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KarmelSonix

# Appendix 4D
# For the Half Year Ended 31 December 2010
# Results for Announcement to the Market

**Current Reporting Period - Half year Ended 31 December 2010**
**Previous Reporting Period - Half year Ended 31 December 2009**

| | | | | |
|---|---|---|---|---|
| Revenues | up | 204.76% | to | $214,526 |
| Loss after tax attributable to members | up | 26.38% | to | ($3,665,337) |
| Net loss for the period attributable to members | up | 26.38% | to | ($3,665,337) |

| Dividends (distribution) | Amount per Security | Franked Amount |
|---|---|---|
| Final dividend | n/a | n/a |
| Previous corresponding period | n/a | n/a |

**Net Tangible Asset per Security (cents per security)**

| | |
|---|---|
| As at 31 December 2010 | 0.17 |
| As at 30 June 2010 | 0.22 |

**Loss per share for loss attributable to the ordinary equity holders**
(Basic and Diluted)

| | |
|---|---|
| As at 31 December 2010 | (0.51) |
| As at 31 December 2009 | (0.47) |

| | |
|---|---|
| Record date for determining entitlements to the dividend, (in the case of a trust, distribution) | n/a |

Explanation of the above information:

KarmelSonix Ltd recorded revenue of $214,526 for the period ended 31 December 2010 (2009: $70,391), this consists of sales revenue from medical devices and interest revenue, last year the majority of this revenue related to interest earned on company bank accounts.

The increase in the loss for the period is predominantly associated with share based payments made to retiring Directors during in the period. In the current period, these share based payments totalled approximately $850,000. This expense was recorded in Consulting, Employee and Director Expenses in the Consolidated Statement of Comprehensive Income.

Please refer to the Directors' Report - Review of Operations for further information on the Company operations over the past six months.

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# Appendix 4D
# Interim Financial Report

## For the Half Year Ended 31 December 2010

(previous corresponding period: half year ended 31 December 2009)

To be read in conjunction with the 30 June 2010 Annual Report.
In compliance with Listing Rule 4.2A

# Contents



This interim financial report does not include all notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2010 and any public announcements made by KarmelSonix Ltd during the interim reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

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# Directors' Report

Your directors present their report on the consolidated entity consisting of KarmelSonix Ltd and the entities it controlled at the end of, or during, the half year ended 31 December 2010.

**Directors**

The following persons were directors of KarmelSonix Ltd during the whole of the half-year and up to the date of this report, unless stated otherwise:

| | |
|---|---|
| Mr Ross Haghighat | Executive Chairman & CEO* |
| Mr Paul Eisen | Executive Director |
| Mr Jerome (Jerry) Korten | Non-Executive Director* |
| Mr Paul Hopper | Non-Executive Director* |
| Mr Fabio Pannuti | Non-Executive Director* |
| Mr Peter Marks | Executive Chairman^ |
| Prof Noam Gavriely | Executive Director & CEO^ |
| Dr Henry Pinskier | Executive Director^ |
| Mr Amir Ohad | Executive Director^ |
| Prof Nathan Intrator | Non-Executive Director^ |

* Appointed on 20 October 2010

^ Resigned on 20 October 2010

**Operating Result**

The consolidated loss of the Company after providing for income tax amounted to $3,665,337 (2009: $2,900,302). For further detail, refer to the Review of Operations below.

**Review of Operations**

The half year to 31 December 2010, was an exciting period in the transformation of the Company. During this period, our leadership team worked diligently to streamline various functions and to bring simplified prices that support the Company's commercial goals. We undertook to implement six top priorities during this period, namely:

***Enhanced Internal Communication*** - We integrated our sales and marketing team with our manufacturing and quality control team. The result has been an enhanced process to identify problems and a more robust means to address them.

***Streamlined Sales Approach*** – We have initiated a process that will result in a more efficient and more simplified sales strategy in our lead markets. Specifically, we have begun working with leading channel partners in several key markets for KarmelSonix Ltd ("KSX") products that will complement the Company's direct sales model. These channel partners will provide end point customers. In addition, they will be an important contributor to our reimbursement strategy with key third part insurers.

***WHolter™ Service*** - The professionals at KSX launched a new service designed to test market our WHolter™ home sleep test device. The WHolter™ is the world's first approved device to record and quantify the presence of nocturnal wheeze and cough in patients at home. This revolutionary device provides a new means to diagnose and quantify the presence of nocturnal wheeze which is one important cause of sleep apnea in a significant percentage of patients undergoing sleep studies, and therefore represents a very significant market. Having launched this test service, on a trial basis last October, our WHolter™ Home Sleep test adoption rate has been strong and as of this writing, we have recently launched our 11th site in the US with prospects for more in 2011. The footprint of our WHolter™ service now spans from California to the Midwest to the East Coast of the United States and is currently being established in Australia.

***Third Party Reimbursement*** – Securing third party reimbursement for our products and services, is key to building a sustainable and growing business in our key markets. In the US, the Company has received CPT III codes for some of its key products. We are working diligently with medical service providers and medical reimbursement specialists to advance our reimbursement codes from CPT Category III to CPT Category I in the US. We are getting encouraging results from this exercise. In some markets, we are getting up to 40% reimbursement rate from private insurers, considered to be significantly more effective than most other new devices in the market place. As a reminder, CPT code is an American Medical Association code system assigned to medical devices, services and tests. A CPT code is required to initiate commercial phase of a new medical device. KSX has a number of dedicated CPT codes for its products.

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***New Team Members*** – To accommodate the growing need (and demand) for our products in key markets, we have had a number of key individuals join our team. Last November, we welcomed Bill Nicklin to our manufacturing team. As the founding VP of Manufacturing at ResMed, Bill has vast experience and standing as a manufacturing and quality control expert with more than 20 years of proven track record of transitioning prototypes to globally successful products in the biomedical device arena. Last month, Mr. David Model joined the Company's finance team and is located in the United States. David, formerly from GE, brings 25 plus years of public and private company background, having been involved in over a dozen M&A's.

***Clinical Validation*** - As a direct result of the pioneering clinical work with our devices at leading medical institutions such as the Royal Melbourne Hospital, the Bromton Hospital (UK), Mass General (Boston), Oakland Children (CA), to name a few, the broader medical community is increasingly able to use our devices with specific clinical symptoms in patient populations who suffer from asthma and other lung function limitations. This has resulted in more rapid acceptance of our acoustic respiratory devices in medical practices in the US and Europe. The Company is pleased to have the result of a number of its clinical studies with key global opinion leaders, accepted for publication in leading respiratory and pulmonology societies in early 2011. These important publications establish direct correlation of KSX's acoustic respiratory management (ARM) techniques with common lung function tests, such as respirometry. These studies not only confirm the value proposition for our novel technology offerings, but they also lay the foundation for new indications that investigate the impact of using our devices on the outcome of asthma, COPD, chronic cough and CF patients.

The Directors would like to thank shareholders for their continued support and interest in the Company. The 2011 financial year has commenced with a significant amount of activity and growing interest in the KSX products across a range of health professionals and users. Importantly, the Company is putting in place the building blocks necessary for it to become a successful medical devices company. We look forward to providing further updates to the market in the coming months.

**Auditors' Independence Declaration**

A copy of the auditors' independence declaration as required under section 307C of the Corporations Act 2001 is set out on the following page.

This report is made in accordance with a resolution of directors.

Mr Ross Haghighat
Executive Chairman

Melbourne
Dated 28 February 2011

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# Auditors' Independence Declaration

PKF

Chartered Accountants
& Business Advisers

**AUDITOR'S INDEPENDENCE DECLARATION**

As lead auditor for the audit of Karmelsonix Limited for the half year ended 31 December 2010, I declare that to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the Corporations Act 2001 in relation to the review; and

(b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Karmelsonix Limited and the entities it controlled during the half year.

David Garvey

D J Garvey
Partner
PKF

28 February 2011
Melbourne

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# Consolidated Statement of Comprehensive Income
# For the Half Year Ended 31 December 2010

| | Note | Consolidated Entity<br>31 December 2010<br>$ | 31 December 2009<br>$ |
|---|---|---|---|
| Revenue | 3 | **214,526** | 70,391 |
| Cost of Goods Sold | | **(107,764)** | (192,516) |
| Gross Profit | | **106,762** | (122,125) |
| Other Income | | **12,079** | 2,075 |
| Amortisation Expenses | | **(86,955)** | (88,323) |
| Consulting, Employee and Director Expenses | | **(1,700,149)** | (922,528) |
| Corporate Administration Expenses | | **(424,443)** | (232,091) |
| Depreciation Expenses | | **(24,064)** | (33,479) |
| Marketing and Promotion Expenses | | **(563,022)** | (579,023) |
| Research and Development Expenses | | **(746,578)** | (739,083) |
| Travel and Entertainment Expenses | | **(238,967)** | (185,725) |
| **Loss Before Income Tax** | | **(3,665,337)** | (2,900,302) |
| Income Tax Expense | | **-** | - |
| **Loss for the Half Year** | | **(3,665,337)** | (2,900,302) |
| **Other Comprehensive Income** | | | |
| Exchange differences on translation of foreign operations | | **16,788** | 63,342 |
| **Total Comprehensive Income for the Half Year** | | **(3,648,549)** | **(2,836,960)** |
| | | **Cents** | **Cents** |
| **Loss per share attributable to the ordinary equity holders of the company:** | | | |
| Basic loss per share | 8 | **(0.51)** | (0.47) |
| Diluted loss per share | 8 | **(0.51)** | (0.47) |

The accompanying notes form part of this financial report.

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# Consolidated Statement of Financial Position
# As at 31 December 2010

| | Note | Consolidated Entity 31 December 2010 $ | 30 June 2010 $ |
|---|---|---|---|
| **Current Assets** | | | |
| Cash and Cash Equivalents | | **1,681,546** | 2,299,686 |
| Trade and Other Receivables | | **370,358** | 382,502 |
| Inventories | | **313,076** | 242,230 |
| Other | | **91,426** | 98,634 |
| **Total Current Assets** | | **2,456,406** | 3,023,052 |
| **Non-Current Assets** | | | |
| Plant and Equipment | | **214,990** | 215,993 |
| Other Intangible Assets | | **1,223,669** | 1,342,077 |
| Other | | **10,712** | 13,970 |
| **Total Non-Current Assets** | | **1,449,371** | 1,572,040 |
| **Total Assets** | | **3,905,777** | 4,595,092 |
| **Current Liabilities** | | | |
| Trade and Other Payables | | **728,226** | 933,548 |
| Other Financial Liabilities | | **44,940** | 44,940 |
| Provisions | | **38,111** | 31,745 |
| **Total Current Liabilities** | | **811,277** | 1,010,233 |
| **Non-Current Liabilities** | | | |
| Other Financial Liabilities | | **625,303** | 708,667 |
| Provisions | | **11,499** | 9,468 |
| **Total Non-Current Liabilities** | | **636,802** | 718,135 |
| **Total Liabilities** | | **1,448,079** | 1,728,368 |
| **Net Assets** | | **2,457,698** | 2,866,724 |
| **Equity** | | | |
| Issued Capital | 6 | **64,949,225** | 61,896,696 |
| Reserves | 7 | **4,633,174** | 4,429,392 |
| Accumulated Losses | | **(67,124,701)** | (63,459,364) |
| **Total Equity** | | **2,457,698** | 2,866,724 |

The accompanying notes form part of this financial report.

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# Consolidated Statement of Changes in Equity
# For the Half Year Ended 31 December 2010

| | Issued Capital $ | Option Reserve $ | Consolidated Entity Foreign Currency Translation Reserve $ | Accumulated Losses $ | Total $ |
|---|---|---|---|---|---|
| Balance at 30 June 2009 | 56,571,097 | 4,446,056 | (172,912) | (57,519,603) | 3,324,638 |
| Total Comprehensive Income for the Half Year | - | - | 63,342 | (2,900,301) | (2,836,959) |
| **Transactions with equity holders in their capacity as equity holders:** | | | | | |
| Shares Issued | 5,678,030 | - | - | - | 5,678,030 |
| Capital Raising Costs | (608,916) | - | - | - | (608,916) |
| Options Exercised Net of Costs | - | - | - | - | - |
| Options Issued | - | 146,313 | - | - | 146,313 |
| Transfer to/from Reserves | - | - | | - | - |
| | 5,069,114 | 146,313 | - | - | 5,215,427 |
| Balance at 31 December 2009 | 61,640,211 | 4,592,369 | (109,570) | (60,419,904) | 5,703,106 |
| Total Comprehensive Income for the Half Year | - | - | (122,361) | (3,039,460) | (3,161,821) |
| **Transactions with equity holders in their capacity as equity holders:** | | | | | |
| Shares Issued | 253,600 | - | - | - | 253,600 |
| Capital Raising Costs | 2,885 | - | - | - | 2,885 |
| Options Issued | - | 68,954 | - | - | 68,954 |
| | 256,485 | 68,954 | - | - | 325,439 |
| Balance at 30 June 2010 | 61,896,696 | 4,661,323 | (231,931) | (63,459,364) | 2,866,724 |
| Total Comprehensive Income for the Half Year | - | - | 16,788 | (3,665,337) | (3,648,549) |
| **Transactions with equity holders in their capacity as equity holders:** | | | | | |
| Shares Issued | 867,505 | - | - | - | 867,505 |
| Convertible Notes Issued | 2,243,686 | - | - | - | 2,243,686 |
| Capital Raising Costs | (58,662) | - | - | - | (58,662) |
| Options Issued | - | 186,994 | - | - | 186,994 |
| | 3,052,529 | 186,994 | - | - | 3,239,523 |
| **Balance at 31 December 2010** | **64,949,225** | **4,848,317** | **(215,143)** | **(67,124,701)** | **2,457,698** |

The accompanying notes form part of this financial report.

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# Consolidated Statement of Cash Flows
# For the Half Year Ended 31 December 2010

| | Consolidated Entity | |
|---|---|---|
| | 31 December 2010 $ | 31 December 2009 $ |
| **Cash Flows Related to Operating Activities** | | |
| Receipts from Customers | **267,301** | 54,999 |
| Payments to Suppliers and Employees | **(3,218,899)** | (2,572,024) |
| Interest Received | **27,386** | 37,078 |
| Receipt of Grant Funding | **86,602** | - |
| Proceeds from Insurance Refunds | **3,989** | - |
| **Net Cash Used in Operating Activities** | **(2,833,621)** | (2,479,947) |
| **Cash Flows Related to Investing Activities** | | |
| Payment for Purchases of Plant and Equipment | **(28,969)** | (78,213) |
| Proceeds from Security Deposits | **2,938** | - |
| **Net Cash Used in Investing Activities** | **(26,031)** | (78,213) |
| **Cash Flows Related to Financing Activities** | | |
| Proceeds from Issues of Securities | **-** | 5,119,400 |
| Proceeds from Issues of Convertible | **2,293,686** | - |
| Capital Raising Costs | **(58,662)** | (494,416) |
| **Net Cash From Financing Activities** | **2,235,024** | 4,624,984 |
| **Net Increase/(Decrease) in Cash and Cash** | **(624,628)** | 2,066,824 |
| Cash and Cash Equivalents at the Beginning of the Half Year | **2,299,686** | 2,959,130 |
| Effects of Exchange Rate Changes on Cash and Cash Equivalents | **6,488** | (4,622) |
| **Cash and Cash Equivalents at the End of the Half** | **1,681,546** | 5,021,332 |

The accompanying notes form part of this financial report.

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**Note 1. Basis of Preparation**

**(a) Basis of Preparation**

The general purpose financial report for the interim half year reporting period ended 31 December 2010 has been prepared in accordance with Accounting Standard AASB 134 Interim Financial Reporting and the Corporations Act 2001.

This interim financial report does not include all notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2010 and any public announcements made by KarmelSonix Ltd during the interim reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

**(b) Summary of the Significant Accounting Policies**

The accounting policies adopted for the interim financial report are consistent with the most recent annual financial report for the year ended 30 June 2010.

**(c) Going Concern**

For the half year ended 31 December 2010 the consolidated entity has incurred a loss of $3,665,337 (2009: $2,900,302) and has had operating cash outflows of $2,833,621 (2009: $2,479,947). Furthermore, the consolidated entity as yet does not have a source of income sufficient to meet its operating costs and is reliant on equity capital or loans from third parties to meet its operating costs. For the period covering 12 months from the signing of the half year report, the consolidated entity expects an increase in operating costs as the Directors are continuing to commercialise the intellectual property owned by the company. These conditions indicate a material uncertainty that may cast significant doubt about the consolidated entity's ability to continue as a going concern.

The financial statements have been prepared on the basis that the consolidated entity is a going concern, which contemplates the continuity of normal business activity, realisation of assets and the settlement of liabilities in the normal course of business.

The ability of the consolidated entity to continue as a going concern is dependent upon a number of factors, one being the continuation and availability of funds. To this end, the consolidated entity is expecting funding from the following sources:

- A number of the Company's products have reached commercialisation stage and the Company is expected to produce income from sales, which will provide additional cash flow to the Company. In the six months to December 2010 the Company has recorded sales from distributors and targeted customers for the PulmoTrack and WheezoMeter units amounting to A$187,140. The Company has forecast a material increase in revenue.

- Since inception, the consolidated entity has been able to raise funds to pursue commercialisation of its medical devices. In the past six months, the consolidated entity has demonstrated that it can raise capital by raising approximately $2,300,000 through the issue of convertible notes, before costs. If required, the Directors believe that there is a reasonable expectation that they can raise additional funding to enable the consolidated entity to continue to pursue the current business objectives.

- Further, the consolidated entity has potential to raise additional funds through the exercise of unlisted options on issue and the payment of the unpaid portion of partly paid shares on issue. The unpaid portion of the partly paid shares and the exercise of the unlisted options are required by 30 April 2011 and could raise approximately $2.5M. The exercise price of these options is below the current share price.

- Notwithstanding, the company has the ability to sufficiently scale down its operations and continue certain programs should the need arise.

Cash flow forecasts prepared by management demonstrate that the consolidated entity has sufficient cash flows to meet its commitments over the next twelve months based on the above factors, and for that reason the financial report has been prepared on the basis that the consolidated entity is a going concern, which contemplates the continuity of normal business activity, realisation of assets and the settlement of liabilities in the normal course of business.

Should the consolidated entity be unable to continue as a going concern, it may be required to realise its assets and extinguish its liabilities other than in the ordinary course of business, and at amounts that differ from those stated in the financial report. The financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or liabilities that might be necessary should the consolidated entity not continue as going concern.

# Notes to the Consolidated Financial Statements

(continued)

**Note 2. Dividends**

The company resolved not to declare any dividends in the period ended 31 December 2010.

| | 31 December 2010 $ | 31 December 2009 $ |
|---|---|---|
| **Note 3. Revenue** | | |
| **Revenue from Operating Activities** | | |
| Sales - Medical devices | 187,140 | 33,307 |
| Interest | 27,386 | 37,084 |
| | 214,526 | 70,391 |

**Note 4. Segment Information**

The consolidated entity has identified its operating segments based on the internal reports that are reviewed and used by the executive management team in assessing performance and determining the allocation of resources.

The executive management team considers the business from both a product and a geographic perspective and has identified three reportable segments. Medical devices consists of research and development, commercialisation and sale of a suite of medical devices being developed by the company by subsidiaries in Israel, United States of America and Australia. Management monitors the performance in these three regions separately. Corporate, administration and support services are provided in Australia and performance is monitored separately to the medical device business.

The board assesses the performance of the operating segments at a number of operating levels including adjusted EBITDA. This measurement excludes the effects of certain expenditure from the operating segments such as depreciation, amortisation and finance costs.

The reportable segments are based on aggregated operating segments determined by similarity of expenses, where expenses in the reportable segments exceed 10% of the total expenses for either the current and/or previous reporting period.

| | ----- Medical Devices ----- | | | | |
|---|---|---|---|---|---|
| | Israel $ | Australia $ | USA $ | Corporate $ | Total $ |
| **31 December 2010** | | | | | |
| Revenue | | | | | |
| External Sales | 138,686 | 3,989 | 44,465 | - | 187,140 |
| Interest Revenue | - | - | - | 27,386 | 27,386 |
| Total Revenue | 138,686 | 3,989 | 44,465 | - | 214,526 |
| Adjusted EBITDA | (1,351,237) | (525,079) | (227,467) | (1,450,535) | (3,554,318) |
| Depreciation and amortisation | (101,360) | (8,019) | (1,107) | (533) | (111,019) |
| Finance costs | - | - | - | - | - |
| Profit/(loss) before income tax | (1,452,597) | (533,098) | (228,574) | (1,451,068) | (3,665,337) |
| Income Tax Expense | - | - | - | - | - |
| Net Result | (1,452,597) | (533,098) | (228,574) | (1,451,068) | (3,665,337) |
| Total Segment Assets | 2,037,897 | 183,850 | 62,966 | 1,621,064 | 3,905,777 |
| Total Segment Liabilities | 1,121,213 | 75,432 | 21,425 | 230,009 | 1,448,079 |



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**Note 4. Segment Information (continued)**

| | ----- Medical Devices ----- | | | | |
|---|---|---|---|---|---|
| | Israel | Australia | USA | Corporate | Total |
| | $ | $ | $ | $ | $ |
| **31 December 2009** | | | | | |
| Revenue | | | | | |
| External Sales | 30,580 | 2,727 | - | - | 33,307 |
| Income Tax Expense | - | - | - | 37,084 | 37,084 |
| Total Revenue | 30,580 | 2,727 | - | 37,084 | 70,391 |
| Adjusted EBITDA | (1,675,247) | (358,941) | - | (744,312) | (2,778,500) |
| Depreciation and amortisation | (116,514) | (4,616) | - | (672) | (121,802) |
| Finance costs | - | - | - | - | - |
| Profit/(loss) before income tax | (1,791,761) | (363,557) | - | (744,984) | (2,900,302) |
| Income Tax Expense | - | - | - | - | - |
| Net Result | (1,791,761) | (363,557) | - | (744,984) | (2,900,302) |
| Total Segment Assets | 2,286,704 | 201,229 | - | 4,792,602 | 7,280,535 |
| Total Segment Liabilities | 641,576 | 42,684 | - | 288,420 | 972,680 |

**Note 5. Contingent Liabilities and Assets**

There has been no changes in contingent liabilities and assets reported since the last annual reporting date.

**Note 6. Issued Capital**

| | | 31 December 2010 | | 30 June 2010 | |
|---|---|---|---|---|---|
| | Notes | No. | $ | No. | $ |
| **Shares** | | | | | |
| Fully Paid Ordinary Shares | (a) | 733,469,869 | 62,650,609 | 687,276,239 | 61,841,766 |
| Convertible Notes | (b) | 149,579,051 | 2,243,686 | - | - |
| Partly Paid Shares | (c) | 27,465,000 | 54,930 | 27,465,000 | 54,930 |
| Total Issued Capital | | | 64,949,225 | | 61,896,696 |
| **(a) Fully Paid Ordinary Shares** | | | | | |
| At the beginning of the period | | 687,276,239 | 61,841,766 | 524,896,573 | 56,497,267 |
| Shares issued | | 46,193,630 | 867,505 | 162,379,666 | 5,950,530 |
| Transaction costs relating to share issues | | | (58,662) | | (606,031) |
| | | 733,469,869 | 62,650,609 | 687,276,239 | 61,841,766 |

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**Note 6. Issued Capital (continued)**

**(b) Convertible Notes**

In October 2010 the Company issued 156,585,719 unlisted convertible notes at 1.5 cent (A$0.015), subsequently approved by shareholders at the Company's Annual General Meeting, held on 30 November 2010.

Each note is convertible into ordinary shares at 1.5 cent (A$0.015) per ordinary share, on or prior to the expiry date of the notes by the noteholder delivering a conversion notice to the Company. The notes will automatically convert in the event a takeover bid is made to acquire a controlling interest in the Company. The Company may elect to redeem or convert the Notes, to the extent not already converted, on the expiry date of the notes, being 30 April 2011.

For every note converted, the Company shall issue one unlisted option, exercisable at $0.015 on or before 30 April 2011 (Option 1). Further, for every Option 1 exercised, the Company shall issue one ordinary share and one new unlisted option, exercisable at $0.023 on or before 31 October 2011 (Option 2).

The full terms and conditions of the convertible notes were included in the Notice of Annual General Meeting, held on 30 November 2010.

Since the notes were issued, 34,000,000 notes have been converted into ordinary shares in KarmelSonix Limited.

**(c) Partly Paid Shares**

In April and May 2009 the Company approved the issue of 37,365,000 unlisted partly paid ordinary shares, paid to 0.2 cents (A$0.002) with 0.8 cents (A$0.008) unpaid. The unpaid portion of the shares will be called by the Company at it's sole discretion for any amount up to the unpaid portion of A$0.008 by providing 30 days written notice, or automatically without notice 24 months from the date of the Subscription agreement. The unpaid portion of the shares can be paid up at any time without being called by the Company at the sole discretion of the shareholder.

Since the 31 December 2010 750,000 unlisted partly paid ordinary shares have been converted into ordinary shares in KarmelSonix Limited on becoming fully paid to $0.01.

**Note 7. Reserves**

| | 31 December 2010 | | 30 June 2010 | |
|---|---|---|---|---|
| | **No.** | **$** | **No.** | **$** |
| Listed Options Over Shares | 62,035,000 | 373,560 | 58,035,000 | 373,560 |
| Unlisted Options Over Shares | 106,539,997 | 4,474,757 | 72,633,330 | 4,287,763 |
| Foreign Currency Translation Reserve | | (215,143) | | (231,931) |
| Total Reserves | | 4,633,174 | | 4,429,392 |

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**Note 8. Loss per Share**

| | 31 December 2010 | 31 December 2009 |
|---|---|---|
| | $ | $ |
| Basic loss per share (cents) | (0.51) | (0.47) |
| Diluted loss per share (cents) | (0.51) | (0.47) |
| | $ | $ |
| a) Net Loss used in the calculation of basic and diluted loss per share | (3,665,337) | (2,900,302) |
| | No. | No. |
| b) Weighted average number of ordinary shares | 713,677,176 | 620,071,089 |

Options that are considered to be potential ordinary shares are excluded from the weighted average number of ordinary shares used in the calculation of basic loss per share. Where dilutive, potential ordinary shares are included in the calculation of diluted loss per share. All the options on issue do not have the effect to dilute the loss per share. Therefore they have been excluded from the calculation of diluted loss per share.

**Note 9. Net Tangible Assets**

| | 31 December 2010 | 30 June 2010 |
|---|---|---|
| | $ | $ |
| Net Tangible Assets | 1,234,029 | 1,524,647 |
| | No. | No. |
| Shares | 733,469,869 | 687,276,239 |
| | $ | $ |
| Net Tangible Assets (cents) | 0.17 | 0.22 |

**Note 10. Events Subsequent to Reporting Date**

No matters or circumstances have arisen since the end of the reporting period, not otherwise disclosed in this report, which significantly affected or may significantly affect the operations of the consolidated entity, the result of those operations or the state of affairs of the consolidated entity in subsequent financial years.

# Directors' Declaration

In the directors' opinion:

• the attached financial statements and notes thereto comply with the Corporations Act 2001, Australian Accounting Standard AASB 134 'Interim Financial Reporting', the Corporate Regulations 2001 and other mandatory professional reporting requirements;

• the attached financial statements and notes thereto give a true and fair view of the consolidated entity's financial position as at 31 December 2010 and of its performance for the financial half-year ended on that date; and

• there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of directors made pursuant to section 303(5) of the Corporations Act 2001.

On behalf of the directors

Mr Ross Haghighat
Executive Chairman

Dated 28 February 2011

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# Independent Auditor's Review Report

**INDEPENDENT AUDITOR'S REVIEW REPORT**
**TO THE MEMBERS OF KARMELSONIX LIMITED**

Chartered Accountants
& Business Advisers

### Report on the Half-Year Financial Report

We have reviewed the accompanying consolidated half-year financial report of KarmelSonix Limited which comprises the statements of financial position as at 31 December 2010, the statements of comprehensive income, statements of changes in equity and statements of cash flows for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity. The consolidated entity comprises KarmelSonix Limited (the company) and the entities it controlled at 31 December 2010 or from time to time during the half-year ended on that date.

*Directors' Responsibility for the Half-Year Financial Report*

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of KarmelSonix Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

### Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half year financial report of the consolidated entity is not in accordance with the *Corporations Act 2001* including:

a) giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and of its performance for the half-year ended on that date; and
b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and *Corporations Regulations 2001*.

### Emphasis of Matter Material Uncertainty Regarding Continuation as a Going Concern

Without qualifying our conclusion, we draw attention to Note 1(c), under 'Going Concern' in the financial report which indicates that the consolidated entity had incurred an operating loss after tax attributable to members for the half year ended 31 December 2010 of $3,665,337 and cash outflows from operating activities of $2,033,621. These conditions, along with other matters as set forth in Note 1(c), give rise to a material uncertainty which may cast significant doubt about the ability of the consolidated entity to continue as a going concern, and therefore the consolidated entity may be unable to realise its assets and discharge its liabilities in the normal course of business.

PKF

PKF

D.J Garvey
Partner

28 February 2011
Melbourne

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