PHOSLOCK®

Phoslock Water Solutions Limited

# Annual Report 2007

# Corporate Directory

## Directors

**Dr David Garman**
Chairman

**Robert Schuitema**
Managing Director

**Russell Brown**
Non Executive Director

**The Hon. Pam Allan**
Non Executive Director

## Management

**Colin Upcroft**
Chief Financial Officer & Company Secretary

**Eddie Edmunds**
Chief Operating Officer

**Nigel Traill**
Regional Manager Europe, Africa & The Middle East

**Sarah Groves**
Technical Manager

**Andrew Winks**
Group Operations Manager

## Auditors

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

## Share Register

**Computershare Investor Services**
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

## Offices

**Sydney – Head Office**
3/81 Frenchs Forest Road
Frenchs Forest NSW 2086
Ph: +61 2 9453 0455 Fax: +61 2 9453 2693
Email: enquiries@phoslock.com.au

**Brisbane**
5/22 Palmer Place
Murarrie QLD 4172
Ph: +61 7 3890 7344 Fax: +61 7 3890 8666

**Melbourne**
235 Sutherlands Road
Riddells Creek VIC 3431
Ph: +61 3 5428 6588 Fax: +61 3 5428 6588

**Europe**
Rue des Colonies 11
1000 Bruxelles Belgium
Tel: +32 2 517 6017 Fax: +32 2 517 6500
Mob: +32 495 77 5544

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

**China**
17th Floor, Room 103, Ao Cheng Building,
#39 Renmin Zhong Road, Kunming City, Yunnan Province, China
Zip: 650021
Phone/Fax: +86 871 361 7693
Mobile: +86 139 8719 1775

**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

# Contents




*Torrens River – Adelaide*

# Chairman's Report

The maturing and re-direction of the Company under the new management team put in place at the beginning of 2007 has put us on track for a successful coming year with well developed prospects and emerging markets. The year has finished on an optimistic note albeit your Board was disappointed that sales targets were not met in the 2006/07 year. The corrections required to remedy this have been put in place.

The revised focus of the Company on large scale applications has proven to be successful. At the time of writing this report Phoslock Water Solutions (PWS) is working on 14 large projects in 9 countries each with potential future applications in the 500 – 2,000 tons range and some in excess of 10,000 tons. These applications are for drinking water reservoirs and highly valued recreational lakes and inner city river systems.

During the year the Company strengthened its technical team with the addition of three highly qualified scientists covering several very specialized areas. Our scientific team is now providing the Company with a longer term data base on completed projects which potential clients can use to assist product evaluation and model the benefits of a Phoslock application. PWS is working on joint studies with a number of potential clients.

The results from the aquaculture trials have been very promising. This area is emerging as a major second market for Phoslock.

The well publicised blue green algal events in China have provided the Company with an excellent opportunity to assist providing solutions to secure safe water supply and sound lake ecologies. Given the complexities of some of these water bodies, Phoslock alone will not solve all issues. The Company is currently working with a respected research institute in northern China to develop a product, incorporating several technologies, to address these problem water bodies.

During the course of the year I met a number of our licensees in North America, Europe, South Africa and Asia. All are making significant progress in developing Phoslock businesses in their license areas.

We are working hard to develop this and other overseas markets, so I expect the international sales to significantly exceed those in Australia in the coming year.

In Australia, the drought which has been exacerbated by the probable impacts of climate change, is presenting new opportunities. Water resource managers are beginning to appreciate that preventative or control applications with Phoslock are as important as remedial applications in dealing with water eutrophication issues.

The company has now established itself both scientifically and technologically as the premier solution for remediation of eutrophic lakes and rivers

The appointment of the Hon. Pam Allan has added new strength to the Board and I am pleased to commend her election.

*PWS Board Members clockwise from top left Russell Brown, Dr David Garman, Robert Schuitema and The Hon. Pam Allan .*

Dr David Garman
Chairman

# Dr David Garman

The PWS Board is pleased to congratulate Chairman Dr David Garman on the first anniversary of his term as President of the world's premier water organization the International Water Association (IWA).

Dr Garman is a founding director of PWS when it listed in 2002. Dr Garman has been a driving force behind the commercialisation of Phoslock and development of the Company's technical group

Dr Garman saw at a very early stage the potential of Phoslock as a long term solution to remediating eutrophied water bodies. Dr Garman has played a leading role in identifying and securing specialised water companies as licensees in various countries

Dr Garman is a very hands on Chairman. Over the last twelve months Dr Garman has personally visited licensees or potential licensees in the United States, Canada, UK, Germany, Poland, Hungary, Israel, South Africa, China, Singapore, Malaysia and Taiwan.

IWA has its roots in two strong associations: the International Water Supply Association (IWSA) and the International Water Quality Association (IAWQ). IWSA was established in 1947 while IAWQ was originally formed as the International Association for Water Pollution Research in 1965. IWSA and IAWQ came together in a merger in 1999 to form IWA.

The IWA's vision is to connect water professionals worldwide to lead the development of effective and sustainable approaches to water management. Its mission is to create and foster a global network of leading-edge water professionals through the provision of services and products to members, including conferences, publications and support for member groups. In addition, to represent the views of members in international forums and to project key messages to the sector at large, aimed at advancing best practice in sustainable water management.

In his role as President of the IWA, Dr Garman has capitalized on the excellent opportunity to build on his water industry linkages and advance the professional contacts and leads so important in establishing the credibility of Phoslock in global markets.

Dr Garman has played a prime role in the promotion and establishment of the Phoslock technology on key projects.

Dr Garman's support for the Phoslock technology also provides important credibility so critical in establishing new technologies in new markets.


*Dr David Garman presenting at the Phoslock Conference Bremen, Germany*

# The Hon. Pam Allan

The PWS Board is delighted to welcome The Hon. Pam Allan to the board of Phoslock Water Solutions. Pam retired at the recent New South Wales parliamentary elections after 18 years as member for Wentworthville and laterly Blacktown. From 1995 to 1999 Pam was Minister of Environment in the Bob Carr ministry.

Pam brings a wealth of skills and experience on water, environmental and governmental issues.

**Career Background**

Pam was elected to the Parramatta City Council in 1983 serving a four year term. In 1988 Pam was elected to the New South Wales Legislative Assembly as member for Wentworthville and then for Blacktown in 1991 and 1995. In 1999 and 2003 Pam was once again elected as the member for Wentworthville.

Pam's parliamentary experience includes Shadow Minister Planning & Environment 1991-1995, Minister for Environment 1995-1999, Chair, Select Committee on Salinity, 2000-2002 and Chair, Standing Committee on Resource Management, May 2003.

Pam is a Fellow at the Graduate School of Environment, Macquarie University.

*The power industry is emerging as a major potential market for both Phoslock and WaterSavr*

# Managing Director's Report

## "Water is the oil of the 21st century"

Benjamin H. Grumbles,
US Environmental Protection Authority
WEFTEC Conference, October 2007

PWS made significant progress during the year commercialising its core product, Phoslock. FY 2006/2007 was the second full year in which Phoslock has been available for sale. At the time of writing this report PWS and its licensees had completed over 130 applications in 20 countries. A number of these projects were “firsts" for PWS. A portion of these applications were pilot projects for larger future projects.

Phoslock is still a relatively new product. The sales process for larger projects is very extensive and time consuming. Pilot projects are necessary to give prospective customers confidence that the product does what it is intended to. The results of the pilot projects have been extremely good and the results are giving customers the confidence to commit to larger projects. By year end PWS was very well positioned on fourteen large future projects in nine different countries ranging from 500 – 2,000 tons and some in excess of 10,000 tons. PWS's pipeline of future applications is approx 20,000 tons representing potential future sales in excess of A$50 million.

PWS's results for FY 2006/2007 include significant marketing and licensee development costs, research & development (which is fully expensed each year), amortization costs associated with the Company's Intellectual Property portfolio and a large one-off termination payment for the previous Managing Director. People costs represent approx 40% of total expenditure. PWS is building a business in which it expects to sell 20,000 – 30,000 tons per annum of Phoslock products on a sustainable basis. The up front costs of developing a global business are expected to be recouped quickly as the Phoslock business grows with more applications. Over the next 12 months, PWS is scheduled to undertake some major projects already in our pipeline. Success on these projects will be the catalyst to opening up these markets for a large number of future opportunities.

The number of large water bodies around the world experiencing blue green algae and other eutrophication problems is rising exponentially each year. Having established Phoslock as an accepted solution to blue green algae and eutrophication problems, the demand for Phoslock products is expected to be significant.

### Production

Phoslock is manufactured at the Company's 71% joint venture factory near Kunming, China. The current capacity for the plant is approx 7,000 tons per annum of Phoslock products. The plant is currently run on a campaign basis as current demand is not sufficient to run the plant on a full time basis. The joint venture can ramp up production to meet larger orders at very short notice.When demand requires additional production PWS has plans in place to build a second manufacturing facility.

PWS and its JV partner, IETC have developed excellent relationships with our key raw material input suppliers.

### Technical

Additional senior resources have been added to the technical function during the year. PWS's technical group is now located at its head office in northern Sydney. Major projects include improvements to the Phoslock production process, product QA and QC, broadening the applicability of Phoslock to a wider range of applications, development of a new Phoslock Plus product, and evaluating new water treatment products.

The technical group has undertaken significant work on the effects of Phoslock post application and monitoring of algal species. The body of research on applications completed shows that Phoslock changes the Nitrogen/Phosphorus ratio in a water body leading to a change in algal species away from toxic blue green algae to benign green algae.

The technical group has spent considerable time and resources working with prawn growing companies to find the optimal timing and amount of Phoslock to apply into growing ponds. Results to date are very encouraging from work with the larger sophisticated prawn growing companies.

### Sales & Marketing

PWS markets Phoslock directly in Australia, United Kingdom & Ireland, and China. Licensees are in place for New Zealand, United States, Canada, Germany, Nethelands, Belgium, Luxemburg, Switzerland, Austria, Poland, Hungary, Southern Africa, Indonesia, Malaysia, South Korea, Singapore and Taiwan. PWS is currently in discussions with potential licensees for Denmark, Romania, Israel, UAE and Japan.

*Rapid development in third world countries is creating major eutrophication issues for waterways*

## Lake Restoration/Drinking Water Reservoirs/Dams

Some of our licensees have made enormous progress in the development of their Phoslock licence. Our German licensee, whose license also covers Switzerland, Austria and Benelux, has built up a seven person business totally dedicated to the development of the Phoslock business. To date they have completed applications to three mid sized lakes and have built up a large future pipeline of applications. Our licensee has indicated that it expects to complete up to 4 lake treatments between now and the end of the year. They are also providing technical resources for PWS for proposals for projects in other European countries.

In Europe (outside Germany) PWS has a large pipeline of potential applications in Poland, The Nethelands and Italy. Some of these projects are expected to receive the official approval in the coming months.

In the United Kingdom, PWS has established its own business. Over 30 small and medium sized applications were completed during the year. The highlight was the application to a drinking water reservoir. Monitoring of this application is continuing and will form an important reference site for PWS's business in the UK. PWS is in discussions with a lake monitoring company to assist PWS with its business in the UK and Ireland.

Our North American licensee has had significant success focusing on lake restoration projects in Ontario and Quebec, Canada. They have identified and targeted a large number of heavily eutrophied water bodies in this area which are receiving government assistance to remedy its problems. Our licensee expects to undertake an application to a 25km canal in the coming months which flows into a large eutrophied lake.

In New Zealand, local authorities have announced details to spend NZ$200 million on Rotorua lakes restoration projects, including NZ$12 million allocated specifically for the use of Phoslock and a further NZ$32 million on other sediment treatments. Smaller amounts of Phoslock have been applied on three separate occasions to Lake Okareka. These applications have been designed to test Phoslock's phosphorus absorption capacity, sediment capping capability and effect on fish or biota.

In Australia PWS completed its two largest applications to date – a drinking water reservoir in southern NSW and part of the River Torrens next to Adelaide city. The results from both applications have been very good with major improvements to the water quality in these water bodies. With the assistance of Total Eden in Western Australia, a number of small and mid-sized applications have been completed in and around Perth. PWS has over 20 proposals with various water body managers around Australia for applications ranging from 10 tons to in excess of 1,000 tons.

*NSW Drinking Water Reservoir*

## Aquaculture

PWS commenced trials using Phoslock in prawn ponds owned by small operators in Indonesia in late 2006. The results of these trials were very positive and lead to Phoslock being trialed by some of the largest prawn growing operators in Indonesia and Malaysia. Trial results to date look very encouraging. These trials are likely to continue until the end of 2007.

PWS is also working with prawn farms in Australia with new commercial trials about to begin when this season's growing cycle commences in October/November.

## Retail Products

In 2006 PWS launched a range of retail products (1.25kg, 2.5kg and 5kg containers) which are sold on the internet and via a network of retail stores throughout Australia. The results to date have been mixed. Several of the larger retail chains, Total Eden in Western Australia and McCrackens in Queensland, NSW and Victoria have performed very well and uptiered sales to larger water bodies controlled by corporate and industrial clients. A number of the smaller retail stores located in water short areas have struggled to find a suitable market. As a result the retail network has been reduced from 75 stores to approx 45.

## WaterSavr

In late 2006 PWS was granted the license to sell the evaporation control product, WaterSavr to the large water body market in Australia. WaterSavr is US FDA approved for use on drinking water reservoirs and has had a number of independent studies completed on the product's effectiveness. PWS took over the Australian license from another company who had undertaken several successful trials which demonstrated that WaterSavr

saved an average of 31% of water from evaporation. PWS made a number of sales to medium sized water authorities in Victoria and southern NSW.

PWS currently has a number of large volume WaterSavr proposals with managers of large water storages in Victoria, NSW and Queensland. Decisions are expected shortly as customers are entering the peak evaporation period.

WaterSavr is an ideal add on product to PWS's product range as it is being marketed to the same water authorities who use Phoslock.

## Future Developments, Prospects and Business Strategies

To improve the economic entity's earnings performance and maximize shareholder value, the following initiatives are being implemented:

i. conversion of sales pipeline into near term sales. PWS has built up an extensive pipeline of potential sales around the world. Most of PWS and its licensees customers are governmental organizations. PWS has undertaken various pilot projects with potential customers to demonstrate the effectiveness of Phoslock. Customers generally have different internal processes to be completed before a purchase order is provided to PWS or its licensee. In many instances customers are currently progressing the Phoslock purchase, having been satisfied on technical issues, through its internal mechanisms.

ii. increased targeted marketing by PWS and its licensees using results of past applications to demonstrate the effectiveness of the product. The current sales cycle for larger water bodies is 6-24 months. As more applications are completed it is expected that the sales cycle period will be significantly reduced.

iii. when demand justifies additional production capacity, PWS proposes to construct a second Phoslock manufacturing plant, most likely in China. A second plant will also mitigate the risks associated with a single production source.

iv. continued focus on the aquaculture sector. The volume of pond grown aquaculture products is increasing each year. Within these closed systems there is significant water quality problems which affect the health, size, and mortality rate of the species in the ponds. Work to date by PWS indicates that the environmental qualities of Phoslock add significant value to the yield from the ponds.

v. evaluation and development of other water treatment products which could be added to PWS's product range. PWS has recently commenced work in northern China with a highly respected institution to develop a hybrid product suitable for extremely poor quality water bodies.

vi. both profitable and cash flow positive for FY07/08. PWS is cash flow positive at sales of approx 800 tons per quarter. Given the vast pipeline of potential applications, the Board and management believe that this is highly achievable for the coming year and will lead to the generation of significant profits in future years.

I would like to thank our hard working team of PWS Directors and executives for their significant contribution during the year. I would like to particularly single out the contribution of the Company's Chairman, Dr David Garman, who has made himself available, often at short notice, to make presentations on Phoslock to prospective clients and regulatory agencies in both Australia and internationally. I would also like to welcome the Hon. Pam Allan to the PWS Board. She brings a wealth of experience and key contacts.

I would also like to thank our long standing shareholders who have remained loyal to the Company and also welcome the new shareholders who have been attracted to the Phoslock story. During the past 12 months the share price has appreciated by 100% (from 12-15 cents range to the 28-32 cent range whilst achieving a peak of 49 cents). The Board and management of PWS believe that the Company's potential is immense with opportunities to deliver significant future benefits to the shareholders.

Robert Schuitema
Managing Director


*Container loading – Kunming factory China*

# PWS Boosts its Technical Resource

PWS has significantly enhanced its Technical support function during the year with the appointment of three key executives.

Eddie Edmunds joined PWS in January as Chief Operating Officer having provided consulting services to the Company since August 2006. Eddie has a B.Sc. (Biological Sciences and Industrial Chemistry) University of Natal, Durban, South Africa. He has spent over 20 years experience in the water treatment industry spanning Asia, Australasia, Africa, Europe and America. This experience includes both developing and commercialising a number of new technologies. Eddie's career to date fits well with PWS's need to provide high level technical and sales support on key projects.

Sarah Groves was appointed as PWS Technical Manager in May 2007. Sarah has completed a B.App.Sc. at the University of Technology, Sydney; B.Sc. Hons (1st Class), University of New South Wales, Kensington, Sydney; and is in the final stages of having her PhD examined (undertaken at the University of New South Wales, Kensington, Sydney). She has a strong background in surface and ground water geochemistry which she gained from completing an honours thesis in Science (focusing on the groundwater hydrogeochemistry of the Sydney Basin), a PhD (focusing on hydrochemistry at a prawn farm built in acid sulfate soils) and working at the CSIRO Marine and Atmospheric Research (CMAR) as a hydrochemist. While working at CSIRO she was a member of the aquaculture group and particularly focused on water quality, chemistry, nutrition, and nutrient and algal dynamics relating to prawn aquaculture. Sarah's skill sets are well suited to providing high level technical support to the PWS sales team.

Anisul Afsar recently joined PWS as an Aquatic scientist to focus on the significant opportunities for Phoslock in the global aquaculture industry. Anisul has a Master of Marine Science degree from University of New South Wales, Sydney, Australia and has recently submitted a thesis for the degree of Doctor of Philosophy (PhD) in Marine Biology from University of New South Wales. Anisul's experience includes teaching, research and working in Aquaculture related disciplines. Anisul's qualifications and experience are ideally suited to the development of the Phoslock aquaculture market.

### What is Phoslock?

Phoslock is a natural product, produced from modified bentonite clay and developed by the Land and Water Division of Australia's CSIRO (Commonwealth Scientific and Industrial Research Organisation) to significantly reduce the amount of Filterable Reactive Phosphorus (FRP) present in the water column and in the sediment pore water of a water body. FRP is an important growth limiting factor for blue green algae and other algae.

Bags containing Phoslock are easily loaded onto a boat or pontoon with the use of a shore-based belt conveyor. Once loaded onto the application device, the Phoslock is mixed using lake water into a slurry. It is then sprayed onto the surface of the water body in accordance with required dose rates. Phoslock can also be applied from land with the use of an applicator mounted on a vehicle.

### How does it work?

As the Phoslock moves down through the water column, up to 95% of the FRP is rapidly removed and adsorbed onto the surface, forming an insoluble complex within the clay structure. As the Phoslock settles on the sediment-water interface it forms a 1-3 mm layer. This layer of Phoslock is capable of adsorbing the FRP from the sediment layer on its available binding sites. Once the FRP is bound to Phoslock, it is no longer bioavailabile for use by algae for assimilation and growth. The lack of nutrients in the water body has a direct impact on the proliferation of algae. One tonne of Phoslock is capable of removing 34kg of phosphate ($PO_4$), or 11 kg of phosphorus (P). Phoslock operates over a wide pH range ~ 4 to 11 and binds with phosphate even under anoxic conditions.

*PWS Technical Group - left to right Chief Operating Officer, Eddie Edmunds, Technical Manager, Sarah Groves & Aquatic Scientist, Anisul Afsar*

## Benefits of Phoslock

### Rapid reduction of FRP

Phoslock rapidly takes up FRP in the water body. Approximately > 90% of FRP can be removed within four hours of application. FRP levels can be reduced to <0.01 mg / l. The FRP is removed from the water column, sediment pore water, inflow water and from internal sources such as algal degradation and excretion from aquatic organisms.

### Significant reduction in blue green algae

In an Australian drinking water body Phoslock effectively reduced the concentration of blue green algae in the reservoir and kept levels low (0 – 400 cells/ml) for up to four months post application (Figure 2). However, the concentrations of green and other algae slightly increased up to two months after the Phoslock application, after that the concentration remained steady.

### Safe for the environment

During the development of Phoslock, extensive laboratory testing was carried out on a range of test species using the United States Environmental Protection Agency toxicity testing criteria.

The CSIRO Centre for Advanced Analytical Chemistry assessed acute and chronic toxicology on a variety of aquatic species with no toxicity effects observed. Since then, the product has received approvals from NICNAS and the EPA in Australia. It can also be imported and sold in Europe under the EINECS system. Extensive ecotoxicology data compiled from independent and in-house sources is available upon request.

### Eutrophication issues

Eutrophication is the enhancement of the natural process of biological production in rivers, lakes and reservoirs. It is caused by an increase in nutrient levels; usually phosphorus and nitrogen. Eutrophication can result in visible cyanobacterial or algal blooms, surface scums, floating plant mats and benthic macrophyte aggregations Concentrations of phosphorus of < 0.1 mg / l are sufficient to cause a cyanobacterial (algal) bloom. The decay of this organic matter may lead to oxygen depletion in the water, which in turn can cause secondary problems such as fish kills and liberation of toxic substances or phosphates that were previously bound to oxidized sediment.


**Figure 1:** By using Phoslock, the overall phosphorus level was reduced from 160 µg to 36 µg in an application on the Silbersee (Germany).

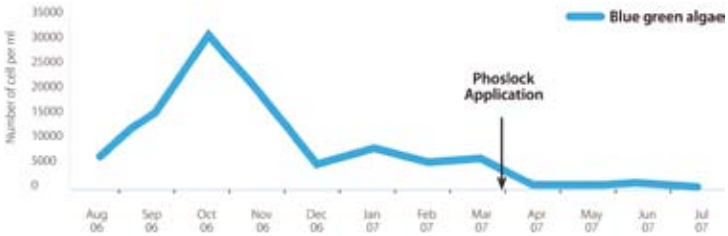



**Figure 2:** Concentrations (cells/ml) of blue green algae in Australian drinking water reservoir (0 – 8 m) before and after application of Phoslock (August 2006 to July 2007). n = 3 (Sampling points)the Silbersee (Germany).

Phosphate released from sediments accelerates eutrophication. Some lakes are naturally eutrophic, but in many other cases the excess nutrient input results from: (1) anthropogenic origin such as municipal wastewater discharges; (2) industrial effluents; and (3) runoff from fertilizers and manure spread on agricultural areas. Nutrient enrichment seriously degrades aquatic ecosystems and impairs the use of water for drinking, industry, agriculture and recreation.

### Phosphorus as a limiting nutrient and the implications

Any nutrient can become a limiting nutrient in an ecosystem. For algae, the most obvious limiting nutrients are (1) nitrogen; (2) certain metals, and; (3) phosphorus. (1) Nitrogen removal is an expensive process, with high energy and chemical costs and specialised equipment. Certain microorganisms, including algae, are able to fix atmospheric nitrogen opportunistically. (2) Removal of metals may disrupt the local ecology, especially that of aquatic plants. (3) Phosphorus limitation is the most practical means of preventing the growth of toxic blue green algae.

Figure 4 illustrates the effect of an increase in the trophic status of a water body on the algal population. In a healthy oligotrophic lake, it is normal for diatoms and small green algae to be present. However, as the trophic level of the water increases, a shift is seen in the algal population from small benign algal species, to larger filamentous green algae and toxic blue green algae. The presence of

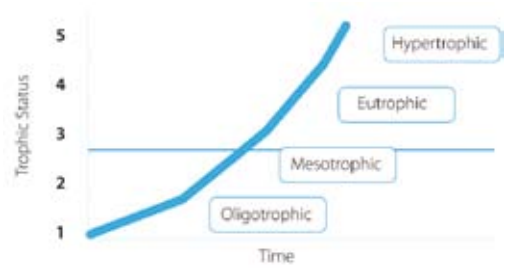



**Figure 3:** Effect of increasing phosphorus concentration on the trophic status of a water body.

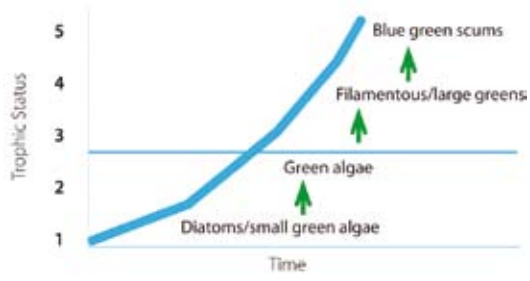



**Figure 4:** Effect of eutrophication on the algal population composition in a water body.

## What can happen if you don't treat eutrophication and blue green algae issues

### Common Remediation options

**Biological treatment**
e.g. WTP Biological Nutrient Removal
- Only really suitable for point sources

**Denitrification**
- N removal is expensive
- High energy (chemical costs) & equipment
- Nitrogen is refixed opportunistically

**Chemical dosing**
- Not suitable for very low levels & natural waterways
- Remobilised under some conditions
- Al & Fe – pH & sludge problems
- Algicides – chemical or biological are unsustainable and have risky ecological impacts

**Mechanical measures**
- Aeration – expensive
- Removal of nutrient rich water from the hypolimnion – unsustainable

### Consequences of not treating

Eutrophication and blue green algal proliferation will only worsen without treatment. Some serious consequences of non-treatment are:

**Algal blooms**
- toxin release
- ecology disruption with BGA
- Epiphyte impact on macrophytes
- DO stress with pH changes

**Ecology disruption**
- Shift from oligotrophic to eutrophic & exotic species

**Microbial risk**
- Biofilm increases

**Corrosion & biodeposition risk**
- Taste / odour
- Coatings
- Corrosion

a large bloom of blue green algae in a lake indicates that it has reached a hypertrophic state. Limiting FRP in the system will cause a positive shift in the algal population back to the benign species, thus reducing the systems productivity and trophic status. Phoslock targets FRP, and in doing so, provides a permanent and sustainable management solution to eutrophication.

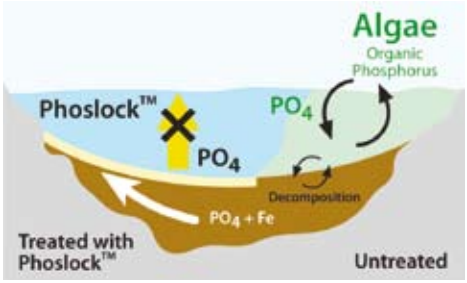



**Figure 5:** Diagram demonstrating how Phoslock will keep removing FRP from the water column and from the pore water contained in sediments even after application.

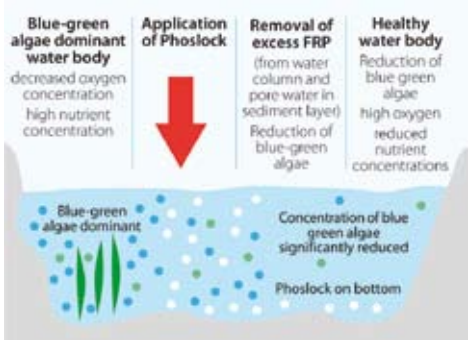



**Figure 6:** Effect of eutrophication on the algal population composition in a water body.

### Sequestering FRP from the water column and from the sediment pore water

Work undertaken by Phoslock Water Solutions Ltd has shown that the effects of Phoslock are sustained over time; the layer of Phoslock at the base of the water body ensures that future FRP is adsorbed (Figure 5), the reduction of FRP is maintained and blue-green algal concentrations are kept low (Figure 6).

### Removing FRP from inflow sources

A significant source of FRP (depending on the catchment) is contained in the inflow water. Water from catchment areas can contain concentrated amounts of P that run into water bodies during periods of rainfall. This input and the FRP released from the sediments are two of the most common long term issues relating to water body remediation (Figure 7).

Phoslock can be used to treat the inflow water before it enters the lake or reservoir (depending on flow rates) or it can be used as a management tool to maintain the concentration of FRP in the water body; reducing the impact of the inflow water.

During rainfall events, the inflow water may contain dissolved organic phosphorus (DOP). Degradation of this material in the water body will increase the concentration of FRP. Phoslock will remove this "hidden" source of FRP.

### Manipulating the N:P ratio – Algal species shift away from blue green algae

The interpretation of data before and after the application of Phoslock in reservoirs and lakes shows the common trend that: the reduction of blue green algae was likely due to the alteration of the N:P ratio by the use of Phoslock. Filterable reactive phosphorus (FRP) in the water column and pore water at the sediment-water interface was "locked up", thus changing the N:P ratio. This resulted in P limiting conditions for growth and proliferation of blue green algae (Figure 8).

The concentration of blue green algae has also been observed to decrease over time

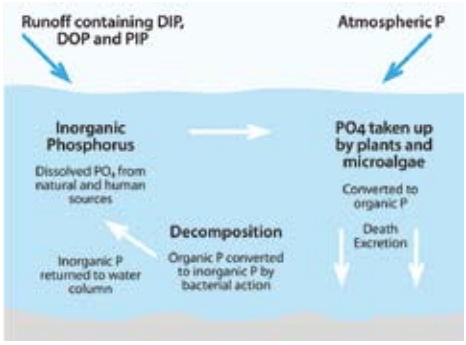



**Figure 7:** Diagram showing the possible inputs of P into a water body.

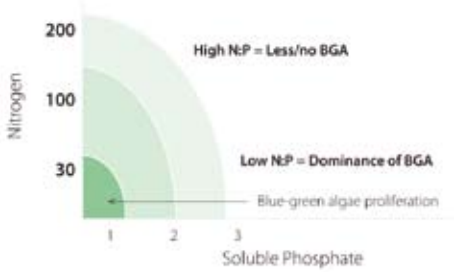



**Figure 8:** Schematic diagram showing the relationship between blue green algae and total N:P ratio.

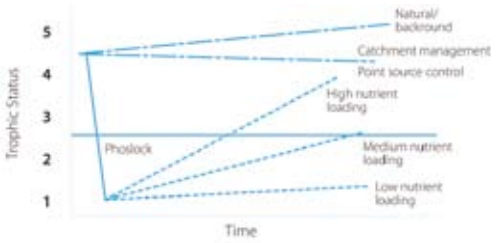



**Figure 9:** A Phoslock application resets the ecological clock of a water body, returning it to an oligotrophic status.


**Figure 10:** Phosphorus data from an application in a German lake. The FRP was significantly reduced after the application and maintained for the monitoring period (4 months after Phoslock was applied).

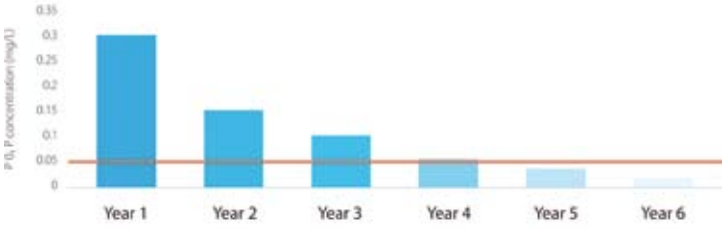



**Figure 11:** Conceptual graph of the reduction of FRP by applying Phoslock in measured doses over time

after a Phoslock application. Once placed into a water body, Phoslock will sequester FRP. As the concentration of FRP is reduced in the water body, it becomes the limiting nutrient for blue green algae and inturn, the population decreases (in most applications, to well below regulatory standards).

### Phoslock – Part of the reservoir management strategy

Phoslock can be used in conjunction with other management strategies for prevention of eutrophied water bodies and blue green algal outbreaks. Some of the other common management methods for lake/reservoir restoration/preservation are:

- Minimise input of nutrients (P) from diffuse and point sources
- Removal of contaminated sediments
- Removal of nutrient rich deep water
- Aeration
- Precipitation of phosphate

## How Phoslock improves your water body

Other options for eutrophication control include various catchment control methods. Implementations of these methods may be environmentally sound, but can take up to 5 years to implement. These methods can be costly, and results are usually only apparent after 10-40 years, sometimes more. Diffuse and point source controls are other options, but there are disadvantages associated with these methods. Dredging is expensive and highly disruptive, and may not remove the nutrient source. The removal of dredged sediment is also a problem, as secondary disposal is now strictly regulated. Constructed wetlands provide a short term solution only, with the nutrients being remobilized unless there is regular nutrient removal. More importantly, internal recycling of nutrients is often the critical source. Phoslock has the ability to reset the ecological clock of an ecosystem (Figure 9).

## Phoslock applications

Since the commencement of commercial scale production, Phoslock has been applied to more than 100 large water bodies. At the time of this publication the amount of Phoslock that has been applied to water bodies was in excess of 800 MT in 20 countries. Applications can be tailor made depending on the application site, the severity of the problem, the climate and budget requirements.

### Single dose application

Phoslock can be added to a water body in a single large application. This type of treatment is beneficial in situations where the concentration of FRP is above government regulations or where there is an immediate or predicted concern for human/environment health due to blue green algal proliferation. The results from a single dose application are immediate and more obvious than smaller, multiple applications (Figure 10).

The dose rate for a single application is calculated upon the knowledge of the phosphorus mass balance for each of the water bodies treated. This calculation is based on the following P sources: (1) water column; (2) sediment pore water; (3) inflow water; (4) cycling of P from biomass and aquatic organisms; (5) atmospheric P (Figure 7).

### Smaller multiple doses over time

Phoslock also has the potential to be used as a eutrophication management tool, whereby the FRP [$PO_4$-P] is removed in a step-wise fashion over a period of 3-6 years (Figure 11). Although the result is not as immediate as with large doses, this approach does offer some advantages: (1) cost effectiveness (as the cost can be factored over a number of years); (2) easier and more practical applications; (3) long term management and monitoring; (4) flexible strategy where necessary to accommodate nutrient loading and climatic influences.

### Eutrophication management strategy

The FRP concentration is reduced by 66% in year 1, 80% in year 2, and 100% in year 3 in a typical water body (Figure 11). Some FRP will remain in the first 2-3 years and algal activity will not disappear entirely. However, the reduced concentration of P ensures reduced algal activity, and a population shift from toxic cyanobacteria to benign green algae and diatoms.

Maintenance of a water body with Phoslock will ensure that there is a sufficient amount of Phoslock at the sediment-water interface to minimise the release of FRP from the sediment.

Highly eutrophic water bodies contain large reserves of P in the sediment and are likely to continue to release P for many years. For water bodies that contain higher than normal concentrations of FRP or deep water bodies, larger initial doses or larger yearly doses are suggested until there is an acceptable reduction in FRP. High concentrations of FRP from inflow sources or in flowing rivers will influence the maintenance treatment.

# Global Application of Phoslock

**UNITED KINGDOM**
**Drinking Water Reservoir**

**CANADA**
**River and Canal leading into Recreational Lake**


**GERMANY**
**Recreational Lake**

**SOUTH AFRICA**
**Hartebeespoort Dam**

**PERTH**
**Recreational Lake**

**POLAND**
**Recreational Lake**

**CHINA**
**River and Canal System in Major City**

**MALAYSIA & INDONESIA**
**Aquaculture**


**NORTH QLD**
**Prawn Farms**

**BRISBANE**
**Golf Course**

**SYDNEY**
**Drinking Water Reservoir**

**ADELAIDE**
**Torrens River**

**NEW ZEALAND**
**Rotorua Lakes**

# Major Licensees

## WESTERN EUROPE

PWS' licensee for Germany, Austria and Switzerland is Bentophos GmbH, a wholly owned subsidiary of the respected and privately run limnological institute, the Institut Dr Nowak (IDN).

IDN is based in Ottersberg in Northern Germany and was founded in 1972 by Dr Karl-Ernst Nowak, one of Germany's leading applied limnologists and a graduate of the well known Max-Planck-Institute for Limnology in Plön.

Over the past 35 years, the institute has grown from a small company specializing in environmental analysis into a major laboratory and environmental consultancy company employing 30 people, most of whom have post-graduate qualifications in fields such as analytical chemistry, hydro-biology, eco-toxicity and applied limnology. Seven of the institute's employees are currently engaged with Phoslock related work – either on a full-time or part-time basis.

The institute undertakes a range of environmental and limnological consultancy work for lake owners across Germany and offers a comprehensive range of water quality testing services for federal, state and local authorities. The institute is accredited under ISO 17025 and in recent years has become the reference laboratory in Germany for testing organo-tin compounds in harbour sediments.

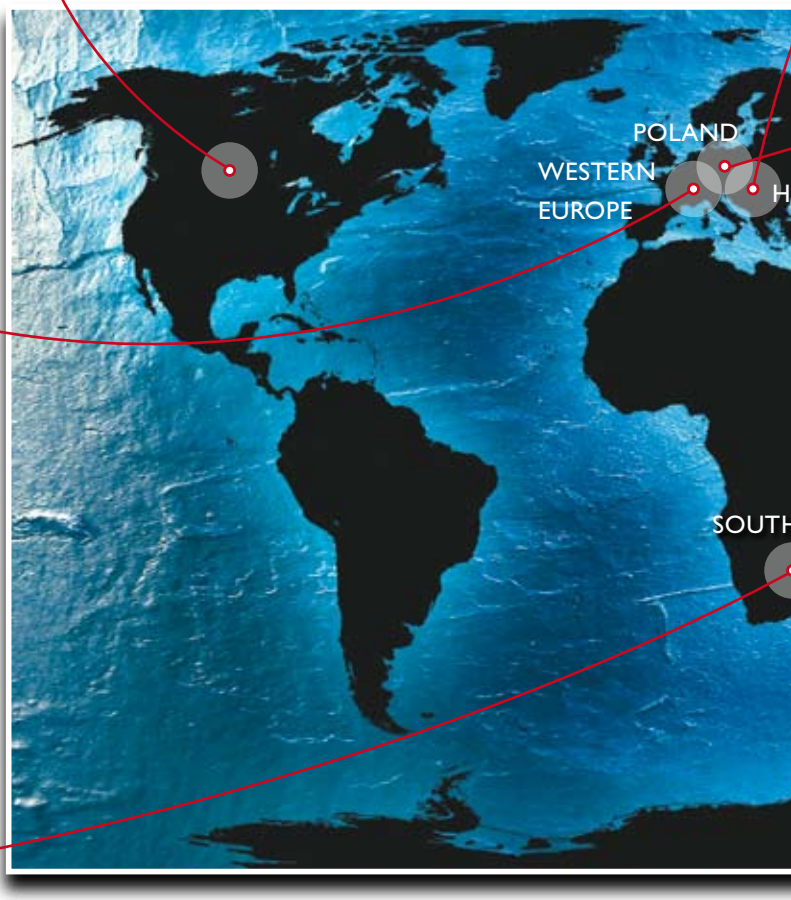
As a result of this expertise, cooperation between PWS and IDN has grown substantially during 2007. In February, PWS appointed IDN as its licensee for the Benelux countries (the Nethelands, Belgium and Luxembourg) and in June, the two companies signed a Technical Cooperation Agreement. Under this agreement, PWS is able to engage IDN to provide limnological consultancy services on a range of major projects outside of the territories for which IDN currently holds a license. Such consultancy services are already being provided by IDN to PWS on major potential projects in Europe.

## NORTH AMERICA

CETCO, is a subsidiary of AMCOL International, a NYSE listed company.

AMCOL is one of the world's largest producers and suppliers of bentonite products.

Cetco have had significant success focusing on lake restoration projects in Canada. They have identified and targeted a large number of heavily eutrophied water bodies in this area.




## SOUTH AFRICA

Phoslock Africa (Pty) Ltd is a joint venture between Phoslock Water Solutions and AGES South Africa (Africa Geo Environmental Services).

AGES is a leading environmental consulting company focusing on environmental management, rehabilitation and control throughout Africa with offices in the major urban centres of Southern Africa. AGES co-operate closely with mining groups and state departments in large scale environmental and water remediation projects.

AGES is part of the Touching Africa group comprising several engineering and development companies that have enabled AGES to increase the market sector exposure and project capacity of Phoslock.

Phoslock Africa has been the Phoslock licensee in Africa since February 2006. Through the University of Pretoria they have completed a major pilot project at Hartebeespoort dam with excellent results.

## HUNGARY

VINYL KFT (www.vinyl.hu/english) are a mid-sized specialist supplier of chemicals and environmental solutions to the water, chemicals, agricultural, plastics, pharmaceuticals and food industries. The company's headquarters are located in Miskolc and its production facilities in Budapest.

PWS awarded the Hungarian license to Vinyl in January 2007. Since obtaining the license, Vinyl has obtained an approval to undertake initial applications of Phoslock in Hungary and the company is now preparing a number of submissions for major lake restoration projects that are planned for Hungary over the coming year.


## POLAND


Ekol Ltd are a leading provider of solutions to the Polish water industry based in Gdansk. Ekol Ltd was founded shortly after the collapse of communism in Poland in 1988 by the environmental engineer and entrepreneur, Wojciech Falkowski, and over the past 20 years has been involved in the design and construction of wastewater treatment plants across the country.

Ekol Ltd has been the licensee for Phoslock in Poland since 2005 and has established a dedicated division with two full time employees for the marketing and sale of Phoslock. The company completed the treatment of the 22 ha Lake Klasztorne Male near Kartuzy in 2006 and is currently seeking to obtain EU funding to undertake several large-scale lake treatments in 2008.

## KOREA

GEOENVITECH (www.geoenvitech.com)

The license for Phoslock in Korea is held by Toyota Tsusho Australasia Pty Ltd, a subsidiary of Toyota Tsusho Japan and part of the Toyota Group. Toyota Tsusho Australasia sells Phoslock in Korea on an exclusive basis through GeoEnviTech, a Seoul based company which specializes in the supply of Phoslock to governmental and other organizations responsible for the management of Korea's water resources.

Since obtaining the license to sell Phoslock in Korea in July 2007, GeoEnviTech has undertaken a number of pilot applications, participated in Korea's largest environmental trade show and made an agreement for the inclusion of Phoslock in a governmental research project aimed at restoring wetlands.

## NEW ZEALAND

Primaxa was appointed in April 2004 as PWS licensee for Phoslock in New Zealand. Primaxa are controlled by Omnia Limited a large South African chemical and fertiliser company.

Primaxa is involved in a wide range of activities within the agriculture, forestry, horticulture, water treatment and viticulture industries – including manufacturing, trading, research and development, consulting and the provision of laboratory services.

Primaxa have recently completed a further application to Lake Okareka in Rotorua. Primaxa has worked with Environmental Bay of Plenty and PWS to progress the use of Phoslock in the remediation of the Rotorua lakes project in the north island of NZ.

# Directors' Report

Your directors present their report on the Company and its controlled entities for the financial year ended 30 June 2007.

## Directors

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

Dr David Garman

Mr Robert Schuitema

Mr Russell Brown

Mr Brett Crowley (retired 9/1/2007)

The Hon. Pam Allan (appointed 10/7/2007)

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 $4,349,332 (2006: ($3,640,320)).

## Dividends Paid or Recommended

No dividends have been paid or declared for payment in relation to the financial year ended 30 June 2007 (2006: $Nil).

## 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.

Phoslock Water Solutions (PWS) made significant progress during the year commercialising its core product, Phoslock. The 2007 financial year was the second full year in which Phoslock has been available for sale. By June 2007, PWS and its licensees had completed over 120 applications in 20 countries. A number of these projects were "firsts' for PWS. A portion of these applications were pilot projects for larger future projects.

Phoslock is still a relatively new product. The sales process for larger projects is very extensive and time consuming. Pilot projects are necessary to give prospective customers confidence that the product does what it is intended to. The results of the pilot projects have been extremely good and the results are giving customers the confidence to commit to larger projects. By year end PWS was very well positioned on 14 large future projects in nine different countries ranging from 100 tons to 6,000 tons. PWS's pipeline of future applications is approx 20,000 tons representing potential future sales in excess of A$50 million.

PWS's results for the 2007 financial year include significant marketing and licensee development costs, research & development (which is fully expensed each year), amortization costs associated with the Company's intellectual property portfolio and a large one-off termination payment for a senior employee. People costs represent approx 40% of total expenditure. PWS is building a business in which it expects to sell 20,000 – 30,000 tons per annum of Phoslock products on a sustainable basis. The up front costs of developing a global business are expected to be recouped quickly as the Phoslock business grows with more applications. Over the next 12 months, PWS is scheduled to undertake some major projects already in our pipeline. Success on these projects will be the catalyst to opening up these markets for a large number of future projects.

The number of large water bodies around the world experiencing blue green algae and other eutrophication problems is rising exponentially each year. Having established Phoslock as an accepted solution to blue green algae and eutrophication problems, the demand for Phoslock products is expected to be significant. At the same time, PWS is seeing more tangible government support to address these issues.

Major developments in the business segments are detailed below:

**Production:**
Phoslock is manufactured at the Company's 71% joint venture factory near Kunming, China. The current capacity for the plant is approx 7,000 tons per annum of Phoslock products. The plant is currently run on a campaign basis as short term demand is not sufficient to run the plant on a full time basis. The joint venture can ramp up production to meet larger orders at very short notice.

**Technical:**
Additional senior resources have been added to the technical function during the year. PWS's technical group is now located at its head office in northern Sydney. Major projects include improvements to the Phoslock production process, product QA and QWC, broadening the applicability of Phoslock to a wider range of applications, development of a new Phoslock Plus product, and evaluating new water treatment products.

The technical group has undertaken significant work on the effects of Phoslock post application and monitoring of algal species. The body of research on applications completed shows that Phoslock changes the Nitrogen/Phosphorus ratio in a water body leading to a change in algal species away from blue green varieties.

The technical group has spent considerable time and resources working with prawn growing companies to find the optimal timing and amount of Phoslock to apply into growing ponds. Results to date are very encouraging from work with the larger sophisticated prawn growing companies.

**Sales and Marketing:**
PWS markets Phoslock directly in Australia, United Kingdom, Ireland, China and several Mediterranean countries. Licensees are in place for New Zealand, United States, Canada, Germany, Nethelands, Belgium, Luxemburg, Switzerland, Austria, Poland, Hungary, Southern Africa, Indonesia, Malaysia, South Korea, Singapore and Taiwan. PWS is currently in discussions with potential licensees for Denmark, Romania, Israel, UAE and Japan.

Progress in each major market segment follows.

**Lake Restoration, Drinking Water Reservoirs & Dams**

Some of our licensees have made significant progress in the development of their Phoslock license. Our German licensee, whose license also covers Switzerland, Austria and Benelux, has developed a seven person organisation totally dedicated to the development of the Phoslock business. To date they have completed applications to three mid sized lakes and have built up a large future pipeline of projects. Our licensee has indicated that it expects to complete 4 and possibly up to 6 lake treatments between now and the end of the year totaling approx 120-150 tons. They are also providing technical resources for PWS for proposals for projects in other European countries.

In Europe (outside Germany) PWS has a large pipeline of potential applications in Poland, Nethelands and Italy. Some of these projects are expected to receive the official go-ahead in the coming months.

In the United Kingdom, PWS has established its own business. Over 30 small and medium sized applications were completed during the year. The highlight was the application to a drinking water reservoir managed by a leading UK water authority. The ongoing monitoring of this application will form an important reference site for PWS's future business in the UK. PWS is in discussions with a lake monitoring company to assist PWS with its business in the UK and Ireland.

Our North American licensee has had significant success focusing on lake restoration issues around the Great Lakes and southern Canada. They have identified and targeted a large number of heavily eutrophied water bodies in this area which are receiving government assistance to remedy its problems. Our licensee expects to undertake an application to a 25km canal in the coming months which flows into a large eutrophied lake.

In New Zealand, local authorities have announced details to spend NZ$120 million on Rotorua lakes restoration projects, including NZ$12 million allocated specifically for the use of Phoslock and a further NZ$32 million on other sediment treatments. Smaller amounts of Phoslock has been applied on three separate occasions to Lake Okareka. These applications have been designed to test Phoslock's phosphorus absorption capacity, sediment capping capability and effect on fish or biota in the lake.

In Australia PWS completed its two largest applications to date – a drinking water reservoir in southern NSW and part of the River Torrens next to Adelaide city. The results from both applications have been excellent. With the assistance of Total Eden in Western Australia, a number of small and mid-sized applications have also been completed in and around Perth. PWS has over 20 proposals with various water body managers around Australia for applications ranging from 10 tons to in excess of 1,000 tons.

## Aquaculture

PWS commenced trials using Phoslock in prawn ponds owned by small operators in Indonesia in late 2006. The results of these trials were very positive and lead to Phoslock being trialed by some of the largest prawn growing operators in Indonesia and Malaysia. Trial results to date look very encouraging. These trials are likely to continue until the end of 2007.

PWS is also working with prawn farms in Australia with new commercial trials about to begin when this season's growing cycle commences in October.

## Retail products

In 2006 PWS launched a range of retail products (1.25kg, 2.5kg and 5kg containers) which are sold on the internet and via a network of retail stores throughout Australia. The results to date have been mixed. Several of the larger retail chains, Total Eden in Western Australia and McCrackens in Queensland, NSW and Victoria have performed very well and uptiered sales to larger water bodies controlled by corporate and industrial clients. A number of the smaller retail stores located in water short areas have struggled to find a suitable market. As a result the retail network stock Phoslock retail products have been reduced from 75 stores to approx 45 stores.

*WaterSavr Applicator*

## WaterSavr

In late 2006 PWS was granted the license to sell the evaporation control product, WaterSavr to the large water body market in Australia. WaterSavr is US FDA approved for use on drinking water reservoirs and has had a number of independent studies completed on the products effectiveness. PWS took over the Australian license from another company who had undertaken several successful trials which demonstrated that WaterSavr saved an average of 31% of water from evaporation. PWS made a number of sales to medium sized water authorities in Victoria and southern NSW.

PWS currently has a number of large volume WaterSavr proposals with managers of large water storages in Victoria, NSW and Queensland. Decisions are expected shortly as customers are entering the peak evaporation period.

WaterSavr is an ideal add on product to PWS's product range as it is being marketed to the same water authorities who use Phoslock.

## Future Developments, Prospects and Business Strategies

To improve the economic entity's earnings performance and maximize shareholder value, the following developments are intended to be implemented:

i. Conversion of sales pipeline into near term sales. PWS has built up an extensive pipeline of potential sales around the world. Most of PWS and its licensees customers are governmental organizations. PWS has undertaken various pilot projects with potential customers to demonstrate the effectiveness of Phoslock. Customers generally have different internal processes to be completed before a purchase order is provided to PWS or its licensee. In many instances customers are currently progressing the Phoslock purchase, having been satisfied on technical issues, through its internal approval system.

ii. Increased targeted marketing by PWS and its licensees using results of past applications to demonstrate the effectiveness of the product. The current sales cycle for larger water bodies is 6-24 months. As more applications are completed it is expected that the sales cycle period will be significantly reduced.

iii. When demand justifies additional production capacity, PWS proposes to construct a second Phoslock manufacturing plant, most likely in China. A second plant will also mitigate the risks associated with a single production source.

iv. Continued focus on the aquaculture sector. The amount of aquaculture products coming from aquaculture ponds is increasing each year. Within these closed systems there is significant water quality problems which affect the health, size, and mortality rate of the species in the ponds. Work to date by PWS indicates that the environmental qualities of Phoslock add significant value to the yield from the ponds.

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

## Financial Position

The net assets of the economic entity have reduced by $383,560 from 30 June 2006 to $7,558,044 in 2007 with trading losses off setting capital raised by share issues and instalment proceeds from sale of the Bentonite mine.

During the past five 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 licensee 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 19th December 2006 the Company issued 12,800,000 ordinary shares at $0.23 each to raise $2,944,000 in additional working capital.

## 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, PWS imports Phoslock from its joint venture in China. Phoslock is certified by NICNAS through to 31 August 2008.

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. All bonuses and incentives are 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 boards 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.

## Information on Directors

| | |
|---|---|
| **Dr David Garman** | Chairman (Non-executive) |
| Qualifications | Ph D (Syd), M. Sc(Syd),B.Sc (Sp Hons) London, MAICD |
| Experience | Board member since 2001, Executive Director CRC for Waste Management Ltd and the Environmental Biotechnology CRC, President and Director of the 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. |
| **Mr Robert Schuitema** | Managing Director (Executive) |
| Qualifications | BCA, CA, NZSIA |
| Experience | Board member since April 2005, 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 | 2,430,000 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. |
| Directorships held in other listed entities | Director of Electro Optic Systems Holdings Limited (since 1 December 2006) |
| **Mr Russell Brown** | Director (Non-executive) |
| Qualifications | B App Sc (Agri), Post Grad International Marketing (UTS) |
| Experience | Board member since July 2005, 15 years in International Marketing of agricultural chemicals. |
| Interest in Shares and Options | 500,000 options to acquire ordinary shares in Phoslock Water Solutions Ltd. |
| Special Responsibilities | Mr Brown is a Member of the Audit Committee and Remuneration Committee. |
| **The Hon. Pam Allan** | Director (Non-executive) (Appointed 10/7/2007) |
| Qualifications | B Arts (Hons) Dip.Ed. University of Sydney, Fellow at the Graduate School of Environment, Macquarie University. |
| Experience | 18 years membership of the NSW Parliament including 5 years as Minister for the Environment. |

### Performance Based Remuneration

It is the intention of the PWS Board to institute a performance based share option scheme for all PWS executives and non-executive directors. The scheme will specifically target areas each executive/director has a direct involvement in and a level of control over. The key performance criteria will be linked to the achievement of sales targets for either the company as a whole, or, for specific sales executives, sales achievement in their area(s) of responsibility.

### Performance Income as a Proportion of Total Income

Directors and specified executives remuneration for the year did not include any performance based components. No director or executive was paid a performance based bonus during the year.

### Options Issued as part of Remuneration for the Year Ended 30 June 2007.

In January, 2007, 2,000,000 performance based options were granted to the Company's new Chief Operating Officer, Mr Eddie Edmunds as part of his 2007 & 2008 salary package in order to secure and retain an employee of the calibre and experience of Mr Edmunds. Issue of the options is linked to achievement of company sales targets.

### Employment Contracts of Directors and Senior Executives

The employment conditions of the Managing Director and executives are formalised in contracts of employment. Other than the Managing Director all executives are permanent employees of Phoslock Water Solutions Ltd. The Managing Director's contract expires on 30 November 2007 and is currently being extended.

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.

| | Options Granted as Part of Remuneration | Total Remuneration Represented by Options | Options Exercised | Options Lapsed | Total |
|---|---|---|---|---|---|
| | $ | % | $ | $ | $ |
| Mr Eddie Edmunds | 106,716 | 48 | – | – | 106,716 |

No options which were granted as part of key executive remuneration lapsed during the year.

### Shares Issued on Exercise of Compensation Options

Options exercised during the year that were granted as compensation in prior periods.

| | No of Ordinary Shares Issued | Amount paid per share | Amount unpaid per share |
|---|---|---|---|
| **Key Management Personnel** | | | |
| Brett Crowley | 1,000,000 | $0.227 | $0.00 |
| Brett Crowley | 2,500,000 | $0.20 | $0.00 |
| Colin Upcroft | 10,000 | $0.20 | $0.00 |
| | 3,510,000 | | |

## Key Management Personnel Remuneration

| | Short-term Employee Benefits | | Post Employment Benefits | Share-based Payments | Long Term Benefits | Total |
|---|---|---|---|---|---|---|
| 2007 | Salary, Fees and Commissions $ | Other $ | Superannuation $ | Options $ | Other $ | $ |
| **Directors** | | | | | | |
| Mr Robert Schuitema | 205,000 | 20,000 | 20,500 | - | - | 245,500 |
| Mr Brett Crowley | 423,842 | 10,416 | 15,907 | - | - | 450,165 |
| Dr David Garman | 60,000 | - | 3,750 | - | - | 63,750 |
| Mr Russell Brown | 45,000 | - | - | - | - | 45,000 |
| | 733,842 | 30,416 | 40,157 | - | - | 804,415 |
| **Specified Executives** | | | | | | |
| Mr Colin Upcroft | 142,500 | 12,500 | 14,100 | - | - | 169,100 |
| Mr Nigel Traill | 100,000 | 60,000 | 9,000 | - | - | 169,000 |
| Mr Eddie Edmunds | 90,443 | 9,445 | 15,393 | 106,716 | - | 221,997 |
| Mr Andrew Winks | 61,948 | - | 4,422 | - | - | 66,370 |
| | 394,891 | 81,945 | 42,915 | 106,716 | - | 626,467 |
| Total | 1,128,733 | 112,361 | 83,072 | 106,716 | - | 1,430,882 |

| 2006 | Salary, Fees and Commissions $ | Other $ | Superannuation $ | Options $ | Other $ | $ |
|---|---|---|---|---|---|---|
| **Directors** | | | | | | |
| Mr Robert Schuitema | 142,500 | 7,500 | 14,024 | 130,401 | - | 294,425 |
| Mr Brett Crowley | 245,000 | 20,000 | 23,450 | 117,400 | - | 405,850 |
| Dr David Garman | 45,000 | - | - | 13,001 | - | 58,001 |
| Mr Russell Brown | 45,000 | - | - | 13,001 | - | 58,001 |
| | 477,500 | 27,500 | 37,474 | 273,803 | - | 816,277 |
| **Specified Executives** | | | | | | |
| Mr Colin Upcroft | 120,000 | 12,801 | 11,700 | 26,002 | - | 170,503 |
| Mr Nigel Traill | 97,500 | - | 8,775 | 26,002 | - | 132,277 |
| Mr Andrew Winks | 82,819 | 13,758 | 6,300 | 39,003 | - | 141,880 |
| | 300,319 | 26,559 | 26,775 | 91,007 | - | 444,660 |
| Total | 777,819 | 54,059 | 64,249 | 364,810 | - | 1,260,937 |

## Meetings of Directors

During the financial year, 13 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 | 11 | 11 | 1 | 1 | 1 | 1 |
| Mr Brett Crowley | 7 | 7 | 1 | 1 | 1 | 1 |
| Dr David Garman | 11 | 11 | 1 | 1 | 1 | 1 |
| Mr Russell Brown | 11 | 11 | 1 | 1 | 1 | 1 |

## 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 |
|---|---|
| **Key Management Person** | |
| Mr Eddie Edmunds | 2,350,000 |

350,000 of these options have an exercise price of $0.20 and were granted on 15 August 2006 and the balance with exercise prices ranging from $0.50 to $0.60 granted on 10 January 2007.

350,000 of these options have already vested, with 1,000,000 vesting on 31 December 2007 and the balance on 31 December 2008.

350,000 of these options expire on 31 December 2008 with 1,000,000 expiring on 30 June 2009 and the balance on 30 June 2010.

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 | 1,700,000 |
| 10 June 2005 | 30 June 2008 | $0.20 | 2,490,000 |
| 10 June 2005 | 30 November 2008 | $0.20 | 1,000,000 |
| 10 August 2005 | 10 August 2010 | $0.22 | 2,997,913 |
| 24 November 2005 | 30 November 2008 | $0.20 | 5,000,000 |
| 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 | 400,000 |
| 31 May 2006 | 30 June 2008 | $0.20 | 100,000 |
| 31 May 2006 | 30 June 2009 | $0.20 | 100,000 |
| 15 August 2006 | 31 December 2008 | $0.20 | 150,000 |
| 15 August 2006 | 31 December 2008 | $0.20 | 350,000 |
| 19 December 2006 | 30 November 2007 | $0.23 | 500,000 |
| 10 January 2007 | 30 June 2009 | $0.50 | 1,150,000 |
| 10 January 2007 | 30 June 2010 | $0.60 | 1,000,000 |
| 31 May 2007 | 31 December 2009 | $0.50 | 100,000 |
| 31 May 2007 | 31 December 2010 | $0.50 | 100,000 |
| 23 June 2007 | 31 December 2009 | $0.50 | 50,000 |

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 5.

## 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 totalling $42,220 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. No indemnities nor agreements to indemnify exist in relation to the Company's auditor.

## 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

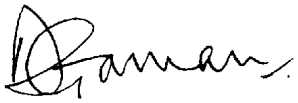
No non-audit services were provided to the Company by the Company's auditors during the reporting period.

## Auditor's Independence Declaration

The lead auditor's independence declaration in accordance with Section 307C of the Corporations Act 2001, for the year ended 30 June 2007 has been received and can be found on page 8 of the directors' report.

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

**Mr Robert Schuitema – Managing Director**



**Dr David Garman – Chairman of Directors**

Dated this 21 day of September 2007

# Auditor's Independence Declaration

## Under Section 307C of the Corporations Act 2001

William Buck
Business Advisors
Chartered Accountants

**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 2007 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 24th September 2007.

William Buck

WILLIAM BUCK
Chartered Accountants

D W Landon
Partner


*Adelaide – Australia*

# 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.

*Remote controlled Phoslock applicator*

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 2007 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 consider it necessary to have a separate nominations committee. The board as a whole fulfills this function.

The Board currently comprises 4 directors: 3 independent non-executive directors including the Chairman, and one executive director being the Managing Director.

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 is not present at the Board 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 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 available 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

*Drinking Water Reservoir – Melbourne*

- Investor information through the companies internet portal at www.phoslock.com.au.

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 Managing Director is excluded from this provision in accordance with Clause 22.5 of the Company's Constitution.

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.

## Risk Management

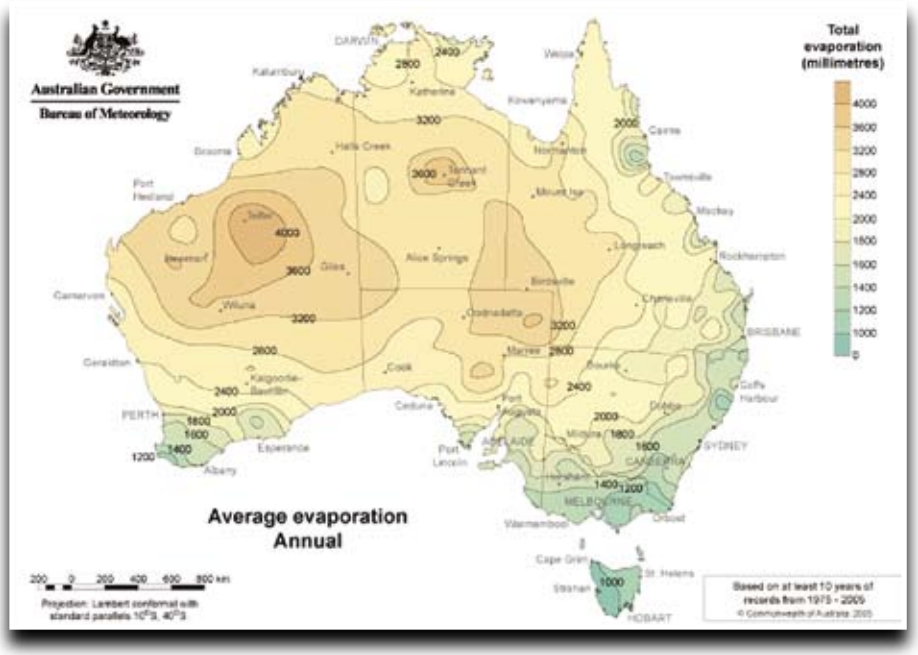
The company's Board is responsible for overseeing the risk management function. The company believes that it is crucial for all board members to be a part of the process and as such has not established a separate risk management committee.

The Board ensures that 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




*Australian Evaporation Rates*

## 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 2007 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 2007 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 2007 Annual Report.

Phoslock Water Solutions Limited and Controlled Entities

ABN 88 099 555 290

## Income Statement for the period ended 30 June 2007

| | | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | Note | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| Sales Revenue | 2 | 1,033,040 | 765,139 | - | - |
| Cost of Sales | | (590,849) | (438,253) | - | - |
| Gross Profit | | 442,191 | 326,886 | - | - |
| Other income | 2 | 91,632 | 568,988 | - | - |
| Distribution expenses | | (80,446) | (38,086) | - | - |
| Marketing expenses | | (575,556) | (270,636) | - | - |
| Occupancy expenses | | (221,437) | (187,951) | - | - |
| Administrative expenses | | (1,353,048) | (1,004,126) | (100) | (4) |
| Employee benefits expense | | (2,093,772) | (1,547,467) | - | - |
| Depreciation and amortisation | | (423,906) | (531,858) | (110,100) | (52,758) |
| Loss on sale of plant and equipment | | - | (596,455) | - | - |
| Other expenses | | (143,190) | (362,328) | - | - |
| Finance Costs | | (3,429) | - | - | - |
| Share of net loss of associates | | (11,276) | - | - | - |
| Loss before income tax | 3 | (4,374,075) | (3,643,033) | (110,200) | (52,762) |
| Income tax expense | 4 | - | - | - | - |
| Loss for the year | | (4,374,075) | (3,643,033) | (110,200) | (52,762) |
| Loss attributable to minority equity interest | | 24,743 | 2,713 | - | - |
| Loss attributable to members of the parent entity | | (4,349,332) | (3,640,320) | (110,200) | (52,762) |
| | | | | | |
| Overall Operations | | | | | |
| Basic earnings per share (cents per share) | 7 | (3.13) | (3.10) | | |
| Diluted earnings per share (cents per share) | 7 | (3.08) | (3.10) | | |

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 2007

| | Note | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| **CURRENT ASSETS** | | | | | |
| Cash and cash equivalents | 8 | 2,176,819 | 2,077,697 | 5,243 | 5,343 |
| Trade and other receivables | 9 | 283,811 | 985,149 | - | - |
| Inventories | 10 | 1,245,289 | 960,127 | - | - |
| Other current assets | 17 | 71,358 | 55,862 | - | - |
| TOTAL CURRENT ASSETS | | 3,777,277 | 4,078,835 | 5,243 | 5,343 |
| **NON-CURRENT ASSETS** | | | | | |
| Trade and other receivables | 9 | 400,000 | 400,000 | 15,442,843 | 11,376,124 |
| Investments accounted for using the equity method | 11 | 34,941 | - | - | - |
| Financial assets | 13 | - | - | 4,647,929 | 4,647,929 |
| Property, plant and equipment | 15 | 843,552 | 903,002 | - | - |
| Intangible assets | 16 | 3,411,338 | 3,590,862 | 1,103,356 | 1,213,456 |
| TOTAL NON-CURRENT ASSETS | | 4,689,831 | 4,893,864 | 21,194,128 | 17,237,509 |
| TOTAL ASSETS | | 8,467,108 | 8,972,699 | 21,199,371 | 17,242,852 |
| **CURRENT LIABILITIES** | | | | | |
| Trade and other payables | 18 | 772,341 | 866,665 | - | - |
| Short-term borrowings | 19 | 3,844 | - | - | - |
| Short-term provisions | 20 | 100,182 | 132,373 | - | - |
| TOTAL CURRENT LIABILITIES | | 876,367 | 999,038 | - | - |
| **NON-CURRENT LIABILITIES** | | | | | |
| Other long-term provisions | 20 | 32,697 | 32,057 | - | - |
| TOTAL NON-CURRENT LIABILITIES | | 32,697 | 32,057 | - | - |
| TOTAL LIABILITIES | | 909,064 | 1,031,095 | - | - |
| NET ASSETS | | 7,558,044 | 7,941,604 | 21,199,371 | 17,242,852 |
| **EQUITY** | | | | | |
| Issued capital | 21 | 24,458,037 | 20,572,379 | 24,458,037 | 20,572,379 |
| Reserves | | 864,592 | 745,652 | 913,625 | 732,564 |
| Accumulated losses | | (17,916,916) | (13,567,584) | (4,172,291) | (4,062,091) |
| Parent interest | | 7,405,713 | 7,750,447 | 21,199,371 | 17,242,852 |
| Minority equity interest | | 152,331 | 191,157 | - | - |
| TOTAL EQUITY | | 7,558,044 | 7,941,604 | 21,199,371 | 17,242,852 |

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 2007

| Consolidated Group | Issued Share Capital | Accumulated Losses | Foreign Currency Translation Reserve | Option Reserve | Minority Equity Interests | Total |
|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ |
| **Balance at 1 July 2005** | 16,773,215 | (9,927,264) | (5,369) | 301,434 | 178,698 | 7,320,714 |
| Loss attributable to members of parent entity | - | (3,640,320) | - | - | - | (3,640,320) |
| Loss attributable to minority shareholders | - | - | - | - | (2,713) | (2,713) |
| Shares Issued during the year | 3,885,318 | - | - | - | - | 3,885,318 |
| Transaction costs | (86,154) | - | - | - | - | (86,154) |
| Adjustments from translation of foreign controlled entities | - | - | 18,457 | - | 15,172 | 33,629 |
| 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 | (13,567,584) | 13,088 | 732,564 | 191,157 | 7,941,604 |
| Shares issued during the year | 4,033,500 | - | - | - | - | 4,033,500 |
| Transaction costs | (147,842) | - | - | - | - | (147,842) |
| Losses attributable to members of parent entity | - | (4,349,332) | - | - | - | (4,349,332) |
| Losses attributable to minority shareholders | - | - | - | - | (24,743) | (24,743) |
| Adjustments from translation of foreign controlled entities | - | - | (62,121) | | (14,083) | (76,204) |
| Option reserve on recognition of employee options expense | - | - | - | 122,714 | - | 122,714 |
| Option reserve on recognition of other issue of options | - | - | - | 58,347 | - | 58,347 |
| **Balance at 30 June 2007** | 24,458,037 | (17,916,916) | (49,033) | 913,625 | 152,331 | 7,558,044 |

| Parent Entity | Issued Share Capital | Accumulated Losses | Foreign Currency Translation Reserve | Option Reserve | Minority Equity Interests | Total |
|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ |
| **Balance at 1 July 2005** | 16,773,215 | (4,009,329) | - | 301,434 | - | 13,065,320 |
| Losses attributable to members of parent entity | - | (52,762) | - | - | - | (52,762) |
| 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 isue of options | - | - | - | 110,122 | - | 110,122 |
| **Balance at 30 June 2006** | 20,572,379 | (4,062,091) | - | 732,564 | - | 17,242,852 |
| Losses attributable to members of parent entity | - | (110,200) | - | - | - | (110,200) |
| Shares issued during the year | 4,033,500 | - | - | - | - | 4,033,500 |
| Transaction costs | (147,842) | - | - | - | - | (147,842) |
| Option reserve on recognition of employee options expense | - | - | - | 122,714 | - | 122,714 |
| Option reserve on recognition of other issue of options | - | - | - | 58,347 | - | 58,347 |
| **Balance at 30 June 2007** | 24,458,037 | (4,172,291) | - | 913,625 | - | 21,199,371 |

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 2007

| | Note | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | | | |
| Receipts from customers | | 1,395,116 | 510,204 | - | - |
| Interest received | | 87,785 | 27,044 | - | - |
| Payments to suppliers and employees | | (5,219,031) | (3,481,416) | (100) | (4) |
| Other Income | | - | 86,713 | | |
| Finance costs | | (4,087) | - | - | - |
| Net cash provided by (used in) operating activities | 25(a) | (3,740,217) | (2,857,455) | (100) | (4) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | | | |
| Proceeds from sale of property, plant and equipment | | 387,255 | 1,597,366 | - | - |
| Proceeds from sale of investments | | - | 489,785 | - | - |
| Purchase of property, plant and equipment | | (261,705) | (459,089) | - | - |
| Purchase of investments | | - | - | - | (2) |
| Purchase of other non-current assets | | (146,438) | (581,459) | - | (470,000) |
| Payment for subsidiary, net of cash acquired | | - | (50,713) | - | (50,713) |
| Net cash provided by (used in) investing activities | | (20,888) | 995,890 | - | (520,715) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | | | |
| Proceeds from issue of shares | | 4,033,500 | 2,365,237 | 4,033,500 | 2,365,237 |
| Repayment of borrowings | | - | - | (3,888,194) | (1,749,662) |
| Capital raising costs | | (145,306) | (89,513) | (145,306) | (89,513) |
| Net cash provided by (used in) financing activities | | 3,888,194 | 2,275,724 | - | 526,062 |
| Net increase (decrease) in cash held | | 127,089 | 414,159 | (100) | 5,343 |
| Cash at beginning of financial year | | 2,077,697 | 1,631,192 | 5,343 | - |
| Effect of exchange rates on cash holdings in foreign currencies | | (31,811) | 32,346 | - | - |
| Cash at end of financial year | 8 | 2,172,975 | 2,077,697 | 5,243 | 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, including Australian Accounting Interpretations, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

The financial report covers the consolidated group 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 complies with all International Financial Reporting Standards (IFRS) in their entirety.

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

### Basis of Preparation

The accounting policies set out below have been consistently applied to all years presented.

*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.

All inter-company balances and transactions between entities in the consolidated group, 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 consolidated group 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 consolidated group 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 assets 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.

The cost of fixed assets constructed within the consolidated group 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 is depreciated on a written down value basis over their useful lives to the consolidated group commencing from the time the asset is held ready for use.

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 that are transferred to entities in the consolidated group 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.

### 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. Derivatives are also categorised as held for trading unless they are designated as hedges. 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.

**Fair value**

Fair value is determined based on current bid prices for all quoted investments. Valuation techniques are applied to determine the fair value for all unlisted securities, including recent arms length transactions, reference to similar instruments and option pricing models.

**Impairment**

At each reporting date, the group assess whether there is objective evidence that a financial instrument has been impaired. In the case of available-for sale financial instruments, a prolonged decline in the value of the instrument is considered to determine whether an impairment has arisen. Impairment losses are recognised in the income statement.

## 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 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 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 is 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 shares 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, deposits held at call with banks and bank overdrafts. Bank overdrafts are shown within short-term borrowings in current liabilities on the balance sheet.

**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.

No provision for impairment of goodwill or intangibles was recognised during the year.

## Note 2 Revenue

| | Note | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| Sales Revenue | | | | | |
| — sale of goods | | 1,033,040 | 765,139 | - | - |
| **Total Sales Revenue** | | 1,033,040 | 765,139 | - | - |
| Other Revenue | | | | | |
| — interest received | 2(a) | 87,931 | 25,749 | - | - |
| — royalties | | 25 | 54,815 | - | - |
| Other Income | 2(b) | 1,838 | 488,424 | - | - |
| **Total Other Revenues** | | 89,794 | 568,988 | - | - |
| **Total Sales Revenue and Other Revenue** | | 1,122,834 | 1,334,127 | - | - |
| (a) Interest revenue from: | | | | | |
| — other persons | | 87,931 | 25,749 | - | - |
| (b) Other Income | | | | | |
| — gain on disposal of property, plant and equipment | | 1,466 | - | - | - |
| — gains on disposal of non-current investments | | - | 488,424 | - | - |
| — other income | | 372 | - | - | - |
| **Total Other Income** | | 1,838 | 488,424 | - | - |

## Note 3 Profit/(Loss) before Income Tax for the Year

| | Note | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| (a) Expenses | | | | | |
| Cost of sales | | 590,849 | 438,253 | - | - |
| Finance costs: | | | | | |
| — Other persons | | 3,429 | - | - | - |
| Impairment of non-current investments to recoverable amount | | - | 342,584 | - | - |
| Foreign currency translation losses | | 12,717 | - | - | - |
| Bad and doubtful debts: | | | | | |
| — trade receivables | | 8,234 | 4,000 | - | - |
| Rental expense on operating leases | | | | | |
| — minimum lease payments | | 221,437 | 187,951 | - | - |
| Gain on disposal of property, plant and equipment | | 1,466 | - | - | - |
| Depreciation of property plant and equipment | | 119,806 | 59,255 | - | - |
| Amortisation of non-current assets | | | | | |
| — bentonite mine | | - | 206,757 | - | - |
| — research and development expenditure | | 7,000 | 6,839 | - | - |
| — Phoslock licence, patents and trademarks | | 319,567 | 259,007 | 110,100 | 52,758 |
| Total amortisation | | 326,567 | 472,603 | 110,100 | 52,758 |
| Research and development costs | | - | 212,801 | - | - |
| Write-down of inventories to net realisable value | | - | 20,621 | - | - |
| (b) Significant Revenue and Expenses | | | | | |
| The following significant revenue and expense items are relevant in explaining the financial performance: | | | | | |
| Sale of Bentonite Mining Tenements | | | | | |
| Consideration on disposal | | - | 2,471,326 | - | - |
| Carrying amount of net assets sold | | - | 3,066,534 | - | - |
| Net loss on disposal | | - | (595,208) | - | - |
| Sale of Puda Share Investment | | | | | |
| Consideration on disposal | | - | 489,523 | - | - |
| Carrying amount of net assets sold | | - | 1,099 | - | - |
| Net gain on disposal | | - | 488,424 | - | - |

## Note 4 Income Tax Expense

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| (a) Prima facie tax payable on loss before income tax at 30% (2006: 30%) | | | | |
| — consolidated group | (1,312,222) | (1,092,910) | | |
| — parent entity | | | (33,060) | (15,829) |
| Add: | | | | |
| Tax effect of: | | | | |
| — non-deductible depreciation and amortisation | 89,130 | 134,026 | 33,030 | 15,828 |
| — other non-allowable items | 3,128 | 959 | - | - |
| — write-downs to recoverable amounts | - | 102,775 | - | - |
| — share options expensed during year | 35,651 | 96,302 | - | - |
| — other items | - | 38,129 | - | - |
| — DTA'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 | 1,199,950 | 740,323 | 30 | 20,609 |
| | 15,637 | 19,604 | - | 20,608 |
| Less: | | | | |
| Tax effect of: | | | | |
| — share of net profits of associates and joint venture entities netted directly | (3,383) | - | - | - |
| — other tax concessions & deductible amounts | 19,020 | 19,604 | - | 20,608 |
| Income tax attributable to entity | - | - | - | - |
| (b) Potential future income tax benefits attributable to tax losses carried forward not brought to account | 4,398,469 | 3,256,534 | 145,087 | 145,057 |

## Note 5 Key Management Personnel Compensation

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

| **Key Management Person** | **Position** |
|---|---|
| Dr David Garman | Chairman - Non Executive |
| Mr Robert Schuitema | Managing Director |
| Mr Russell Brown | Director - Non Executive |
| Mr Brett Crowley (Retired 9/1/2007) | Managing Director |
| Mr Colin Upcroft | Chief Financial Officer and Company Secretary |
| Mr Nigel Traill | Regional Manager Europe, Africa and The Middle East |
| Mr Eddie Edmunds | Chief Operating Officer |
| Mr Andrew Winks | Group Operations Manager |

(b) Options and Rights Holdings

Number of Options Held by Key Management Personnel

| | Balance 1.07.2006 | Granted as Compensation | Options Exercised* | Net Change Other* | Balance 30.06.2007 | Total Vested 30.06.2007 | Total Vested & Exercisable 30.06.2007 | TotalVested & Unexercisable 30.06.2007 |
|---|---|---|---|---|---|---|---|---|
| **2007** | | | | | | | | |
| Dr David Garman | 900,000 | - | - | - | 900,000 | 900,000 | 900,000 | - |
| Mr Robert Schuitema | 7,000,000 | - | - | - | 7,000,000 | 5,000,000 | 5,000,000 | - |
| Mr Russell Brown | 500,000 | - | - | - | 500,000 | 500,000 | 500,000 | - |
| Mr Brett Crowley (Retired 9/1/2007) | 7,500,000 | - | 3,500,000 | - | 4,000,000 | 4,000,000 | 4,000,000 | - |
| Mr Colin Upcroft | 1,500,000 | - | 10,000 | - | 1,490,000 | 1,490,000 | 1,490,000 | - |
| Mr Nigel Traill | 1,800,000 | - | - | - | 1,800,000 | 1,800,000 | 1,800,000 | - |
| Mr Eddie Edmunds | - | 2,350,000 | - | - | 2,350,000 | 350,000 | 350,000 | - |
| Mr Andrew Winks | 1,500,000 | - | - | - | 1,500,000 | 1,500,000 | 1,500,000 | - |
| | 20,700,000 | 2,350,000 | 3,510,000 | - | 19,540,000 | 15,540,000 | 15,540,000 | - |

The net change other column above includes those options that have been forfeited by holders as well as options issued during the year under review.

(c) Shareholdings

Number of Shares held by Key Management Personnel

| | Balance 1.07.2006 | Received as Compensation | Options Exercised | Net Change Other* | Balance 30.06.2007 |
|---|---|---|---|---|---|
| **2007** | | | | | |
| **Key Management Personnel** | | - | - | | |
| Dr David Garman | 400,000 | - | - | - | 400,000 |
| Mr Robert Schuitema | 2,400,000 | - | - | - | 2,400,000 |
| Mr Russell Brown | - | - | - | - | - |
| Mr Brett Crowley (Retired 9/1/2007) | 459,000 | - | 3,500,000 | 3,959,000 | - |
| Mr Colin Upcroft | - | - | 10,000 | - | 10,000 |
| Mr Nigel Traill | 2,300,529 | - | - | - | 2,300,529 |
| Mr Eddie Edmunds | - | - | - | - | - |
| Mr Andrew Winks | - | - | | - | - |
| | 5,559,529 | - | 3,510,000 | 3,959,000 | 5,110,529 |

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

## Note 6 Auditors' Remuneration

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| Remuneration of the auditor of the parent entity for: | | | | |
| — auditing or reviewing the financial report | 53,675 | 25,474 | - | - |
| Remuneration of other auditors of subsidiaries for: | | | | |
| — auditing or reviewing the financial report of subsidiaries | 7,492 | 3,148 | - | - |

## Note 7 Earnings per Share

| | | Consolidated Group | |
|---|---|---|---|
| | | **2007** | 2006 |
| | | **$** | $ |
| (a) | Reconciliation of earnings to profit or loss | | |
| | Profit / (Loss) | (4,374,075) | (3,643,033) |
| | Profit / (Loss) attributable to minority equity interest | 24,743 | 2,713 |
| | Earnings used to calculate basic EPS | (4,349,332) | (3,640,320) |
| | Earnings used in the calculation of dilutive EPS | (4,349,332) | (3,640,320) |
| (b) | Reconciliation of earnings to profit or loss from continuing operations | | |
| | Profit / (Loss) from continuing operations | (4,374,075) | (3,643,033) |
| | Profit / (Loss) attributable to minority equity interest in respect of continuing operations | 24,743 | 2,713 |
| | Earnings used to calculate basic EPS from continuing operations | (4,349,332) | (3,640,320) |
| | Earnings used in the calculation of dilutive EPS from continuing operations | (4,349,332) | (3,640,320) |
| | | No. | No. |
| (c) | Weighted average number of ordinary shares outstanding during the year used in calculating basic EPS | 138,962,332 | 117,260,231 |
| | Weighted average number of options outstanding | 2,200,000 | - |
| | Weighted average number of ordinary shares outstanding during the year used in calculating dilutive EPS | 141,162,332 | 117,260,231 |

(d) Classification of securities

26,237,913 of the 28,437,913 options remaining unconverted at year-end are not included in basic and 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 8 Cash and Cash Equivalents

| | | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | Note | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| Cash at bank and in hand | | 2,080,697 | 2,013,120 | 5,243 | 5,343 |
| Short-term bank deposits | | 96,122 | 64,577 | - | - |
| | | 2,176,819 | 2,077,697 | 5,243 | 5,343 |

The effective interest rate on short-term bank deposits was 5.5% (2006: 5.5%); 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 | | 2,176,819 | 2,077,697 | 5,243 | 5,343 |
| Bank overdrafts | 19 | (3,844) | - | - | - |
| | | 2,172,975 | 2,077,697 | 5,243 | 5,343 |

## Note 9 Trade and Other Receivables

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| CURRENT | | | | |
| Trade receivables | 89,736 | 397,221 | - | - |
| Provision for impairment of receivables | (8,000) | (8,000) | - | - |
| | 81,736 | 389,221 | - | - |
| Other receivables | 202,075 | 595,928 | - | - |
| | 283,811 | 985,149 | - | - |
| NON-CURRENT | | | | |
| Other receivables | 400,000 | 400,000 | - | - |
| Amounts receivable from: | | | | |
| — wholly-owned entities | - | - | 15,442,843 | 11,376,124 |
| | 400,000 | 400,000 | 15,442,843 | 11,376,124 |

## Note 10 Inventories

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| CURRENT | | | | |
| At cost | | | | |
| Raw materials and stores | 100,453 | 122,502 | - | - |
| Finished goods | 1,144,836 | 837,625 | - | - |
| | 1,245,289 | 960,127 | - | - |

## Note 11 Investments Accounted for Using the Equity Method

| | | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| Associated companies | 12(a) | 34,941 | - | - | - |
| | | 34,941 | - | - | - |

## Note 12 Associated Companies

Interests are held in the following associated companies

| Name | Principal Activities | Country of Incorporation | Shares | Ownership Interest | | Carrying Amount of Investment | |
|---|---|---|---|---|---|---|---|
| | | | | **2007** | 2006 | **2007** | 2006 |
| | | | | **$** | $ | **$** | $ |
| Unlisted: | | | | | | | |
| Phoslock Africa Pty Ltd | Phoslock sales | South Africa | Ord | 50 | - | 34,491 | - |
| | | | | | | 34,491 | - |

(a) Movements during the Year in Equity Accounted Investments in Associated Companies

| | | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | Note | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| Balance at beginning of the financial year | | - | - | - | - |
| Add: New investments during the year | | 46,217 | - | - | - |
| Share of associated Company's loss after income tax | 12(b) | (11,276) | - | - | - |
| Balance at end of the financial year | | 34,941 | - | - | - |

(b) Equity accounted profits of associates are broken down as follows:

| | | | | |
|---|---|---|---|---|
| Share of associate's loss before income tax expense | (11,276) | - | - | - |
| Share of associate's income tax expense | - | - | - | - |
| Share of associate's loss after income tax | (11,276) | - | - | - |

(c) Summarised Presentation of Aggregate Assets, Liabilities and Performance of Associates

| | | | | |
|---|---|---|---|---|
| Current assets | 76,248 | - | - | - |
| Non-current assets | - | | - | - |
| Total assets | 76,248 | - | - | - |
| Current liabilities | 6,365 | - | - | - |
| Non-current liabilities | - | - | - | - |
| Total liabilities | 6,365 | - | - | - |
| Net assets | 69,883 | - | - | - |
| Revenues | - | - | - | - |
| Profit / (Loss) after income tax of associates | (22,553) | - | - | - |

(d) Ownership interest in Phoslock Africa Pty Ltd at that Company's balance date was 50% of ordinary shares. The reporting date of Phoslock Africa Pty Ltd is 28 February.

## Note 13 Financial Assets

| | | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| NON CURRENT | | | | | |
| Available-for-sale financial assets | 13(a) | - | - | 4,647,929 | 4,647,929 |
| | | - | - | 4,647,929 | 4,647,929 |

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

| | | | | | |
|---|---|---|---|---|---|
| NON CURRENT | | | | | |
| Unlisted investments, at cost | | | | | |
| — shares in controlled entities | | - | - | 4,647,929 | 4,647,929 |
| Total non-current available-for-sale financial assets | | - | - | 4,647,929 | 4,647,929 |

Available-for-sale financial assets comprise investments in the ordinary issued capital of various entities. There are no fixed returns or fixed maturity date attached to these investments.

## Note 14 Controlled Entities

(a) Controlled Entities Consolidated

| | Country of Incorporation | Percentage Owned (%)* | |
|---|---|---|---|
| **Parent Entity:** | | 2007 | 2006 |
| Phoslock Water Solutions Limited | Australia | | |
| **Subsidiaries of Phoslock Water Solutions Limited:** | | | |
| Phoslock Pty Ltd | Australia | 100 | 100 |
| Yunnan Jinxingyan Environmental Conservational Consultative Co Ltd | China | 100 | 100 |
| IETC Environmental Protection Technology (Kunming) Ltd | China | 71 | 71 |
| Phoslock Water Solutions UK (Co) Ltd | UK | 100 | 100 |
| Phoslock Technologies Pty Ltd | Australia | 100 | 100 |
| **Subsidiaries of Phoslock Pty Ltd:** | | | |
| Purezza Marketing Inc | USA | 100 | 100 |

## Note 15 Property, Plant and Equipment

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| PLANT AND EQUIPMENT | | | | |
| Plant and equipment: | | | | |
| At cost | 1,235,128 | 1,071,483 | - | - |
| Accumulated depreciation | (345,749) | (168,481) | - | - |
| Exchange differences | (45,827) | - | | |
| Total plant and equipment | 843,552 | 903,002 | - | - |

(a) Movements in Carrying Amounts

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

| | Plant and Equipment | Total |
|---|---|---|
| | $ | $ |
| **Economic Entity:** | | |
| Balance at 30 June 2006 | 903,002 | 903,002 |
| Additions | 226,001 | 226,001 |
| Disposals | (55,368) | (55,368) |
| Depreciation expense | (184,256) | (184,256) |
| Exchange differences | (45,827) | (45,827) |
| Balance at 30 June 2007 | 843,552 | 843,552 |

## Note 16 Intangible Assets

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| Goodwill | | | | |
| Cost | 401,977 | 401,977 | - | - |
| Accumulated impairment losses | (342,584) | (342,584) | - | - |
| Net carrying value | 59,393 | 59,393 | - | - |
| Phoslock patents, trademarks and licences | | | | |
| Cost | 4,050,806 | 3,906,314 | 1,266,214 | 1,266,214 |
| Accumulated amortisation | (776,470) | (453,494) | (162,858) | (52,758) |
| Net carrying value | 3,274,336 | 3,452,820 | 1,103,356 | 1,213,456 |
| Development costs | | | | |
| Cost | 323,740 | 317,780 | - | - |
| Accumulated amortisation and impairment | (246,131) | (239,131) | - | - |
| Net carrying value | 77,609 | 78,649 | - | - |
| Total intangibles | 3,411,338 | 3,590,862 | 1,103,356 | 1,213,456 |

**Consolidated Group:**

| | Goodwill | Trademarks & Licences | Development Costs | Total |
|---|---|---|---|---|
| | | $ | $ | $ |
| **Year ended 30 June 2006** | | | | |
| Balance at the beginning of year | - | 2,228,153 | 85,488 | 2,313,641 |
| Additions | 401,977 | 1,483,674 | | 1,885,651 |
| Amortisation charge | (259,007) | (6,839) | (265,846) | |
| Impairment losses | (342,584) | | | (342,584) |
| Closing carrying value at 30 June 2006 | 59,393 | 3,452,820 | 78,649 | 3,590,862 |
| **Year ended 30 June 2007** | | | | |
| Balance at the beginning of year | 59,393 | 3,452,820 | 78,649 | 3,590,862 |
| Additions | - | 144,492 | 5,960 | 150,452 |
| Amortisation charge | - | (322,976) | (7,000) | (329,976) |
| Closing carrying value at 30 June 2007 | 59,393 | 3,274,336 | 77,609 | 3,411,338 |

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.

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 lile of the Phoslock licence, a period of 10 years. The cash flows are discounted at a pretax rate of 14%.

Management has based the value-in-use calculations 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 Assets

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| CURRENT | | | | |
| Prepayments | 71,358 | 55,862 | - | - |
| | 71,358 | 55,862 | - | - |

## Note 18 Trade and Other Payables

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| CURRENT | | | | |
| Unsecured liabilities | | | | |
| Trade payables | 534,425 | 473,682 | - | - |
| Sundry payables and accrued expenses | 237,916 | 392,983 | - | - |
| | 772,341 | 866,665 | - | - |

## Note 19 Borrowings

| | Note | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| CURRENT | | | | | |
| Bank overdrafts | 19(a) | 3,844 | - | - | - |
| (a) Total current and non-current secured liabilities: | | | | | |
| Bank overdraft | | 3,844 | - | - | - |

## Note 20 Provision for Long-term Employee Benefits

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| Employee Entitlements | | | | |
| Balance at end of the year | 100,182 | 132,373 | - | - |
| NON CURRENT | | | | |
| Employee Entitlements | | | | |
| Balance at end of the year | 32,697 | 32,057 | - | - |
| Total provisions | 132,879 | 164,430 | - | - |

**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 21 Issued Capital

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| 148,233,784 (2006: 130,323,784) fully paid ordinary shares | 24,458,037 | 20,572,379 | 24,458,037 | 20,572,379 |

| | | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | | **2007** | 2006 | **2007** | 2006 |
| | | No. | No | **$** | $ |
| a) | Ordinary Shares | | | | |
| | At the beginning of reporting period | 130,323,784 | 104,659,494 | 20,572,379 | 16,773,215 |
| | Shares issued during year | | | | |
| | — 6 October 2005 | 2,997,915 | | 475,977 | |
| | — 7 December 2005 | 9,500,000 | | 1,263,500 | |
| | — 16 December 2005 | 3,700,000 | | 734,308 | |
| | — 3 January 2006 | 2,071,823 | | 298,104 | |
| | — 20 March 2006 | 5,137,802 | | 713,75 | |
| | — 30 March 2006 | 2,256,750 | | 313,525 | |
| | — 14 December 2006 | 500,000 | | 111,320 | |
| | — 19 December 2006 | 12,800,000 | | 2,817,040 | |
| | — 19 January 2007 | 480,000 | | 106,868 | |
| | — 7 February 2007 | 520,000 | | 110,240 | |
| | — 8 February 2007 | 500,000 | | 106,000 | |
| | — 13 February 2007 | 1,000,000 | | 212,000 | |
| | — 21 February 2007 | 500,000 | | 106,372 | |
| | — 7 March 2007 | 100,000 | | 19,618 | |
| | — 12 March 2007 | 500,000 | | 98,080 | |
| | — 19 April 2007 | 500,000 | | 98,080 | |
| | — 24 April 2007 | 500,000 | | 98,080 | |
| | — 27 June 2007 | 10,000 | | 1,960 | |
| | At reporting date | 148,233,784 | 130,323,784 | 24,458,037 | 20,572,379 |

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

(i) For information relating to the Phoslock Water Solutions Limited employee option plan, including details of options issued, exercised and lapsed during the financial year and the options outstanding at year-end. Refer to Note Note 26: Share-based Payments.

(ii) For information relating to share options issued to key management personnel during the financial year. Refer to Note Note 26: Share-based Payments.

## Note 22 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 23 Capital and Leasing Commitments

| | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|
| | **2007** | 2006 | **2007** | 2006 |
| | **$** | $ | **$** | $ |
| (a) Operating Lease Commitments | | | | |
| Non-cancellable operating leases contracted for but not capitalised in the financial statements | | | | |
| Payable – minimum lease payments | | | | |
| — not later than 12 months | 237,701 | 178,227 | - | - |
| — between 12 months and 5 years | 391,739 | 219,497 | - | - |
| — greater than 5 years | 70,833 | 70,833 | - | - |
| | 700,273 | 468,557 | - | - |

Lease 1 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 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 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 all lease areas.

Lease 4 is cancellable with a four month notice period required. Rent is payable monthly in advance. No renewal option exists.

Lease 5 is a non-cancellable lease with a thirty nine month 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 initial term for an additional term of three years. The lease allows for subletting of all lease areas.

## Note 24 Segment Reporting

**Primary Reporting — Business Segments**

| | Environmental Technologies | | Bentonite Mining | | Consolidated Group | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2006 | 2005 |
| | $ | $ | $ | $ | $ | $ |
| REVENUE | | | | | | |
| External Sales | 1,033,040 | 760,339 | 25 | 59,615 | 1,033,065 | 819,954 |
| Total sales revenue | 1,033,040 | 760,339 | 25 | 59,615 | 1,033,065 | 819,954 |
| Unallocated revenue | | | | | 89,769 | 25,749 |
| Total revenue | | | | | 1,122,834 | 845,703 |
| RESULT | | | | | | |
| Segment result | (3,299,116) | (2,911,982) | 25 | (244,398) | (3,299,091) | (3,156,380) |
| Unallocated expenses net of unallocated revenue | | | | | (1,074,984) | (486,653) |
| Finance Costs | | | | | 3,429 | - |
| Share of net profits of associates and joint venture entities | | | | | (11,276) | - |
| Profit before income tax | | | | | (4,374,075) | (3,643,033) |
| Income tax expense | | | | | - | - |
| Profit after income tax | | | | | (4,374,075) | (3,643,033) |

| | | | | | | |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Segment assets | 7,974,866 | 8,484,338 | 404,252 | 400,000 | 8,379,118 | 8,884,338 |
| Unallocated assets | | | | | 87,990 | 88,361 |
| Total assets | | | | | 8,467,108 | 8,972,699 |
| **LIABILITIES** | | | | | | |
| Segment liabilities | | | | | 749,169 | 953,919 |
| Unallocated liabilities | | | | | 159,895 | 77,176 |
| Total liabilities | | | | | 909,064 | 1,031,095 |
| **OTHER** | | | | | | |
| Investments accounted for using the equity method | | 34,941 | - | - | - | 34,941 |
| Acquisitions of non-current segment assets | 385,665 | 1,839,126 | - | - | 385,665 | 1,839,126 |
| Depreciation and amortisation of segment assets | 510,823 | 378,864 | - | 206,757 | 510,823 | 585,621 |

**Secondary Reporting — Geographical Segments**

| | Segment Revenues from External Customers | | Carrying Amount of Segment Assets | | Acquisitions of Non-current Segment Assets | |
|---|---|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| | $ | $ | $ | $ | $ | $ |
| **Geographical location:** | | | | | | |
| Australia | 644,000 | 308,193 | 7,229,720 | 7,278,792 | 283,391 | 1,513,256 |
| China | - | - | 1,042,611 | 1,456,213 | 48,746 | 254,669 |
| United States of America | - | 271,096 | - | - | - | - |
| United Kingdom | 128,146 | 14,955 | 163,517 | 197,155 | 32,823 | 28,185 |
| Europe | 229,000 | 56,000 | 31,260 | 40,539 | 20,705 | 43,016 |
| Other Countries | 31,894 | 169,710 | - | - | - | - |
| | 1,033,040 | 819,954 | 8,467,108 | 8,972,699 | 385,665 | 1,839,126 |

**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 consolidated group at an arm's length. These transfers are eliminated on consolidation.

**Business and Geographical Segments**

**Business segments**

The consolidated group has the following business segments:

— The Environmental Technology segment is responsible for the development, manufacture and sale of environmental technology products. The major products are a water treatment technology known as Phoslock and an evaporation retardent product distributed as Watesavr.

— The mining segment divested its interest in bentonite mining tenements last year but continues to receive deferred settlement payment royalties based on tons sold from the resource.

**Geographical segments**

The consolidated group's business segments are located in Australia, China, UK, Europe and the USA. Management and administration are based in Australia with manufacturing operations located in China. The Company operates sales from Australia, UK and Europe.

## Note 25 Cash Flow Information

| | | Consolidated Group | | Parent Entity | |
|---|---|---|---|---|---|
| | Note | **2007** | 2006 | **2007** | 2006 |
| | | **$** | $ | **$** | $ |
| (a) | Reconciliation of Cash Flow from Operations with Loss after Income Tax | | | | |
| | Loss after income tax | (4,374,075) | (3,643,033) | (110,200) | (52,762) |
| | Cash flows excluded from loss attributable to operating activities | | | | |
| | Non-cash flows in loss | | | | |
| | Amortisation | 331,047 | 472,603 | 110,100 | 52,758 |
| | Depreciation | 179,775 | 113,018 | - | - |
| | Net loss on disposal of property, plant and equipment | 1,466 | 596,455 | - | - |
| | Net gain on disposal of investments | - | (488,424) | - | - |
| | Share options expensed | 1 81,061 | 321,008 | - | - |
| | Impairment loss | 342,584 | - | - | |
| | Share of associated companies net loss after income tax and dividends | 11,276 | - | - | - |
| | Changes in assets and liabilities, net of the effects of purchase and disposal of subsidiaries | | | | |
| | (Increase)/decrease in trade and term receivables | 309,678 | (377,734) | - | - |
| | (Increase)/decrease in prepayments | 3,971 | 86,283 | - | - |
| | (Increase)/decrease in inventories | (78,698) | (750,024) | - | - |
| | Increase/(decrease) in trade payables and accruals | (286,560) | 423,072 | - | - |
| | Increase/(decrease) in provisions | (19,158) | 46,737 | - | - |
| | Cash flow from operations | (3,740,217) | (2,857,455) | (100) | (4) |

(b) Acquisition of Entities

During the prior year 51% of the controlled entity IETC (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 |

(c) Non-cash Financing and Investing Activities

(i) Options issue

500,000 options were issued in December 2006 as consideration for capital raising related management services. The options have an exercise price of $0.23 and expire in November 2007.

## Note 26 Share-based Payments

The following share-based payment arrangements existed at 30 June 2007:

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

| Number of Options | Grant Date | Exercise Price | Expiry Date |
|---|---|---|---|
| 50,000 | 15.08.2006 | $0.20 | 30.12.2008 |
| 100,000 | 15.08.2006 | $0.20 | 31.12.2008 |
| 350,000 | 15.08.2006 | $0.20 | 31.12.2008 |
| 1,150,000 | 10.01.2007 | $0.50 | 30.06.2009 |
| 1,000,000 | 10.01.2007 | $0.60 | 30.06.2010 |
| 100,000 | 30.05.2007 | $0.50 | 31.12.2009 |
| 100,000 | 30.05.2007 | $0.50 | 31.12.2010 |
| 50,000 | 23.06.2007 | $0.50 | 31.12.2009 |

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 when exercised.

| | Consolidated Group | | | | Parent Entity | | | |
|---|---|---|---|---|---|---|---|---|
| | 2007 | | 2006 | | 2007 | | 2006 | |
| | 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 | 30,147,913 | 0.25 | 9,700,000 | 0.21 | 30,147,913 | 0.25 | 9,700,000 | 0.21 |
| Granted | 3,400,000 | 0.45 | 23,447,913 | 0.27 | 3,400,000 | 0.45 | 23,447,913 | 0.27 |
| Exercised | (5,110,000) | 0.21 | - | - | (5,110,000) | 0.21 | - | - |
| Expired | - | - | (3,000,000) | 0.20 | - | - | (3,000,000) | 0.20 |
| Outstanding at year-end | 28,437,913 | 0.28 | 30,147,913 | 0.25 | 28,437,913 | 0.28 | 30,147,913 | 0.25 |
| Exercisable at year-end | 21,040,000 | 0.25 | 19,250,000 | 0.22 | 21,040,000 | 0.25 | 19,250,000 | 0.22 |

There were 5,110,000 options exercised during the year ended 30 June 2007. These options had a weighted average share price of $0.41 at exercise date.

The options outstanding at 30 June 2007 had a weighted average exercise price of $0.28 and a weighted average remaining contractual life of 2.1 years. Exercise prices range from $0.20 to $0.60 in respect of options outstanding at 30 June 2007

The weighted average fair value of the options granted during the year was $0.05.

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

| | |
|---|---|
| Weighted average exercise price | $0.45 |
| Weighted average life of the option | 2.1 years |
| Underlying share price | $0.34 |
| Expected share price volatility | 30% |
| Risk free interest rate | 5% |

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 $122,714 (2006: $321,008), and relates, in full, to equity-settled share-based payment transactions.

Included under administration expense in the income statement is $58,347 representng the fair value of 500,000 options issued in December 2006 as consideration for capital raising related management services. The options have an exercise price of $0.23 and expire in November 2007.

**Options Issued as Part of Remuneration for the Year Ended 30 June 2007**

Options were issued to specified executives and directors as part of their remuneration with Phoslock Water Solutions Ltd. 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 Represented | Total Remuneration Exercised by Options | Options Lapsed | Options | Total |
|---|---|---|---|---|---|
| | $ | % | $ | $ | $ |
| Mr Eddie Edmunds | 106,716 | 48 | - | - | 106,716 |

No options which were granted as part of key executive remuneration lapsed during the year.

**Shares Issued on Exercise of Compensation Options**

| Key Management Personnel | No of Ordinary Shares Issued | Amounts Paid per Share | Amounts Unpaid per Share |
|---|---|---|---|
| Brett Crowley | 1,000,000 | $0.227 | $0.00 |
| Brett Crowley | 2,500,000 | $0.20 | $0.00 |
| Colin Upcroft | 10,000 | $0.20 | $0.00 |

## Note 27 Events After the Balance Sheet Date

The financial report was authorised for issue on 20 September 2007 by the board of directors.

No other events occurred after the balance date which require disclosure in the financial report.

## Note 28 Financial Instruments

(a) Financial Risk Management

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

(i) Financial Risks

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

**Interest rate risk**

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

The group is exposed to fluctuations in foreign currencies, particularly 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 consolidated group does not have any material credit risk exposure to any single receivable or group of receivables under financial instruments entered into by the consolidated group.

(b) Financial Instruments

(i) Interest Rate Risk

The consolidated group'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 | | Fixed Interest Rate Maturing 1 to 5 years | |
|---|---|---|---|---|---|---|---|---|
| | % | | $ | | $ | | $ | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| **Financial Assets:** | | | | | | | | |
| Cash and cash equivalents -Receivables | 4.95 | 4.83 | 2,080,697 | 2,013,120 | 96,122 | 64,577 | - | |
| Total Financial Assets | | | 2,080,697 | 2,013,120 | 96,122 | 64,577 | - | - |
| **Financial Liabilities:** | | | | | | | | |
| Bank loans and overdrafts | 8.25 | - | 3,844 | - | - | - | - | - |
| Trade and sundry payables | | | - | - | - | - | - | - |
| Total Financial Assets | | | 3,844 | - | - | - | - | - |

| | Fixed Interest Rate Maturing Over 5 yearsl | | Non - Interest Bearing | | Total | |
|---|---|---|---|---|---|---|
| | $ | | $ | | $ | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| **Financial Assets:** | | | | | | |
| Cash and cash equivalents | - | - | - | - | 2,176,819 | 2,077,697 |
| Receivables | - | - | 691,811 | 1,393,149 | 691,811 | 1,393,149 |
| Total Financial Assets | - | - | 691,811 | 1,393,149 | 2,868,630 | 3,470,846 |
| **Financial Liabilities:** | | | | | | |
| Bank loans and overdrafts | - | - | - | - | 3,844 | - |
| Trade and sundry payables | - | - | 772,341 | 866,665 | 772,341 | 866,665 |
| Total Financial Liabilities | - | - | 772,341 | 866,665 | 776,185 | 866,665 |

(ii) Net Fair Values

The net fair values of other assets and other liabilities approximate their carrying value. No financial assets or liabiliites are readily tradable on organised markets in standardised form. The aggregate net fair values and carrying amounts of financial assets and liabilities are disclosed in the balance sheet and in the notes to the financial statements.

## Note 29 Change In Accounting Policy

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

| AASB Amendment | Standard Affected | Outline Amendment | Application date of the standard | Application date for group |
|---|---|---|---|---|
| AASB 1 | AASB 1 | Disclosure only - no impact | 31 December 2007 | 1 July 2008 |
| AASB 2 | AASB 2 | Disclosure only - no impact | 29 February 2008 | 1 July 2008 |
| AASB 7 | AASB 130 | Disclosure only - no impact | 31 December 2007 | 1 July 2008 |
| AASB 101 | AASB 101 | Disclosure only - no impact | 31 December 2007 | 1 July 2008 |
| AASB 114 | AASB 114 | Disclosure only - no impact | 31 December 2007 | 1 July 2008 |
| AASB 132 | AASB 132 | Disclosure only - no impact | 31 December 2007 | 1 July 2008 |
| AASB 133 | AASB 133 | Disclosure only - no impact | 31 December 2007 | 1 July 2008 |
| AASB 139 | AASB 139 | Disclosure only - no impact | 31 December 2007 | 1 July 2008 |
| AASB 2007-3 | Various | Disclosure only - no impact | 31 December 2009 | 1 July 2010 |
| AASB 2007-4 | Various | Disclosure only - no impact | 30 June 2008 | 1 July 2008 |
| AASB 2007-6 | Various | Disclosure only - no impact | 31 December 2009 | 1 July 2010 |
| AASB 2007-7 | Various | Disclosure only - no impact | 30 June 2008 | 1 July 2009 |
| Interpretation 10 | N/A | Disclosure only - no impact | 31 October 2007 | 1 July 2008 |

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

| AASB Amendment | AASB Standard Affected |
|---|---|
| AASB 4 | AASB 4 Insurance Contracts |
| AASB 8 | AASB 8 Operating Segments |
| AASB 117 | AASB 8 Leases |
| AASB 123 | AASB 123 Borrowing Costs |
| AASB 1023 | AASB 1023 General Insurance Contracts |
| AASB 1038 | AASB 1023 Insurance Contracts |
| AASB 1049 | AASB 1049 Financial Reporting of General Government Sectors by Governments |
| AASB 2007-5 | AASB 102 Inventories held for Distribution by Not-for-Proift Entities |
| Interpretation 4 | N/A - Determining whether an arrangement contains a lease |
| Interpretation 11 | N/A - Group and Treasury Share Transactions |
| Interpretation 12 | N/A - Service Concession Arrangements |

## Note 30 Company Details

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

Phoslock Water Solutions Limited
3/81 Frenchs Forest Road
Frenchs Forest NSW 2086

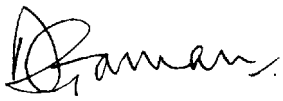
*WaterSavr application site – Victoria*

# Directors' Declaration

The directors of the Company declare that:

1. the financial statements and notes, as set out on pages 29 to 56, 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 2007 and of the performance for the year ended on that date of the Company and consolidated group;
2. the Chief Executive Officer and Chief Finance 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.



**Director**

**Dr David Garman**

**Director**

**Mr Robert Schuitema**

Dated this 21st day of September 2007

# Independent Audit Report

**Report on the Financial Report**
We have audited the accompanying financial report of Phoslock Water Solutions Limited, which comprises the balance sheet as at 30 June 2007, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies and other explanatory notes and the directors' declaration of the consolidated entity comprising the Company and the entities it controlled at the year's end or from time to time during the financial year.

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

**Directors' Responsibility for the Financial Report**
The directors of the Company are responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101: Presentation of Financial Statements, that compliance with the Australian equivalents to International Financial Reporting Standards (IFRS) ensures that the financial report, comprising the financial statements and notes, complies with IFRS.

The directors also are responsible for preparation and presentation of the remuneration disclosures contained in the directors' report in accordance with the Corporations Regulations 2001.

**Auditor's Responsibility**
Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement and that the remuneration disclosures in the directors' report comply with Accounting Standard AASB 124.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the fin

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report and the remuneration disclosures in the directors' report.

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

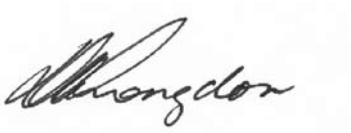
**Independence**
In conducting our audit, we have complied with the independence requirements of the Corporations Act 2001. We confirm that the independence declaration required by the Corporations Act 2001, provided to the directors of Phoslock Water Solutions Limited on [insert date], would be in the same terms if provided to the directors as at the date of this auditor's report.

**Auditor's Opinion**
In our opinion:

a. the financial report of Phoslock Water Solutions Limited and Controlled Entities is in accordance with 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 2007 and of their performance for the year ended on that date; and
   ii. complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001;
b. the financial report also complies with International financial Reporting Standards as disclosed in Note 1; and
c. the remuneration disclosures that are contained in the directors' report comply with Accounting Standard AASB 124.

Signed at Brisbane, 24th September 2007

William Buck
Chartered Accountants



D W Langdon
Partner

William Buck
Business Advisors
Chartered Accountants

# Shareholder Information

The shareholder information set out below was applicable at 20 October 2007.

## Distribution of Shareholders

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

| Category of holding | Number | Number of shares |
|---|---|---|
| 1 – 1,000 | 59 | 20.925 |
| 1,001 – 5,000 | 245 | 803,494 |
| 5,001 – 10,000 | 280 | 2,485,010 |
| 10,001 – 100,000 | 757 | 29,355,469 |
| 100,001 shares and over | 215 | 115,668,886 |
| | 1556 | 148,333,784 |

b. There are 90 shareholders with less than a marketable parcel of shares.

c. There is two substantial shareholders in the Company's Register of Substantial Shareholders as at 20 October 2007 being:

| Name | Number of shares held |
|---|---|
| Link Traders (Aust) Pty Ltd | 17,487,946 |
| Newvest Pty Ltd | 7,884 ,375 |

## Unquoted Securities

As at 20 October 2007 there were 27,937,913 options unquoted as follows:

**Options**

| Number of Options | Number of Holders |
|---|---|
| 27,937,913 | 101 |

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

| Name | Number of options held |
|---|---|
| Sail Ahead Pty Ltd | 7,000,000 |

*Phoslock Conference - Bremen Germany*

## Twenty Largest Shareholders

As at 20 October 2007 the twenty largest holders of ordinary shares are listed below:

| Name | No of Shares Held | % of Shares Held |
|---|---|---|
| Link Traders Pty Ltd | 17,487,946 | 11.79 |
| Newvest Pty Ltd | 7,884,375 | 5.32 |
| ANZ Nominees Pty Ltd | 5,001,460 | 3.37 |
| Commonwealth Scientific & Industrial Research Organisation (CSIRO) | 3,700,000 | 2.49 |
| Paul and Loraine Cayzer | 3,535,800 | 2.38 |
| GFK Investments Pty Ltd | 3,000,000 | 2.02 |
| The Australian National University | 2,800,000 | 1.89 |
| Sail Ahead Pty Ltd | 2,430,000 | 1.64 |
| Nigel Traill | 2,300,529 | 1.55 |
| First Manhattan Securities Pty Ltd | 2,290,000 | 1.54 |
| Fortis Clearing Nominees Pty Ltd | 2,079,800 | 1.40 |
| National Nominees Limited | 1,800,000 | 1.21 |
| Sahib Nominees Co Pty Ltd | 1,682,600 | 1.13 |
| MCHA Pty Ltd | 1,600,000 | 1.08 |
| Evan Clucas | 1,349,300 | 0.91 |
| Chelsea Securities Ltd | 1,270,000 | 0.86 |
| Adrian and Sharon Brant | 1,144,000 | 0.77 |
| Colowell Pty Ltd | 1,070,000 | 0.72 |
| RBC Dexia Investor Services Australia Nominees Pty Ltd | 1,065,000 | 0.72 |
| HSBC Custody Nominees (Australia) Limited | 1,038,500 | 0.70 |
| **Total** | **64,529,310** | **43.50** |
| **Total Shares Issued** | **148,333,784** | **100** |

## Restricted Securities

As at 20 October 2007 there were 2,997,913 options subject to escrow provisions, as follows:

| Date of release from escrow | No of Options |
|---|---|
| 10 August 2008 | 2,997,913 |

## 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.

PHOSLOCK®

Phoslock Water Solutions Limited