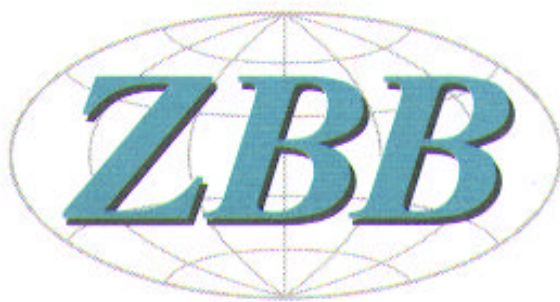


ZBB ENERGY CORPORATION

A.R.B.N. 082 338 789



**ANNUAL REPORT
2004**

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 25.2 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

N93 W14475 Whittaker Way
Menomonee Falls
Wisconsin
USA 53051

Tel: +1 262 253 9800
Fax: +1 262 253 9822
Email zbbtec@zbbenergy.com

Registered Office in Australia

240 Barrington Street
Bibra Lake WA 6163
AUSTRALIA

A.R.B.N. 082 338 789

Principal Place of Business in Australia

240 Barrington Street
Bibra Lake WA 6163
AUSTRALIA

PO Box 2047
Kardinya WA 6163

Tel: +61 8 9494 2055
Fax: +61 8 9494 2066
Email info@zbbenergy.com
Website www.zbbenergy.com

Auditors in United States

S.W. Scampini, S.C
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

Tel: +61 8 9323 2000
Fax: +61 8 9323 2033

Chairman's Report

Dear Shareholder,

It is my pleasure to report to you on the activities and affairs of the Company in this past financial year.

Some of the significant advances we made during the year are summarised below:

1. California Energy Commission (CEC)/Pacific Gas & Electric (PG&E) 2MW/2MWh System (California, USA).

This A\$3.5million project was announced in December 2003 and was formally contracted in May 2004. The system will consist of four (4) 500kWh/500kW trailer-mounted ZBB battery systems, installed in series, resulting in a 2000kWh/2000kW (2MWh/2MW) total battery storage system. This project will demonstrate that a storage system can defer a 15 MW distribution upgrade estimated to cost approximately US\$3 million in capital expenditures, saving California ratepayers about US\$390,000 for one year. The target market is the 802 MW of distribution upgrades forecast for California over 10 years.

2. Detroit Edison/Department of Energy and SNL 400 kWh System (Michigan, USA).

This project has been sponsored by the U.S. Department of Energy and Sandia National Laboratories with Detroit Edison serving as host utility. A 400-kWh battery system was used to address two separate problems on the utility grid. Initially the unit was installed at a rural substation to balance the load placed on the system when large electric motors used for grain drying are turned on and off. The unit was then moved to another location for use in peak-shaving. It was connected to a platform-mounted substation on a weak part of the system that was under stress at peak demand time. The ZBB system performed well in both applications.

3. United Energy 400 kWh System (Victoria, Australia).

This system was installed on site in Melbourne, Australia to undergo a series of tests to collect operating experience across different seasonal conditions. The test regime, conducted in association with input from the power utility, was designed to test the functionality of all aspects of the energy storage system. Tests defining the system's abilities have addressed, among others, its storage capacities over various dispatch schedules, peak shaving, power factor control and reactive power (VAR) compensation capabilities, monitoring operations, availability and maintenance requirements. The system is operating primarily as a distribution system peak shaving device.

4. Australian Greenhouse Office (AGO) 500 kWh System (Australia).

The Company has entered into an agreement with the Australian Greenhouse Office ("AGO") for the delivery and installation of a 500kWh energy storage system. The agreement with the AGO provides that the system will be installed at an appropriately identified "Sustainable Energy" site to be identified by the AGO. This project has become increasingly significant for the future direction to be set by ZBB in targeting its products into the Renewable Energy/Sustainable Energy markets. This project is an important link for the Company to secure its position as a part of the Australian Government policy for energy storage, as quoted above.

5. PowerLight/NYSERDA 50 kWh Systems (New York State, USA)

ZBB entered into a collaborative contract with PowerLight Corporation, an integrator and marketer of photovoltaic (PV) systems, to develop an integrated 50 kWh stand-alone battery system that will provide dispatchable peak shaving, uninterruptible power supply, and/or other power quality benefits for industrial customers. The ZBB system was installed in January 2004 and commissioned into operation in July 2004 as an integrated component of the total energy management system. The entire system, inclusive of ZBB's storage system, is currently being evaluated as part of an existing PowerLight project sponsored by the New York State Energy Research and Development Agency.

The Company is currently negotiating with Axis Financial Limited to underwrite a public offering on the Australian Stock Exchange (ASX) seeking to raise a minimum of A\$6million by the issue of new ordinary shares in the Company and at the time of writing this report is in the final stages of preparing a Prospectus. This offering is anticipated to occur in fourth quarter of calendar 2004 and upon completion and listing of the company on the ASX will not only provide shareholders with a market to trade their shareholdings but also provide the company greater access to the public equity markets to enable it to grow in accordance with its business plan. Further details of the public offering and timing will be forwarded to shareholders shortly.

There have been some significant advancements over the past year in understanding the vital role that energy storage has to play in the global energy markets. We are in a volatile time in regard to energy supply, energy prices and energy security. Internationally, the Electric Power Research Institute (EPRI) and the United States Department of Energy (DOE) have recognised the importance of energy storage for the environment and for renewable energy enhancement.

“There are several possible ways that the environment can benefit from use of electricity storage. Perhaps, most importantly, storage may lead to reduced fossil fuel use for and/or reduced air emissions from central generation. They include: 1) reduced use of less efficient fossil-fueled “peaker” generation with relatively high emissions per kWh, 2) reduced need for generation to provide spinning reserve and load following, and 3) time-shifting of electric energy from intermittent renewable generation, making renewables more viable alternatives to fossil-fueled generation.”¹

In June 2004 the Australian Federal Government released its energy policy paper “Securing Australia’s Energy Future” and outlined specifically its commitment to energy storage as a key facilitator in the greater uptake and more efficient utilization of Renewable Energy technologies;

“\$20 million will be provided to support development of advanced electricity storage technologies, including batteries, electro-mechanical and chemical storage. Important renewable energy technologies, including wind and solar produce electricity intermittently, which can reduce their attractiveness and ability to contribute to the electricity system. Breakthroughs in storage could rapidly accelerate renewable energy use, and Australia has technological leadership in some storage technologies.”²

These are timely announcements and we believe ZBB is well positioned to market its products to the energy storage market.

In summary, it has been a difficult and challenging year however our pathway forward is clear and if we achieve what we are working towards the coming year should be a most exciting time for all involved with the Company.



Robert Parry
Chairman and Chief Executive Officer

¹ EPRI-DOE Handbook of Energy Storage for Transmission and Distribution Applications, EPRI, Palo Alto, CA, and the U.S. Department of Energy, Washington. DC: 2003. 1001834

² Announcement by Prime Minister John Howard, June 15 2004 “Securing Australia’s Energy Future”

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 an Australian lawyer who has practised in the corporate and commercial areas of law for 23 years. Mr Payne has had extensive experience in advising public and private companies and in acting as a director of public and private companies. He is a Director of Indcor Limited and the Broome International Airport group of 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 2004 was \$1,927,658. No dividend was declared or paid during the year.

SIGNIFICANT EVENTS AFTER BALANCE DATE

The Company is negotiating with a financial services company to underwrite a public offering on the Australian Stock Exchange. This offering is anticipated to occur in fourth quarter of calendar 2004.

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 1 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 Meetings Held While in Office	Number of Meetings Attended While in Office
Mr R.J. Parry	4	4	-	-
Mr R.A. Payne	4	4	1	1
Mr G.D. Hann	4	4	1	1
Mr T.G. Folliard	4	4	1	1

Signed in accordance with a resolution of directors.



Robert John Parry
Chairman and Chief Executive Officer
Milwaukee, 26 August 2004



Geoffrey David Hann
Director and Chief Financial Officer

ZBB ENERGY CORPORATION
CONSOLIDATED PROFIT AND LOSS STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2004 AND THE YEAR ENDED 30 JUNE 2003

	Notes	2004 \$US	2003 \$US
SALES		116,042	539,032
COST OF SALES	1	<u>192,278</u>	<u>187,686</u>
GROSS PROFIT (LOSS)		(76,236)	351,346
SELLING & ADMINISTRATIVE EXPENSES		<u>2,102,902</u>	<u>2,588,407</u>
LOSS FROM OPERATIONS		(2,179,138)	(2,237,061)
OTHER INCOME (DEDUCTIONS)		<u>(685,564)</u>	<u>-</u>
LOSS BEFORE CREDIT FOR INCOME TAXES		(2,864,702)	(2,237,061)
CREDIT FOR INCOME TAXES	2	<u>937,044</u>	<u>731,743</u>
NET LOSS		<u>(1,927,658)</u>	<u>(1,505,318)</u>

See accompanying notes to consolidated financial statements.

ZBB ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS
AS AT 30 JUNE 2004 AND 30 JUNE 2003

	Notes	2004 \$US	2003 \$US
CURRENT ASSETS			
Cash		272,023	142,051
Receivables	4	944,212	101,574
Inventories	5	<u>2,039,757</u>	<u>2,018,552</u>
TOTAL CURRENT ASSETS		<u>3,255,992</u>	<u>2,262,177</u>
NON-CURRENT ASSETS			
Plant and Equipment	6	479,858	600,959
Intangibles	7	1,880,413	1,929,072
Deferred Tax Benefit	2	<u>3,434,838</u>	<u>2,497,794</u>
TOTAL NON-CURRENT ASSETS		<u>5,795,109</u>	<u>5,027,825</u>
TOTAL ASSETS		<u><u>9,051,101</u></u>	<u><u>7,290,002</u></u>
CURRENT LIABILITIES			
Borrowings	8	2,875,105	2,089,908
Accounts Payable	9	416,404	296,222
Provisions	10	<u>864,463</u>	<u>47,787</u>
TOTAL CURRENT LIABILITIES		<u>4,155,972</u>	<u>2,433,917</u>
NON-CURRENT LIABILITIES			
Borrowings	11	<u>59,029</u>	<u>195,423</u>
TOTAL LIABILITIES		<u>4,215,001</u>	<u>2,629,340</u>
STOCKHOLDERS' EQUITY			
Common Stock	12	12,908,537	10,525,663
Accumulated Other Comprehensive Income - Currency Translation Reserve		838,481	(1,282,149)
Accumulated Deficit		<u>(8,910,918)</u>	<u>(4,582,852)</u>
TOTAL STOCKHOLDERS' EQUITY		<u>4,836,100</u>	<u>4,660,662</u>
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY		<u><u>9,051,101</u></u>	<u><u>7,290,002</u></u>

See accompanying notes to consolidated financial statements.

ZBB ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
FOR THE YEAR ENDED 30 JUNE 2004 AND THE YEAR ENDED 30 JUNE 2003

	<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>			
Balance June 30, 2001	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	-	-	-
Balance June 30, 2002	15,815,520	7,994,582	-	(3,938)	(3,077,534)
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	-	-
Balance June 30, 2003	17,365,600	10,525,663	1,345,360	(1,282,149)	(4,582,852)
Net Loss	-	-	-	-	(1,927,658)
Net Translation Adjustment	-	348,742	-	2,120,630	(2,400,408)
Stock Subscriptions (Refer Note 12)	3,375,942	2,034,132	27,240	-	-
Balance June 30, 2004	20,741,542	12,908,537	1,372,634	838,481	(8,910,918)

See accompanying notes to consolidated financial statements.

ZBB ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED 30 JUNE 2004 AND THE YEAR ENDED 30 JUNE 2003

	Notes	2004	2003
		\$US	\$US
CASHFLOWS FROM OPERATING ACTIVITIES			
Net Loss		<u>(1,927,658)</u>	<u>(1,505,318)</u>
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES			
Depreciation and amortization		299,710	351,538
(Increase) decrease in accounts receivable		(813,033)	144,335
(Increase) in inventories		8,809	(127,230)
(Increase) in deferred tax benefit		(937,044)	(731,743)
Decrease in other assets		(25,503)	-
Increase (decrease) in accounts payable		128,134	(46,634)
Increase (decrease) in accrued liabilities		<u>810,647</u>	<u>453</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		<u>(528,280)</u>	<u>(1,914,599)</u>
CASHFLOWS FROM INVESTING ACTIVITIES			
Payments for the purchase of property		<u>9,573</u>	<u>(374,445)</u>
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES		<u>9,573</u>	<u>(374,445)</u>
CASHFLOW FROM FINANCING ACTIVITIES			
(Decrease) increase in bank lines of credit		621,874	(57,404)
Proceeds (conversion) of convertible notes		-	1,345,360
Proceeds of share issue		2,034,132	2,531,081
Principal payments on long-term debt		<u>-</u>	<u>(141,748)</u>
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES		<u>2,665,016</u>	<u>3,677,289</u>
FOREIGN EXCHANGE TRANSLATION		<u>(88,679)</u>	<u>(1,278,211)</u>
NET (DECREASE) INCREASE IN CASH AND EQUIVALENTS		129,972	110,034
Cash and equivalents, beginning of year		<u>142,051</u>	<u>32,017</u>
Cash and equivalents, end of year		<u>272,023</u>	<u>142,051</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.

Principal business activity

The Corporation is developing and manufacturing an advanced energy storage system.

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.
- During the year \$151,663 of obsolete inventory was written off.

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.

	2004 \$US	2003 \$US
NOTE 2 – INCOME TAX		
The prima facie tax on the loss differs from the income taxes provided in the accounts as follows:		
Loss before income taxes	(2,864,702)	(2,237,061)
Prima facie federal and state tax on losses calculated at 32.71%	<u>(937,044)</u>	<u>(731,743)</u>
Future income tax benefits arising from tax losses expiring through 2023	<u>3,434,838</u>	<u>2,497,794</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 \$8,179,302 and generally begin to expire in 2014.

NOTE 3 - CONTRIBUTIONS TO PROFIT BEFORE TAX

ZBB Energy Corporation	(1,801,367)	(1,631,952)
ZBB Technologies, Ltd	(450,935)	(4,212)
ZBB Technologies, Inc.	<u>(612,400)</u>	<u>(600,897)</u>
	<u>(2,864,702)</u>	<u>(2,237,061)</u>

NOTE 4 - RECEIVABLES (CURRENT)

Trade debtors	846,618	38,574
Deposits	<u>97,594</u>	<u>63,000</u>
	<u>944,212</u>	<u>101,574</u>

The total trade debt is from the California Energy Commission. It is part of a \$2.4million contract for the installation of four 500kWh systems. The company will recognize income on the project as work is incurred (\$72,142 as of June 30,2004). The difference between amounts billed and the amount earned is carried as unearned revenue. See Note 8 regarding a project financing arrangement.

Notes (continued)

	2004 \$US	2003 \$US
NOTE 5 - INVENTORIES (CURRENT)		
Raw materials - at cost	179,956	240,929
Work in progress - at cost	27,060	18,285
Finished goods - at cost	<u>1,832,741</u>	<u>1,759,338</u>
	<u>2,039,757</u>	<u>2,018,552</u>
NOTE 6 - PLANT AND EQUIPMENT		
Plant and equipment - at cost	1,685,654	1,690,239
Provision for depreciation	<u>(1,205,796)</u>	<u>(1,089,280)</u>
	<u>479,858</u>	<u>600,959</u>
Depreciation expense	<u>119,802</u>	<u>139,881</u>
NOTE 7 - INTANGIBLES		
Goodwill	1,026,733	991,798
Provision for amortisation	<u>(453,474)</u>	<u>(388,454)</u>
	<u>573,259</u>	<u>603,344</u>
Intellectual property and deferred research and development costs	1,533,141	1,491,335
Provision for amortisation	<u>(360,562)</u>	<u>(280,329)</u>
	<u>1,172,579</u>	<u>1,211,006</u>
License fee	6,937	6,700
Patents and trademarks	<u>127,638</u>	<u>108,022</u>
	<u>1,880,413</u>	<u>1,929,072</u>
NOTE 8 - BORROWINGS (CURRENT)		
- Bank overdrafts (refer Note 18)	141,665	84,623
- Equipment leases	136,394	128,925
- Line of credit	437,500	531,000
- Project financing	786,912	-
- Convertible notes	<u>1,372,634</u>	<u>1,345,360</u>
	<u>2,875,105</u>	<u>2,089,908</u>

The bank overdrafts and line of credit are secured by a general security interest on all the company's assets. The interest is a floating rate (7% line of credit, 13% overdraft loans at June 30, 2004).

The equipment leases are secured by a charge over the manufacturing equipment. The rates are from 5-6%, with the final payment due in April 2006.

The Project financing borrowings are secured by the specific receivables that have been financed. The interest charge is generally 2% of the amount financed.

	2004 \$US	2003 \$US
NOTE 9 – ACCOUNTS PAYABLE (CURRENT)		
Trade creditors	416,404	296,222
	<u>416,404</u>	<u>296,222</u>
NOTE 10 – PROVISIONS (CURRENT)		
Unearned revenue	774,476	-
Employee entitlements	89,987	47,787
	<u>864,463</u>	<u>47,787</u>
NOTE 11 – BORROWINGS (NON-CURRENT)		
Secured by charge over manufacturing equipment - equipment leases	59,029	195,423
	<u>59,029</u>	<u>195,423</u>

NOTE 12 – COMMON STOCK

At balance date there are 50,000,000 authorised shares in the Company with 20,741,542 issued.

EMPLOYEE/DIRECTOR OPTION PLANS

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, 2004 all 1,600,000 KESOP options had been granted. During the period ended 30 June, 2004, 385,000 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, 2004 there remains 336,000 KESOP options with exercise prices between US\$0.75 and US\$1.50 and exercise dates between 11 February 2005 and 15 March 2008 outstanding.

In 1999 the Company entered into an Outside (Non-Executive) Directors Stock Option Plan (ODSOP) whereby 400,000 options were 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 400,000 ODSOP options had been granted. During the period ended 30 June, 2004, 48,000 ODSOP options were exercised at US\$0.75 each in accordance with their terms and conditions. At 30 June, 2004 there remains 320,000 ODSOP options with prices of US\$0.75 and exercise dates between 2 January 2005 and 2 January 2008 outstanding.

In 2002 the Company established the Company's 2002 Stock Option Plan whereby a stock option committee comprising all Directors was 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. During the period ended 30 June, 2004 1,123,641 options were exercised at a price of US \$1.00 each in accordance with their terms and conditions. At 30 June, 2004 there remains 1,957,801 options with exercise prices of not less than US\$1.00 and exercise dates up to 31 March 2008 outstanding and a further 1,852,697 available to be issued.

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 raised A\$2,008,000 by the issue of 2,008,000 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 could 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.

During 2004 the holders of the convertible notes on issue agreed to amend the terms and conditions in respect of the notes to the same terms and conditions as those applicable to a new series of convertible notes with a 10% coupon rate payable on the earlier of the notes conversion date or a new maturity date being 31 December 2004. These notes are secured by a charge over all the assets and undertakings of the Corporation.

Under the terms and conditions of this new series of convertible notes, the notes can be converted by the note holder exercising its option to convert the notes into ZBB shares at any time up to 31 December 2004 in accordance with the following formula, or if prior to 31 December 2004 the Corporation is admitted to the official list of the ASX after an equity raising of at least A\$5,000,000 (**equity financing**), all notes held by each holder will be taken immediately prior to the Corporation's admission to the official list of the ASX to be automatically converted into such number of ASX listed shares in the Corporation calculated in accordance with the following formula:

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

where

- N = the number of shares to be issued and allotted to a holder (rounded up to the nearest whole number).
 A = the aggregate principal amount of the notes in respect of which a Conversion Notice has been duly given or to be automatically converted.
 P = the price per share paid by subscribers in the equity financing.

Grant of options on conversion: Upon any conversion of notes, for each four ZBB shares issued to a note holder, the note holder will be issued with one free option to subscribe for one ZBB share which may be exercised on or before 31 January 2007 at an exercise price being the price per share paid by subscribers in the equity financing.

Repayment: If subsequent to 31 December 2004 the Corporation has not been admitted to the official list of the ASX, all notes held by each holder will become repayable within 14 days.

NON RELATED PARTY OPTIONS

During the year the holders of the 2,398,192 options that were due to expire on 31 January 2004 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, 1,787,301 options were exercised under these amended terms and conditions and accordingly 1,787,301 options with an expiry date of 31 January 2006 and an exercise price of A\$0.75 were issued and are outstanding as at June 30, 2004.

NOTE 13 – INVESTMENTS IN CONTROLLED ENTITIES

Investment in controlled entities comprises:

	Country of incorporation	Beneficial percentage held by economic entity	
		2004 %	2003 %
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 \$177,427 and \$167,601 for 2004 and 2003 respectively.

Future minimum payments due under operating leases are:

- 2005	184,664
- 2006	188,173
- 2007	102,103
	<u>474,939</u>

CAPITAL LEASES

The Company leased \$514,000 of equipment during the year ended 30 June 2002. Accumulated amortisation was \$117,810 and \$102,891 at 30 June 2004 and 30 June 2003 respectively.

Future minimum payments due under capital leases are:

- 2005	143,844
- 2006	59,948
	<u>203,792</u>
Less amount representing interest	<u>(8,369)</u>
Present value of minimum lease payments	<u>195,423</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 2004 and 2003, the Company paid the firm \$74,964 and \$26,909 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 \$31,634 and \$37,172 in 2004 and 2003.

NOTE 17 - SEGMENT INFORMATION

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

(a) Industry Segments	Research, Development and Commercialisation		Elimination		Consolidated			
	2004 \$US	2003 \$US	2004 \$US	2003 \$US	2004 \$US	2003 \$US		
Sales to customers outside the Economic entity	116,042	539,032	-	-	116,042	539,032		
Intersegment sales	<u>720,000</u>	<u>720,000</u>	<u>(720,000)</u>	<u>(720,000)</u>	<u>-</u>	<u>-</u>		
	<u>836,042</u>	<u>1,259,032</u>	<u>(720,000)</u>	<u>(720,000)</u>	<u>116,042</u>	<u>539,032</u>		
Unallocated expenses					<u>(2,043,700)</u>	<u>(2,044,380)</u>		
Economic entity's loss					<u>(1,927,658)</u>	<u>(1,505,318)</u>		
Segment assets	<u>9,051,101</u>	<u>7,290,002</u>	<u>-</u>	<u>-</u>	<u>9,051,101</u>	<u>7,290,002</u>		
(b) Geographical Segments	Australia		United States		Elimination		Consolidated	
	2004 \$US	2003 \$US	2004 \$US	2003 \$US	2004 \$US	2003 \$US	2004 \$US	2003 \$US
Sales to customers outside the Economic entity	43,900	476,432	72,142	62,600	-	-	116,042	539,032
Intersegment sales	<u>-</u>	<u>-</u>	<u>720,000</u>	<u>720,000</u>	<u>(720,000)</u>	<u>(720,000)</u>	<u>-</u>	<u>-</u>
	<u>43,900</u>	<u>476,432</u>	<u>792,142</u>	<u>782,600</u>	<u>(720,000)</u>	<u>(720,000)</u>	<u>116,042</u>	<u>539,032</u>
Segment result	<u>(1,315,258)</u>	<u>(904,421)</u>	<u>(612,400)</u>	<u>(600,897)</u>	<u>-</u>	<u>-</u>	<u>(1,927,658)</u>	<u>(1,505,318)</u>
Economic entity's loss							<u>(1,927,658)</u>	<u>(1,505,318)</u>
Segment assets	<u>6,036,408</u>	<u>2,098,431</u>	<u>3,014,693</u>	<u>5,191,571</u>	<u>-</u>	<u>-</u>	<u>9,051,101</u>	<u>7,290,002</u>

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:

	2004			2003		
	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
Financial Assets						
- Cash	272,023			142,051	-	-
- Trade debtors	944,212			101,574	-	-
Total Financial Assets	<u>1,216,235</u>			<u>243,625</u>		
Financial Liabilities						
- Bank overdraft	-	13.10	141,665	-	9.00	84,623
- Bank lines of credit	-	7.00	437,500	-	5.95	531,000
- Trade creditors and accruals	416,404	-	-	296,222	-	-
- Equipment leases	-	8.00	195,423	-	8.00	324,348
- Provisions	864,463	-	-	47,787	-	-
- Convertible Notes	-	10.00	1,372,634	-	8.00	1,345,360
Total Financial Liabilities	<u>1,280,867</u>		<u>2,147,222</u>	<u>344,009</u>		<u>2,285,331</u>

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 the earlier of 31 December 2004 or the date the Corporation lists on the Australian Stock Exchange.

(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 party 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.

NOTE 19 – SUBSEQUENT EVENTS

The company is negotiating with a financial services company to underwrite a public offering on the Australian Stock Exchange. This offering is anticipated to occur in fourth quarter of calendar 2004.

S.W. Scampini, S.C.

A Professional Service Corporation

Certified Public Accountants

W188 N11707 Maple Road

Germantown, WI 53022

Phone 262-255-5790

Fax 262-250-3730

e-mail scott.scampini@mgstech.com

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, 2004 and June 30, 2003, and the related consolidated statements of profit and loss, stockholder's equity, and cash flows for the twelve months ended June 30, 2004 and the twelve months ended June 30, 2003. 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, 2004 and June 30, 2003, and the results of their operations and their cash flows for each of the twelve months ended June 30, 2004 and the twelve months ended June 30, 2003, in conformity with generally accepted accounting principles.



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

26 August 2004