by directors to ensure it is not in excess of the recoverable amount from these assets. The recoverable amount is assessed on the basis of the expected net cash flows that will be received from the assets employment and subsequent disposal. The expected net cash flows have been discounted to their present values in determining recoverable amounts.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Depreciation

The depreciable amount of all fixed assets is depreciated on a straight-line basis over their useful lives to the economic entity commencing from the time the asset is held ready for use. Leasehold improvements are depreciated over the shorter of either the unexpired period of the lease or the estimated useful lives of the improvements.

The depreciation rates used for each class of depreciable assets are:

Class of fixed asset	Depreciation rates
Plant & Equipment	10 - 30 %
Office equipment	15 - 33 %
Office furniture	20 %

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount. These gains and losses are included in the income statement. When revalued assets are sold, amounts included in the revaluation reserve relating to that asset are transferred to retained earnings.

e. Leases

Leases of fixed assets where substantially all the risks and benefits incidental to the ownership of the asset, but not the legal ownership are transferred to entities in the economic entity are classified as finance leases. Finance leases are capitalised by recording an asset and a liability at the lower of the amounts equal to the fair value of the leased property or the present value of the minimum lease payments, including any guaranteed residual values. Lease payments are allocated between the reduction of the lease liability and the lease interest expense for the period.

Leased assets are depreciated on a straight-line basis over the shorter of their estimated useful lives or the lease term. Lease payments for operating leases, where substantially all the risks and benefits remain with the lessor, are charged as expenses in the periods in which they are incurred. Lease incentives under operating leases are recognised as a liability and amortised on a straight-line basis over the life of the lease term.

f. Financial Instruments

Recognition

Financial instruments are initially measured at cost on trade date, which includes transaction costs, when the related contractual rights or obligations exist. Subsequent to initial recognition these instruments are measured as set out below.

Financial assets at fair value through profit and loss

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management and within the requirements of AASB 139: Recognition and Measurement of Financial Instruments. Realised and unrealised gains and losses arising from changes in the fair value of these assets are included in the income statement in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are stated at amortised cost using the effective interest rate method.

Held-to-maturity investments

These investments have fixed maturities, and it is the group's intention to hold these investments to maturity. Any held-to-maturity investments held by the group are stated at amortised cost using the effective interest rate method.

Available-for-sale financial assets

Available-for-sale financial assets include any financial assets not included in the above categories. Available-for-sale financial assets are reflected at fair value. Unrealised gains and losses arising from changes in fair value are taken directly to equity.

Financial liabilities

Non-derivative financial liabilities are recognised at amortised cost, comprising original debt less principal payments and amortisation.

g. Impairment of Assets

At each reporting date, the group reviews the carrying values of its tangible and intangible assets to determine whether there is any indication that those assets have been impaired. If such an indication exists, the recoverable amount of the asset, being the higher of the asset's fair value less costs to sell and value in use, is compared to the assets carrying value. Any excess of the assets carrying value over its recoverable amount is expensed to the income statement.

Impairment testing is performed annually for goodwill and intangible assets with indefinite lives.

Where it is not possible to estimate the recoverable amount of an individual asset, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

h. Investments in Associates

Investments in associate companies are recognised in the financial statements by applying the equity method of accounting. The equity method of accounting recognised group's share of post acquisition reserves of its associates.

i. Intangibles

Goodwill

Goodwill and goodwill on consolidation are initially recorded at the amount by which the purchase price for a business or for an ownership interest in a controlled entity exceeds the fair value attributed to its net assets at date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Phoslock Licence Patents and trademarks

Licences patents and trademarks are recognised at cost of acquisition. All intellectual property has a finite life and carried at cost less any accumulated amortisation and any impairment losses. Licences, patents and trademarks are amortised over their useful lives representing the term of the intellectual property till 2017.

Research and development

Expenditure during the research phase of a project is recognised as an expense when incurred. Development costs are capitalised only when technical feasibility studies identify that the project will deliver future economic benefits and these benefits can be measured reliably.

Development costs have a finite life and are amortised on a systematic basis matched to the future economic benefits over the useful life of the project.

j. Foreign Currency Transactions and Balances

Functional and presentation currency

The functional currency of each of the group's entities is measured using the currency of the primary economic environment in which that entity operates. The consolidated financial statements are presented in Australian dollars which is the parent entity's functional and presentation currency.

Transaction and balances

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary items are translated at the yearend exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are reported at the exchange rate at the date when fair values were determined.

Exchange differences arising on the translation of monetary items are recognised in the income statement, except where deferred in equity as a qualifying cash flow or net investment hedge.

Exchange differences arising on the translation of non-monetary items are recognised directly in equity to the extent that the gain or loss is directly recognised in equity, otherwise the exchange difference is recognised in the income statement.

Group companies

The financial results and position of foreign operations whose functional currency is different from the group's presentation currency are translated as follows:

- assets and liabilities are translated at year-end exchange rates prevailing at that reporting date;
- income and expenses are translated at average exchange rates for the period; and
- retained earnings are translated at the exchange rates prevailing at the date of the transaction.

Exchange differences arising on translation of foreign operations are transferred directly to the groups foreign currency translation reserve in the balance sheet. These differences are recognised in the income statement in the period in which the operation is disposed.

k. Employee Benefits

Provision is made for the company's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits that are expected to be settled within one year have been measured at the amounts expected to be paid when the liability is settled, plus related on-costs.

Employee benefits payable later than one year have been measured at the present value of the estimated future cash outflows to be made for those benefits.

Equity-settled compensation

The group operates an employee share option arrangement. The bonus element over the exercise price of the employee services rendered in exchange for the grant of options is recognised as an expense in the income statement. The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted.

l. Provisions

Provisions are recognised when the group has a legal or constructive obligation, as a result of past events, for which it is probable that an outflow of economic benefits will result and that outflow can be reliably measured.

m. Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and deposits held at call with banks.

n. Revenue

Revenue from the sale of goods is recognised upon the delivery of goods to customers. Interest revenue is recognised on a proportional basis taking into account the interest rates applicable to the financial assets.

Revenue from the rendering of a service is recognised upon the delivery of the service to the customers.

All revenue is stated net of the amount of goods and services tax (GST).

o. Borrowing Costs

Borrowing costs are recognised in income in the period in which they are incurred.

p. Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense.

Receivables and payables in the balance sheet are shown inclusive of GST.

Cash flows are presented in the cash flow statement on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

q. Comparative Figures

When required by Accounting Standards, comparative figures have been adjusted to conform to changes in presentation for the current financial year.

Critical accounting estimates and judgments

The directors evaluate estimates and judgments incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the group.

Key estimates – Impairment

The group assesses impairment at each reporting date by evaluating conditions specific to the group that may lead to impairment of assets. Where an impairment trigger exists, the recoverable amount of the asset is determined. Value-in-use calculations performed in assessing recoverable amounts incorporate a number of key estimates.

Note 2 First-time Adoption of Australian Equivalents to International Financial Reporting Standards

	Previous GAAP at 1 July 2004 $	Effect of Transition to Australian Equivalents to IFRS $	Australian Equivalents to IFRS at 1 July 2004 $
Economic Entity			
Reconciliation of Equity at 1 July 2004			
Current Assets			
Cash and cash equivalents	664,469	-	664,469
Trade and other receivables	37,669	-	37,669
Inventories	37,021	-	37,021
Other current assets	13,394	-	13,394
TOTAL CURRENT ASSETS	752,553	-	752,553
Non-current Assets			
Investments accounted for using the equity method	152,587	-	152,587
Financial assets	3,048	-	3,048
Property, plant and equipment	3,417,355	-	3,417,355
Intangible assets	2,645,565	(225,368)	2,420,197
TOTAL NON-CURRENT ASSETS	6,218,555	(225,368)	5,993,187
TOTAL ASSETS	6,971,108	(225,368)	6,745,740
Current Liabilities			
Trade and other payables	297,185	-	297,185
Short-term provisions	122,354	-	122,354
TOTAL CURRENT LIABILITIES	419,539	-	419,539
TOTAL LIABILITIES	419,539	-	419,539
NET ASSETS	6,551,569	(225,368)	6,326,201
Equity			
Issued capital	13,876,370	-	13,876,370
Reserves	1,552	-	1,552
Accumulated losses	(7,326,353)	(225,368)	(7,551,721)
Parent interest	6,551,569	(225,368)	6,326,201
Minority equity interest	-	-	-
TOTAL EQUITY	6,551,569	(225,368)	6,326,201

	Previous GAAP at 30 June 2005	Effect of Transition to Australian Equivalents to IFRS	Australian Equivalents to IFRS at 30 June 2005
	$	$	$
Economic Entity			
Reconciliation of Equity at 30 June 2005			
Current Assets			
Cash and cash equivalents	1,631,192	-	1,631,192
Trade and other receivables	73,880	-	73,880
Inventories	38,147	-	38,147
Other current assets	105,466	-	105,466
TOTAL CURRENT ASSETS	1,848,685	-	1,848,685
Non-current Assets			
Investments accounted for using the equity method	119,618	-	119,618
Financial assets	1,099	-	1,099
Property, plant and equipment	3,316,622	-	3,316,622
Intangible assets	2,523,781	(210,140)	2,313,641
TOTAL NON-CURRENT ASSETS	5,961,120	(210,140)	5,750,980
TOTAL ASSETS	7,809,805	(210,140)	7,599,665
Current Liabilities			
Trade and other payables	162,280	-	162,280
Short-term provisions	116,671	-	116,671
TOTAL CURRENT LIABILITIES	278,951	-	278,951
TOTAL LIABILITIES	278,951	-	278,951
NET ASSETS	7,530,854	(210,140)	7,320,714
Equity			
Issued capital	16,773,215	-	16,773,215
Reserves	(5,369)	301,434	296,065
Accumulated losses	(9,415,690)	(511,574)	(9,927,264)
Parent interest	7,352,156	(210,140)	7,142,016
Minority equity interest	178,698	-	178,698
TOTAL EQUITY	7,530,854	(210,140)	7,320,714

	Previous GAAP at 1 July 2004 $	Effect of Transition to Australian Equivalents to IFRS $	Australian Equivalents to IFRS at 1 July 2004 $
Parent Entity			
Reconciliation of Equity at 1 July 2004			
Assets			
NON-CURRENT ASSETS			
Trade and other receivable	5,620,977	-	5,620,977
Other financial assets	4,248,013	-	4,248,013
TOTAL NON-CURRENT ASSETS	9,868,990	-	9,868,990
TOTAL ASSETS	9,868,990	-	9,868,990
NET ASSETS	9,868,990	-	9,868,990
Equity			
Issued capital	13,876,370	-	13,876,370
Accumulated losses	(4,007,380)	-	(4,007,380)
TOTAL EQUITY	9,868,990	-	9,868,990

	Previous GAAP at 30 June 2005 $	Effect of Transition to Australian Equivalents to IFRS $	Australian Equivalents to IFRS at 30 June 2005 $
Parent Entity			
Reconciliation of Equity at 30 June 2005			
Assets			
NON CURRENT ASSETS			
Trade and other receivables	8,516,373	301,434	8,817,807
Financial assets	4,247,513	-	4,247,513
TOTAL NON-CURRENT ASSETS	12,763,886	301,434	13,065,320
TOTAL ASSETS	12,763,886	301,434	13,065,320
NET ASSETS	12,763,886	301,434	13,065,320
Equity			
Issued capital	16,773,215	-	16,773,215
Reserves	-	301,434	301,434
Accumulated losses	(4,009,329)	-	(4,009,329)
TOTAL EQUITY	12,763,886	301,434	13,065,320

	Previous GAAP at 30 June 2005	Effect of Transition to Australian Equivalents to IFRS	Australian Equivalents to IFRS at 30 June 2005
	$	$	$
Economic Entity			
Reconciliation of Profit or Loss for 2005			
Sales Revenue	99,440	-	99,440
Cost of Sales	(122,729)	-	(122,729)
Gross Profit	(23,289)	-	(23,289)
Other income	115,304	-	115,304
Distribution expenses	(3,577)	-	(3,577)
Marketing expenses	(55,718)	-	(55,718)
Occupancy expenses	(151,947)	-	(151,947)
Administrative expenses	(594,443)	-	(594,443)
Employee benefits expense	(830,244)	(301,434)	(1,131,678)
Depreciation and Amortisation	(409,329)	15,228	(394,101)
Other expenses	(176,612)	-	(176,612)
Share of net losses of associates and joint ventures	(32,969)	-	(32,969)
Loss before income tax expense	(2,162,824)	(286,206)	(2,449,030)
Income tax expense	39,859	-	39,859
Loss for the year	(2,122,965)	(286,206)	(2,409,171)
Loss attributable to minority equity interest	(33,629)	-	(33,629)
Loss attributable to members of the parent entity	(2,089,336)	(286,206)	(2,375,542)
Parent Entity			
Reconciliation of Profit or Loss for 2005			
Other expenses	(1,949)	-	(1,949)
Loss before income tax expense	(1,949)	-	(1,949)
Income tax expense	-	-	-
Loss for the year	(1,949)	-	(1,949)
Loss attributable to minority equity interest	-	-	-
Loss attributable to members of the parent entity	(1,949)	-	(1,949)

Notes to the reconciliations of equity and profit and loss at 1 July 2004 and 30 June 2005

		30 June 2005 $	1 July 2004 $
(a)	Adjustments to profit/loss comprise:		
	Economic Entity		
	Depreciation and Amortisation – Write off of capitalised research expenses	15,228	(225,368)
	Employee benefits expense – Expensing of employee share options	(301,434)	-
	Total	(286,206)	(225,368)
(b)	Adjustment to reserves comprise:		
	Economic Entity		
	Option reserve of valuation of employee share options	301,434	-
	Parent Entity		
	Option reserve of valuation of employee share options	301,434	-
(c)	Adjustments to retained earnings comprise:		
	Economic Entity		
	Write off of capitalised research expenses	-	(225,368)
	Expensing of employee share options	(301,434)	-
	Total	(301,434)	(225,368)

Note 3 Revenue

	Note	Economic Entity		Parent Entity	
		2006	2005	**2006**	2005
		$	$	**$**	$
Operating activities					
— sale of goods		765,139	99,440	-	-
— interest received	3(a)	25,749	68,695	-	-
— royalties		54,815	46,609	-	-
Total Revenue		845,703	214,744	-	-
Non-operating activities					
— gains on disposal of non-current investments		488,424	-	-	-
Other Income		488,424	-	-	-
(a) Interest revenue from:					
— other persons		25,749	68,695	-	-
Total interest revenue		25,749	68,695	-	-

Note 4 Loss before Income Tax

(a) Expenses				
Cost of sales	438,253	122,729	-	-
Impairment of non-current investments to recoverable amount	342,584	-	-	-
Bad and doubtful debts:				
— trade receivables	4,000	-	-	-
Rental expense on operating leases				
— minimum lease payments	187,951	151,812	-	-
Royalties – Bentonite	-	14,553	-	-
Depreciation of property, plant and equipment	59,255	21,345	-	-
Amortisation of non-current assets	-	-	-	-
— bentonite mine	206,757	203,556	-	-
— research and development expenditure	6,839	22,152	-	-
— Phoslock licence, patents and trademarks	259,007	162,276	52,758	-
Total amortisation	472,603	387,984	52,758	-
Write-down of inventories	20,621	50,041	-	-

(b) Significant Revenue and Expenses

The following significant revenue and expense items are relevant in explaining the financial performance:

Sale of Bentonite Mining Tenements				
Carrying amount of net assets sold	3,066,534			
Consideration on disposal	2,471,236			
Net loss on disposal	(595,298)			
Sale of Puda Share Investment		-	-	-
Carrying amount of net assets sold	1,099			
Consideration on disposal	489,523	-	-	-
Net gain on disposal	488,424	-	-	-

Note 5 Income Tax (Revenue)/Expense

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
(a) The components of tax expense/(benefit) comprise:					
Current tax		-	(39,859)	-	-
		-	(39,859)	-	-
(b) The prima facie tax on loss before income tax is reconciled to the income					
Prima facie tax payable on loss before income tax at 30% (2005: 30%)		(1,092,910)	(734,709)	(15,829)	(585
Add:					
Tax effect of:					
— non-deductible depreciation and amortisation		134,026	109,750	15,828	-
— other non-allowable items		959	359	-	-
— write-downs to recoverable amounts		102,775	-	-	-
— share options expensed during year		96,302	-	-	-
— other items		38,129			
— FITB's not brought to account, the benefits of which will only be realised if the conditions for deductibility set out in Note 1(b) occur		740,323	585,297	20,609	21,193
		19,604	(39,303)	20,608	20,608
Less:					
Tax effect of:					
— share of losses of associates and joint venture entities netted directly		-	(51,681)	-	-
— Other tax concessions & deductible amounts		19,604	52,237	20,608	20,608
Income tax attributable to entity		-	(39,859)	-	-

Note 6 Key Management Personnel Compensation

(a) Names and positions held of economic and parent entity key management personnel in office at any time during the financial year are:

Key Management Person	Position
Mr Robert Schuitema	Chairman – Executive
Mr Brett Crowley	Managing Director – Executive
Dr David Garman	Director – Non Executive
Mr Russell Brown	Director – Non Executive
Mr Colin Upcroft	Chief Financial Officer and Company Secretary
Mr Andrew Winks	Group Operations Manager
Mr Nigel Traill	Sales Manager Europe & Africa

(b) Compensation Practices

The board's policy for determining the nature and amount of compensation of key management for the group is as follows:

The compensation structure for key management personnel is based on a number of factors, including length of service, particular experience of the individual concerned, and overall performance of the Company. The contracts for service between the Company and key management personnel are reviewed on a continuing basis, the terms of which are not expected to change in the immediate future. Upon retirement key management personnel are paid employee benefit entitlements accrued to date of retirement.

The group seeks to emphasise payment for results through providing incentive payments via issue of share options based on the achievement of earnings targets.

This condition provides management with a performance target focused upon organic sales growth utilising existing group resources.

The objective of the incentive scheme is to both reinforce the short and long-term goals of the group and to provide a common interest between management and shareholders.

The Remuneration Committee determines the proportion of fixed and variable compensation for each key management personnel. Refer Note 6(c).

(c) Key Management Personnel Compensation

	Short-term benefits		Post Employment Benefits	Share-based payment	Total	Performance related
	Salary Fees and Commission	Other	Super-annuation	Options		
	$	$	$	$	$	%
2006						
Key Management Person						
Mr Robert Schuitema	142,500	7,500	14,024	130,401	294,425	44%
Mr Brett Crowley	215,000	20,000	20,750	117,400	373,150	31%
Dr David Garman	45,000	-	-	13,001	58,001	22%
Mr Russell Brown	45,000	-	-	13,001	58,001	22%
Mr Colin Upcroft	120,000	12,801	11,700	26,002	170,503	15%
Mr Andrew Winks	82,819	13,758	6,300	39,003	141,880	27%
Mr Nigel Traill	97,500	-	8,775	26,002	132,277	20%
	747,819	54,059	61,549	364,810	1,228,237	

	Short-term benefits		Post Employment Benefits	Share-based payment	Total	Performance related
	Salary Fees and Commission	Other	Super-annuation	Options		
	$	$	$	$	$	%
2005						
Key Management Person						
Mr Robert Schuitema	22,500	-	2,025	-	24,525	-
Mr Brett Crowley	203,495	20,000	19,087	71,770	314,352	23%
Dr David Garman	41,284	-	3,716	28,708	73,708	39%
Mr Russell Brown	-	-	-	-	-	-
Mr Yunhui Liu	-	-	-	-	-	-
Mr Joel Bidois	134,311	60,000	12,184	71,770	278,265	26%
Mr Leo Respinger	-	-	-	-	-	-
Mr Colin Upcroft	117,205	12,058	11,448	35,885	176,596	20%
Mr Andrew Winks	16,333	4,235	1,470	-	22,038	-
Mr Nigel Traill	81,250	25,000	9,562	57,416	173,228	33%
	616,378	121,293	59,492	265,549	1,062,712	

(d) Compensation Options

Options Granted as Compensation

					Terms & Conditions for Each Grant		
	Vested No.	Granted No.	Grant Date	Value per Option at Grant Date $	Exercise Price $	First Exercise Date	Last Exercise Date
Key Management Person							
Mr Robert Schuitema	3,000,000	3,000,000	24.11.2005	0.026	0.20	30.11.2005	30.11.2008
	-	2,000,000	24.11.2005	0.015	0.30	30.11.2006	30.11.2009
	-	2,000,000	24.11.2005	0.011	0.40	30.11.2007	30.11.2010
Mr Brett Crowley	2,500,000	2,500,000	24.11.2005	0.026	0.20	30.11.2005	30.11.2008
	-	2,000,000	24.11.2005	0.015	0.30	30.11.2006	30.11.2009
	-	2,000,000	24.11.2005	0.011	0.40	30.11.2007	30.11.2010
Dr David Garman	500,000	500,000	24.11.2005	0.026	0.20	30.11.2005	30.11.2008
Mr Russell Brown	500,000	500,000	24.11.2005	0.026	0.20	30.11.2005	30.11.2008
Mr Colin Upcroft	500,000	500,000	24.11.2005	0.026	0.20	31.03.2006	30.11.2008
Mr Andrew Winks	500,000	500,000	24.11.2005	0.026	0.20	31.03.2006	30.11.2008
Mr Nigel Traill	500,000	500,000	24.11.2005	0.026	0.20	31.03.2006	30.11.2008
	8,000,000	16,000,000					

All options granted vest within one to three years of grant date and expire within three years of vesting.

Exercise prices have been determined with reference to the listed market price for Phoslock Water Solutions Ltd securities.

The service and performance criteria set to determine compensation are included per Note 6(b) and Note 26.

All options were granted for NIL consideration.

(e) Options and Rights Holdings

Number of Options Held by Key Management Personnel

	Balance 1.07.2005	Granted as Compensation	Options Exercised*	Net Change Other*	Balance 30.06.2006	Total Vested 30.06.2006	Total Exercisable 30.06.2006	Total Unexercisable 30.06.2006
Mr Robert Schuitema	-	7,000,000	-	-	7,000,000	3,000,000	3,000,000	4,000,000
Mr Brett Crowley	4,000,000	6,500,000	-	(3,000,000)	7,500,000	3,500,000	3,500,000	4,000,000
Dr David Garman	400,000	500,000	-	-	900,000	900,000	900,000	-
Mr Russell Brown	-	500,000	-	-	500,000	500,000	500,000	-
Mr Colin Upcroft	1,000,000	500,000	-	-	1,500,000	1,500,000	1,500,000	-
Mr Andrew Winks	1,000,000	500,000	-	-	1,500,000	1,500,000	1,500,000	-
Mr Nigel Traill	1,300,000	500,000	-	-	1,800,000	1,800,000	1,800,000	-
	7,700,000	16,000,000	-	(3,000,000)	20,700,000	12,700,000	12,700,000	8,000,000

The net change other column above includes those options that have lapsed during the year under review.

(f) Shareholdings

Number of Shares held by Key Management Personnel

	Balance 30.06.2005	Received as Compensation	Options Exercised	Net Change Other*	Balance 30.06.2006
2006					
Key Management Personnel		-	-		
Mr Robert Schuitema	1,975,000	-	-	425,000	2,400,000
Mr Brett Crowley	214,000	-	-	245,000	459,000
Dr David Garman	400,000	-	-	-	400,000
Mr Russell Brown	-	-	-	-	-
Mr Colin Upcroft	-	-	-	-	-
Mr Andrew Winks	-	-	-	-	-
Mr Nigel Traill	2,300,529	-	-	-	2,300,529
	4,889,529	-	-	670,000	5,559,529

* Net change other refers to shares purchased or sold during the financial year.

Note 7 Auditors' Remuneration

	Note	Economic Entity		Parent Entity	
		2006	2005	**2006**	2005
		$	$	**$**	$
Remuneration of the auditor of the parent entity for:					
— auditing or reviewing the financial report		25,474	16,990	4,283	2,965
Remuneration of other auditors of subsidiaries for:					
— auditing or reviewing the financial report of subsidiaries		3,148	-	-	-

Note 8 Earnings per Share

		Economic Entity	
		2006	2005
		$	$
(a)	Reconciliation of earnings to profit or loss		
	Loss	(3,643,033)	(2,409,171)
	Losses attributable to minority equity interest	2,713	33,629
	Earnings used to calculate basic EPS	(3,640,320)	(2,375,542)
	Earnings used in the calculation of dilutive EPS	(3,640,320)	(2,375,542)
(b)	Reconciliation of earnings to profit or loss from continuing operations		
	Loss from continuing operations	(3,643,033)	(2,409,171)
	Loss attributable to minority equity interest in respect of continuing operations	2,713	33,629
	Earnings used to calculate basic EPS from continuing operations	(3,640,320)	(2,375,542)
	Earnings used in the calculation of dilutive EPS from continuing operations	(3,640,320)	(2,375,542)
(c)	Weighted average number of ordinary shares outstanding during the year used in calculating basic and dilutive EPS	No. 117,260,231	No. 99,132,097

(d) Classification of securities

The 30,147,913 options remaining unconverted at year-end are not included in basic or dilutive EPS as the exercise of the options is contingent upon future events.

As at reporting date, conditions which would result in the exercise of the options and issue of shares had not been met.

Note 9 Cash and Cash Equivalents

	Note	Economic Entity		Parent Entity	
		2006	2005	**2006**	2005
		$	$	**$**	$
Cash at bank and in hand		2,013,120	635,078	5,343	-
Short-term bank deposits		64,577	996,114	-	-
		2,077,697	1,631,192	5,343	-

The effective interest rate on short-term bank deposits was 5.5% (2005: 5.47%); these deposits have an average maturity of 90 days.

Reconciliation of cash

Cash at the end of the financial year as shown in the cash flow statement is reconciled to items in the balance sheet as follows:

Cash and cash equivalents		2,077,697	1,631,192	5,343	-
		2,077,697	1,631,192	5,343	-

Note 10 Trade and Other Receivables

		Economic Entity		Parent Entity	
	Note	**2006**	2005	**2006**	2005
		$	$	**$**	$
CURRENT					
Trade receivables		397,221	48,767	-	-
Provision for impairment of receivables		(8,000)	(4,000)	-	-
		389,221	44,767	-	-
Other receivables		595,928	19,348	-	-
Amounts receivable from:					
— associated companies		-	9,765	-	-
		985,149	73,880	-	-
NON-CURRENT					
Other receivables		400,000	-	-	-
Amounts receivable from:					
— wholly-owned entities		-	-	11,376,124	8,817,807
		400,000	-	11,376,124	8,817,807

Note 11 Inventories

		Economic Entity		Parent Entity	
	Note	**2006**	2005	**2006**	2005
		$	$	**$**	$
CURRENT					
At cost					
Raw materials and stores		122,502	693	-	-
Finished goods		837,625	-	-	-
		960,127	693	-	-
At net realisable value					
Raw materials and stores		-	18,503	-	-
Finished goods		-	18,951	-	-
		-	37,454	-	-
		960,127	38,147	-	-

Note 12 Investments Accounted for Using the Equity Method

		Economic Entity		Parent Entity	
	Note	**2006**	2005	**2006**	2005
	$	$	**$**	$	
NON CURRENT					
Associated companies		-	119,618	-	-
		-	119,618	-	-

Note 13 Financial Assets

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
NON CURRENT					
Available-for-sale financial assets	13(a)	-	1,099	4,647,929	4,247,513
		-	1,099	4,647,929	4,247,513

(a) Available-for-sale financial assets Comprise:

NON CURRENT				
Unlisted investments, at cost				
— shares in controlled entities	-	-	4,647,929	4,079,183
— shares in other corporations	-	1,099	-	-
— shares in associates	-	-	-	168,330
Total non-current available-for-sale financial assets	-	1,099	4,647,929	4,247,513

Note 14 Controlled Entities

(a) Controlled Entities Consolidated

	Country of Incorporation	Percentage Owned (%)* 2006	Percentage Owned (%)* 2005
Parent Entity:			
Phoslock Water Solutions Limited and Controlled Entities	Australia		
Subsidiaries of Phoslock Water Solutions Limited:			
Phoslock Pty Ltd	Australia	100	100
Yunnan Jinxingyan Environmental Conservational Consultative Co Ltd	China	100	100
Phoslock Water Solutions UK (Co) Limited **	UK	100	-
IETC Environmental Protection Technology (Kunming) Ltd	China	71	20
Phoslock Technologies Pty Ltd **	Australia	100	-
Subsidiaries of Phoslock Pty Ltd:			
Purezza Marketing Inc	USA	100	52

* Percentage of voting power is in proportion to ownership

** Phoslock Water Solutions UK (Co) Limited was incorporated in June 2006 with a total capital contribution of $2.

** Phoslock Technologies Pty Ltd was incorporated in December 2005 with a total capital contribution of $1.

(b) Acquisition of Controlled Entities

On the 1st July 2005 the parent entity acquired the 51% shareholding of International Environmental Technology Solutions Pty Ltd (IETS) in the parent entity's China based manufacturing company, IETC Environmental Protection Technology (Kunming) Ltd increasing the parent entity shareholding to a controlling 71% stake. The purchase was satisfied by the issue of 2,071,832 shares in the parent entity and a cash consideration of $100,000.

On the 10th August 2005 Phoslock Pty Ltd, a subsidiary of the parent entity, acquired the 48% minority shareholdings in US Phoslock licencee Purezza Marketing Inc to assume 100% control of the entity. 2,997,915 shares and 2,997,915 options in the parent company were issued as consideration for the purchase.

Note 15 Property, Plant and Equipment

	Note	Economic Entity		Parent Entity	
		2006	2005	**2006**	2005
		$	$	**$**	$
BENTONITE MINE					
At Directors' valuation 2003		-	3,500,000	-	-
Accumulated amortisation independent valuation [insert year]		-	(300,778)	-	-
Total Bentonite Mine		-	3,199,222	-	-
PLANT AND EQUIPMENT					
Plant and equipment:					
At cost		1,071,483	157,025	-	-
Accumulated amortisation		(168,481)	(39,625)	-	-
Total Plant and Equipment		903,002	117,400	-	-
Total Property, Plant and Equipment		903,002	3,316,622	-	-

(a) Movements in Carrying Amounts

Movements in carrying amounts for each class of property , plant and equipment between the beginning and thee and of the current financial year.

	Bentonite Mine	Plant and Equipment	Total
	$	$	$
Economic Entity:			
Balance at the beginning of year	3,199,222	117,400	3,316,622
Additions	108,069	556,970	665,039
Disposals	(3,100,534)	(2,065)	(3,102,599)
Additions through acquisition of entity	-	343,715	343,715
Depreciation expense	(206,757)	(113,018)	(319,775)
Carrying amount at the end of year	-	903,002	903,002

Note 16 Intangible Assets

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Goodwill					
Cost		401,977	-	-	-
Accumulated impairment losses		(342,584)	-	-	-
Net carrying value		59,393	-	-	-
Phoslock patents, trademarks and licences					
Cost		3,906,314	2,390,429	1,266,214	-
Accumulated amortisation and impairment		(453,494)	(162,276)	(52,758)	-
Net carrying value		3,452,820	2,228,153	1,213,456	-
Development costs					
Cost		317,780	317,780	-	-
Accumulated amortisation and impairment		(239,131)	(232,292)	-	-
Net carrying value		78,649	85,488	-	-
Total intangibles		3,590,862	2,313,641	1,213,456	-

Economic Entity:

	Goodwill $	Trademarks & Licences $	Development Costs $
Year ended 30 June 2005			
Balance at the beginning of year	-	2,252,984	107,640
Additions	-	137,445	-
Disposals	-	-	-
Amortisation charge	-	(162,276)	(22,152)
Impairment losses	-	-	-
Closing carrying value at 30 June 2005	-	2,228,153	85,488
Year ended 30 June 2006			
Balance at the beginning of year	-	2,228,153	85,488
Additions	-	1,284,107	-
Acquisitions through business combinations	401,977	199,567	-
Amortisation charge	-	(259,007)	(6,839)
Impairment losses	(342,584)	-	-
Closing carrying value at 30 June 2006	59,393	3,452,820	78,649

Intangible assets, other than goodwill have finite useful lives. The current amortisation charges in respect of intangible assets are included under depreciation and amortisation expense per the income statement. Goodwill has an infinite life.

Impairment Disclosures

Goodwill is allocated to cash-generating units which are based on the group's reporting segments

	2006 $	2005 $
China manufacturing segment	59,393	-
Total	59,393	-

The recoverable amount of each cash-generating unit above is determined based on value-in-use calculations. Value-in-use is calculated based on the present value of cash flow projections over the life of the Phoslock licence, a period of 11 years. The cash flows are discounted at a pre-tax rate of 14%.

Management has based the value-in-use calculation on budgets for each reporting segment. These budgets use historical weighted average growth rates to project revenue. Costs are calculated taking into account historical gross margins as well as estimated weighted average inflation rates over the period which are consistent with inflation rates applicable to the locations in which the segments operate. Discount rates are pre-tax and are adjusted to incorporate risks associated with a particular segment.

Note 17 Other Current Assets

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Prepayments		55,862	105,466	-	-
		55,862	105,466	-	-

Note 18 Trade and Other Payables

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
CURRENT					
Unsecured liabilities					
Trade payables		473,682	40,871	-	-
Sundry payables and accrued expenses		392,983	121,409	-	-
		866,665	162,280	-	-

Note 19 Provisions

	Note	2006 $	2005 $	2006 $	2005 $
CURRENT					
Mine Restorations					
Opening balance at beginning of year		25,000	-	-	-
Additional provisions raised during year		9,000	25,000	-	-
Unused amounts reversed		(34,000)	-	-	-
Balance at end of the year		-	25,000	-	-
Employee Entitlements					
Opening balance at beginning of year		91,671	97,354	-	-
Additional provisions raised during year		63,702	28,663	-	-
Amounts used		(23,000)	(34,346)	-	-
Balance at end of the year		132,373	91,671	-	-

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
NON CURRENT					
Employee Entitlements					
Opening balance at beginning of year		-	-	-	-
Additional provisions raised during year		32,057	-	-	-
Balance at end of the year		32,057	-	-	-

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
Analysis of Total Provisions					
Current		132,373	116,671	-	-
Non-current		32,057	-	-	-
		164,430	116,671	-	-

Provision for Employee Entitlements

A provision has been recognised for employee entitlements relating to long service leave. In calculating the present value of future cash flows in respect of long service leave, the probability of long service leave being taken is based on historical data. The measurement and recognition criteria relating to employee benefits has been included in Note 1 to this report.

Note 20 Issued Capital

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
130,323,784 (2005: 104,659,494) fully paid ordinary shares		20,572,379	16,773,215	20,572,379	16,773,215
		20,572,379	16,773,215	20,572,379	16,773,215

	Note	Economic Entity 2006 $ No.	Economic Entity 2005 $ No.	Parent Entity 2006 $ No.	Parent Entity 2005 $ No.
a) Ordinary Shares					
At the beginning of reporting period		104,659,494	89,659,494	104,659,494	89,659,494
Shares issued during year					
— 8 September 2004		-	7,500,000	-	7,500,000
— 17 January 2005		-	7,500,000	-	7,500,000
— 6 October 2005		2,997,915	-	2,997,915	-
— 7 December 2005		9,500,000	-	9,500,000	-
— 16 December 2005		3,700,000	-	3,700,000	-
— 3 January 2006		2,071,823	-	2,071,823	-
— 20 March 2006		5,137,802	-	5,137,802	-
— 30 March 2006		2,256,750	-	2,256,750	-
At reporting date		130,323,784	104,659,494	130,323,784	104,659,494

Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held.

At the shareholders meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

(b) Options

For information relating to share options issued to key management personnel during the financial year refer to Note 26 Share based payments.

Note 21 Reserves

(a) Foreign Currency Translation Reserve

The foreign currency translation reserve records exchange differences arising on translation of a foreign controlled subsidiary

(b) Option Reserve

The option reserve records items recognised as expenses on valuation of employee share options

Note 22 Capital and Leasing Commitments

		Economic Entity		Parent Entity	
	Note	**2006**	2005	**2006**	2005
		$	$	**$**	$
(a) Operating Lease Commitments					
Non-cancelable operating leases contracted for but not capitalised in the financial statements					
Payable — minimum lease payments					
— not later than 12 months		178,227	84,666	-	-
— between 12 months and 5 years		219,497	130,730	-	-
— greater than 5 years		70,833	-	-	-
		468,557	215,396	-	-

Seven property leases are current at reporting date:

Lease 1 is a non-cancellable lease expiring in January 2007, with rent payable monthly in advance. This lease will not be renewed.

Lease 2 is a non-cancellable lease with a three-year term, with rent payable monthly in advance. Contingent rental provisions within the lease agreement require the minimum lease payments shall be increased by the higher of CPI or 4% per annum. An option exists to renew the lease at the end of the three-year term for an additional term of three years. The lease allows for subletting of all lease areas.

Lease 3 is a non-cancellable lease with a three-year term, with rent payable monthly in advance. Contingent rental provisions within the lease agreement require the minimum lease payments shall be increased by the higher of CPI or 4% per annum. An option exists to renew the lease at the end of the three-year term for an additional term of three years. The lease allows for subletting of all lease areas.

Lease 4 is a non-cancellable lease with a one year term, rent is payable monthly in advance. No option exists to renew the lease at the end of the one-year term.

Lease 5 is cancellable with a two month notice period required. Rent is payable monthly in advance. No renewal option exists.

Lease 6 is a non-cancellable lease expiring in January 2007, with rent payable monthly in advance. No renewal options presently exist.

Lease 7 is a non-cancellable lease with an eight-year term, with rent payable monthly in advance. Contingent rental provisions within the lease agreement require the minimum lease payments shall be increased annually by negotiation. Renewal options are available by negotiation. The lease does not allow for subletting of al lease areas.

Note 23 Contingent Liabilities and Contingent Assets

There are no material contingent assets or liabilities.

Note 24 Segment Reporting

Primary Reporting — Business Segments

	Environmental Technologies		Bentonite Mining		Eliminations		Economic Entity	
	2006	2005	2006	2005	2006	2005	2006	2005
	$	$	$	$	$	$	$	$
Revenue								
External Sales	760,339	85,360	59,615	60,689	-	-	819,954	146,049
Total sales revenue	760,339	85,360	59,615	60,689	-	-	819,954	146,049
Unallocated revenue							25,749	68,695
Total revenue							845,703	214,744
Result								
Segment result	(2,911,982)	(1,711,890)	(244,398)	(175,396)	-	-	(3,156,380)	(1,887,286)
Unallocated expenses net of unallocated revenue							(486,653)	(561,084)
Finance Costs								
Share of net profits of associates and joint venture entities							2,713	32,969
Profit before income tax Income tax expense							(3,640,320)	(2,415,401)
Income Tax (Expense) / benefit							-	39,859
Profit after income tax							(3,640,320)	(2,375,542)
Assets								
Segment assets	8,484,338	4,351,612	400,000	3,211,073			8,884,338	7,562,685
Unallocated assets							88,361	36,980
Total assets							8,972,699	7,599,665
Liabilities								
Segment liabilities	880,618	93,323	73,301	38,838			953,919	132,161
Unallocated liabilities							77,176	146,790
Total liabilities							1,031,095	278,951
Other								
Investments accounted for using the equity method	-	119,618	-	-	-	-	-	119,618
Acquisitions of non-current segment assets	1,839,126	186,813	-	-	-	-	1,839,126	186,813
Depreciation and amortisation of segment assets	378,864	190,545	206,757	203,556	-	-	585,621	394,101

Secondary Reporting — Geographical Segments

	Segment Revenues from External Customers		Carrying Amount of Segment Assets		Acquisitions of Non-current Segment Assets	
	2006	2005	2006	2005	2006	2005
	$	$	$	$	$	$
Geographical location:						
Australia	308,193	99,541	7,319,331	7,215,642	1,556,272	186,813
China	-	-	1,456,213	13,627	254,669	-
USA	271,096	2,522	-	-	-	-
Other Countries	240,665	43,986	197,155	370,396	28,185	-
	819,954	146,049	8,972,699	7,599,665	1,839,126	186,813

Accounting Policies

Segment revenues and expenses are those directly attributable to the segments and include any joint revenue and expenses where a reasonable basis of allocation exists. Segment assets include all assets used by a segment and consist principally of cash, receivables, inventories, intangibles and property, plant and equipment, net of allowances and accumulated depreciation and amortisation. While most such assets can be directly attributed to individual segments, the carrying amount of certain assets used jointly by two or more segments is allocated to the segments on a reasonable basis. Segment liabilities consist principally of payables, employee benefits, accrued expenses and provisions.

Intersegment Transfers

Segment revenues, expenses and results include transfers between segments. The prices charged on intersegment transactions are the same as those charged for similar goods to parties outside of the economic entity at arm's length. These transfers are eliminated on consolidation

Business and Geographical Segments

Business segments

The economic entity has the following two business segments:

— The Environmental Technology segment is responsible for the development, manufacture and sale of environmental technology products. The major product line is a water treatment technology known as Phoslock.

— The mining segment divested its interest in bentonite mining tenements during the year but continues to receive royalty revenues based on tons sold from the resource.

Geographical segments

The economic entity's business segments are located in Australia, China, UK and USA. Management, sales and administration are based in Australia with manufacturing operations located in China. The company also has a sales operation based in the UK and sales representation in Europe.

Note 25 Cash Flow Information

	Note	Economic Entity 2006 $	Economic Entity 2005 $	Parent Entity 2006 $	Parent Entity 2005 $
(a) Reconciliation of Cash Flow from Operations with Loss after Income Tax					
Loss after income tax		(3,643,033)	(2,409,171)	(52,762)	(1,949)
Cash flows excluded from loss attributable to operating activities					
Non-cash flows in profit					
Amortisation		472,603	372,756	52,758	-
Depreciation		113,018	21,345	-	-
Net loss on disposal of property, plant and equipment		596,455	-	-	-
Net gain on disposal of investments		(488,424)	-	-	-
Write-downs to recoverable amount		-	34,286	-	1,949
Share options expensed		321,008	301,434	-	-
Impairment loss		342,584	-	-	-
Share of associated companies net profit after income tax and dividends		-	32,969	-	-
Changes in assets and liabilities, net of the effects of purchase and disposal of subsidiaries					
(Increase)/decrease in trade and term receivables		(377,734)	(36,212)	-	-
(Increase)/decrease in prepayments		86,283	(92,071)	-	-
(Increase)/decrease in inventories		(750,024)	(1,126)	-	-
Increase/(decrease) in trade payables and accruals		423,072	(135,887)	-	-
Increase/(decrease) in provisions		46,737	(5,683)	-	-
Cash flow from operations		2,857,455)	(1,917,360)	(4)	-
(b) Acquisition of Entities					
During the year 51% of the controlled entity IETC Environmental Protection Technology (Kunming) Ltd was acquired. Details of this transaction are:					
Purchase consideration		400,414	-	400,414	-
Cash consideration		100,000	-	100,000	-
Cash outflow		100,000	-	100,000	-
Assets and liabilities held at acquisition date:					
Receivables		33,240	-	33,240	-
Inventories		171,956	-	171,956	-
Property, plant and equipment		388,257	-	388,257	-
Other assets		289,192	-	289,192	-
Payables		(213,976)	-	(213,976)	-
		668,669	-	668,669	-
Goodwill on consolidation		59,393	-	59,393	-
Minority equity interests in acquisition		(327,648)	-	(327,648)	-
		400,414	-	400,414	-
Outflow of cash to acquire subsidiary net of cash acquired:					
Cash consideration		100,000		100,000	
Less: Cash balances acquired		49,287		49,287	
Outflow of cash		50,713	-	50,713	-

The goodwill is attributable to the significant synergies expected to arise after the group's gain of control of IETC Environmental Protection Technology (Kunming) Ltd.

The assets and liabilities arising from the acquisition are recognised at fair value which is equal to its carrying value.

(c) Non-cash Financing and Investing Activities

(i) Share & Options issue

2,071,823 shares were issued at $0.145 as part of the consideration for the purchase of 51% of IETC Environmental Protection Technology (Kunming) Ltd.. The share issue was based on the fair value of the company which was determined by the directors prior to the purchase.

2,997,915 shares and 2,997,915 options were issued as consideration for the purchase of the 48% minority shareholding of Purezza Marketing Inc.. The shares were issued at a price of $0.16 and the options have an exercise price of $0.22. The issue was based on the fair value of the shareholdings which was determined by the directors prior to the purchase.

3,700,000 shares and 2,400,000 options were issued as part consideration for the purchase from the CSIRO of the Phoslock technology licence, patents and trademarks. The shares were issued at a price of $0.20 and the options have exercise prices ranging from $0.20 to $0.40. The issue was based on the fair value of the intellectual property which was determined by the directors prior to the purchase.

Note 26 Share-based Payments

The following share-based payment arrangements existed at 30 June 2006.

During the year share options were granted to key employees as remuneration incentives. The options hold no voting or dividend rights and are not transferable. Details of the options issued are as follows:

Number of Options	Grant Date	Exercise Price	Expiry Date
1,500,000	24.11.2005	$0.20	30.11.2008
350,000	24.11.2005	$0.20	30.06.2008
900,000	20.03.2006	$0.20	31.12.2008
200,000	31.05.2006	$0.20	30.06.2008
100,000	31.05.2006	$0.20	30.06.2009

During the year share options were granted to directors as remuneration incentives. The options hold no voting or dividend rights and are not transferable. Details of the options issued are as follows:

Number of Options	Grant Date	Exercise Price	Expiry Date
5,000,000	24.11.2005	$0.20	30.11.2008
4,000,000	24.11.2005	$0.30	30.11.2009
4,000,000	24.11.2005	$0.40	30.11.2010

All options granted to key management personnel are ordinary shares in Phoslock Water Solutions Limited which confer a right of one ordinary share for every option held.

On the 10th of August 2005 a total of 2,997,915 options were issued to shareholders of the Company's former US licencee Purezza Marketing Inc as a component of the purchase consideration for the buyout of minority shareholdings. The options have a minimum issue price of $0.22, a vesting date of 10 August 2008 and an expiry date of 10 August 2010.

On the 15th of December 2005 a total of 2,400,000 options were issued to the CSIRO as a component of the purchase consideration for the acquisition of the Phoslock Technology licence, patents and trademarks. Details of the options issued are as follows:

Number of Options	Grant Date	Exercise Price	Expiry Date
800,000	15.12.2005	$0.20	30.11.2008
800,000	15.12.2005	$0.30	30.11.2009
800,000	15.12.2005	$0.40	30.11.2010

	Economic Entity				Parent Entity			
	2006		2005		2006		2005	
	Number of Options	Weighted Average Exercise Price $	Number of Options	Weighted Average Exercise Price $	Number of Options	Weighted Average Exercise Price $	Number of Options	Weighted Average Exercise Price $
Outstanding at the beginning of the year	9,700,000	$0.212	3,000,000	$0.20	9,700,000	$0.212	3,000,000	$0.20
Granted	23,447,913	$0.265	6,700,000	$0.217	23,447,913	$0.265	6,700,000	$0.217
Forfeited	-	-	-	-	-	-	-	-
Exercised	-	-	-	-	-	-	-	-
Expired	(3,000,000)	$0.20	-	-	(3,000,000)	$0.20	-	-
Outstanding at year-end	30,147,913	$0.254	9,700,000	$0.212	30,147,913	$0.254	9,700,000	$0.212
Exercisable at year-end	30,147,913	$0.254	9,700,000	$0.212	30,147,913	$0.254	9,700,000	$0.212

The options outstanding at 30 June 2006 had a weighted average exercise price of $0.254 and a weighted average remaining contractual life of 3.23 years. Exercise prices range from $0.20 to $0.40 in respect of options outstanding at 30 June 2006.

The weighted average fair value of the options granted during the year was $0.0162.

This price was calculated by using a Black Scholes option pricing model applying the following inputs:

Weighted average exercise price	$0.254
Weighted average life of the option	3.23
Underlying share price	$0.155
Expected share price volatility	30.0%
Risk free interest rate	5.3%

Historical volatility has been the basis for determining expected share price volatility as it assumed that this is indicative of future tender, which may not eventuate.

The life of the options is based on the historical exercise patterns, which may not eventuate in the future.

Included under employee benefits expense in the income statement is $321,008 (2005:Nil), and relates, in full, to equity-settled share-based payment transactions.

Note 27 Events After the Balance Sheet Date

The financial report was authorised for issue on 28 September 2006 by the board of directors.

Note 28 Financial Instruments

(a) Financial Risk Management

The group's financial instruments consist mainly of deposits with banks, accounts receivable and accounts payable.

The group had no derivatives at 30 June 2006.

(i) Financial Risks

The main risks the group is exposed to through its financial instruments are interest rate risk, foreign currency risk, liquidity risk and credit risk.

Interest rate risk

For details on interest rate risk refer to Note 28(b)(i)).

Foreign currency risk

The group is exposed to fluctuations in foreign currencies, principally the USD $ arising from the sale and purchase of goods and services in currencies other than the group's measurement currency. This risk is managed by the maintenance of a USD $ denominated bank account.

Liquidity risk

The group manages liquidity risk by monitoring forecast cash flows and ensuring that adequate access to cash facilities are maintained.

Credit risk

The economic entity does not have any material credit risk exposure to any single receivable or group of receivables under financial instruments entered into by the economic entity

(b) Financial Instruments

(i) Interest Rate Risk

The economic entity's exposure to interest rate risk, which is the risk that a financial instruments value will fluctuate as a result of changes in market interest rates and the effective weighted average interest rates on classes of financial assets and financial liabilities, is as follows:

	Weighted Average Effective Interest Rate %		Floating Interest Rate $		Fixed Interest Rate Maturing Within Year $		1 to 5 years $	
	2006	2005	2006	2005	2006	2005	2006	2005
Financial Assets:								
Cash and cash equivalents	4.83	4.22	2,013,120	272,660	64,577	1,358,281	-	-
Total Financial Assets			2,013,120	272,660	64,577	1,358,281	-	-

	Non - Interest Bearing $		Total $	
	2006	2005	2006	2005
Financial Assets:				
Cash and cash equivalents	-	251	2,077,697	1,631,192
Receivables	1,385,149	73,880	1,385,149	73,880
Investments	-	1,099	-	1,099
Total Financial Assets	1,385,149	75,230	3,462,846	1,706,171
Financial Liabilities:				
Trade and sundry payables	866,665	162,280	866,665	162,280
Total Financial Liabilities	866,665	162,280	866,665	162,280

(ii) Net Fair Values

The net fair value of other assets and other liabilities approximate their carrying value.

Note 29 Change In Accounting Policy

(a) The following Australian Accounting Standards have been issued or amended but are not yet effective and are applicable to the entity. They have not been adopted in preparation of the financial statements at reporting date.

AASB Amendment	AASB Standard Affected	Nature of change in accounting policy and impact	Application date of the standard	Application date for the group
2004-3	AASB 1: First-time adoption of AIFRS	No change, no impact	1 January 2006	1 July 2006
	AASB 101: Presentation of Financial Statements	No change, no impact	1 January 2006	1 July 2006
	AASB 124: Related Party Disclosures	No change, no impact	1 January 2006	1 July 2006
2005-1	AASB 139: Financial Instruments: Recognition and Measurement	No change, no impact	1 January 2006	1 July 2006
2005-5	AASB 1: First-time adoption of AIFRS	No change, no impact	1 January 2006	1 July 2006
	AASB 139: Financial Instruments: Recognition and Measurement	No change, no impact	1 January 2006	1 July 2006
2005-06	AASB 3: Business Combinations	No change, no impact	1 January 2006	1 July 2006
2005-10	AASB 139: Financial Instruments: Recognition and Measurement	No change, no impact	1 January 2007	1 July 2007
	AASB 101: Presentation of Financial Statements	No change, no impact	1 January 2007	1 July 2007
	AASB 114: Segment Reporting	No change, no impact	1 January 2007	1 July 2007
	AASB 117: Leases	No change, no impact	1 January 2007	1 July 2007
	AASB 133: Earnings per share	No change, no impact	1 January 2007	1 July 2007
	AASB 132: Financial Instruments: Disclosure and Presentation	No change, no impact	1 January 2007	1 July 2007
	AASB 1: First-time adoption of AIFRS	No change, no impact	1 January 2007	1 July 2007
2006-1	AASB 121: The Effects of Changes in Foreign Exchange Rates	No change, no impact	1 January 2006	1 July 2006
New Standard	AASB 7: Financial Instruments: Disclosure	No change, no impact	1 January 2007	1 July 2007
	AASB 119: Employee Benefits: December 2004	No change, no impact	1 January 2006	1 July 2006

All other pending standards issued between the previous financial report and the current reporting dates have no application to either the parent or economic entity.

AASB Amendment	AASB Standard Affected
2005-2	AASB 1023: General Insurance Contracts
2005-4	AASB 139: Financial Instruments: Recognition and Measurement
	AASB 132: Financial Instruments: Disclosure and Presentation
2005-9	AASB 4: Insurance Contracts
	AASB 1023: General Insurance Contracts
	AASB 139: Financial Instruments: Recognition and Measurement
	AASB 132: Financial Instruments: Disclosure and Presentation
2005-10	AASB 4: Insurance Contracts
	AASB 1023: General Insurance Contracts
	AASB 1038: Life Insurance Contracts

Note 30 Company Details

The registered office and principal place of business of the Company is:

Phoslock Water Solutions Limited

116 Rothschild Avenue Rosebery

Sydney NSW 2018

Phoslock application – Lake Klastorne, Kartuzy, Poland, May 2006

Directors' Declaration

The directors of the Company declare that:

1. the financial statements and notes, as set out on pages 22 to 52 are in accordance with the Corporations Act 2001 and:
   a. comply with Accounting Standards and the Corporations Regulations 2001; and
   b. give a true and fair view of the financial position as at 30 June 2006 and of the performance for the year ended on that date of the Company and economic entity;
2. the Chief Executive Officer and Chief Financial Officer have each declared that:
   a. the financial records of the Company for the financial year have been properly maintained in accordance with section 286 of the Corporations Act 2001;
   b. the financial statements and notes for the financial year comply with the Accounting Standards; and
   c. the financial statements and notes for the financial year give a true and fair view;
3. in the directors' opinion there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

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

Mr Brett Crowley
Managing Director

Mr Robert Schuitema
Executive Chairman

Dated this 28th day of September 2006

Independent Audit Report

To the Members of Phoslock Water Solutions Limited.

William Buck
Business Advisors
Chartered Accountants

Scope

The financial report and directors' responsibility

We have audited the financial report of Phoslock Water Solutions Limited ("the company") and its controlled entities for the financial year ended 30 June 2006. The financial report comprises the income statement, balance sheet, statement of changes in equity, cash flow statement, accompanying notes, the disclosures made as required by Australian Accounting Standard AASB 124 Related Party Disclosures in the Remuneration Report in the Directors' Report as permitted by ASIC Class Order 06/105 Calculation of Director and Executive Remuneration/ Corporations Act Regulation 2M.6.04 ("remuneration disclosures") and the directors' declaration.

The remuneration report contains information not required by Australian Accounting Standard AASB 124 which is not subject to our audit.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit Approach

We conducted an independent audit in order to express an opinion to the members of the company. Our audit was conducted in accordance with Australian Auditing Standards, in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgment, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and of their performance as represented by the results of their operations and cash flows.

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

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

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

Independence

In conducting our audit, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

In accordance with ASIC Class Order 05/83, we declare to the best of our knowledge and belief that the auditor's independence declaration which forms part of the directors' report has not changed as at the date of providing our audit opinion.

Audit Opinion

1. In our opinion, the financial report of Phoslock Water Solutions Limited is in accordance with:
   a. the Corporations Act 2001, including:
      i. giving a true and fair view of the company's and consolidated entity's financial position as at 30 June 2006 and of their performance for the year ended on that date; and
      ii. complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
   b. other mandatory professional reporting requirements in Australia.
2. The remuneration disclosures that are contained in the Remuneration Report in the Directors' Report comply with Australian Accounting Standard AASB 124 Related Party Disclosures and ASIC Class Order 06/105 Calculation of Director and Executive Remuneration/ Corporations Act Regulation 2M.6.04.

Signed at Brisbane, 29th September 2006

WILLIAM BUCK
Chartered Accountants

D W LANGDON
Partner

Major stakeholder & sharebroker visit to China operations, August 2006

Shareholder Information

The shareholder information set out below was applicable at 20 October 2006.

Distribution of Shareholders

a. Analysis of number of shareholders by size of holding:

Category of holding	Number	Number of shares
1 – 1,000	48	19,140
1,001 – 5,000	98	349,742
5,001 – 10,000	191	1,750,396
10,001 – 100,000	590	25,252,840
100,001 shares and over	212	102,951,666
	1,139	130,323,784

b. There are 79 shareholders with less than a marketable parcel of shares.

c. There is one substantial shareholders in the company's Register of Substantial Shareholders as at 20 October 2006 being:

Name	Number of shares held
Link Traders (Aust) Pty Ltd	15,162,946

Unquoted Securities

As at 20 October 2006 there were 30,347,915 options unquoted as follows:

Options

Number of Options	Number of Holders
30,347,915	98

There are two significant (> 20%) holders of unquoted securities.

Name	Number of options held
Sail Ahead Pty Ltd	7,000,000
Brett Crowley	7,500,000

Twenty Largest Shareholders

As at 20 October 2006 the twenty largest holders of ordinary shares are listed below:

Name	No of Shares Held	% of Shares Held
Link Traders (Aust) Pty Ltd	15,162,946	11.30
Newvest Pty Ltd	6,450,000	4.95
ANZ Nominees Pty Ltd	5,212,775	4.00
Commonwealth Scientific & Industrial Research Organisation (CSIRO)	3,700,000	2.84
Paul and Loraine Cayzer	3,350,800	2.57
International Environmental Technology Solutions Pty Ltd	2,700,000	2.07
Sail Ahead Pty Ltd	2,400,000	1.84
Nigel Traill	2,300,529	1.77
National Nominees Ltd	1,900,000	1.46
Irrewarra Investments Pty Ltd	1,706,889	1.31
Sahib Nominees Co Pty Ltd	1,435,000	1.10
GFK Investments Pty Ltd	1,420,000	1.09
First Manhattan Securities Pty Ltd	1,400,000	1.07
Foster Advertising & Marketing Enterprises Pty Ltd	1.344.610	1.03
Anning Holdings Pty Ltd	1,297,902	1.00
Evan and Leanne Weston	1,114,300	0.86
Adrian and Sharon Brant	1,070,000	0.82
RBC Dexia Investor Services Australia Nominees Pty Ltd	1,065,000	0.82
Donald Burns	1,060,000	0.81
Level 1 Pty Ltd	1,035,000	0.79
Total	**57,125,751**	**43.83**
Total Shares Issued	**130,323,784**	**100**

Restricted Securities

As at 20 October 2006 there were 2,997,915 options subject to escrow provisions, as follows:

Date of release from escrow	No of Options
10 August 2008	2,997,915

Voting Rights

At a general meeting of shareholders:

a. On a show of hands, each person who is a member or sole proxy has one vote.

b. On a poll, each shareholder is entitled to one vote for each fully paid share.

Offices

Sydney – Head Office
116 Rothschild Avenue
Rosebery, NSW, 2018
Ph: 02 9317 3390 Fax: 02 9317 4437
Email: enquiries@phoslock.com.au

Brisbane
5/22 Palmer Place
Murarrie, QLD 4172
Ph: 07 3890 7344 Fax: 07 3890 8666

Melbourne
235 Sutherlands Road
Riddells Creek, VIC 3431
Ph: 03 5428 6588 Fax: 03 5428 6588

Europe
Park Atrium
Rue des Colonies 11
1000 Bruxelles, Belgium
Ph: 32 2 517 6017 Fax: 32 2 517 6530

United Kingdom
Building A, Trinity Court
Workington Road, Bracknell,
Berkshire RG 42 1 PL
Ph: 44 870 734 6334 Fax: 44 1344 668 200

China
Cui Ming, Yuan Apartment B-1501
#8 Bei Men Jie, Kunming, Yunnan, China 65001
Ph/Fax: 86 871 511 1120

South Africa (Phoslock Africa Pty Ltd)
81 Quintin Brant Street
Block E, Apex Corporate Park
Persequor Technopark
Pretoria, South Africa
Ph: 27 12 349 1862 Fax: 27 12 349 1339

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Phoslock Water Solutions Limited
ACN: 099 555 290