

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

PHOSLOCK WATER SOLUTIONS LTD  
(ABN 88 099 555 290)  
Appendix 4D  
Half year report  
Period Ending 31 December 2005

**The following information constitutes the half year report required under Listing Rule 4.2A and should be read in conjunction with the annual financial report for the period ended 30 June 2005.**

Results for announcement to the market:

Revenues from ordinary activities	up	340%	to	<u>\$A'000</u> 396
Profit (loss) from ordinary activities after tax attributable to members	up	35%	to	(1,630)
Net profit (loss) for the period attributable to members	up	35%	to	(1,630)

The company does not propose to pay any dividends for the half year ended 31 December 2005

**PHOSLOCK WATER SOLUTIONS LIMITED**  
**ABN 88 099 555 290**

**FINANCIAL REPORT**  
**FOR THE HALF YEAR ENDED**  
**31 DECEMBER 2005**

**PHOSLOCK WATER SOLUTION LIMITED**  
**FINANCIAL REPORT**  
**FOR THE HALF YEAR ENDED**  
**31 DECEMBER 2005**

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**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**DIRECTORS' REPORT**

Your directors submit the financial report of the economic entity for the half-year ended 31 December 2005.

**Directors**

The names of directors who held office during or since the end of the half-year unless otherwise stated:

Robert Schuitema  
Dr David Garman  
Russell Brown  
Brett Crowley

**Operating Results**

The consolidated loss of the economic entity for the half year after providing for income tax was \$(1,629,580).

**Review of Operations**

Total revenues of \$396,354 increased 340% on the previous half year reflecting the growth in sales of Phoslock products . The loss before interest, tax, depreciation and amortisation of \$1,392,969 is up 68% on the loss recorded in the previous half year . The increased loss largely reflects the significant additional investment in global marketing and technical support resources. In addition, the cost of options and impairment losses have been recognised as expenses for the first time under new international accounting standards.

During the reporting period the Consolidated Entity:

- Completed the acquisition of former US Phoslock Licencee, Purezza Marketing Inc from its 48% minority shareholders.
- Completed the acquisition of a further 51% of the Chinese Phoslock manufacturing entity IETC Environmental Protection Technology (Kunming) Ltd lifting total equity interest to 71%.
- Completed the acquisition of Phoslock patents and trademarks from the CSIRO.
- Continued marketing initiatives to identify distributors / licencees in US, Europe and Asia.
- Completed negotiations for the formation of a South African based joint venture to market and sell Phoslock products in Africa.
- Launched a new retail Phoslock powder product.
- Established a European marketing and sales office.
- Completed a placement of 9.5m ordinary shares at an issue price of \$0.14 to provide funding for the CSIRO acquisition and additional Phoslock inventories

**Auditor's Independence Declaration**

The lead auditor's independence declaration under Section 307C of the Corporations Act is set out on page 4 and forms part of the Directors' report for the half year ended 31 December 2005.

Signed in accordance with a resolution of the Board of Directors on 14 March 2006.



Robert Schuitema  
Executive Chairman

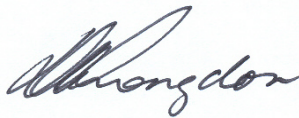
**AUDITORS INDEPENDENCE DECLARATION  
UNDER SECTION 307c OF THE CORPORATIONS ACT, 2001  
TO THE DIRECTORS OF PHOSLOCK WATER SOLUTIONS LIMITED**

I declare that, to the best of my knowledge and belief, during the half-year ended 31 December 2005 there have been:

- (a) no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the review
- (b) no contraventions of any applicable code of professional conduct in relation to the review.



WILLIAM BUCK  
Chartered Accountants



D LANGDON  
Audit Partner

Dated this the 14<sup>th</sup> day of March 2006.  
Brisbane, Australia

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**INCOME STATEMENT**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

		ECONOMIC ENTITY	
	NOTE	31 DECEMBER 2005 \$	31 DECEMBER 2004 \$
Revenues from ordinary activities			
- Sales		360,895	39,880
- Interest received		17,008	25,000
- Other revenues - Royalties		18,451	25,510
Total operating revenue		396,354	90,390
Cost of sales		(220,736)	(62,322)
Administrative expenses		(448,235)	(275,960)
Depreciation and amortisation		(236,611)	(416,643)
Manpower expenses	3	(707,499)	(472,477)
Marketing expenses		(54,658)	(15,871)
Occupancy expenses		(81,962)	(75,818)
Other expenses from ordinary activities	3	(277,059)	(1,949)
Share of net profits / (losses) of associates accounted for using the equity method	3	-	(16,882)
Profit/(loss) from ordinary activities before income tax		(1,630,406)	(1,247,532)
Income tax relating to ordinary activities		-	39,859
Loss from ordinary activities after related income tax expense		(1,630,406)	(1,207,673)
Net Loss attributable to outside equity interests		826	-
Net profit/(loss) attributable to members of the parent entity		(1,629,580)	(1,207,673)
Total changes in equity other than those resulting from transactions with		(1,629,580)	(1,207,673)
Basic earnings per share (cents per share)		(1.50)	(1.03)
Diluted earnings per share (cents per share)		(1.50)	(1.03)
NTA per share (cents per share)		4.64	5.75

*The accompanying notes form part of this financial report.*

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**BALANCE SHEET**  
**AS AT 31 DECEMBER 2005**

	ECONOMIC ENTITY	
	31 DECEMBER	30 JUNE
	2005	2005
	\$	\$
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	713,342	1,631,192
Trade and other receivables	348,698	73,880
Inventories	393,782	38,147
Other current assets	382,224	105,466
<b>TOTAL CURRENT ASSETS</b>	1,838,046	1,848,685
<b>NON-CURRENT ASSETS</b>		
Investments accounted for using the equity method	-	119,618
Property, plant, and equipment	3,779,028	3,316,622
Other financial assets	1,099	1,099
Intangible assets	3,454,956	2,228,153
Other non-current assets	73,170	85,488
<b>TOTAL NON-CURRENT ASSETS</b>	7,308,253	5,750,980
<b>TOTAL ASSETS</b>	9,146,299	7,599,665
<b>CURRENT LIABILITIES</b>		
Trade and other payables	537,037	162,280
Short term provisions	148,770	116,671
<b>TOTAL CURRENT LIABILITIES</b>	685,807	278,951
<b>TOTAL LIABILITIES</b>	685,807	278,951
<b>NET ASSETS</b>	8,460,492	7,320,714
<b>EQUITY</b>		
Issued capital	19,368,504	16,773,215
Reserves	153,912	(5,369)
Retained profits (Accumulated losses)	(11,255,408)	(9,625,830)
Parent Entity Interest	8,267,008	7,142,016
Outside Equity Interest	193,484	178,698
<b>TOTAL EQUITY</b>	8,460,492	7,320,714

*The accompanying notes form part of this financial report.*

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**STATEMENT OF CHANGES IN EQUITY**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

	\$ Share Capital	\$ Retained Losses	\$ Exchange Reserve	\$ Options Reserve	\$ Minority Interests	\$ Total
Balance at 1.7.2004	13,876,370	(7,536,493)	1,552		-	6,341,429
Shares issued during the year	2,751,600					2,751,600
Profit attributable to members of the parent entity		(997,532)				(997,532)
Profit attributable to minority shareholders					-	-
Change in Reserves			(7,291)			(7,291)
Balance at 31.12.2004	<u>16,627,970</u>	<u>(8,534,025)</u>	<u>(5,739)</u>	-	-	<u>8,088,206</u>
Balance at 1.7.2005	16,773,215	(9,625,828)	(5,369)		178,698	7,320,716
Shares issued during the year	2,595,289					2,595,289
Profit attributable to members of the parent entity		(1,629,580)				(1,629,580)
Profit attributable to minority shareholders					(826)	(826)
Change in Reserves			7,410	151,871	15,612	174,893
Balance at 31.12.2005	<u>19,368,504</u>	<u>(11,255,408)</u>	<u>2,041</u>	<u>151,871</u>	<u>193,484</u>	<u>8,460,492</u>

*The accompanying notes form part of this financial report.*



**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**CASH FLOW STATEMENT**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

	ECONOMIC ENTITY	
	31 DECEMBER 2005 Inflows (Outflows)	31 DECEMBER 2004 Inflows (Outflows)
	\$	\$
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	234,315	77,256
Payments to suppliers and employees	(1,739,857)	(1,089,879)
Interest received	16,870	24,999
Tax (payments)/receipts		37,050
Other income	22,890	46,508
Net Cash from Operating Activities	<u>(1,465,782)</u>	<u>(904,066)</u>
<b>CASH FLOWS FROM INVESTMENT ACTIVITIES</b>		
Payments for property, plant & equipment	(142,745)	(156,468)
Payments for intellectual property	(537,978)	-
Payments for investments	(100,000)	-
Loans to other entities	-	(24,967)
Cash acquired on gain of control of subsidiary	49,287	-
Net Cash from Investing Activities	<u>(731,436)</u>	<u>(181,435)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from share issues	1,330,000	2,850,000
Payment of listing costs	(73,150)	(98,400)
Proceeds from borrowings		-
Repayment of borrowings		-
Net Cash from Finance Activities	<u>1,256,850</u>	<u>2,751,600</u>
Net Increase (Decrease) in Cash Held	(940,368)	1,666,099
Cash at Beginning of the Financial Period	1,631,192	664,469
Exchange rate adjustments	22,518	(8,129)
Cash at the End of the Financial Period	<u>713,342</u>	<u>2,322,439</u>

*The accompanying notes form part of this financial report.*

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

**NOTE 1 - BASIS OF PREPARATION**

The half-year consolidated financial statements are a general purpose financial report that has been prepared in accordance with the requirements of the Corporations Act 2001, Australian Accounting Standard AASB 134: Interim Financial Reporting, Urgent Issues Group Interpretations and other authoritative pronouncements of the Australian Accounting Standards Board.

It is recommended that this financial report be read in conjunction with the annual financial report for the year ended 30 June 2005 and any public announcements made by Phoslock Water Solutions Ltd and its controlled entities during the half-year in accordance with continuous disclosure requirements arising under the Corporations Act 2001.

As this is the first interim financial report prepared under Australian equivalents to IFRS, the accounting policies applied are inconsistent with those applied in the 30 June 2005 annual report as this report was presented under previous Australian GAAP. Accordingly, a summary of the significant accounting policies under Australian equivalents to IFRS has been included below. A reconciliation of equity and profit and loss between previous GAAP and Australian equivalents to IFRS has been prepared per Note 2.

The half-year report does not include full disclosures of the type normally included in an annual financial report.

**Principles of Consolidation**

A controlled entity is any entity controlled by Phoslock Water Solutions Ltd. Control exists where Phoslock Water Solutions Ltd has the capacity to dominate the decision-making in relation to financial and operating policies so as to obtain a benefit from its activities.

All inter-company balances and transactions between entities in the economic entity, including any unrealised profits or losses, have been eliminated on consolidation.

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

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

**Income Tax**

The economic entity adopts the liability method of tax-effect accounting whereby the income tax expense is based on the profit from ordinary activities adjusted for any non-assessable or disallowed items.

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 Ltd and its wholly-owned Australian subsidiaries have formed an income tax consolidated group under the Tax Consolidation Regime. Phoslock Water Solutions Ltd is responsible for recognising the current and deferred tax assets and liabilities for the tax consolidated group. 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 net profit before tax of the tax consolidated group.

**Inventories**

Inventories are measured at the lower of purchase cost and net realisable value.

**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.

**Property**

The carrying amount of the bentonite mine is reviewed annually by directors to ensure it is not in excess of the recoverable amount from this asset. The recoverable amount is assessed on the basis of the expected net cash flows which will be received from the asset's employment and subsequent disposal. The expected net cash flows have been discounted to their present values in determining recoverable amounts. The bentonite mine is being amortised on a straight line basis for the period till expiration of the current mining lease in 2022.

**Plant and equipment**

Plant and equipment are measured on the cost basis less depreciation and impairment losses.

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 which will be received from the assets employment and subsequent disposal. The expected net cash flows have not been discounted to their present values in determining recoverable amounts.

The cost of fixed assets constructed within the economic entity includes the cost of materials, direct labour, borrowing costs and an appropriate proportion of fixed and variable overheads.

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 but excluding the bentonite mine, are depreciated on a diminishing value basis over their useful lives to the economic entity commencing from the time the asset is held ready for use.

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

<u>Class of Fixed Asset</u>	<u>Depreciation Rate</u>
Plant & Equipment	10 - 30%
Office equipment	15 - 33%
Office furniture	20%

**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, recording an asset and a liability equal to the present value of the minimum lease payments, including any guaranteed residual values. Leased assets are depreciated on a straight line basis over their estimated useful lives where it is likely that the economic entity will obtain ownership of the asset or over the term of the lease. Lease payments are allocated between the reduction of the lease liability and the lease interest expense for the period.

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.

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**  
**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

**Note 1 - (cont'd)**

**Impairment of Assets**

At each reporting date, the economic entity 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 assets fair value less costs to sell and value in use, is compared to the asset's carrying value. Any excess of the asset's carrying amount 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.

**Investments in Associates**

Investments in associate companies are recognised in the financial statements by applying the equity method of accounting where significant influence is exercised over an investee. Significant influence exists where the investor has the power to participate in the financial and operating policy decisions of the investee but does not have control or joint control over those policies. The equity method of accounting recognises the economic entity's share of past acquisition reserves of its associates.

**Interests in Joint Ventures**

The economic entity's share of the assets, liabilities, revenue and expenses of joint venture operations are included in the appropriate items of the consolidated statements of financial performance and financial position.

The economic entity's interests in joint venture entities are brought to account using the equity method of accounting in the consolidated financial statements. The parent entity's interests in joint venture entities are brought to account using the cost method.

**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 acquisition of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on disposal of an entity includes the carrying amount of goodwill relating to the entity sold.

**Research and Development Expenditure**

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

Capitalised development expenditure is amortised on a straight line basis for the period until expiration of the Phoslock licence in 2017.

**Licences**

The Phoslock licence has been brought to account at cost and is being amortised on a straight line basis for the period until the expiration of the licence in 2017. The licence is tested annually for impairment.

**Patents and Trademarks**

Patents and Trademarks are valued at cost of acquisition. Patents and Trademarks have a finite life and are carried at cost less accumulated amortisation and any impairment losses. Patents and Trademarks are amortised on the same basis as the Phoslock licence.

**Foreign Currency Transactions and Balances**

The functional currency of each of the members of the economic entity 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.

Foreign currency transactions during the year are converted to Australian currency at the rates of exchange applicable at the dates of the transactions. Amounts receivable and payable in foreign currencies at balance date are converted at the rates of exchange ruling at that date. 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 the 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 cashflow 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.

The assets and liabilities of the overseas controlled entities, which are self-sustaining, are translated at year-end rates and operating results are translated at average rates for the period. Gains and losses arising on translation are taken directly to the foreign currency translation reserve. These differences are recognised in the income statement in the period in which the operation is disposed.

**Employee Entitlements**

Provision is made for the company's liability for employee benefits arising from services rendered by employees to balance date. Employee benefits expected to be settled within one year together with entitlements arising from wages and salaries and annual leave which will be settled after one year, have been measured at the amounts expected to be paid when the liability is settled plus related on-costs. Other 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.

**Provision for Mine Restoration**

Provision is made in respect of the economic entity's estimated liability for rehabilitation of mining sites in accordance with the relevant clauses of the mining permits. Such costs have been determined using estimates of future costs, current legal requirements and technology on an undiscounted basis.

**Cash**

For the purpose of the statement of cash flows, cash includes cash on hand and at call deposits with banks or financial institutions.

**Revenue**

Revenue from the sale of goods is recognised upon the delivery of goods to customers.

Interest revenue is recognised on a time 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).

**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 statement of financial position are shown inclusive of GST.

**Comparative Figures**

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

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

<u>Note 2 - First-time Adoption of Australian Equivalents to International Financial Reporting Standards</u>	Previous GAAP at 1.7.2004	Adjustments on introduction of Australian equivalents to IFRS	Australian equivalents to IFRS at 1.7.2004
	\$	\$	\$
<b>Reconciliation of Equity at 1 July 2004</b>			
<b>CURRENT ASSETS</b>			
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
<b>TOTAL CURRENT ASSETS</b>	<u>752,553</u>	-	<u>752,553</u>
<b>NON-CURRENT ASSETS</b>			
Investments accounted for using the equity method	152,587		152,587
Property, plant, and equipment	3,417,355		3,417,355
Other financial assets	3,048		3,048
Intangible assets	2,327,785		2,327,785
Other non-current assets	317,780	(210,140)	107,640
<b>TOTAL NON-CURRENT ASSETS</b>	<u>6,218,555</u>	<u>(210,140)</u>	<u>6,008,415</u>
<b>TOTAL ASSETS</b>	<u>6,971,108</u>	<u>(210,140)</u>	<u>6,760,968</u>
<b>CURRENT LIABILITIES</b>			
Trade and other payables	297,185		297,185
Short term provisions	122,354		122,354
<b>TOTAL CURRENT LIABILITIES</b>	<u>419,539</u>	-	<u>419,539</u>
<b>TOTAL LIABILITIES</b>	<u>419,539</u>	-	<u>419,539</u>
<b>NET ASSETS</b>	<u>6,551,569</u>	<u>(210,140)</u>	<u>6,341,429</u>
<b>EQUITY</b>			
Issued capital	13,876,370		13,876,370
Reserves	1,552		1,552
Retained profits (Accumulated losses)	(7,326,353)	(210,140)	(7,536,493)
<b>TOTAL EQUITY</b>	<u>6,551,569</u>	<u>(210,140)</u>	<u>6,341,429</u>

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

<u>Note 2 - First-time Adoption of Australian Equivalents to International Financial Reporting Standards (cont'd)</u>	Previous GAAP at 31.12.2004	Adjustments on introduction of Australian equivalents to IFRS	Australian equivalents to IFRS at 31.12.2004
	\$	\$	\$
<b>Reconciliation of Equity at 31 December 2004</b>			
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	2,322,439		2,322,439
Trade and other receivables	51,543		51,543
Inventories	62,778		62,778
Other current assets	51,874		51,874
<b>TOTAL CURRENT ASSETS</b>	<u>2,488,634</u>	-	<u>2,488,634</u>
<b>NON-CURRENT ASSETS</b>			
Investments accounted for using the equity method	9,764		9,764
Property, plant, and equipment	3,425,969		3,425,969
Other financial assets	136,804		136,804
Intangible assets	2,280,286		2,280,286
Other non-current assets	305,558	(210,140)	95,418
<b>TOTAL NON-CURRENT ASSETS</b>	<u>6,158,381</u>	<u>(210,140)</u>	<u>5,948,241</u>
<b>TOTAL ASSETS</b>	<u>8,647,015</u>	<u>(210,140)</u>	<u>8,436,875</u>
<b>CURRENT LIABILITIES</b>			
Trade and other payables	193,517		193,517
Short term provisions	155,152		155,152
<b>TOTAL CURRENT LIABILITIES</b>	<u>348,669</u>	-	<u>348,669</u>
<b>TOTAL LIABILITIES</b>	<u>348,669</u>	-	<u>348,669</u>
<b>NET ASSETS</b>	<u>8,298,346</u>	<u>(210,140)</u>	<u>8,088,206</u>
<b>EQUITY</b>			
Issued capital	16,627,970		16,627,970
Reserves	(5,739)		(5,739)
Retained profits (Accumulated losses)	(8,323,885)	(210,140)	(8,534,025)
<b>TOTAL EQUITY</b>	<u>8,298,346</u>	<u>(210,140)</u>	<u>8,088,206</u>

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

<u>Note 2 - First-time Adoption of Australian Equivalents to International Financial Reporting Standards (cont'd)</u>	Previous GAAP at 30.6.2005	Adjustments on introduction of Australian equivalents to IFRS	Australian equivalents to IFRS at 30.6.2005
	\$	\$	\$
<b>Reconciliation of Equity at 30 June 2005</b>			
<b>CURRENT ASSETS</b>			
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
<b>TOTAL CURRENT ASSETS</b>	<u>1,848,685</u>	-	<u>1,848,685</u>
<b>NON-CURRENT ASSETS</b>			
Investments accounted for using the equity method	119,618		119,618
Property, plant, and equipment	3,316,622		3,316,622
Other financial assets	1,099		1,099
Intangible assets	2,228,153		2,228,153
Other non-current assets	295,628	(210,140)	85,488
<b>TOTAL NON-CURRENT ASSETS</b>	<u>5,961,120</u>	<u>(210,140)</u>	<u>5,750,980</u>
<b>TOTAL ASSETS</b>	<u>7,809,805</u>	<u>(210,140)</u>	<u>7,599,665</u>
<b>CURRENT LIABILITIES</b>			
Trade and other payables	162,280		162,280
Short term provisions	116,671		116,671
<b>TOTAL CURRENT LIABILITIES</b>	<u>278,951</u>	-	<u>278,951</u>
<b>TOTAL LIABILITIES</b>	<u>278,951</u>	-	<u>278,951</u>
<b>NET ASSETS</b>	<u>7,530,854</u>	<u>(210,140)</u>	<u>7,320,714</u>
<b>EQUITY</b>			
Issued capital	16,773,215		16,773,215
Reserves	(5,369)		(5,369)
Retained profits (Accumulated losses)	(9,415,690)	(210,140)	(9,625,830)
Parent Entity Interest	7,352,156	(210,140)	7,142,016
Outside Equity Interest	178,698		178,698
<b>TOTAL EQUITY</b>	<u>7,530,854</u>	<u>(210,140)</u>	<u>7,320,714</u>

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

**Note 2 - First-time Adoption of Australian Equivalents  
to International Financial Reporting Standards (cont'd)**

	Previous GAAP	Effect of transition to Australian equivalents to IFRS	Australian equivalents to IFRS
	\$	\$	\$
<b>Reconciliation of Profit or Loss for the half year to 31 December 2004</b>			
Revenue	90,390		90,390
Cost of sales	(62,322)		(62,322)
Administrative expenses	(275,960)		(275,960)
Depreciation and amortisation	(206,503)	(210,140)	(416,643)
Manpower expenses	(472,477)		(472,477)
Marketing expenses	(15,871)		(15,871)
Occupancy expenses	(75,818)		(75,818)
Other expenses from ordinary activities	(1,949)		(1,949)
Share of net profits / (losses) of associates accounted for using the equity method	(16,882)		(16,882)
Profit/(loss) from ordinary activities before income tax	(1,037,392)	(210,140)	(1,247,532)
Income tax relating to ordinary activities	39,859		39,859
Loss from ordinary activities after related income tax expense	(997,533)	(210,140)	(1,207,673)
Net Loss attributable to outside equity interests	-		-
Net profit/(loss) attributable to members of the parent entity	(997,533)	(210,140)	(1,207,673)
<b>Reconciliation of Profit or Loss for the full year to 30 June 2005</b>			
Revenue	214,744		214,744
Cost of sales	(122,729)		(122,729)
Administrative expenses	(598,020)		(598,020)
Depreciation and amortisation	(409,329)	(210,140)	(619,469)
Manpower expenses	(830,244)		(830,244)
Marketing expenses	(55,718)		(55,718)
Occupancy expenses	(151,947)		(151,947)
Other expenses from ordinary activities	(176,612)		(176,612)
Share of net profits / (losses) of associates accounted for using the equity method	(32,969)		(32,969)
Profit/(loss) from ordinary activities before income tax	(2,162,824)	(210,140)	(2,372,964)
Income tax relating to ordinary activities	39,859		39,859
Loss from ordinary activities after related income tax expense	(2,122,965)	(210,140)	(2,333,105)
Net Loss attributable to outside equity interests	33,629		33,629
Net profit/(loss) attributable to members of the parent entity	(2,089,336)	(210,140)	(2,299,476)
<b>Notes to the reconciliation of Equity and Profit or Loss at 1 July 2004, 31 December 2004 and 30 June 2005.</b>			
	<b>30.6.2005</b>	<b>31.12.2004</b>	<b>1.7.2004</b>
	\$	\$	\$
2(a) Write off of capitalised research expenses	(210,140)	(210,140)	(210,140)

**PHOSLOCK WATER SOLUTIONS LTD**  
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**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

**NOTE 3 - PROFIT FROM ORDINARY ACTIVITIES**

The following items are relevant in explaining the financial performance for the interim period.

Included in other expenses is an impairment loss of \$267,696 relating to the Purezza Marketing Inc US investment which has been written down to its recoverable amount.

Included in Manpower expenses is the cost of options issued in the half year to December 2005. The options were valued on the same basis as those reported in the 2005 annual report.

Share of net profits / (Losses) of Chinese associate IETC Environmental Protection Technology (Kunming) Ltd accounted for using the equity method - 20% holding

ECONOMIC ENTITY	
31 DECEMBER 2005	31 DECEMBER 2004
\$	\$
(267,696)	-
(151,871)	-
-	(16,882)

**NOTE 4 - SEGMENT INFORMATION**

Primary Reporting - Business segments

	Environmental Technologies		\$	Bentonite Mining		Economic Entity	
	2005	2004		2005	2004	2005	2004
	\$	\$		\$	\$	\$	\$
Segment Revenue	356,095	25,800		23,251	39,590	379,346	65,390
Unallocated revenues	-	-		-	-	17,008	25,000
Total operating revenues	356,095	25,800		23,251	39,590	396,354	90,390
Segment Result	(1,184,058)	(922,904)		(152,830)	(113,344)	(1,336,888)	(1,036,248)
Unallocated expenses						(293,518)	(211,284)
Profit from ordinary activities before income tax						(1,630,406)	(1,247,532)



**PHOSLOCK WATER SOLUTIONS LTD**  
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**NOTES TO AND FORMING PART OF THE ACCOUNTS**  
**FOR THE HALF-YEAR ENDED 31 DECEMBER 2005**

**NOTE 5 - ACQUISITION of SUBSIDIARIES**

As disclosed in the 2005 Annual Report the parent entity acquired the 51% holding of International Environmental Technology Solutions Pty Ltd (IETS) in the parent entity's Chinese associate Phoslock manufacturing entity, IETC Environmental Protection Technology (Kunming) Ltd. The purchase was satisfied by the issue of 2,071,823 shares in the parent entity and a cash payment of \$100,000. The issue was based on the market price at the time of purchase.

	Economic Entity \$
Purchase Consideration	
- Shares Issued	300,414
- Cash	100,000
	<u>400,414</u>
Assets and liabilities acquired at acquisition date	
- Cash & cash equivalents	25,136
- Receivables	15,956
- Inventories	82,545
- Other current assets	17,607
- Fixed assets	186,377
- Intangibles	96,079
- Trade & other payables	(102,717)
	<u>320,983</u>
Goodwill on Consolidation	79,431
Total	<u>400,414</u>

As disclosed in the annual report Phoslock Pty Ltd a subsidiary of the parent entity, acquired the 48% minority shareholdings in US based Phoslock licensee Purezza Marketing Inc. The purchase was satisfied by the issue of 2,997,915 shares and 2,997,915 options in the parent entity.

	Economic Entity \$
Purchase Consideration	
- Shares Issued	479,666
	<u>479,666</u>
Assets and liabilities acquired at acquisition date	
- Cash & cash equivalents	176,461
- Receivables	47,603
- Other current assets	1,329
	<u>225,393</u>
Goodwill on Consolidation	254,273
Total	<u>479,666</u>

**NOTE 6 - CONTINGENT LIABILITIES**

There has been no change in contingent liabilities since the last annual reporting date.

**NOTE 7 - EVENTS SUBSEQUENT TO REPORTING DATE**

There have been no events subsequent to reporting date which have had a material effect on the financial position of the company.

**PHOSLOCK WATER SOLUTIONS LTD**  
**ABN 88 099 555 290 and CONTROLLED ENTITIES**

**DIRECTORS' DECLARATION**

The directors of the company declare that:

- (a) the financial statements and notes set out on pages 5 - 16
  - (i) comply with Accounting Standard AASB 134 : Interim Financial Reporting and the Corporations Regulations 2001; and
  - (ii) give a true and fair view of the financial position of the economic entity's financial position as at 31 December 2005 and its performance, as represented by the results of its operations and its cash flows, for the half-year ended on that date; and
- (b) 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.

Signed in accordance with a resolution of the Board of Directors on 14 March 2006.

A handwritten signature in black ink, appearing to read 'R. Schuitema', with a long horizontal stroke extending to the right.

Robert Schuitema  
Executive Chairman

**INDEPENDENT REVIEW REPORT TO THE MEMBERS OF  
PHOSLOCK WATER SOLUTIONS LIMITED**

**Scope**

We have reviewed the financial report of Phoslock Water Solutions Limited and controlled entities for the half-year ended 31 December 2005 as set out on pages 5 to 17. The company's directors are responsible for the financial report. The financial report includes the consolidated financial statements of the consolidated entity comprising the company and the entities it controlled at the end of the half-year or from time to time during the half-year. We have performed an independent review of the financial report in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the financial report is not presented fairly in accordance with Accounting Standard AASB 134: Interim Financial Reporting and other mandatory professional reporting requirements in Australia and statutory requirements, so as to present a view which is consistent with our understanding of the company's financial position, and performance as represented by the results of its operations and its cash flows, and in order for the company to lodge the financial report with the Australian Securities and Investments Commission/Australian Stock Exchange Limited.

Our review has been conducted in accordance with Australian Auditing Standards applicable to review engagements. A review is limited primarily to inquiries of company personnel and analytical procedures applied to the financial data. These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

**Independence**

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

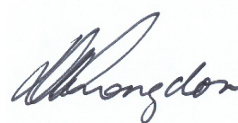
**Statement**

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report Phoslock Water Solutions Limited and controlled entities, is not in accordance with:

- a. the *Corporations Act 2001*, including:
  - i. giving a true and fair view of the company's financial position as at 31 December 2005 and of its performance for the half-year ended on that date; and
  - ii. complying with Accounting Standard AASB 134: Interim Financial Reporting and the Corporations Regulations 2001; and
- b. other mandatory professional reporting requirements in Australia.



WILLIAM BUCK  
Chartered Accountants



DON LANGDON  
Audit Partner

Dated this the 14<sup>th</sup> day of March 2006.

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