



29th August 2006

CERAMIC FUEL CELLS LIMITED

PRELIMINARY RESULTS

12 MONTHS ENDED 30 JUNE 2006

Ceramic Fuel Cells Limited (AIM / ASX: CFU) a world leading manufacturer of solid oxide fuel cells and provider of enabling technology for micro-combined heat and power (m-CHP) units and distributed generation, announces its preliminary results for the year ended 30 June 2006.

2006 Highlights

Financials

- Net assets of £34.7m (A\$85.7m) and no debt.
- Revenue for the year from continuing operations was £840k (A\$2m), up 153% from last year, as a result of successful field trial contracts and higher interest earnings.
- Operational expenses – excluding borrowing costs – down by 3.2% including reduced research and product development costs.
- Achieved successful and oversubscribed admission to the London Stock Exchange AIM market in March 2006, raising gross proceeds of approximately £37.2 million.
- All convertible notes issued in August 2005 to raise £3.3m (A\$8.2m) were converted into CFCL shares before June 2006.

Technical

- Passed a key milestone of 10,000 hours of system operation in commercial field trials of m-CHP units across its current programme of independent customer field trials in Germany, Australia and New Zealand.
- Launched NetGen™, a pre-commercial m-CHP unit, in October 2005. NetGen™ is less than half the size of the field trial m-CHP units.
- Granted four additional patents: two relating to CFCL's solid oxide fuel cell (SOFC) technology; one for the process of producing ceramic powders used in solid oxide fuel cells; and one relating to the process of producing electricity using a fuel supply that includes hydrocarbons higher than methane. This brings the total number of patents within the portfolio to 50 (in 28 patent families).

Partnerships

- In June 2006, signed a second international contract with EWE, the fifth largest utility in Germany, to supply them with ten NetGen™ units, following the initial two m-CHP field trials that began in January 2006. This is CFCL's most significant contract to date, taking the company within striking distance of its target selling of 12 NetGen™ units by December 2006.
- Building relationships with appliance manufacturers, to integrate CFCL's fuel cells into m-CHP units and other distributed generation applications.

Market

- European “CE” safety approval awarded to NetGen™, CFCL’s fully integrated pre-commercial m-CHP system.
- UK government has voiced its support for CHP and distributed generation in its Energy Challenge Report, published July 2006, and by allocating an additional £50 million to develop microgeneration technologies.
- Placed the first fuel cell electricity generator into an Australian office in szencorp’s groundbreaking energy efficient commercial office building in Melbourne, known as “40A”.

Operational

- Appointment of Mike Atkinson, Manager, Capital Projects, and Simon Howard, Powder Manufacturing Engineer, to supplement CFCL’s UK management team.
- Appointment of Professor Michael Dureau to CFCL’s Board of Directors as an independent Non-Executive Director.

Since 30 June 2006

- Appointment of Robert (Bob) Kennett to the Board of Directors as CFCL’s first UK-based Non-Executive Director on 24 August 2006. Bob Kennett, 56, has spent his career in the energy sectors and has been focused on Combined Heat and Power and renewables. He was Managing Director of Powergen Combined Heat and Power Ltd for 12 years and, for three years simultaneously, was Chairman of PowerGen Renewables Ltd. Bob is currently a consultant advising financiers and investors on business opportunities in the UK Combined Heat and Power and Renewable Energy markets. This appointment reflects the Company’s commitment to strengthening its base in the United Kingdom, following on from its listing on AIM and also its increased focus on commercialising its technology, particularly throughout the European market.

Brendan Dow, Chief Executive Officer, commented:

“Ceramic Fuel Cells has continued to build momentum month by month on each of the financial, technical and partnership fronts during the year. I am pleased to report that the strategy and timeline we presented to the market late last year has not changed – we are doing what we said we would do.

As we move towards the commercialisation of our technology, we are encouraged by the excellent headway made in both deepening our existing relationships with utilities and developing new relationships. We plan to have signed up further utilities and appliance partners by December 2006.

In order to reach our key commercial milestones, we are focused on developing the most commercially viable solid oxide fuel cell for use in micro-CHP and distributed generation. We are also constructing a ceramic powder plant in the UK and implementing our plans for a high volume fuel cell foundry in Europe.

We are delighted that Bob Kennett, former Managing Director of Powergen Combined Heat and Power, has agreed to join our board. His previous experience in CHP and Renewable Energy markets in the UK, will be of enormous benefit to Ceramic Fuel Cells.”

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ASX

Preliminary

Final Report

Year ended 30 June 2006



Lodged with the ASX under Listing Rule 4.3A

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Results for announcement to the market

Year ended 30 June 2006

(Previous corresponding period: Year ended 30 June 2005)

	Movement	%		\$
Revenue from continuing operations	Up	153.1	to	2,077,249
Loss after tax attributable to members	Down	22.8	to	(13,317,335)
Net Loss for the period attributable to members	Down	22.8	to	(13,317,335)

Dividend type	Amount per security	Franked amount per security
Final dividend	None	Not applicable
Interim dividend	None	Not applicable
<p>No dividends were recommended, declared or paid during the period.</p> <p>The Directors do not propose to recommend the payment of a dividend in respect of the period.</p> <p>There is no dividend re-investment plan in operation.</p>		

Brief Explanation of Revenue

During the period:

- Sales revenue of \$480,981 was up 186.3% as the company expanded its field trial programme.
- Interest received on surplus funds invested was up by 144.6% on the previous corresponding period due to significantly increased cash levels in the last quarter of the reporting period, arising from the company's listing and fund raising on the London AIM market.

Brief Explanation of Loss (and Net Loss)

The net loss for the period attributable to members of \$13,317,335 compares to a net loss in the previous corresponding period of \$17,239,831. The major reasons for the lower loss were:

- a net foreign exchange gain of \$2,850,898 on the translation of foreign currency denominated cash, cash equivalents and investments was earned for the first time, hence no such gain was earned in the corresponding reporting period, and
- an increase in interest received of \$943,666 over the corresponding reporting period (see above).

These items were partially offset by an increase in borrowing costs of \$820,831 relating primarily to the issue of convertible notes during the year (these notes had all converted to equity by 30 June 2006).

Preliminary Income Statements

For the year ended 30 June 2006

	Note	Consolidated		Parent entity	
		2006 \$	2005 \$	2006 \$	2005 \$
Revenue from continuing operations	2	2,077,249	820,602	1,795,247	819,807
Other income	3	3,058,990	153,066	3,153,698	153,066
Research & Product Development		(10,765,691)	(11,910,499)	(10,765,691)	(11,910,499)
General & Administration		(5,618,265)	(5,297,025)	(5,618,265)	(5,297,025)
Sales & Marketing		(1,247,137)	(1,004,325)	(453,314)	(537,286)
Borrowing costs		(822,481)	(1,650)	(822,481)	(1,650)
Profit/(loss) before income tax		(13,317,335)	(17,239,831)	(12,710,806)	(16,773,587)
Income tax expense		-	-	-	-
Profit/(loss) for the year attributable to members of Ceramic Fuel Cells Limited	6	(13,317,335)	(17,239,831)	(12,710,806)	(16,773,587)
		Cents	Cents		
Earnings per share for profit/(loss) attributable to the ordinary equity holders of the company					
Basic and diluted earnings per share	9	(7.64)	(15.66)		

The above preliminary income statements should be read in conjunction with the accompanying notes.

Preliminary Balance Sheets

As at 30 June 2006

	Note	Consolidated		Parent entity	
		2006	2005	2006	2005
		\$	\$	\$	\$
ASSETS					
Current Assets					
Cash and cash equivalents		11,367,347	5,470,018	11,330,196	5,456,800
Receivables		110,859	214,764	104,277	722,505
Financial assets	4	30,087,872	-	30,087,872	-
Other		269,200	900,831	258,848	900,831
Total Current Assets		<u>41,835,278</u>	<u>6,585,613</u>	<u>41,781,193</u>	<u>7,080,136</u>
Non-Current Assets					
Financial assets	4	44,661,266	-	44,661,266	-
Other financial assets		-	-	807,882	3
Plant and equipment		2,090,618	3,138,484	2,063,929	3,094,988
Intangibles		1,000	1,000	1,000	1,000
Total Non-Current Assets		<u>46,752,884</u>	<u>3,139,484</u>	<u>47,534,077</u>	<u>3,095,991</u>
Total Assets		<u>88,588,162</u>	<u>9,725,097</u>	<u>89,315,270</u>	<u>10,176,127</u>
LIABILITIES					
Current Liabilities					
Payables		1,330,551	1,038,932	1,359,402	1,023,718
Provisions		764,345	547,915	764,345	547,915
Deferred (unearned) revenue		537,984	157,000	149,649	157,000
Total Current Liabilities		<u>2,632,880</u>	<u>1,743,847</u>	<u>2,273,396</u>	<u>1,728,633</u>
Non-Current Liabilities					
Provisions		201,331	151,898	201,331	151,898
Total Non-Current Liabilities		<u>201,331</u>	<u>151,898</u>	<u>201,331</u>	<u>151,898</u>
Total Liabilities		<u>2,834,211</u>	<u>1,895,745</u>	<u>2,474,727</u>	<u>1,880,531</u>
Net Assets		<u>85,753,951</u>	<u>7,829,352</u>	<u>86,840,543</u>	<u>8,295,596</u>
EQUITY					
Contributed equity	5	185,549,893	94,407,155	185,549,893	94,407,155
Reserves	6	99,196	-	113,014	-
Retained profits/(losses)	6	(99,895,138)	(86,577,803)	(98,822,365)	(86,111,559)
Total Equity		<u>85,753,951</u>	<u>7,829,352</u>	<u>86,840,543</u>	<u>8,295,596</u>

The above preliminary balance sheets should be read in conjunction with the accompanying notes.

Preliminary Statements of Changes in Equity

For the year ended 30 June 2006

	Consolidated		Parent entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
Total equity at the beginning of the year	<u>7,829,352</u>	<u>24,779,604</u>	<u>8,295,596</u>	<u>24,779,604</u>
Changes in the fair value of financial assets	77,815	-	77,815	-
Exchange differences on translation of foreign operations	<u>(13,818)</u>	-	<u>-</u>	-
Net income (expense) recognised in equity	<u>63,997</u>	-	<u>77,815</u>	-
Profit/(loss) for the year	<u>(13,317,335)</u>	<u>(17,239,831)</u>	<u>(12,710,806)</u>	<u>(16,773,587)</u>
Total recognised income (expense) for the year	<u>(13,253,338)</u>	<u>(17,239,831)</u>	<u>(12,632,991)</u>	<u>(16,773,587)</u>
Transactions with equity holders in their capacity as equity holders:				
Contributions of equity (net of transaction costs)	91,380,789	289,579	91,380,789	289,579
Employee share options	35,199	-	35,199	-
Dividends provided for or paid	-	-	-	-
	<u>91,415,988</u>	<u>289,579</u>	<u>91,415,988</u>	<u>289,579</u>
Total equity at the end of the year	<u>85,992,001</u>	<u>7,829,352</u>	<u>87,078,593</u>	<u>8,295,596</u>

Total recognised income and expense for the year is entirely attributable to members of Ceramic Fuel Cells Limited.

The above preliminary statements of changes in equity should be read in conjunction with the accompanying notes.

Preliminary Cash Flow Statements

For the year ended 30 June 2006

	Consolidated		Parent entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
Cash Flows from Operating Activities				
Receipts from customers (inclusive of goods and services tax)	1,775,818	951,341	1,106,853	951,341
Payments to suppliers and employees (inclusive of goods and services tax)	<u>(15,856,923)</u>	<u>(16,229,480)</u>	<u>(14,880,436)</u>	<u>(15,601,008)</u>
	(14,081,105)	(15,278,139)	(13,773,583)	(14,649,667)
Grant revenue	150,000	142,387	150,000	142,387
Interest received	1,604,607	637,649	1,603,235	637,649
Other revenue	41,007	10,221	41,007	10,221
Interest paid	<u>(525)</u>	<u>(1,650)</u>	<u>(525)</u>	<u>(1,650)</u>
Net cash inflow (outflow) from operating activities	<u>(12,286,016)</u>	<u>(14,489,532)</u>	<u>(11,979,866)</u>	<u>(13,861,060)</u>
Cash Flows from Investing Activities				
Payments for purchase of subsidiaries	-	-	-	(3)
Loan to subsidiary	-	-	(330,083)	(685,183)
Proceeds from sale of plant and equipment	72,355	5,140	72,355	5,140
Payments for plant and equipment	<u>(705,969)</u>	<u>(709,552)</u>	<u>(705,969)</u>	<u>(666,056)</u>
Net cash inflow (outflow) from investing activities	<u>(633,614)</u>	<u>(704,412)</u>	<u>(963,697)</u>	<u>(1,346,102)</u>
Cash Flows from Financing Activities				
Gross payments for financial assets	<u>(209,575,697)</u>	-	<u>(209,575,697)</u>	-
Gross proceeds from disposal of financial assets	<u>135,325,852</u>	-	<u>135,325,852</u>	-
Net payments for financial assets	(74,249,845)	-	(74,249,845)	-
Proceeds from issue of shares	91,366,499	-	91,366,499	-
Share issue costs	(7,593,713)	(746,434)	(7,593,713)	(746,434)
Repayment of borrowings	(283,881)	-	(283,881)	-
Interest paid on borrowings	(12,065)	-	(12,065)	-
Proceeds from issuing convertible notes	8,200,000	-	8,200,000	-
Convertible note issue costs	(531,815)	-	(531,815)	-
Interest paid on convertible notes	<u>(516,126)</u>	-	<u>(516,126)</u>	-
Net cash inflow (outflow) from financing activities	<u>16,379,054</u>	<u>(746,434)</u>	<u>16,379,054</u>	<u>(746,434)</u>
Net increase (decrease) in cash and cash equivalents	3,459,424	(15,940,378)	3,435,491	(15,953,596)
Cash and cash equivalents at the beginning of the financial year	5,470,018	21,410,396	5,456,800	21,410,396
Effects of exchange rate changes on cash and cash equivalents	<u>2,437,905</u>	-	<u>2,437,905</u>	-
Cash and cash equivalents at the end of the year	<u>11,367,347</u>	<u>5,470,018</u>	<u>11,330,196</u>	<u>5,456,800</u>

The above preliminary cash flow statements should be read in conjunction with the accompanying notes.

Notes to the Preliminary Financial Statements

Year ended 30 June 2006

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Notes to the Preliminary Financial Statements

Year ended 30 June 2006

Note 1. Summary of Significant Accounting Policies

With the exception of a new accounting policy applicable to investments and other financial assets (refer below), there have been no material changes in the company's application of its significant accounting policies as presented in the company's consolidated financial statements for the half-year ended 31 December 2005. Readers of this report should refer to Note 1, *Summary of Significant Accounting Policies*, in the aforementioned financial statements for details of these accounting policies.

(a) Investments

The group's current and non-current investments have been classified as available-for-sale financial assets. Available-for-sale financial assets, comprising principally marketable securities, are non-derivatives that are either designated in this category or not classified in any of the other financial asset categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

The investments are initially recognised at fair value plus transaction costs and are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Group has transferred substantially all the risks and rewards of ownership. The investments continue to be carried at fair value in the balance sheet, with fair value gains and losses being recognised directly in equity. Fair value is calculated for each individual asset by the group's independent treasury adviser, using period-end projected swap curves.

Translation differences on monetary securities denominated in a foreign currency and classified as available-for-sale are recognised in the income statement as foreign exchange gains or losses, as appropriate, whilst changes in their fair value are recognised in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement.

(b) Explanation of transition to AIFRS

The application of AIFRS significant accounting policies has not had any material effect upon the retained earnings of the group as at 1 July 2004, nor upon the reported profit of the group for the year ended 30 June 2005.

<i>Consolidated</i>		<i>Parent entity</i>	
2006	2005	2006	2005
\$	\$	\$	\$

Note 2. Revenue

From continuing operations

Sales revenue

Field trial income	391,704	168,000	111,074	168,000
Licensing income	<u>89,277</u>	-	<u>89,277</u>	-
	480,981	168,000	200,351	168,000

Other revenue

Interest	<u>1,596,268</u>	<u>652,602</u>	<u>1,594,896</u>	<u>651,807</u>
Total revenue from continuing operations	<u>2,077,249</u>	<u>820,602</u>	<u>1,795,247</u>	<u>819,807</u>

Note 3. Other Income

Net gain on disposal of plant and equipment	17,085	-	17,085	-
Foreign exchange gains	2,850,898	-	2,850,898	-
Export Market Development Grant (see below)	150,000	142,387	150,000	142,387
Sundry income	<u>41,007</u>	<u>10,679</u>	<u>135,715</u>	<u>10,679</u>
Total other income	<u>3,058,990</u>	<u>153,066</u>	<u>3,153,698</u>	<u>153,066</u>

Export Market Development Grant

There are no unfulfilled conditions or other contingencies attaching to these grants. The group did not benefit from any other forms of government assistance.

Notes to the Preliminary Financial Statements

Year ended 30 June 2006

(continued)

	Consolidated		Parent entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
Note 4. Investments				
Current assets				
Financial assets	30,087,872	-	30,087,872	-
Non-current assets				
Financial assets	<u>44,661,266</u>	-	<u>44,661,266</u>	-
	<u>74,749,138</u>	-	<u>74,749,138</u>	-

Note 5. Contributed Equity

(a) Share capital

The share capital account of Ceramic Fuel Cells Limited (the company) consisted of 309,505,559 fully paid up, ordinary shares.

(b) Movements in ordinary share capital

Movements in ordinary share capital of the company during the past two years were as follows:

Date	Details	Number of shares	Issue price	Amount \$
1-7-2004	Opening balance	109,836,448	\$1.00	94,117,576
24-9-2004	Issued for services rendered	300,000		300,000
	Less: Transaction costs arising on share issues	-		(10,421)
30-6-2005	Balance	<u>110,136,448</u>		<u>94,407,155</u>
11-8-2005	Conversion of notes	380,000	\$0.50	190,000
15-8-2005	Conversion of notes	380,000	\$0.50	190,000
17-8-2005	Conversion of notes	1,000,000	\$0.50	500,000
30-8-2005	Conversion of notes	200,000	\$0.50	100,000
13-9-2005	Conversion of notes	400,000	\$0.50	200,000
11-10-2005	Conversion of notes	60,000	\$0.50	30,000
21-10-2005	Conversion of notes	100,000	\$0.50	50,000
3-11-2005	Conversion of notes	40,000	\$0.50	20,000
5-12-2005	Conversion of notes	100,000	\$0.50	50,000
31-1-2006	Conversion of notes	20,000	\$0.50	10,000
21-2-2006	Conversion of notes	60,000	\$0.50	30,000
22-2-2006	Conversion of notes	300,000	\$0.50	150,000
2-3-2006	London AIM listing and raising	175,000,000	\$0.50	87,500,000
3-3-2006	Conversion of notes	460,000	\$0.50	230,000
14-3-2006	Conversion of notes	2,000,000	\$0.50	1,000,000
14-3-2006	Issued for services rendered	236,111	\$0.60	141,667
20-3-2006	Conversion of notes	120,000	\$0.50	60,000
23-3-2006	Australian private placement	7,733,000	\$0.50	3,866,500
27-3-2006	Conversion of notes	2,640,000	\$0.50	1,320,000
5-4-2006	Conversion of notes	460,000	\$0.50	230,000
13-4-2006	Conversion of notes	20,000	\$0.50	10,000
10-5-2006	Conversion of notes	500,000	\$0.50	250,000
16-5-2006	Conversion of notes	2,040,000	\$0.50	1,020,000
30-5-2006	Conversion of notes	300,000	\$0.50	150,000
5-6-2006	Conversion of notes	560,000	\$0.50	280,000
9-6-2006	Conversion of notes	4,200,000	\$0.50	2,100,000
21-6-2006	Conversion of notes	60,000	\$0.50	30,000
	Less: Convertible note transaction costs (net of interest accretion)	-		(238,050)
	Less: Transaction costs arising on share issues	-		(8,327,378)
30-6-2006	Balance	<u>309,505,559</u>		<u>185,549,893</u>

Notes to the Preliminary Financial Statements

Year ended 30 June 2006

(continued)

(c) Ordinary shares

Ordinary shares entitle the holder to participate in dividends, and the proceeds on winding up of the company, in proportion to the number of and amounts paid on the shares held.

On a show of hands every holder of ordinary shares present at a meeting of the company, either personally or by duly authorised representative, proxy or attorney, is entitled to one vote, and upon a poll each share is entitled to one vote.

(d) Share options

Unissued ordinary shares of Ceramic Fuel Cells Limited under option at 30 June 2006 totalled 844,200, all of which have been issued under the Ceramic Fuel Cells Limited Share Option Plan. All of the 5,274,999 share options issued under the Private Placement of 6 May 2004 lapsed unexercised on 31 March 2006.

Issued to former directors

Number of shares: 75,000

Consideration for grant of option: \$Nil.

Consideration for exercise of option: \$1.50 per share

When exercisable: Immediately, provided that, at the time of exercise:

- (a) the option has not lapsed; and
 - (b) shares are quoted on a stock market of an Approved Stock Exchange; or
 - (i) if a takeover scheme or takeover announcement or scheme or arrangement is made or undertaken in respect of CFCL and the Board reasonably determines exercise to be appropriate; or
 - (ii) if an entity becomes entitled to 50% or more of the company's shares, and the Board reasonably determines exercise to be appropriate; or
 - (iii) in any other circumstance if the Board in its absolute discretion determines;
- and in each case the options must be exercised within 30 days after the Board notifies members of its determination.

The entire 75,000 options have been escrowed as a condition of admitting the company to the official list of the Australian Stock Exchange (ASX). They are unable to be exercised before 5 July 2006.

Issued to current employees

Number of shares: 366,200

Consideration for grant of option: \$Nil.

Consideration for exercise of option: \$0.58 per share

Issue date: 12 October 2005

When exercisable: The options cannot be exercised before 12 October 2008. The percentage of options which vest is dependent upon escalating performance hurdles as follows:

Compound share price growth p.a.	% of options that vest
Less than 15%	0
15%	50%
20%	75%
25%	100%

Issued to current employee

Number of shares: 30,000

Consideration for grant of option: \$Nil.

Consideration for exercise of option: \$0.77 per share

When exercisable: The options are fully vested and the conditions for exercise are the same as those for directors.

Issued to current & former employees

Number of shares: 278,000

Consideration for grant of option: \$Nil.

Consideration for exercise of option: \$1.50 per share

When exercisable: The options are fully vested and the conditions for exercise are the same as those for directors.

Issued to former contractor

Number of shares: 170,000

Consideration for grant of option: \$Nil.

Consideration for exercise of option: \$2.01 per share

When exercisable: The options are fully vested and the conditions for exercise are the same as those for directors.

No option holder has any right under the options to participate in any other share issue of the company or of any other entity.

Notes to the Preliminary Financial Statements

Year ended 30 June 2006

(continued)

	Consolidated		Parent entity	
	2006	2005	2006	2005
	\$	\$	\$	\$
Note 6. Reserves and Retained Profits				
(a) Reserves				
Investments revaluation reserve	77,815	-	77,815	-
Share-based payments reserve	35,199	-	35,199	-
Foreign currency translation reserve	(13,818)	-	-	-
Total reserves	<u>99,196</u>	-	<u>113,014</u>	-
<i>Investments revaluation reserve</i>				
Balance at 1 July	-	-	-	-
Revaluation - gross	77,815	-	77,815	-
Balance at 30 June	<u>77,815</u>	-	<u>77,815</u>	-
<i>Share-based payments reserve</i>				
Balance at 1 July	-	-	-	-
Option expense	35,199	-	35,199	-
Balance at 30 June	<u>35,199</u>	-	<u>35,199</u>	-
<i>Foreign currency translation reserve</i>				
Balance at 1 July	-	-	-	-
Currency translation differences arising during the year	(13,818)	-	-	-
Balance at 30 June	<u>(13,818)</u>	-	-	-
(b) Retained profits				
Movements in retained profits/(losses) were as follows:				
Balance at 1 July	(86,577,803)	(69,337,972)	(86,111,559)	(69,337,972)
Net profit/(loss) for the year	(13,317,335)	(17,239,831)	(12,710,806)	(16,773,587)
Balance at 30 June	<u>(99,895,138)</u>	<u>(86,577,803)</u>	<u>(98,822,365)</u>	<u>(86,111,559)</u>

Note 7. Interest Bearing Liabilities

On 2 August 2005 Ceramic Fuel Cells Limited (the company) issued A\$8,200,000 of secured convertible notes. The notes had a maturity date of 2 August 2008 and bore interest at a fixed rate of 10% per annum payable quarterly in arrears. The noteholders were able to elect to convert their notes into fully paid ordinary shares in the company at any time prior to the maturity date at A\$0.50 per share.

On 6 March 2006 the company gave noteholders 90 days notice of its intention to redeem, on 9 June 2006, all notes then outstanding. All noteholders elected to convert their notes during the notice period, hence no redemption of notes was necessary. The notes were secured by a fixed and floating charge over the assets of the company, which is in the process of being discharged.

Notes to the Preliminary Financial Statements

Year ended 30 June 2006

(continued)

Note 8. Contingent Liability

The consolidated entity has the following contingent liability:

R&D Start Grant

Under an agreement with the Industry Research and Development Board (IR&D Board) acting on behalf of the federal government, the company received a \$15 million grant under the R&D Start Grant programme. The company has received the full amount of the grant. The agreement runs until 2009 and imposes certain obligations upon the company. If the company was to breach the agreement or become insolvent, the IR&D Board may elect to terminate the agreement. In the event of such a termination, or in other specific circumstances, the agreement provides that the IR&D Board may choose to require the repayment of any or all of the grant with or without interest.

At the end of the year the maximum amount of this liability would have been \$21.40 million (2005 - \$20.17 million).

	<i>Consolidated</i>	
	<i>2006</i>	<i>2005</i>
Note 9. Earnings Per Share		
Basic and diluted earnings per share	Cents (7.64)	Cents (15.66)
	Number	Number
Weighted average number of shares		
Weighted average number of shares used as the denominator in calculating basic and diluted earnings per share	174,392,301	110,065,763
	\$	\$
Earnings used in calculating basic and diluted earnings per share		
Profit attributable to the ordinary equity holders of the company	(13,317,335)	(17,239,831)

Net tangible asset backing

	<i>Consolidated</i>	
	<i>2006</i>	<i>2005</i>
	<i>cents</i>	<i>cents</i>
Net tangible asset backing per ordinary share	27.7	6.5

Control over other entities

During the period the company established a wholly owned European subsidiary, Ceramic Fuel Cells (Powder) Limited, headquartered in the United Kingdom. No control was gained or lost over any other entity during the period.

Associates and joint venture entities

The company has no associates, nor has it formed any joint ventures with any other entity/s during the period.

Commentary on the results for the period

Overview

The main activities of the Company during the year ended 30 June 2006 included:

- Conducting field trials of demonstration micro-Combined Heat and Power (m-CHP) units in customer's premises in New Zealand, Australia and Germany;
- Designing, building and demonstrating NetGen™, a pre-commercial m-CHP unit, as the next step from the field trial units to a commercial product;
- Raising funds from new institutional investors, and existing investors, and listing the Company's shares on the London Stock Exchange AIM market;
- Planning the construction of a plant in the UK to produce ceramic powders, using the Company's patented technology;
- Continued work on establishing a large scale fuel cell manufacturing plant in Europe;
- The continued development of improved fuel cells and associated systems.

The Company continued to implement its strategy and business plan – and timeline - presented to the market in late 2005. The Company made significant progress on its commercialisation activities, having commissioned and operated m-CHP units in three countries for an aggregate of more than 10,000 hours of system operation.

Financial Results

In the Income Statement revenue for the year from continuing operations was \$2,077,249 (£840,663), up 153% from \$820,602 (£332,098) last year. The increase was due to higher revenue from field trial contracts and higher interest income due to significantly increased cash levels in the last quarter of the year, arising from the Company's listing and fund raising on the London AIM market.

The Income Statement also includes other income of \$3,058,990 (£1,237,973), due largely to a net foreign exchange gain. As the Company holds its cash in several currencies to cover forecast expenditure, but reports its income in Australian dollars, foreign exchange movements will affect the Company's earnings as reported in the Income Statement. This year the income included a translation gain of \$2,850,898 (£1,153,758), which arose because those other currencies appreciated against the Australian dollar; however in future years the effect may be the opposite. The Company does not currently intend to hedge against foreign exchange movements (other than the 'natural' hedge of holding cash in the same currency as expected expenditure).

Underlying operational expenses – excluding borrowing costs – were \$17,631,093 (£7,135,303), 3.2% lower than last year. Of these expenses, Research & Product Development costs for the year were 9.6% lower, at \$10,765,691 (£4,356,875). The Company would expect these costs to increase in the coming financial year, as the Company builds and deploys its pre-commercial NetGen m-CHP units. (In accordance with Australian equivalents to IFRS (AIFRS) the cost of prototypes are being expensed as incurred.) Research and Product Development costs incorporate direct labour and direct materials costs, as well as most of the company's depreciation and amortisation charges. They exclude indirect project support costs and otherwise apportionable overheads which are borne in the General & Administration expense classification.

The Company's R&PD and production headcount level was 79.8 full time equivalent positions, which was similar to last year.

Sales & Marketing costs increased from \$1,004,325 (£406,450) last year to \$1,247,137 (£504,716) in the current year. The majority of these costs relate to business development and commercialisation activities in Europe. These costs are expected to increase in the coming year as the Company expands its efforts to form partnerships with utilities and appliance manufacturers.

The Company's expenditure on General and Administrative expenses rose 6% over last year.

The net loss for the period of \$13,317,335 (£5,389,525) was \$3,922,496 (£1,587,434) lower than the net loss for the preceding period of \$17,239,831 (£6,976,960). The major reasons for the lower loss were a foreign exchange gain of \$2,850,898 (£1,153,758) on the translation of foreign currency denominated investments, and an increase in interest received of \$943,666 (£381,902). These items were partially offset by an increase in borrowing costs of \$820,831 (£332,190) relating primarily to the issue of convertible notes during the year (these notes had all converted to equity by 30 June 2006).

The net loss of \$13,317,335 (£5,389,525) represents a loss per share of 7.64 cents compared to 15.66 cents in the prior year. The much lower loss per share is mainly due to the large number of shares that were issued to raise equity during the year.

The company's operating cash outflow for the year was \$12,286,016 (£4,972,151). This includes interest received of \$1,604,607 (£649,384). Cash outflows from underlying operational activities (receipts from customers less payments to suppliers and staff) was \$14,081,105 (£5,698,623), down from \$15,278,139 (£6,183,063).

Cash outflows from investing activities were \$633,614 (£256,424) which were similar to the prior year. The Company expects this to increase in the coming year as the Company upgrades its Australian production facilities and invests in its European specialist ceramics powder manufacturing plant and fuel cell manufacturing plant.

Cash flows from financing activities reflect three fundraising activities during the year and the investment of temporarily surplus funds pending their use in executing the business plan:

- An issue of convertible notes to raise \$8,200,000 (£3,318,540) in August 2005. These notes were all converted to shares before 30 June 2006.
- A placement to UK and European investors in March 2006 in connection with the Company's listing on the London Stock Exchange AIM market, raising \$87,500,000 (£35,411,250) before costs;
- A placement to existing Australian investors in March 2006, raising \$3,866,500 (£1,564,773) before costs.
- Net payments to acquire financial assets \$74,249,845 (£30,048,912)

The cumulative effect of financing activities was a net cash inflow of \$16,379,054 (£6,628,603)

At 30 June 2006 the Company's total net assets were \$85,753,951 (£34,704,624), compared to A\$7,829,352 (£3,168,539) on 30 June 2005.

Technical

The Company passed a key milestone when its field trial m-CHP units passed an aggregate of 10,000 hours of system operation in commercial field trials in Germany, Australia and New Zealand. The Company built and launched its NetGen™ unit, a pre-commercial m-CHP unit, as the next phase of its commercialisation activities, from field trials to commercial product development. NetGen™ is less than half the size of the field trial m-CHP units.

The Company was granted four additional patents during the year: two relating to the Company's solid oxide fuel cell (SOFC) technology; one for a process of producing the ceramic powders used in solid oxide fuel cells; and one relating to the process of producing electricity using a fuel supply that includes hydrocarbons higher than methane.

The Company is continuing to work on improving the performance of its fuel cells, in particular to increase power density and stack life. The Company has considerable experience with many SOFC designs and materials, having successfully designed, built and operated both 'all-ceramic' and 'metal supported' kW size fuel cell stacks. This broad expertise is reflected in the Company's intellectual property portfolio, including 28 patent families around its principal inventions.

Commercial

The Company placed the first fuel cell electricity generator in an Australian office in szencorp's groundbreaking energy efficient commercial office building in Melbourne, known as "40A".

In June 2006 the Company signed a second international contract with EWE, the fifth largest utility in Germany, to supply them with ten NetGen™ units, in addition to the two m-CHP field trial units that were commissioned in Germany in January 2006. This is the Company's most significant contract to date.

The Company is also continuing to build relationships with appliance manufacturers, to integrate CFCL's fuel cells into m-CHP units and other distributed generation applications.

The Company was also awarded European "CE" safety approval for the NetGen™ unit, allowing the unit to be deployed in Europe.

The European market for fuel cells and m-CHP unit continues to develop. The UK government has voiced its support for CHP and distributed generation in its Energy Challenge Report, published July 2006, and by allocating an additional £50 million to develop microgeneration technologies.

Personnel

During the year the Company appointed Mike Atkinson, Manager, Capital Projects, and Simon Howard, Powder Manufacturing Engineer, to supplement the Company's UK management team.

Professor Michael Dureau was also appointed to CFCL's Board of Directors as an independent Non-Executive Director.

Since 30 June 2006

Robert (Bob) Kennett has been appointed to the Board of Directors as CFCL's first UK-based Non-Executive Director. Bob Kennett has spent his career in the energy sectors and has been focused on Combined Heat and Power and renewables. This appointment reflects the Company's commitment to strengthening its base in the United Kingdom and its focus on the European market.

Future Growth

The Company will continue the commercialisation of its technology in the coming year. Significant areas of focus will be delivering NetGen units to EWE and other utility partners, engaging with appliance manufacturers to develop products using the Company's fuel cell technology, and the construction of the European powder plant and fuel cell manufacturing plant.

Compliance statement

This report is based on accounts which are in the process of being audited.