

MIKOH Corporation Limited

ABN 41 003 218 862

Appendix 4E

**PRELIMINARY FINAL REPORT
FOR THE YEAR ENDED 30 JUNE 2006**

Period 1 July 2005 to 30 June 2006

(Previous Corresponding Period 1 July 2004 to 30 June 2005)

Appendix 4E

Preliminary Final Report

Name of entity

MIKOH Corporation Limited

ABN or equivalent company reference	Half yearly (tick)	Preliminary final (tick)	Financial year ended ('current period')
41 003 218 862	<input type="checkbox"/>	<input checked="" type="checkbox"/>	30 June 2006

Results for Announcement to the Market

Results		\$A
Revenues from ordinary activities	Down	61% to 641,261
(Loss) from ordinary activities after tax attributable to members	Up	71% to (2,006,832)
Net (Loss) for the period attributable to members	Up	71% to (2,006,832)
Dividends (distributions)	Amount per security	Franked amount per security
Final dividend	NIL	NIL
Previous corresponding period	NIL	NIL
Record date for determining entitlements to the dividend,	<input style="width: 150px; height: 30px;" type="text" value="N/A"/>	
<p>The Company does not have a dividend reinvestment plan and no dividends are proposed to be declared for the current year.</p>		
<p>Note: This report is based on accounts that are in the process of being audited.</p>		
<p>This Appendix 4E should be read in conjunction with the Commentary on the Results of the Preliminary Financial Report for the year ended 30 June 2006 and with the accompanying notes to the Appendix 4E.</p>		

Commentary on the Results

COMMENTARY ON THE RESULTS

Review of Results

The 2005/2006 financial period was a year of significant investment in MIKOH's core business, during which strategic alliances were developed as a platform for future growth in all sectors. It was a year where MIKOH restored control over brands and technologies, and consolidated the Company's direction through market research, partnering, and targeted marketing and sales activities. Several capital raisings were undertaken during the year and the directors wish to thank shareholders for their support and welcome new shareholders to MIKOH Corporation Limited.

Market research results were used to redirect to those sectors where sales are expected to develop most rapidly. For example, the company now believes that licensing revenues for Smart&Secure will take longer than anticipated, and is instead refocusing on niche security applications in government. Also, as explained later in this report, market research indicated that the company should be looking at targeting specific market niches for our printers. While these adjustments are expected to generate improved sales in the coming year, course corrections such as this necessarily create a dislocation, and as a result sales revenue for the past year fell from \$1,657,277 in 2005 to \$641,261 in 2006, a decrease of 61%. The majority of the revenue reduction related to the company's range of digital ink-jet printers, where sales dropped 71%.

The Consolidated Entity recorded a loss of \$2,006,832 for the year, compared to a prior year loss of \$1,174,074. This increased loss was consistent with the reduced revenue, with operating costs consistent year to year. However as foreshadowed in last year's Annual Report, administration expenses were reduced substantially, and marketing and sales expenses increased.

While the results of this increased marketing effort were not evident in 2005/06, the Directors are confident of a substantially improved performance in 2006/07 as the Company's refocused activities over the last twelve months generate additional revenues.

Further detail on these efforts, and the company's prospects, are provided below for each product sector.

Security Products

MIKOH made notable progress in positioning Smart&Secure as a vital protection technology for use in most RFID implementations. This progress can be summarised with the following activities:

- A Fortune 100 company directly placing a purchase order for the supply of Smart&Secure Tags for evaluation in the Ground Transportation sector and other key target markets where this company has the market presence to enable global deployment;
- A leading US Government agency placing a purchase order for Smart&Secure Tags for an asset management application that has widespread requirements;
- Negotiations are continuing with a US-based international company regarding the use of Smart&Secure RFID tags to monitor a specific detection device sold by the company. The next step is to develop a new Smart&Secure tag design for pilot programs that are expected to commence in 2007 with global rollout expected in 2008, with anticipated volumes of approximately 10 million tags per year;
- Telstra and MIKOH partnering to supply Smart&Secure RFID tags to the Australian market;
- MIKOH entering into agreement with a Korean technology company to license Smart&Secure for the Korea, Japan and China markets;
- MIKOH entering into agreement with a Malaysia-based technology company to promote Smart&Secure in SE Asia;
- MIKOH's Chief Technology Officer, Dr Peter Atherton, appointed as Chief Technology Officer of the RFID sub-committee for the Washington-DC based Industry Advisory Council (IAC) which advises US government bodies (federal, state and local) on issues relating to RFID;

Commentary on the Results

- MIKOH designed and patented a Secure Container technology that it is currently promoting to US federal agencies for use in document and equipment security applications – the company is also developing relationships with system integrators to promote the technology in commercial applications;
- MIKOH has developed (and lodged patent protection) and plans to license a new tag design for retail applications.

The Directors are confident that physical security will be required for tags in most RFID applications and are preparing the Company for significant growth in demand for Smart&Secure during the next several years.

Radio Frequency Identification (RFID) Tags

Sales of Smart&Secure tags fell from \$314,263 in 2005 to \$248,820 in 2006, while Smart&Secure consulting revenue in 2005 of \$167,533 was not repeated.

This result does not accurately reflect MIKOH's RFID successes during the past year, however, as 2006 was a period of controlled positioning in what is a substantial and expanding market opportunity for the company.

During late 2005 MIKOH engaged the services of Denver-based public relations company Visitech PR to raise the profile of MIKOH as the leading provider of secure RFID. This resulted in over 60 articles in RFID and end-user industry publications, and generated interest from major corporations that are referenced later in this report. MIKOH will resume its public relations campaign in the latter part of calendar 2006.

MIKOH is becoming increasingly focused on realising its potential in the rapidly developing RFID industry, and is directing more resources to commercialising its security products, which include Smart&Secure, the Secure Container, the recently-announced Retail (RFID) Tag, and SubScribe (non-RFID security seal).

RFID General Market Overview

RFID is a wireless data collection technology that uses electronic tags for storing data. Like bar codes, RFID tags are used to identify items. Unlike bar codes, which must be brought within view of the scanner for reading, RFID tags do not require line-of-sight and can be read when they are within the reasonable proximity of a transmitted radio signal.

Most large-scale RFID applications are driven by the expectation of increased process efficiency or reduced operating costs, and to date have been supply-chain based. In supply chain deployments all companies in the chain must participate for the full benefits of RFID to accrue. Because of this all-or-nothing situation, RFID has been slow to develop in such applications.

In some application areas RFID adoption is driven by other factors, such as security. MIKOH's Smart&Secure technology provides physical security for RFID tags, and so MIKOH is focused on applications where security is a critical requirement – in particular government niche applications (in both defence and civilian agencies), ground transportation, and pharmaceuticals.

Analysts differ greatly on the size of the global RFID market. However the following is provided to indicate the overall growth potential for the technology.

RFID Market Size (US\$B), Venture Data

2004	2005	2006	2007	2008	2009	2010
\$1.8	\$2.4	\$2.7	\$4.3	\$5.9	\$6.0	\$6.1

Commentary on the Results

RFID Spending (US\$B), Gartner

2004	2005	2006	2007	2008	2009	2010
\$0.4	\$0.5	\$0.7	\$1.0	\$1.3	\$2.1	\$3.0

Analysts do agree that the benefits demonstrated so far in pilot programs show promise of justifying large-scale deployment of RFID solutions in specific markets. In MIKOH's target markets, where security is a focus, the return on investment is different and in most applications more compelling.

Smart&Secure – Security for RFID Tags

MIKOH's focus is on providing physical security for RFID tags through inclusion of its Smart&Secure™ technology, which causes an RFID tag to stop working if it is tampered with or moved from one item to another.

Physical security for RFID tags is essential in ensuring that an RFID system collects reliable data regarding tagged items, since the system detects only the RFID tags, and from this infers the presence of each corresponding tagged item. Without tag security, an RFID system cannot effectively be used to combat product counterfeiting and substitution, or to ensure secure track & trace operations, or to provide security for asset management systems, or to ensure product and document authenticity.

Smart&Secure has been patented in the US, with parallel patents pending in other countries. MIKOH believes the technology will prove crucial to the widespread adoption of RFID in most anticipated markets. Without Smart&Secure, RFID tags do not reliably indicate the presence of the tagged items.

RFID Tag Security - Market Perception

RFID end-users in a variety of application areas are increasingly placing importance on the physical security of tags. A survey of US federal agencies (both defence and civilian) was undertaken recently by the Washington-DC based Industry Advisory Council. The results were published in the September 11th issue of Government Computer News (www.gcn.com). The survey results indicate that asset management and inventory control are expected to be the most common future applications of RFID, with passive tags (the lowest cost RFID tags that do not include a battery) the most widely used tag type. Smart&Secure is specifically designed to detect tag tampering.

The primary anticipated benefit resulting from the adoption of RFID was found to be increased security (ahead of increased asset visibility and increased speed of operation), while the greatest security concern regarding RFID was found to be tag security (including tag cloning, "spoofing", and tag tampering), ahead of issues such as data security and privacy.

Smart&Secure Licensing – Korea and Malaysia

During the year MIKOH announced that it had entered into agreements to expand its product offering in Malaysia and Korea (including Japan and China). This licensing model allows MIKOH to pursue RFID opportunities outside of Australia and the US while incurring only a marginal increase in costs. Additionally, to meet its production requirements in the next several years, it is important that MIKOH extends its production from the US into Malaysia and Korea and these agreements make provision for such expansion.

Smart&Secure Markets – Ground Transportation

Electronic Vehicle Registration (EVR) refers to the use of an RFID tag, usually applied to a vehicle windscreen, to store the vehicle's registration information. This information can be read and verified as the vehicle moves past a read point, and penalties can be automatically processed for vehicles that do not have valid registration status. In most countries a significant proportion of vehicles on public

Commentary on the Results

roads are unregistered – typically around 10%, and sometimes higher. Enforcing vehicle registration laws can result in the recovery of substantial government revenue.

It is estimated that there are over 600 million motor vehicles in the world today. If present trends continue, the number of cars on Earth will double in the next 30 years to 1,200,000,000¹.

To capture some of this market potential, MIKOH has collaborated with TransCore to develop a Smart&Secure vehicle tag that can be used for EVR. The tag has been thoroughly tested for use on vehicles, and can readily be adapted for use in RFID systems other than TransCore's. MIKOH has supplied this tag for use in US government vehicle access control applications.

EVR is a global application that has been slow to develop in the USA, due primarily to privacy issues raised by civil liberty groups. It is being aggressively marketed outside the US by RFID system integrators, and MIKOH is optimistic of sales progress in the near term, with the possibility of large-scale contracts on a country-by-country basis in the medium term.

Smart&Secure Markets – Government Applications

MIKOH has laid the foundation for entry into US government high security niche applications, both in defence and civilian agencies, and was pleased to announce recently the first Smart&Secure tag order from a leading high security US agency (see MIKOH announcement dated 18 August 2006). The company will continue to focus on these applications, where Smart&Secure meets critical end-user security requirements.

Smart&Secure Markets – Commercial Applications

During the past six months or so MIKOH has worked towards developing strategic relationships with RFID and systems integrators that can access specific Smart&Secure target applications, including:

- secure asset and inventory management;
- ground transportation;
- supply chain security;
- anti-counterfeiting;
- document security;
- sealing of equipment, containers and locations.

Smart&Secure in Telstra

On 28 July 2006 MIKOH announced a three-year Sales, Marketing and Supply Agreement with Telstra Corporation Limited.

This was a significant step for MIKOH in that it brought back to Australia some of the technology that the company has been working on for the past several years, and represents recognition by an Australian icon such as Telstra. The supply agreement also provides for joint promotion of Smart&Secure by MIKOH and Telstra. Additionally, the technology will be showcased in Telstra's Melbourne Centre of Excellence. This will demonstrate RFID technology from leading RFID component suppliers and system integrators – in MIKOH's case demonstrating the importance of tag physical security – and will be an ideal forum for end users to evaluate the benefits of Smart&Secure.

Smart&Secure and the Secure Container

A cost-effective alternative to item-level tagging with Smart&Secure RFID tags is container-level tagging. In this approach an RFID tag is applied to a container that houses multiple items, rather than

¹ Source: http://globalwarming.enviroweb.org/ishappening/sources/sources_co2_facts3.html

Commentary on the Results

to each item in the container. The container tag is read in order to monitor or track the container, and to determine whether the container (and therefore the container contents) has been tampered.

This approach allows items such as documents, equipment, or seized goods to be securely stored or transported in containers sealed using Smart&Secure tags. It can also be used to resolve the problem of reading tagged items in containers as the containers are moved at high speed through a supply chain. This problem has been encountered by integrators deploying RFID within the pharmaceutical supply chain. When a sealed container is used, only a single tag need be read to detect the container (and therefore also the container contents) and determine whether the container contents have been tampered with or stolen.

MIKOH has developed a prototype secure container, as demonstrated at the Shareholder Information Session held on 14 June 2006. During 2007 the company is expecting to develop further partnerships with system integrators, the objective being to launch the Secure Container into US federal government applications and targeted commercial applications such as the pharmaceutical supply chain.

Smart&Secure and the Retail Tag

On 23 August 2006 MIKOH announced that it had developed and applied for patent protection for an RFID tag that is intended for use in high-volume retail applications of RFID.

The tag provides two important capabilities:

- It provides an easy way for a consumer, after purchasing a product that is labeled with an RFID tag, to reduce the tag's read distance and thereby prevent privacy infringements. (Privacy is a major concern in retail applications. RFID tags used to label consumer goods could, in theory, be monitored after the goods have been purchased in order to track consumer buying habits). The tag's full read distance can easily be restored if the product is later returned to the retailer.
- It includes Smart&Secure, thereby providing a way for the consumer to completely disable the tag before discarding it (in the event there are any lingering privacy concerns), and prevents the tags being moved from one item to another (e.g. counterfeit goods or fraudulent product returns).

Since the retail tag is intended for consumer applications rather than MIKOH's core security business, the company's intention during 2007 is to license the technology to RFID tag manufacturers that supply into retail applications. This is a long term project and revenues are not expected to flow during the 2006/2007 financial year.

SubScribe

The directors are pleased with progress following the decision to move SubScribe to MIKOH's Preston facility, as the SubScribe product range is now tracking profitably. Revenue dropped from \$97,265 in 2004/05 to \$65,791 in 2005/06 when substantial difficulties were encountered transitioning production from the previous licensee. However, income increased almost tenfold in the second half of the calendar year compared to the first half.

The technology has enjoyed a steady increase in demand in a number of key application areas, including:

- Asset management;
- Chain of custody;
- Document sealing & authentication;
- ID & membership card validation;
- Equipment warranty non-tampering validation;
- Product identification;
- Records management;
- Safe hand shipments;
- Utility metering.

Commentary on the Results

MIKOH expects to see a further increase in demand for SubScribe – in particular in Australia and the US – since it provides a low-cost entry to essentially the same applications as MIKOH is targeting with its RFID products.

Since moving the SubScribe business to MIKOH's Preston facility and as the market for SubScribe developed in the security area, the reporting of this technology has been moved from the Digital Marking Products to the company's Security Products division.

Digital Marking Products

The revenue from Digital Marking Products fell from \$1,057,209 in 2005 to \$313,156 in 2006. During the year MIKOH grew the number of ink-jet printer sales prospects, and was expecting to convert some of these to revenues. Unfortunately, the sales cycle for industrial-grade ink-jet printers – and more generally for the industrial Variable Data Printing (VDP) market – has proven to be well in excess of 12 months, and only two MIKOH printers were sold during the year.

Several of the prospects that were expected to proceed during 2006 put their decisions on hold awaiting MIKOH's next-generation printer. This printer is based on new ink-jet print heads that MIKOH expected from the manufacturer several months ago, but which have been delayed until later this month (September). MIKOH will develop and demonstrate the new printers as quickly as possible, and is optimistic this will lead to more immediate orders.

The sales pipeline in MIKOH's ink-jet print business has consistently been promising. However as the longer-than-expected sales cycle became evident, MIKOH commissioned a report from a New York-based market research organisation, GrokChina, to determine whether MIKOH's sales cycle is characteristic of the VDP market, and whether MIKOH should re-position its printer product offerings.

The findings of the report can be summarised as follows:

- MIKOH's printer technology is well positioned to capture some of the projected mid-range digital printer market (i.e. digital printers of the type MIKOH produces) of US\$950M in 2005, growing to US\$2.2B by 2008;
- The VDP market is expected to experience stronger growth than most other printing sub-markets over the next several years;
- MIKOH's printers are technologically superior in certain respects, giving them a competitive edge in specific market niches;
- Sales lead times are typically in excess of 12 months;
- Specialised applications should be targeted within specific market niches.

MIKOH is factoring these findings into its future strategy for this line of products.

Consolidated Income Statement

For the year ended 30 June 2006

	Note	Year ended 30 June 2006 \$	Year ended 30 June 2005 \$
Revenue from ordinary activities	2	641,261	1,657,277
Less cost of goods sold		-368,552	-697,870
Gross Profit		<u>272,709</u>	<u>959,407</u>
Expenses by function:-			
Manufacturing		-160,734	-156,059
Administration and general		-719,688	-918,927
Finance costs		0	-3,390
Marketing and sales		-910,076	-694,038
Research and development		<u>-685,966</u>	<u>-564,662</u>
Loss before income tax	2	-2,203,755	-1,377,669
Income tax benefit		<u>196,923</u>	<u>203,595</u>
Loss for the year		<u>-2,006,832</u>	<u>-1,174,074</u>
Basic loss per share for the year	15	(1.48 cents)	(1.15 cents)
Diluted loss per share for the year	15	(1.48 cents)	(1.15 cents)

The accompanying notes form part of these financial statements.

Consolidated Balance Sheet

As at 30 June 2006

	Note	30 June 2006 \$	30 June 2005 \$
Current Assets			
Cash assets		83,594	922,311
Trade and other receivables	3	56,902	107,018
Inventories	4	192,514	140,474
Other assets	5	188,714	238,758
Total Current Assets		<u>521,724</u>	1,408,561
Non-Current Assets			
Plant and equipment	6	287,304	296,500
Total Non-Current Assets		<u>287,304</u>	296,500
Total Assets		<u>809,028</u>	1,705,061
Current Liabilities			
Trade and other payables	7	833,086	743,151
Provisions	8	64,804	39,677
Other liabilities	9	0	71,103
Total Current Liabilities		<u>897,890</u>	853,931
Non-Current Liabilities			
Trade and other payables	10	0	26,113
Provisions	11	172,442	165,584
Total Non-Current Liabilities		<u>172,442</u>	191,697
Total Liabilities		<u>1,070,332</u>	1,045,628
Net Assets		<u><u>-261,304</u></u>	659,433
Equity			
Issued capital	12	22,130,811	21,067,512
Reserves	13	52,088	29,292
Accumulated losses	14	-22,444,203	-20,437,371
Total Equity		<u><u>-261,304</u></u>	659,433
Net tangible asset backing per ordinary security		(0.18) cents	0.51 cents

The accompanying notes form part of these financial statements.

Consolidated Cash Flow Statement**For the year ended 30 June 2006**

	Note	Year ended 30 June 2006 \$	Year ended 30 June 2005 \$
Cash Flows from Operating Activities (inclusive of Goods and Services Tax)			
Receipts from Customers		614,257	1,975,551
Payments to suppliers and employees		<u>-2,472,775</u>	<u>-2,731,353</u>
		-1,858,518	-755,802
Interest received		<u>14,139</u>	8,590
Net cash outflow from operating activities	16	<u>-1,844,379</u>	<u>-747,212</u>
Cash Flows from Investing Activities			
Payments for plant and equipment		<u>-57,196</u>	<u>-67,350</u>
Net cash outflow from investing activities		<u>-57,196</u>	<u>-67,350</u>
Cash Flows from Financing Activities			
Proceeds from the issue of shares		1,090,840	1,376,526
Payment for share issue expenses		<u>-27,542</u>	<u>-99,924</u>
Net cash inflow from financing activities		<u>1,063,298</u>	<u>1,276,602</u>
Net decrease in cash held		-838,277	462,040
Cash at the beginning of the year		922,311	468,381
Effects of exchange rate changes on cash		<u>-440</u>	<u>-8,110</u>
Cash at the end of the year		<u>83,594</u>	<u>922,311</u>

The accompanying notes form part of these financial statements.

Consolidated Statement of Changes in Equity

For the year ended 30 June 2006

	Note	Year ended 30 June 2006 \$	Year ended 30 June 2005 \$
Total equity at the beginning of the period		659,433	610,584
Exchange differences on translation of foreign operations		<u>9,023</u>	-38,156
Total income and expense for the period recognised directly in equity		9,023	-38,156
Profit (loss) for the period		<u>-2,006,832</u>	-1,174,074
Total recognised income and expense for the half year		-1,997,809	-1,212,230
Transactions with equity holders in their capacity as equity holders:			
Issue of share capital		1,090,840	1,370,276
Less share issue expenses		-27,541	-115,447
Issue of share options		13,773	
Exercise of options			<u>6,250</u>
Total equity at the end of the period		<u><u>-261,304</u></u>	<u>659,433</u>

The accompanying notes form part of these financial statements.

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

BASIS OF PREPARATION OF THE FULL YEAR FINANCIAL REPORT

The full-year financial report does not include all notes of the type normally included within the annual financial report. The preliminary financial report should be read in conjunction with annual financial report as at 30 June 2005, which was prepared based on Australian Accounting Standards applicable before 1 January 2005 (AGAAP). It is also recommended that the preliminary financial report be considered together with any public announcements made by MIKOH Corporation Limited during the year ended 30 June 2006 in accordance with the continuous disclosure obligations arising under the Corporations Act 2001.

The preliminary financial report is a general purpose financial report prepared in accordance with the Corporations Act 2001 and applicable accounting standards including AASB 134 'Interim Financial Reporting'.

The consolidated entity changed its accounting policies on 1 July 2004 to comply with Australian Equivalents to International Financial Reporting Standards (AIFRS). The transition to AIFRS was accounted for in accordance with AASB1 'First-Time Adoption of Australian Equivalents to International Financial Reporting Standards', with 1 July 2004 as the date of transition. The comparative financial data for the year ended 30 June 2005 has been restated accordingly. An explanation of how the transition from AGAAP to AIFRS has affected the consolidated entity's financial position and financial performance is provided in Note 6.

The accounting policies detailed below have been applied in preparing the financial statements for the year ended 30 June 2006, the comparative information presented in these financial statements, and in the preparation of the AIFRS balance sheet at 1 July 2005.

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Going Concern

As at 30 June 2006 the consolidated entity had a deficit of capital and reserves of \$261,304 (30 June 2005 surplus of \$659,433) and a working capital deficit of \$376,166 (30 June 2005 - surplus of \$554,630). The consolidated entity has experienced operating losses during the year ended 30 June 2006 amounting to \$2,006,832 (up from \$1,174,074 last year) and negative net operating cash flows of \$1,844,379 (up from \$747,212 for last year). Accordingly, the continuing viability of the consolidated entity and its ability to continue as a going concern and meet its debts and commitments as they fall due are dependent upon the consolidated entity being successful in the following objectives:-

- Achieving sufficient future cash flows from its operations to enable its obligations to be met; and/or
- Establishing strategic alliances to assist in funding the commercialisation of the technologies; and/or
- Obtaining additional funding or capital raising.

As a result of the financial position outlined above, there is significant uncertainty whether the consolidated entity will continue as a going concern and, therefore, whether it will realise its assets and settle its liabilities and commitments in the normal course of business and at the amounts stated in the financial report. However, the directors currently believe that the consolidated entity will be successful in achieving the above objectives and accordingly have prepared the financial report on a going concern basis.

At this time, the directors are of the opinion that no asset is likely to be realised for an amount less than the amount at which it is recorded in the financial report as at 31 June 2006. Accordingly, no adjustments have been made to the financial report relating to the recoverability and classification of the asset carrying amounts or the amounts and classification of liabilities that might be necessary should the consolidated entity not continue as a going concern.

(b) Principles of Consolidation

The consolidated financial statements comprise the financial statements of MIKOH Corporation Limited and its subsidiaries (the Group). The financial statements of subsidiaries are prepared for the same reporting period as the parent, using consistent accounting policies.

In preparing the consolidated financial statements, all intercompany balances and transactions, and any unrealised profits arising within the consolidated entity, are eliminated in full.

(c) Cash and cash equivalents

Cash in the balance sheet comprise cash on hand, cash at bank, and short-term deposits with an original maturity of 30 days or less.

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

(d) Employee Benefits

Provision is made in the financial statements for all employee benefits, including on-costs, when it is probable that settlement will be required and they are capable of being measured reliably.

Liabilities for salaries and wages (including non-monetary benefits), annual leave and long service leave expected to be settled within 12 months of the reporting date are recognised in respect of employees' service up to the reporting date, and are measured at the amounts expected to be paid when the liabilities are settled.

The liability for annual leave and long service leave expected to be settled more than 12 months from the reporting date are measured as the present value of the expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to expected future salary and wage levels, experience of employee departures, and periods of service. Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match, as closely as possible, the estimated future cash outflows.

Contributions to employee superannuation funds are expensed as the contributions are paid or become payable.

(e) Foreign Currency Translation

Transactions

Both the presentation and functional currency of MIKOH Corporation Limited and its Australian subsidiaries is Australian dollars, whereas the functional currency of MIKOH Corporation is US dollars.

Transactions denominated in foreign currencies (currencies other than the functional currency of an entity) are recorded using the exchange rate ruling at the date of the underlying transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date. Non-monetary items measured at fair value in a foreign currency have been translated using the exchange rates ruling when the fair value was determined.

Foreign Entities

Foreign entities' income statements are translated at the weighted average exchange rates for the period. The exchange differences arising on the translation are taken directly to a separate component of equity. The balance sheets are translated at the closing rate on the balance sheet date.

(f) Goods and Services Tax

Revenues, expenses and assets are recognised net of GST except

- i. where the amount of GST incurred on a purchase of goods or services is not recoverable from the relevant taxation authority, in which case it is recognised as part of the cost of acquisition of the asset or as part of the expense item, as applicable; and
- ii. for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet. Cash flows are included in the cash flow statement on a gross basis, and the GST component of cash flows arising from financing and investing activities which is recoverable from or payable to the taxation authority are classified as operating cash flows.

(g) Impairment of Assets

Amounts paid for the acquisition of identifiable intangible assets are capitalised at the fair value of the consideration paid. Identifiable intangible assets with a finite life are amortised on straight-line basis over their anticipated useful lives.

At each reporting date, the consolidated entity reviews the carrying amount of its tangible and intangible assets to determine whether there is any indication that the carrying value of those assets has been impaired. Where any such indicator of impairment exists, the recoverable amount of the asset is estimated to determine the extent, if any, of the impairment. Recoverable amount is the greater of fair value less costs to sell, and the value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Where the asset does not generate cash inflows that are largely independent from those of other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

(h) Income Tax

Current tax is calculated as the income taxes payable or recoverable in respect of the taxable profit or loss for the period, using tax rates and tax laws enacted or substantively enacted at the reporting date. It includes any adjustment to tax payable or recoverable in respect of previous years.

Deferred tax is provided for using the balance sheet liability method, providing for the tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes, and the amounts used for tax assessment or deduction purposes.

Deferred income tax assets are recognised to the extent that it is probable that sufficient taxable profits will be available against which deductible temporary differences, and the carry-forward of unused tax losses and unused tax losses can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets or liabilities (other than as a result of a business combination) which, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss. In addition, a deferred tax asset is only recognised in relation to investments in subsidiaries to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

(i) Leased Assets

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

(j) Trade and Other Payables

Trade payables and other accounts payable are recognised when the consolidated entity becomes obligated to make future payments resulting from the purchase of goods and services. They are initially recognised at fair value, which is the amount expected to be paid, and subsequently at amortised cost.

(k) Plant & Equipment

Plant and equipment, and leasehold improvements, are stated at cost less accumulated depreciation and any impairment losses. Cost includes any expenditure that is directly attributable to the acquisition of the item.

The depreciation of plant and equipment is calculated to write off the net cost of each asset over its expected useful life. Estimates of remaining useful lives for all fixed assets are reviewed at least annually. The expected useful lives for plant and equipment at acquisition are between 3 and 10 years.

Leasehold improvements are depreciated over the shorter of the period of the lease, or the useful life, using the straight line method.

(l) Research and Development

Expenditure incurred on research and development activities and on patent registration is expensed as incurred on the basis that continuing research is part of the cost of being in business. To the extent that future benefits deriving from development expenditure are expected beyond reasonable doubt to exceed such expenditure, these costs are capitalised and amortised over the period of expected benefit.

(m) Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the consolidated entity and the revenue can be reliably measured. Amounts disclosed as revenue are net of returns, trade allowances, and duties and taxes paid. The following specific recognition criteria must also be met before revenue is recognised:

- Sale of goods - Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, which occurs at the time of delivery to the buyer.
- Other revenue - Other revenue, such as licensing fees and consulting fees, is recognised as it is earned. In the case of consulting jobs in process at balance date, revenue is recognised by reference to the stage of completion.

Income received but not earned as at balance date, as it is expected to be earned within twelve months, is deferred, and treated as a current liability.

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

(n) Share-Based Payments

For equity-settled share-based payments, the fair value at grant date of the equity instrument is charged to the income statement on a straight-line basis over the vesting period, based on the consolidated entity's estimate of shares that will ultimately vest. The corresponding accrued employee entitlement is recorded in the Employee Share Options reserve.

Fair value is measured by an external valuer using a binomial model, which considers the following factors:

- exercise price
- expected life of the award
- current market price of the underlying shares
- expected share price volatility
- expected dividends
- risk-free interest rate

(o) Trade and Other Receivables

Trade receivables, which generally have terms of from 14 to 30 days, are recognised initially at fair value, and subsequently at amortised cost, less an allowance for any uncollectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

2. Profit from operations

	Consolidated	
(a) Revenue	2006	2005
Revenue from continuing operations consisted of the following items:	\$	\$
Sale of goods	650,379	1,412,488
Consulting fees	0	167,533
Royalties and license fees	-8,000	56,250
Interest from other entities	13,494	8,590
Export Market Development Grant	-14,612	12,390
Sundry income	0	26
Total revenues from ordinary activities	641,261	1,657,277

(b) Expenses

The loss before income tax has been arrived at after charging the following expenses:

Interest paid to other entities	247	0
Net loss on disposal of plant and equipment	0	3,508
Depreciation of plant and equipment	66,465	70,978
Net bad and doubtful debts expense	2,810	105,332
Contributions to defined benefit superannuation plans	41,028	37,616
Equity settled share based payments	13,773	67,448
Operating lease rental expenses:		
Minimum lease payments	152,708	20,165
Contingent rental expenses	0	32,729
Research and development	685,966	564,662

(c) Unusual Items

Inventory write-down to net realisable value	0	65,000
--	---	--------

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

3. Current trade and other receivables	Consolidated	
	2006	2005
	\$	\$
Trade receivables	28,993	169,908
Allowance for doubtful debts	-1,035	-105,018
	27,958	64,890
Goods and services tax receivable	10,973	17,187
Other receivables	17,971	24,941
	56,902	107,018

4. Inventories

Raw materials at cost	128,747	74,609
Finished goods at cost	63,767	65,865
	192,514	140,474

5. Other current assets

Prepayments	5,675	52,260
Accrued income	183,039	186,498
	188,714	238,758

6. Plant and equipment

Net Book Value	Leasehold Improvements	Plant and Equipment	Total
	\$	\$	\$
as at 30 June 2005	0	296,500	296,500
as at 30 June 2006	13,621	273,683	287,304

7. Current trade and other payables	Consolidated	
	2006	2005
	\$	\$
Trade payables	561,301	396,431
Goods and services tax payable	797	0
Sundry creditors and accruals	270,988	346,720
	833,086	743,151

8. Current provisions

Employee benefits	64,804	39,677
-------------------	--------	--------

9. Other current liabilities

Unearned income	0	71,103
-----------------	---	--------

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

10. Non-current trade and other payables	Consolidated	
	2006	2005
Trade payables	\$ 0	\$ 26,113

11. Non-current provisions

Employee benefits	172,442	165,584
-------------------	---------	---------

12. Issued capital	Consolidated	
	2006	2005
147,223,238 fully paid ordinary shares (2005: 128,917,375)	\$ 22,130,811	\$ 21,067,512

Fully paid ordinary shares	Number	\$
Balance as at 30 June 2004	96,669,433	19,806,433
Exercise of options on 17 September 2004	125,000	6,250
Placement on 15 February 2005	10,636,713	404,195
Rights issue on 6 June 2005	21,486,229	966,081
Costs associated with issue of shares		-115,447
Balance at 30 June 2005	128,917,375	21,067,512
Placement on 10 November 2005	5,386,000	350,090
Placement on 15 March 2006	8,800,000	440,000
Placement on 9 May 2006	4,119,863	300,750
Costs associated with issue of shares		-27,541
Balance at 30 June 2006	147,223,238	22,130,811

Share Options

The consolidated entity has an ownership based remuneration scheme for directors and executives under which share options are issued at the discretion of the Board.

	2006	2005
	Number	Number
Balance at the beginning of the financial year	12,166,800	10,287,700
Granted during the financial year	1,000,000	5,500,000
Exercised during the financial year		-125,000
Lapsed during the financial year		-3,495,900
Balance at the end of the financial year	13,166,800	12,166,800

In addition, 10,636,952 listed options expired during the year ended 30 June 2005.

Options outstanding as at 30 June 2006 were

<u>Expiry Date</u>	<u>Exercise price per option</u>	<u>Number</u>
15/07/2006	15 cents	1,666,800
25/09/2008	20 cents	5,000,000
31/12/2008	10 cents	1,000,000
31/03/2010	10 cents	2,500,000
31/03/2010	15 cents	1,000,000
31/03/2010	20 cents	1,000,000
31/03/2011	10 cents	500,000
31/03/2011	15 cents	250,000
31/03/2011	20 cents	250,000

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

13. Reserves	Consolidated	
	2006	2005
	\$	\$
Employee equity-settled benefits reserve	81,221	67,448
Foreign currency translation	-29,133	-38,156
	52,088	29,292

Employee equity-settled benefits reserve

Balance at the beginning of the financial year	67,448	0
Share-based payment	13,773	67,448
Balance at the end of the financial year	81,221	67,448

Foreign currency translation

Balance at the beginning of the financial year	-38,156	0
(Deficit)/surplus from translation of financial statements of foreign operations	9,023	-38,156
Balance at the end of the financial year	-29,133	-38,156

14. Retained Earnings

Balance at the beginning of the financial year	-20,437,371	-19,263,297
Net profit/(loss) attributable to members of the parent entity	-2,006,832	-1,174,074
Dividends paid	0	0
	-22,444,203	-20,437,371

15. Earnings per share

	Consolidated	
	2006	2005
	Cents per share	Cents per share
Basic earnings per share	-1.48	-1.15
Diluted earnings per share	-1.48	-1.15

The earnings and weighted average number of ordinary shares used in the calculation of basic earnings per share are as follows:

Earnings	-2,006,832	-1,174,074
Weighted average number of shares	135,557,624	102,202,649

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

16. Reconciliation of Net Cash provided by Operating Activities to Profit from Ordinary Activities after Income tax	Consolidated	
	2006	2005
	\$	\$
Profit (Loss) from ordinary activities after income tax	-2,006,832	-1,174,074
Add (less) non-cash flows included in loss		
Depreciation of non-current assets	66,465	70,978
Provision for doubtful debts	2,810	105,018
Net foreign exchange differences	9,391	
Equity settled share-based payments	13,773	
Net loss on sale of non-current assets		3,508
Changes in operating assets and liabilities		
Decrease (increase) in other debtors and prepayments	97,350	95,680
Decrease (increase) in inventories	-52,040	280,884
Increase (decrease) in trade and other creditors, provisions, and unearned income	24,704	-129,206
Net cash inflow (outflow) from operating activities	-1,844,379	-747,212

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

17. Segment Reporting

The consolidated entity has grouped its operations into two segments, Security Technologies and Digital Marking Technologies.

The following table presents the revenue and profit information by business segment for the years ending 30 June 2006 and 30 June 2005. Unallocated items represent corporate functions which cannot be directly attributed to either segment.

2005/2006	Security Technologies	Digital Marking Technologies	Unallocated	Consolidated
	\$	\$	\$	\$
Segment revenue	314,611	313,156	13,494	641,261
Segment result	-252,322	-246,892		-499,214
Unallocated revenue less unallocated expenses				-1,704,541
Profit/(loss) from ordinary activities before related income tax expense				-2,203,755
2004/2005				
	\$	\$	\$	\$
Segment revenue	583,628	1,073,649		1,657,277
Segment result	123,827	-767,531		-643,704
Unallocated revenue less unallocated expenses				-733,965
Profit/(loss) from ordinary activities before related income tax expense				-1,377,669

18. Contingent Liabilities

Since the last annual reporting date there has been no material change in any contingent liabilities.

19. Subsequent Events

On 16 August 2006 the company successfully completed a Share Purchase Plan which raised \$454,000 through the issue of 5,044,382 shares at 9 cents each, and on 7 September 2006 the company completed a private placement of 6,111,114 shares at 9 cents each, raising \$550,000. Other than that, no matters or circumstances have arisen since the end of the year that have significantly affected, or may significantly affect, the operations, results of operations, or state of affairs of MIKOH Corporation Limited and subsidiaries in subsequent accounting periods.

MIKOH Corporation Limited and Controlled Entities
Notes to Financial Statements for the year ending 30 June 2006

20. Impact of Adoption of Australian Equivalents to International Financial Reporting Standards

The impacts of adopting AIFRS on the total equity and profit after tax as reported under Australian Accounting Standards applicable before 1 January 2005 (AGAAP) are set out in the following tables and the notes that accompany the tables.

Reconciliation of total equity as presented under AGAAP to that under AIFRS

	1-Jul-04	30-Jun-05
	\$	\$
Total equity under AGAAP	898,139	805,536
<i>Adjustments to equity:</i>		
Impairment of assets (a)	-287,555	-146,103
Total equity under AIFRS	610,584	659,433

(a) Under AASB 136 'Impairment of Assets', the recoverable amount of an asset is determined as the higher of its fair value less costs to sell, and its value in use. Impairment losses under AIFRS were recognised for MIKOH's intangible assets. There was no tax effect of this transaction.

Reconciliation of profit after tax as presented under AGAAP to that under AIFRS

	Year ended 30-Jun-05
	\$
Profit after tax under AGAAP	-1,353,682
<i>Adjustments to equity:</i>	
Impairment of assets (a)	141,452
Foreign currency translation (b)	38,156
Profit after tax under AIFRS	-1,174,074

(a) Under AASB 136 'Impairment of Assets', the recoverable amount of an asset is determined as the higher of its fair value less costs to sell, and its value in use. Impairment losses under AIFRS were recognised for MIKOH's intangible assets. There was no tax effect of this transaction.

(b) The Group has elected to take the exemption in AASB 1 'First Time Adoption of Australian Equivalents to International Financial Reporting Standards' to not retrospectively recognise the cumulative translation differences for all foreign operations. At transition date (1 January 2004) this reserve is deemed to be nil under this exemption.

There were no tax effects of these transactions.

There were no material differences between the cash flow statements presented under AIFRS and those presented under AGAAP.