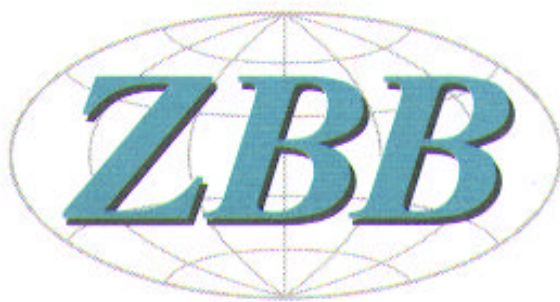


# **ZBB ENERGY CORPORATION**

A.R.B.N. 082 338 789



**ANNUAL REPORT  
2003**

## **ZBB ENERGY CORPORATION**

is a Wisconsin based developer of proprietary **zinc/bromine battery technology**. Headquartered and with its manufacturing and development facility in Menomonee Falls, Milwaukee, the Company also maintains research and development laboratories and regional marketing and administrative offices in Perth, Western Australia. The Company is ideally suited to focus regional marketing activities in both the Northern and Southern hemispheres.

The Company has 25.3 million shares of common stock outstanding on a fully diluted basis but it is not currently listed on any official stock exchange.

### **CORPORATE DIRECTORY**

#### **Directors**

Robert John Parry (Chief Executive Officer)  
Geoffrey David Hann (Chief Financial Officer)  
Richard Andrew Payne (Non Executive Director)  
Thomas George Folliard (Non Executive Director)

#### **President**

Robert John Parry

#### **Secretary**

Geoffrey David Hann

#### **Registered Office in United States**

780 North Water Street  
City of Milwaukee, Milwaukee County  
WISCONSIN USA 53202

#### **Principal Place of Business in United States**

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USA 53051

Tel: +1 262 253 9800  
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Email [zbbtec@zbbenergy.com](mailto:zbbtec@zbbenergy.com)

#### **Registered Office in Australia**

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**A.R.B.N.** 082 338 789

#### **Principal Place of Business in Australia**

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Website [www.zbbenergy.com](http://www.zbbenergy.com)

#### **Auditors in United States**

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W188 N11707 Maple Road  
Germantown,  
WISCONSIN USA 53022

#### **Attorneys in United States**

Godfrey & Kahn, SC  
780 North Water Street  
Milwaukee,  
WISCONSIN USA 53202

#### **Solicitors in Australia**

Richard Payne & Associates  
33 Colin Street  
West Perth WA 6005  
AUSTRALIA

#### **Share Registry**

Computershare Registry Services Pty Ltd  
Level 2, Reserve Bank Building  
45 St George's Terrace  
Perth WA 6000  
AUSTRALIA

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Fax: +61 8 9323 2033

## Chairman's Report

Dear Shareholders

Although this report covers the financial period to 30 June 2003, almost all of our shareholders would have received several reports during the year, including a formal Prospectus issued by GTN Resources Ltd (GTN) relative to the merger of GTN and ZBB which included a comprehensive review of operations up to 31 March 2003 and audited financial accounts for the Company up to that same date. It is therefore more relevant at this time to bring you up to date in this report and advise all shareholders of the most recent events surrounding both Corporate and Business Development activities within the Company.

### Corporate Developments;

At our January 2003 meeting of shareholders, in Australia, we announced the Board of Directors would immediately begin the process of seeking to list our Company's shares on an appropriate stock exchange, by way of an initial public offering (IPO). This led us into a process of discussion, and eventually into a merger agreement with a listed Australian Company, GTN, and which if successfully concluded would have achieved the stated objective of giving all of ZBB's shareholders new ZBB shares tradable on the Australian Stock Exchange (ASX). The merger agreement with GTN was conditional upon attracting a minimum level of new investment into the merged company and accordingly a Prospectus was prepared and issued for this purpose. Shareholders received a copy of this comprehensive document in September 2003. The time period for raising the new investment was relatively short and expired on 31 October 2003 without the minimum new investment being concluded. Shareholders were advised of the unsuccessful result and the termination of the GTN merger transaction by letter from the Company on 7 November 2003.

Since that date the Company has moved swiftly to negotiate its own path forward toward achieving our IPO objective. To this end, on 15 December 2003 ZBB entered into a mandate agreement with Axis Financial Group (Australia) Ltd, Sydney and Melbourne based stock-broking firm and licensed securities dealers.

Under the terms of the mandate agreement, ZBB has appointed Axis as its financial advisors and lead managers for the proposed initial public offering (IPO) and listing of ZBB on the ASX. The process of listing of ZBB on the ASX will also include a pre-IPO fund raising of A\$3,000,000. Axis will manage ZBB's entire fund raising process and become underwriters to the IPO as well as providing "after market" support for ZBB stock once listed on the ASX. Your directors are very pleased with this major commitment by Axis to ZBB and believe it will lead to a successful listing of ZBB's shares.

The timing for the listing process is relatively short and is helped in part by the due diligence process that was completed as part of the proposed merger with GTN. We are aiming to achieve the IPO listing of ZBB in the second quarter of 2004.

During the first half of 2003 the Company raised significant funding by the issue of convertible notes to new investors, on terms that will see these new notes convert to ordinary shares as a part of the IPO process. We appreciate this support and welcome these new investors to ZBB.

### Business Development;

The past eighteen months has indeed been a period of significant advancement for the Company and its products, and has been the real highlight in our progress.

We have continued the operation of our 400kWh system under test in the United Energy, Ltd sub-station in Melbourne, Australia. This significant program has seen the successful demonstration of our large capacity storage systems for network support and capital deferment purposes, both of which are key target applications for our products within the utilities marketplace. We have arrived at a point where the future for this particular system now moves toward marketing, and away from our own test program.

Similarly the 400kWh testing program that has been undertaken with Detroit Edison Company in Michigan, USA has completed its most recent phase which was the integration by Detroit Edison of the ZBB battery system into the utilities own "remote dispatching" software program. This final step by the utility gives them the capability to remotely control and utilize various distributed generation assets within the utilities own network. Importantly, this demonstrates the flexibility of ZBB's modular energy storage systems.

We have enjoyed a closer working relationship in Australia with the Australian Greenhouse Office (AGO), which is committed to supporting the installation of our storage systems into renewable energy applications. We have been for some time working toward developing a system for a remote solar site in Western New South Wales (Australia) however there have been delaying circumstances outside of the Company's control which has resulted in ZBB and the AGO working together to re-site this particular system. We are encouraged by the commitment from AGO and their support of "energy storage" as a key facilitator in the optimisation of wind, solar and other renewable energy resources.

In March 2003 we entered into a significant product distribution agreement with California based company, PowerPlus Corporation. This agreement provides for the exclusive marketing, sales and distribution of ZBB's systems in the USA States of California, Arizona and Nevada. This is a milestone agreement for the Company and a format for future product distribution in other regions, globally.

Most recently, in December 2003 the Company was awarded a major contract by the California Energy Commission with support from the US Department of Energy, to install 2MW/2MWh of storage systems into the California grid system in conjunction with the power utility, PG&E and with participation from our distribution partner, PowerPlus. The bid process to win this contract was extensive and it is important to note that the project was evaluated extensively on both technical and financial bases and a demonstration of the commercial benefit to the State of California. The ZBB proposal received the highest ratings on these criteria, and was the only flow-battery energy storage system to receive a contract award, surely a resounding endorsement of our technology and products by these Government agencies.

In November 2003 the Company delivered two 50kWh, fully integrated, Z-Bess systems for installation on the Greenpoint building in Brooklyn, New York. These are the first two 50kWh modular systems, complete with power conversion systems for grid interaction, and to store solar generated power from photovoltaic panels installed on the building roof. This is a high profile demonstration project being conducted by PowerLight Corporation and the New York Solar Energy Research Development Authority. Testing of the entire building energy management system will commence in 2004.

We continued our "non-flow" battery development program in our Perth Australia research facility and successfully completed the two-year, Australian Government funded program, on time in June 2003. The results from this program have been most encouraging and the Company is now reviewing the status of the program and considering various options to move into a commercial product phase. This will include a full investigation of various partnership, joint venture and licensing possibilities toward maximizing the benefits from this program for the Company.

There has been a significant increase in the awareness of the role played by energy storage, both in the power utilities markets and in the renewable energy industry. Several high profile power blackouts during 2003, worldwide, have focused attention on the need for reliability in the power delivery Transmission and Distribution networks. ZBB's systems when distributed throughout these networks are designed to provide relief on stressed networks by injecting pre-stored power at critical zone and sub stations, and to additionally provide back-up power as needed. We expect to see a continued awareness of ZBB and its products through the coming year and particularly as we move into our high profile, California utility project.

Finally, I would again like to give particular thanks to our very dedicated and extremely talented group of employees in both of our facilities. It is important to recognize that a strong and viable company can only be built around strong, talented and reliable people and ZBB has such a core group of managerial, professional and technical staff to carry us successfully into the future.



Rob Parry  
Chairman and Chief Executive Officer

## **BOARD OF DIRECTORS**

The names and details of the directors of the Company in office during the financial year and until the date of this report are:

### **Robert John Parry (Chairman and Chief Executive Officer)**

Robert Parry is a Fellow of the Australian Society of Certified Practising Accountants. He was a foundation Director of ZBB (Australia) Ltd, which was the foundation company in 1982 for the ZBB group. He became Managing Director in 1987 and has been the Chief Executive Officer for the group since that date.

Mr Parry has extensive international experience in corporate management, finance and technology acquisition and transfer.

### **Geoffrey David Hann (Chief Financial Officer and Company Secretary)**

Geoffrey Hann has been the Company Secretary since 1992 and a Director of all the Company's subsidiary companies since that time. Mr Hann is a Certified Practising Accountant and has had extensive experience in the administration and management of public and private companies in Australia and the United Kingdom.

### **Richard Andrew Payne (Non Executive Director)**

Richard Payne is a solicitor who has practised in the corporate and commercial areas of law for 21 years. Mr Payne has had extensive experience in advising public and private companies and in acting as a director of public and private companies.

### **Thomas George Folliard (Non Executive Director)**

Thomas Folliard is a Certified Public Accountant. Mr Folliard is the Founder and President of Corporate Development Resources, Inc., a US organisation specialising in the provision of assistance to corporations in the area of financial and business strategy, capital raisings, mergers acquisitions and divestitures.

## **RESULTS AND DIVIDENDS**

The consolidated loss of the Company for the financial year ended 30 June 2003 was \$1,505,318. No dividend was declared or paid during the year.

## **SIGNIFICANT EVENTS AFTER BALANCE DATE**

Subsequent to year end, 444,228 options issued under the Corporation's KESOP and 2002 Stock Option Program were exercised at prices between US\$0.75 and US\$1.00 each in accordance with their terms and conditions.

On 31 October 2003 the proposed merger agreement between GTN Resources Limited and ZBB Energy Corporation was terminated.

Subsequent to year end, the holders of the 2,398,192 options that were due to expire on 31 January 2004 (referred to in Note 12 of the Consolidated Financial Statements) were offered the opportunity to have the same number of options issued to them with a 31 January 2006 exercise date should they exercise their 31 January 2004 options prior to 15 December 2003. As at 15 December 2003, 1,719,427 options had been exercised under these amended terms and conditions and accordingly 1,719,427 options with an expiry date of 31 January 2006 and an exercise price of A\$0.75 have been issued.

## ENVIRONMENTAL REGULATION AND PERFORMANCE

The Company is not subject to any particular or significant environmental regulation.

## DIRECTORS' BENEFITS

Disclosure of benefits provided to directors during the financial year is made in note 15 of the financial statements.

## DIRECTORS' MEETINGS

During the financial year, 4 directors meetings and 2 audit committee meetings were held. The number of meetings attended by each director during the year is as follows:

	DIRECTORS' MEETINGS		AUDIT COMMITTEE MEETINGS	
	Number of Meetings Held While in Office	Number of Meetings Attended While in Office	Number of Meeting Held While in Office	Number of Meetings Attended While in Office
Mr R.J. Parry	4	4	-	-
Mr R.A. Payne	4	4	2	2
Mr G.D. Hann	4	4	2	2
Mr T.G. Folliard	4	4	2	2

Signed in accordance with a resolution of directors.



Robert John Parry  
Chairman and Chief Executive Officer  
Milwaukee, 18 December 2003



Geoffrey David Hann  
Director and Chief Financial Officer

**ZBB ENERGY CORPORATION**  
**CONSOLIDATED PROFIT AND LOSS STATEMENTS**  
**FOR THE YEAR ENDED 30 JUNE 2003 AND THE YEAR ENDED 30 JUNE 2002**

	Notes	<b>2003</b> <b>\$US</b>	<b>2002</b> <b>\$US</b>
<b>SALES</b>		539,032	1,138,450
<b>COST OF SALES</b>		<u>187,686</u>	<u>878,228</u>
<b>GROSS PROFIT (LOSS)</b>		351,346	260,222
<b>SELLING &amp; ADMINISTRATIVE EXPENSES</b>		<u>2,588,407</u>	<u>1,764,852</u>
<b>LOSS FROM OPERATIONS</b>		(2,237,061)	(1,504,630)
<b>OTHER INCOME (DEDUCTIONS)</b>		<u>-</u>	<u>6,589</u>
<b>LOSS BEFORE CREDIT FOR INCOME TAXES</b>		(2,237,061)	(1,498,041)
<b>CREDIT FOR INCOME TAXES</b>	2	<u>731,743</u>	<u>490,009</u>
<b>NET LOSS</b>		<u>(1,505,318)</u>	<u>(1,008,032)</u>

See accompanying notes to consolidated financial statements.

**ZBB ENERGY CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
**AS AT 30 JUNE 2003 AND 30 JUNE 2002**

	Notes	2003 \$US	2002 \$US
<b>CURRENT ASSETS</b>			
Cash		142,051	32,017
Receivables	4	101,574	245,909
Inventories	5	<u>2,018,552</u>	<u>1,891,322</u>
<b>TOTAL CURRENT ASSETS</b>		<u>2,262,177</u>	<u>2,169,248</u>
<b>NON-CURRENT ASSETS</b>			
Plant and Equipment	6	600,959	738,924
Intangibles	7	1,929,072	1,768,199
Deferred Tax Benefit	2	<u>2,497,794</u>	<u>1,766,051</u>
<b>TOTAL NON-CURRENT ASSETS</b>		<u>5,027,825</u>	<u>4,273,174</u>
<b>TOTAL ASSETS</b>		<u><u>7,290,002</u></u>	<u><u>6,442,422</u></u>
<b>CURRENT LIABILITIES</b>			
Borrowings	8	2,089,908	794,894
Accounts Payable	9	296,222	342,856
Provisions	10	<u>47,787</u>	<u>47,332</u>
<b>TOTAL CURRENT LIABILITIES</b>		<u>2,433,917</u>	<u>1,185,082</u>
<b>NON-CURRENT LIABILITIES</b>			
Borrowings	11	<u>195,423</u>	<u>344,230</u>
<b>TOTAL LIABILITIES</b>		<u>2,629,340</u>	<u>1,529,312</u>
<b>STOCKHOLDERS' EQUITY</b>			
Common Stock	12	10,525,663	7,994,582
Accumulated Other Comprehensive Income - Currency Translation Reserve		(1,282,149)	(3,938)
Accumulated Deficit		<u>(4,582,852)</u>	<u>(3,077,534)</u>
<b>TOTAL STOCKHOLDERS' EQUITY</b>		<u>4,660,662</u>	<u>4,913,110</u>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>		<u><u>7,290,002</u></u>	<u><u>6,442,422</u></u>

See accompanying notes to consolidated financial statements.

**ZBB ENERGY CORPORATION**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**  
**FOR THE YEAR ENDED 30 JUNE 2003 AND THE YEAR ENDED 30 JUNE 2002**

	<u>Common Stock</u>		<u>Convertible Notes</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Accumulated Deficit</u>
	<u>Number of Shares</u>	<u>Amount</u>			
<b>Balance June 30, 2001</b>	12,737,500	6,846,574	-	533,133	(2,069,502)
Net Loss	-	-	-	-	(1,008,032)
Net Translation Adjustment	-	-	-	(537,071)	-
Stock Subscriptions (Refer Note 12)	3,078,020	1,148,008	-	-	-
<b>Balance June 30, 2002</b>	<u>15,815,520</u>	<u>7,994,582</u>	<u>-</u>	<u>(3,938)</u>	<u>(3,077,534)</u>
Net Loss	-	-	-	-	(1,505,318)
Net Translation Adjustment	-	-	-	(1,278,211)	-
Stock Subscriptions (Refer Note 12)	1,550,080	2,531,081	1,345,360	-	-
<b>Balance June 30, 2003</b>	<u>17,365,600</u>	<u>10,525,663</u>	<u>1,345,360</u>	<u>(1,282,149)</u>	<u>(4,582,852)</u>

See accompanying notes to consolidated financial statements.

**ZBB ENERGY CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEAR ENDED 30 JUNE 2003 AND THE YEAR ENDED 30 JUNE 2002**

	Notes	<b>2003</b> <b>\$US</b>	<b>2002</b> <b>\$US</b>
<b>CASHFLOWS FROM OPERATING ACTIVITIES</b>			
Net Loss		<u>(1,505,318)</u>	<u>(1,008,032)</u>
<b>ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>			
Depreciation and amortization		351,538	293,942
(Increase) decrease in accounts receivable		144,335	1,954
(Increase) in inventories		(127,230)	(404,848)
(Increase) in deferred tax benefit		(731,743)	(490,009)
Decrease in other assets		-	4,174
Increase (decrease) in accounts payable		(46,634)	162,232
Increase (decrease) in accrued liabilities		<u>453</u>	<u>(35,411)</u>
<b>NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>		<u>(1,914,599)</u>	<u>(1,475,998)</u>
<b>CASHFLOWS FROM INVESTING ACTIVITIES</b>			
Payments for the purchase of property		<u>(374,445)</u>	<u>(872,939)</u>
<b>NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES</b>		<u>(374,445)</u>	<u>(872,939)</u>
<b>CASHFLOW FROM FINANCING ACTIVITIES</b>			
(Decrease) increase in bank lines of credit		(57,404)	590,972
Proceeds (conversion) of convertible notes		1,345,360	-
Proceeds from capital leases		-	514,000
Proceeds of share issue		2,531,081	1,148,008
Principal payments on long-term debt		<u>(141,748)</u>	<u>(75,629)</u>
<b>NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES</b>		<u>3,677,289</u>	<u>2,177,351</u>
<b>FOREIGN EXCHANGE TRANSLATION</b>		<u>(1,278,211)</u>	<u>(537,071)</u>
<b>NET (DECREASE) INCREASE IN CASH AND EQUIVALENTS</b>		110,034	(708,657)
Cash and equivalents, beginning of year		<u>32,017</u>	<u>740,674</u>
Cash and equivalents, end of year		<u>142,051</u>	<u>32,017</u>

See accompanying notes to consolidated financial statements.

## NOTES TO AND FORMING PART OF THE CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### **Basis of accounting**

The financial statements have been prepared in accordance with the historical cost convention.

The financial report is a general purpose financial report in all material respects prepared in accordance with United States Generally Accepted Accounting Principles.

#### **Principles of consolidation**

The consolidated financial statements are those comprising ZBB Energy Corporation and all entities which ZBB Energy Corporation controlled from time to time during periods. The Corporation is developing an advanced energy storage system.

The financial statements of controlled entities are prepared for the same reporting period as ZBB Energy Corporation using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies which may exist.

All intercompany balances and transactions, and unrealised profits arising from intra-economic entity transactions, have been eliminated in full.

#### **Cash**

For the purposes of the statement of cash flows, cash includes cash on hand and in banks, and money market investments readily convertible to cash within 2 working days.

#### **Recoverable amount**

Non-current assets are not carried at an amount above their recoverable amount, and where carrying values exceed this recoverable amount assets are written down.

#### **Inventories**

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

Costs incurred in bringing each product to its present location and condition are accounted for as follows:

- Raw materials - purchase cost of direct material.
- Finished goods and work-in-progress - purchase cost of direct material plus direct labour plus a proportion of manufacturing overheads.

#### **Use of Estimates in Preparation of Financial Statements**

The preparation of the accompanying financial statements in conformity with generally accepted accounting principles requires management to make certain estimates and assumptions that directly affect the results of reported assets, liabilities, revenue, and expenses. Actual results may differ from these estimates.

#### **Foreign currencies**

##### *Translation of foreign currency transactions*

Transactions in foreign currencies of entities within ZBB Energy Corporation are converted to local currency.

Amounts payable to and by the entities controlled by ZBB Energy Corporation that are outstanding at the balance date and are denominated in foreign currencies have been converted to local currency using rates of exchange ruling at the end of the financial year.

#### ***Translation of financial reports of overseas operations***

All overseas operations are deemed self-sustaining as each is financially and operationally independent of ZBB Energy Corporation. The financial reports of overseas operations are translated using the current rate method and any exchange differences are taken directly to the foreign currency translation reserve which is carried in the Stockholder's Equity section in the balance sheet.

#### **Plant and equipment**

##### ***Cost and valuation***

Plant and equipment is carried at cost.

##### ***Depreciation***

Depreciation is provided on all plant and equipment at rates calculated to allocate the cost, less estimated residual value at the end of the useful lives of the assets, against revenue over those estimated useful lives.

Major depreciation periods are:

- . Plant and equipment - 2 to 10 years.
- . Office equipment - 3 to 8 years.

#### **Intangibles**

##### ***Patents***

Patents are amortised over their useful lives, being 15 years once the patent has been issued.

##### ***Intellectual property***

Intellectual property is amortised by the straight line method over the period during which benefits are expected to be received. This is taken as being 20 years.

##### ***Deferred Research and Development Costs***

Certain research and development costs are deferred by an Australian subsidiary. This is in accordance with industry practice in Australia, as well as Australian accounting standards.

##### ***Goodwill***

Goodwill represents the excess of the purchase consideration over the fair value of identifiable net assets acquired at the time of acquisition of a business or shares in a controlled entity.

Goodwill is amortised by the straight line method over the period during which benefits are expected to be received. This is taken as being 20 years.

#### **Income tax**

Tax-effect accounting is applied using the liability method whereby income tax is regarded as an expense and is calculated on the accounting profit after allowing for permanent differences. To the extent timing differences occur between the time items are recognised in the financial statements and when items are taken into account in determining taxable income, the net related taxation benefit or liability, calculated at current rates, is disclosed as a future income tax benefit or a provision for deferred income tax.

**Employee entitlements**

Provision is made for employee entitlement benefits accumulated as a result of employees rendering services up to the reporting date. These benefits include wages and salaries, annual leave, sick leave and long service leave. Vested benefits are classified as current liabilities.

The contributions made to superannuation funds and 401(k) plans by entities within ZBB Energy Corporation are charged against profits when due.

	2003 \$US	2002 \$US
<b>NOTE 2 – INCOME TAX</b>		
The prima facie tax on the loss differs from the income taxes provided in the accounts as follows:		
Loss before income taxes	(2,237,061)	(1,498,041)
Prima facie federal and state tax on losses calculated at 32.71%	<u>(731,743)</u>	<u>(490,009)</u>
Future income tax benefits arising from tax losses expiring through 2023	<u>2,497,794</u>	<u>1,766,051</u>

Deferred taxes are provided due to timing differences between financial statement and income tax reporting methods, principally for patent costs, insurance costs, depreciation and utilization of net operating loss carry forwards. Net operating losses total \$5,314,595 and generally begin to expire in 2014.

**NOTE 3 - CONTRIBUTIONS TO PROFIT BEFORE TAX**

ZBB Energy Corporation	(1,631,952)	(1,482,619)
ZBB Technologies, Ltd	(4,212)	(26,815)
ZBB Technologies, Inc.	<u>(600,897)</u>	<u>42,237</u>
	<u>(2,237,061)</u>	<u>(1,498,041)</u>

**NOTE 4 - RECEIVABLES (CURRENT)**

Trade debtors	38,574	203,212
Deposits	<u>63,000</u>	<u>42,697</u>
	<u>101,574</u>	<u>245,909</u>

## Notes (continued)

	2003 \$US	2002 \$US
<b>NOTE 5 - INVENTORIES (CURRENT)</b>		
Raw materials - at cost	240,929	303,252
Work in progress - at cost	18,285	37,762
Finished goods - at cost	<u>1,759,338</u>	<u>1,550,308</u>
	<u>2,018,552</u>	<u>1,891,322</u>
<b>NOTE 6 - PLANT AND EQUIPMENT</b>		
Plant and equipment - at cost	1,690,239	1,668,468
Provision for depreciation	<u>(1,089,280)</u>	<u>(929,544)</u>
	<u>600,959</u>	<u>738,924</u>
Depreciation expense	<u>139,881</u>	<u>148,375</u>
<b>NOTE 7 - INTANGIBLES</b>		
Goodwill	991,798	839,328
Provision for amortisation	<u>(388,454)</u>	<u>(286,770)</u>
	<u>603,344</u>	<u>552,558</u>
Intellectual property and deferred research and development costs	1,491,335	1,308,875
Provision for amortisation	<u>(280,329)</u>	<u>(190,211)</u>
	<u>1,211,006</u>	<u>1,118,664</u>
License fee	6,700	5,670
Patents and trademarks	<u>108,022</u>	<u>91,307</u>
	<u>1,929,072</u>	<u>1,768,199</u>
<b>NOTE 8 - BORROWINGS (CURRENT)</b>		
Secured by floating charge		
- bank overdrafts (refer Note 18)	84,623	125,601
- equipment leases	128,925	121,867
- line of credit	531,000	547,426
Unsecured		
- convertible notes	<u>1,345,360</u>	<u>-</u>
	<u>2,089,908</u>	<u>794,894</u>

The bank overdrafts and line of credit are secured by a charge over the Company's assets.

The equipment leases are secured by a charge over the manufacturing equipment.

## Notes (continued)

	2003 \$US	2002 \$US
<b>NOTE 9 – ACCOUNTS PAYABLE (CURRENT)</b>		
Trade creditors	296,222	342,856
	<u>296,222</u>	<u>342,856</u>
<b>NOTE 10 – PROVISIONS (CURRENT)</b>		
Employee entitlements	47,787	47,382
	<u>47,787</u>	<u>47,382</u>
<b>NOTE 11 – BORROWINGS (NON-CURRENT)</b>		
Secured by charge over manufacturing equipment - equipment leases	195,423	344,230
	<u>195,423</u>	<u>344,230</u>

**NOTE 12 – COMMON STOCK**

At balance date there are 50,000,000 authorised shares in the Company with 17,365,600 issued.

**EMPLOYEE/DIRECTOR OPTION PLANS**

During the period ended 30 June 2003, 462,500 options that were due to expire on 30 November 2002 were exercised at a price of A\$0.50 cents each in accordance with their terms and conditions.

In 1998 the Company entered into a Key Employees Stock Option Plan (KESOP) whereby a stock option committee comprising three Directors were given the discretion to grant up to 1,600,000 options to key employees of the Company. At 30 June, 2003 all 1,600,000 KESOP options had been granted. During the period ended 30 June, 2003, 346,000 KESOP options were exercised at prices between US\$0.75 and US\$1.50 each in accordance with their terms and conditions. At 30 June, 2003 there were 721,000 KESOP options with exercise prices between US\$0.75 and US\$1.50 and exercise dates between 1 September 2003 and 15 March 2008 outstanding.

In 1999 the Company entered into an Outside (Non-Executive) Directors Stock Option Plan (ODSOP) whereby 400,000 options will be issued to Non-Executive Directors over a five year period commencing on 2 January 1999 in lieu of Directors Fees. At 30 June, 2003 all ODSOP options had been granted.

During the period ended 30 June, 2003 the Company established the Company's 2002 Stock Option Plan whereby a stock option committee comprising all Directors were given the discretion to grant up to 5,000,000 options to key employees of the Company at exercise prices to be determined (but in any case not less than US\$1.00 per share) and exercisable at times to be determined by the Company commencing from 1 July 2007. At 30 June, 2003, 3,147,303 options have been written into key employees work contracts of which 594,752 options were exercised at a price of US \$1.00 each in accordance with their terms and conditions.

Compensation costs have not been calculated on the above options due to the startup nature of the Company, and the subsequent difficulty of valuing the options.

**CONVERTIBLE NOTES**

During March 2003 the company commenced raising up to A\$2,000,000 (US \$1,345,360) by the issue of 2,000,000 convertible notes for a principal amount of Australian one dollar (A\$1.00) each with an 8% coupon rate with interest payable on 31 July 2003 and 31 January 2004. The convertible notes may be converted as follows:

- (a) *automatic conversion*: if, before 31 January 2004, ZBB lists on the Australian Stock Exchange (**ASX**) or ZBB's shareholders approve a scheme of arrangement or plan of merger whereby they agree to exchange their ZBB shares for shares (**exchange shares**) in another company quoted on the ASX (**exchange company**), all notes will be automatically converted into such number of ZBB shares or exchange shares (as the case may be) calculated in accordance with the following formula:

$$N = \frac{A}{(P \times 80\%)}$$

where

N = the number of ZBB shares or exchange shares (as the case may be).

A = the aggregate principal amount of the notes to be automatically converted.

P = either:

- (i) the price per ZBB share or exchange share (as the case may be) paid by subscribers in any financing or series of related financings by any venture capital, institutional or other investors involving the issue of ZBB shares or exchange shares (as the case may be) which will yield aggregate cash proceeds to ZBB or the exchange company (as the case may be) of at least A\$10,000,000 (**financing**); or
- (ii) if a financing has not been completed by the conversion date, either:
  - (a) the fair market value of a ZBB share as at the conversion date determined in good faith by ZBB's board of directors acting in reliance on advice from an independent expert; or
  - (b) the fair market value of an exchange share as approved (whether directly or indirectly) by ZBB's shareholders pursuant to the scheme of arrangement or plan of merger.

- (b) *election by note holder to convert:* by the note holder exercising its option to convert the notes into ZBB shares at any time up to 31 January 2004 in accordance with the following formula:

$$N = \frac{A}{(P \times 80\%)}$$

where

N = the number of ZBB shares.

A = the aggregate principal amount of the notes converted.

P = the price per ZBB shares paid by subscribers in any financing or, if a financing has not been completed by the conversion date, the fair market value of a ZBB Share as at that determined in good faith by ZBB's board of directors acting in reliance on advice from an independent expert.

*Free options on conversion:* upon any conversion of notes, for each four ZBB shares or exchange shares (as the case may be) issued to a note holder, the note holder will be issued with one free option to subscribe for one ZBB share or exchange share (as the case may be) which may be exercised on or before 31 January 2005 at an exercise price being:

- (i) if the note holder exercises its option to convert or there is an automatic conversion by reason of ZBB being listed on the ASX, the lesser of the price per ZBB share paid by subscribers in the financing (if any) or A\$2.50 per share;
- (ii) if there is an automatic conversion by reason of scheme of arrangement or plan of merger whereby ZBB's shareholders agree to exchange their ZBB shares for exchange shares, the lesser of the price per exchange share paid by subscribers in the financing (if any) or the fair market value of an exchange share as at the conversion date as approved (whether directly or indirectly) by ZBB's shareholders pursuant to the scheme of arrangement or plan of merger.

*Repayment of notes:* If any notes are not converted by 31 January 2004, then the aggregate principal amount of the notes will be repaid in full together with accrued interest.

At 30 June, 2003 A\$2,008,000 (US \$1,345,360) had been raised by the issue of convertible notes.

#### **NON RELATED PARTY OPTIONS**

At 30 June, 2003 there were 2,398,192 options outstanding over unissued ordinary shares exercisable on or before 31 January 2004 at A\$0.75 cents per share. During the year 146,828 options were exercised at a price of A\$0.75 each in accordance with their terms and conditions.

#### **NOTE 13 – INVESTMENTS IN CONTROLLED ENTITIES**

Investment in controlled entities comprises:

	Country of incorporation	2003 %	Beneficial percentage held by economic entity 2002 %
ZBB Technologies, Ltd - ordinary shares	Australia	100	100
ZBB Technologies, Inc - ordinary shares	United States	100	100

Overseas controlled entities carry on business in the country of incorporation.

#### **NOTE 14 - LEASE EXPENDITURE COMMITMENTS**

##### **OPERATING LEASES**

The Company has a lease for premises in Menomonee Falls, Wisconsin that expires on 31 January 2007. The Company also has a lease for premises in Bibra Lake, Western Australia that expires on 31 October 2006. Lease expenses were \$167,601 and \$101,977 for 2003 and 2002 respectively.

Future minimum payments due under operating leases are:

- 2004	165,485
- 2005	168,994
- 2006	172,503
- 2007	96,880
	<u>603,862</u>

##### **CAPITAL LEASES**

The Company leased \$514,000 of equipment during the year ended 30 June 2002. Accumulated amortisation was \$102,891 and \$47,818 at 30 June 2003 and 30 June 2002 respectively.

Future minimum payments due under capital leases are:

- 2004	143,844
- 2005	143,844
- 2006	59,948
	<u>347,636</u>
Less amount representing interest	<u>(23,288)</u>
Present value of minimum lease payments	<u>324,348</u>

**NOTE 15 - RELATED PARTY DISCLOSURES**

Transactions within the group are made under normal commercial terms and conditions.

One of the Company's directors is a principal in a law firm that performed legal services for the Company. During 2003 and 2002, the Company paid the firm \$26,909 and \$2,900 respectively.

**NOTE 16 - RETIREMENT PLANS**

All Australian employees are entitled to varying levels of benefits on retirement, disability or death. The Company contributes to an accumulation fund on behalf of the employees under an award which is legally enforceable. For US employees the Company has a 401K plan. All participants are 100% vested immediately.

Expenses under these plans were \$37,172 and \$27,508 in 2003 and 2002.

**NOTE 17 - SEGMENT INFORMATION**

(a) Industry Segments	Research, Development and Commercialisation		Elimination		Consolidated	
	2003 \$US	2002 \$US	2003 \$US	2002 \$US	2003 \$US	2002 \$US
Sales to customers outside the Economic entity	539,032	1,138,450	-	-	539,032	1,138,450
Intersegment sales	720,000	820,000	(720,000)	(820,000)	-	-
Unallocated revenue	-	6,589	-	-	-	6,589
	<u>1,259,032</u>	<u>1,965,039</u>	<u>(720,000)</u>	<u>(820,000)</u>	<u>539,032</u>	<u>1,145,039</u>
Unallocated expenses					(2,044,380)	(2,153,071)
Economic entity's loss					(1,505,318)	(1,008,032)
Segment assets	<u>7,290,002</u>	<u>6,442,422</u>	<u>-</u>	<u>-</u>	<u>7,290,002</u>	<u>6,442,422</u>

(b) Geographical Segments	Australia		United States		Elimination		Consolidated	
	2003 \$US	2002 \$US	2003 \$US	2002 \$US	2003 \$US	2002 \$US	2003 \$US	2002 \$US
Sales to customers outside the Economic entity	476,432	532,297	62,600	606,153	-	-	539,032	1,138,450
Intersegment sales	-	-	720,000	820,000	(720,000)	(820,000)	-	-
Unallocated revenue	-	3,812	-	2,777	-	-	-	6,589
	<u>476,432</u>	<u>536,109</u>	<u>782,600</u>	<u>1,428,930</u>	<u>(720,000)</u>	<u>(820,000)</u>	<u>539,032</u>	<u>1,145,039</u>
Segment result	<u>(904,421)</u>	<u>(1,050,269)</u>	<u>(600,897)</u>	<u>42,237</u>	<u>-</u>	<u>-</u>	<u>(1,505,318)</u>	<u>(1,008,032)</u>
Economic entity's loss							(1,505,318)	(1,008,032)
Segment assets	<u>2,098,431</u>	<u>1,859,204</u>	<u>5,191,571</u>	<u>4,583,218</u>	<u>-</u>	<u>-</u>	<u>7,290,002</u>	<u>6,442,422</u>

ZBB Energy Corporation operated predominantly in the research, development and commercialisation of zinc bromine battery technology in Australia and the United States of America.

**NOTE 18 - FINANCIAL INSTRUMENTS**

## (a) Interest Rate Risk

ZBB Energy Corporation's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of change in the market, interest rate and the effective weighted average interest rate on these financial assets, is as follows:

	2003			2002		
	Non Interest Bearing \$US	Weighted Average Effective Interest Rate %	Floating Interest Rate \$US	Non Interest Bearing \$US	Weighted Average Effective Interest Rate %	Floating Interest Rate \$US
<b>Financial Assets</b>						
- Cash	142,051	-	-	32,017	-	-
- Trade debtors	101,574	-	-	245,909	-	-
<b>Total Financial Assets</b>	<b>243,625</b>		<b>-</b>	<b>277,926</b>		<b>-</b>
<b>Financial Liabilities</b>						
- Bank overdraft	-	9.00	84,623	-	9.00	125,601
- Bank lines of credit	-	5.95	531,000	-	5.75	547,426
- Trade creditors and accruals	296,222	-	-	342,856	-	-
- Equipment leases	-	8.00	324,348	-	8.00	466,097
- Provisions	47,787	-	-	47,332	-	-
- Convertible Notes	-	8.00	1,345,360	-	-	-
<b>Total Financial Liabilities</b>	<b>344,009</b>		<b>2,285,331</b>	<b>390,188</b>		<b>1,139,124</b>

ZBB Energy Corporation's accounting policies, including the terms and conditions of each class of financial asset, financial liability and equity instrument, both recognized and unrecognised in the balance sheet are as follows:

**Financial Assets**

- **Trade debtors**  
Trade debtors are carried at nominal amounts due less any provision for doubtful debts. A provision for doubtful debts is recognised when collection of the full nominal amount is no longer probable.

**Financial Liabilities**

- **Bank Lines of Credit**  
The bank lines of credit are carried at the principal amount. Interest is charged as an expense as it accrues.
- **Trade Creditors and Accruals**  
Liabilities are recognised for amounts to be paid in future for goods and services received, whether or not billed to ZBB Energy Corporation.
- **Convertible Notes**  
Convertible notes are carried at the principal amount. Interest is charged as an expense as it accrues and is payable on 31 July 2003 and 31 January 2004.

## (b) Credit Risk

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance date, to recognise financial assets is the carrying amount net of any provisions for doubtful debts, as disclosed in the balance sheet and notes to and forming part of the consolidated financial statements.

ZBB Energy Corporation does not have any material credit risk exposure to any single debtor or group of debtors under financial instruments entered into by it.

## (c) Net Fair Values

For assets and other liabilities the net fair value approximates their carrying value. ZBB Energy Corporation has no financial assets or liabilities that are readily traded on organised markets at balance date and has no financial assets where the carrying amount exceeds net fair values at balance date.

The aggregate net fair values and carrying amounts of financial assets and financial liabilities are disclosed in the balance sheet and in the notes to and forming part of the consolidated financial statements.

## **S.W. Scampini, S.C.**

**A Professional Service Corporation**

Certified Public Accountants

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### **INDEPENDENT AUDITORS' REPORT**

The Board of Directors and Shareholders  
ZBB Energy Corporation

We have audited the accompanying consolidated balance sheets of ZBB Energy Corporation and subsidiaries as of June 30, 2003 and June 30, 2002, and the related consolidated statements of profit and loss, stockholder's equity, and cash flows for the twelve months ended June 30, 2003 and the twelve months ended June 30, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We have conducted our audits in accordance with generally accepted United States auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ZBB Energy Corporation and subsidiaries as of June 30, 2003 and June 30, 2002, and the results of their operations and their cash flows for each of the twelve months ended June 30, 2003 and the twelve months ended June 30, 2002, in conformity with generally accepted accounting principles.



S.W. Scampini, S.C.  
Milwaukee, Wisconsin

18 December 2003