



HALF-YEAR REPORT

Balance Date 31 December 2005

Report Date 15 March 2006



**WINDFLOW TECHNOLOGY LIMITED
CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE SIX MONTH PERIOD ENDED 31ST DECEMBER 2005

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WINDFLOW TECHNOLOGY LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL PERFORMANCE
FOR THE SIX MONTH PERIOD ENDED 31ST DECEMBER 2005

Twelve Months to 30th June 2005		Six Months to 31st Dec 2005	Six Months to 31st Dec 2004
\$		\$	\$
		Notes	
	Operating Revenue		
33,860	Consultancy Fees Received	(605)	25,847
269,495	Sales and Benefits	181,878	20,142
11,700	Grants received	-	11,700
-	Sundry Income	4,500	-
85,946	Interest received	109,734	71,913
401,001		295,507	129,602
	Operating Expenses		
75,038	Amortisation of Licences & Wind Rights	45,067	75,038
98,801	Cost of Sales	223,167	16,333
183,721	Engineering Costs	173,545	128,394
793,962	Research and Development Costs	47,151	274,718
203,253	Marketing Costs	9,899	108,370
741,441	General and Administration Costs	504,292	336,394
331,882	Depreciation	153,188	124,783
2,428,098		1,156,309	1,064,030
233	Share of Associate Deficit	486	4,266
2,428,331		1,156,795	1,068,296
(2,027,330)	Net Surplus / (Deficit)	(861,288)	(938,694)
	Net Surplus / (Deficit) comprises:		
(2,037,045)	Parent interests	(828,838)	(938,694)
9,715	Minority Interests	(32,450)	-
(2,027,330)		(861,288)	(938,694)

WINDFLOW TECHNOLOGY LIMITED
CONSOLIDATED STATEMENT OF MOVEMENTS IN EQUITY
 FOR THE PERIOD ENDED 31ST DECEMBER 2005

Twelve Months to 30th June 2005		Six Months to 31st Dec 2005	Six Months to 31st Dec 2004
\$		\$	\$
		Notes	
5,651,996	Equity at Beginning of Year	6,906,575	5,651,996
(20,357)	Prior Period Adjustment	-	103,460
5,631,639		6,906,575	5,755,456
(2,037,045)	Net Deficit comprising		
9,715	Parent Interests	(828,838)	(938,694)
	Minority Interests	(32,450)	-
	Associate Entity Retained Earnings	167,079	-
(2,027,330)	Total Net Deficit	(694,209)	(938,694)
3,302,266	Contributions from Owners		
	Ordinary Shares Issued during the Year	-	-
-	Gain due to Issue of Shares by Associate	1,088,214	-
6,906,575	Equity at End of Year	7,300,580	4,816,762

WINDFLOW TECHNOLOGY LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT THE 31ST DECEMBER 2005

As At 30th June 2005		As At 31st Dec 2005	As At 31st Dec 2004
\$		\$	\$
	Shareholders' Equity		
12,283,029	Share Capital	12,283,029	8,980,763
(5,365,813)	Retained Earnings Account	(6,027,572)	(4,164,001)
<u>6,917,216</u>		<u>6,255,457</u>	<u>4,816,762</u>
	<i>Minority Interest</i>		
22,375	Contributed Capital	22,375	-
(33,016)	Retained Earnings Account	(65,466)	-
<u>(10,641)</u>		<u>(43,091)</u>	<u>-</u>
-	Capital Reserve	1,088,214	-
<u>6,906,575</u>	Total Shareholders' Equity	<u>7,300,580</u>	<u>4,816,762</u>
	Current Liabilities		
-	Turbine Progress Payments	1,260,000	-
348,186	Accounts Payable	344,710	430,783
<u>348,186</u>	Total Current Liabilities	<u>1,604,710</u>	<u>430,783</u>
<u>7,254,761</u>	Total Equity and Liabilities	<u>8,905,290</u>	<u>5,247,545</u>

WINDFLOW TECHNOLOGY LIMITED
CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)
AS AT THE 31ST DECEMBER 2005

As At 30th June 2005		As At 31st Dec 2005	As At 31st Dec 2004
\$		\$	\$
	Current Assets		
3,173,317	Cash on Hand and at Bank	322,681	71,681
16,391	Term Deposits	1,500,308	1,171,835
67	Interest Accrued	14,284	5,284
24,684	Accounts Receivable	1,538,276	76,628
625,090	Prepayments	832,212	634,680
116,812	GST Refund	-	120,350
1,040,797	Work in Progress and Stock on Hand	988,902	1,119,692
1,690	Other Assets	786	29
4,998,848	Total Current Assets	5,197,449	3,200,179
	Non Current Assets		
1,087,553	Fixed Assets	1,011,765	1,151,540
1,147,816	Intangible Assets	53,588	691,412
-	Investments in Associates	1,807,580	-
20,544	Advances to Associates	834,908	734
-	Resource Consent	-	160,204
-	Advance to Joint Venture	-	43,476
2,255,913	Total Non Current Assets	3,707,841	2,047,366
7,254,761	Total Assets	8,905,290	5,247,545

Signed for and on behalf of the Board as at the 31st December, 2005

Director



Director



Dated 15 March 2006

WINDFLOW TECHNOLOGY LIMITED
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE PERIOD ENDED 31ST DECEMBER 2005

Twelve Months to 30th June 2005		Six Months to 31st Dec 2005	Six Months to 31st Dec 2004
\$		\$	\$
	Cash flows from operating activities		
	<i>Cash was provided from:</i>		
250,064	Receipts from Outwork	143,130	-
37,145	Receipts from consulting fees	500	8,500
11,700	Funding Received	-	11,700
19,938	Other Income	8,658	21,513
-	Income Tax Refunded	333	44
85,944	Interest Received	81,791	
10,356	Net GST Inflows	8,523	70,128
415,147		242,935	111,885
	<i>Cash was disbursed to:</i>		
1,968,042	Payments to suppliers	602,879	1,096,062
562,867	Payments to employees	543,378	245,451
-	Payments Reimbursements to JV Partner	-	225,886
459	Interest paid	151	-
-	Net GST	797	24,321
-	Income Tax	194	29
2,531,368		1,147,399	1,591,749
(2,116,221)	Net Cash Flows from operating activities	(904,464)	(1,479,864)
	Cash flows from investing activities		
	<i>Cash was provided from:</i>		
7,538	Sale of Fixed Assets	2,068	-
-	Sale of Intangible Assets	846,488	-
2,605,192	Disbursed from Term Deposit Accounts	5,491,473	1,449,748
2,612,730		6,340,029	1,449,748
	<i>Cash was disbursed to:</i>		
-	Development of the Wind Turbine and associated costs	-	-
168,465	Acquisition of Intangible Assets	-	-
85,695	Purchase of other fixed assets	75,607	44,634
-	Resource Consent	-	114,769
356,035	Disbursed to Term Deposit Accounts	6,975,389	-
610,195		7,050,996	159,403
2,002,535	Net Cash Flows from investing activities	(710,967)	1,290,345

WINDFLOW TECHNOLOGY LIMITED
CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE PERIOD ENDED 31ST DECEMBER 2005

Twelve Months to 30th June 2005		Six Months to 31st Dec 2005	Six Months to 31st Dec 2004
\$		\$	\$
	Cash flows from financing activities		
	<i>Cash was provided from:</i>		
3,302,266	Issue of Shares	-	-
-	Adjustment due to change from subsidiary to an equity investment	122,001	-
-	Advances - Joint Venture Partner	-	78,553
<u>3,302,266</u>		<u>122,001</u>	<u>78,553</u>
	<i>Cash was disbursed to:</i>		
265,461	Issue Costs of Equity	(593)	88,328
-	Advances to Equity Investments	1,357,799	-
20,777	Advance to Joint Venture Partner	-	-
<u>286,238</u>		<u>1,357,206</u>	<u>88,328</u>
3,016,028	Net Cash Flows from financing activities	(1,235,205)	(9,775)
2,902,342	Net Increase (Decrease) in cash held	(2,850,636)	(199,294)
270,975	Cash at beginning of year	<u>3,173,317</u>	<u>270,975</u>
<u>3,173,317</u>	Cash at end of year	<u>322,681</u>	<u>71,681</u>

WINDFLOW TECHNOLOGY LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE SIX MONTHS ENDED 31ST DECEMBER 2005

1. Accounting Policies

The financial statements have been prepared in accordance with Financial Reporting Standard number 24 and should be read in conjunction with the 2005 Annual Report.

A prior period adjustment has been included within the previous half year accounts, the change in accounting is in regard to the valuation of the wind blades held as work in progress. The wind blades have been valued of cost but from the period 1st July 2004 this now includes the depreciation on the wind blade moulds as per There have been no other material changes in accounting policies. Apart from the change in policy in regard valuation of the wind blades all policies have been applied on bases consistent with those used in previous and annual financial statements.

During the six month period, NZ Windfarms Limited, a subsidiary of Windflow Technology Limited which had been consolidated using the purchase method, completed a share issue. As a result of this issue Windflow Technology Limited now owns 43.07% of the total shares issued by NZ Windfarms Limited, due to this event NZ Windfarms Limited is no longer a subsidiary but an Associate Company within the Group and has been equity accounted

2. Unaudited

The Financial Statements for the current period and the previous six month period are unaudited. The Financial Statements for the twelve months to 30th June 2005 have been audited.

3. Significant Events Subsequent to Balance Date

None

WINDFLOW TECHNOLOGY LIMITED
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
FOR THE SIX MONTHS ENDED 31ST DECEMBER 2005

4. Reconciliation of reported deficit with Cash Flows from Operating Activities

Twelve Months to 30th June 2005		Six Months to 31st Dec 2005	Six Months to 31st Dec 2004
(2,027,330)	Net Deficit	(861,288)	(938,694)
	<i>Less</i>		
	<i>Non Cash Items and Non Operating Items</i>		
75,038	Amortisation of Licences and Wind Rights	37,519	75,038
-	Deferred Tax Movement	36	-
	Impairment of Intangible Assets	7,548	
331,882	Depreciation	153,188	124,783
-	Depreciation included J V Cost of Sales	-	23,347
-	Equity Earnings	486	4,266
459	Interest Charged	87	3,161
347,311	Issue Costs of Equity	(593)	88,328
-	Loss on Transfer of Blade to Research and Development	(60,000)	-
754,690		138,271	318,923
-	Prior Period Adjustment	-	103,461
	<i>Cash Flow from Operations before working capital changes</i>	(723,017)	(516,310)
(1,272,640)			
	<i>Movements in Working Capital</i>		
	Adjustment due to		
	Change of Investment from Subsidiary to an Equity Investment	40,415	-
-	Increase (Decrease) in accounts payable excluding asset purchases	(43,868)	37,702
20,366	Decrease (Increase) in tax refund	903	15
(1,646)	Decrease (Increase) in interest accrued	(14,217)	4,537
-	Decrease (Increase) in accounts receivable	(82,918)	(27,460)
34,238	Decrease (Increase) in Work in Progress	51,896	(696,496)
(617,601)	Decrease (Increase) in Prepayments	(207,122)	(277,715)
(268,125)	Decrease (Increase) in GST receivable	73,464	(4,137)
(10,813)		(181,447)	(963,554)
(843,581)			
(2,116,221)	<i>Net Cash Flows from Operating Activities</i>	(904,464)	(1,479,864)

DIRECTORS' HALF-YEAR REVIEW TO DECEMBER 2005

The calendar year finished on a very positive note for Windflow as we were able to mark a major milestone in the Company's progress as a manufacturer by submitting our first claim for progress payments towards turbine sales. NZ Windfarms completed its Initial Public Offering (IPO), raising just over \$4 million by early December, which will allow it to get underway with civil works and other infrastructure as planned. An essential part of the IPO was the Sale and Purchase Agreement (SPA) between Windflow and NZ Windfarms for 97 turbines for the Te Rere Hau project which is intended to be built in four batches. The IPO enabled NZ Windfarms to confirm the order for batch one, 5 turbines.

In turn the SPA provided that we could then invoice NZ Windfarms for 40% of the contract price. This payment is reflected in the 6-monthly Financial Statements as a current liability (progress payments held). This can be compared to some of our current assets, being prepayments and stock in hand for the 5-turbine build.

We are aiming to complete the batch of 5 and have them running on site at Te Rere Hau by the third quarter of this calendar year, 2006. The Windflow team has developed the production schedule and is finalising orders for components so that manufacturing and assembly can begin. In Windflow's role as Project Engineer for the Te Rere Hau wind farm, we have been working with Connell Wagner to put out tender documents for the civil works contract. Initial work has begun on site to establish ground load-bearing capacity so that the detailed foundation designs can be completed. The roading, electrical, and turbine foundation work will be formally underway in March.

The IPO for NZ Windfarms has resulted in another significant change to the Financial Statements this year. Previously Windflow held 100% of the shares in NZ Windfarms and thus consolidated NZ Windfarms as a subsidiary into its Group accounts. Following the IPO, Windflow retains a holding of 3,000,000 shares, which is 43% of the company and thus is being equity-accounted (not consolidated) from now on.

Other highlights in the financial statements are:

- as reported previously our insurance company, NZI, has accepted our claim for the damage caused by last year's extreme wind shift event. This is significantly reducing the costs of rebuilding the prototype.
- The consolidated interim result was a loss of \$861,288, down from last year's loss of \$938,694.
- The net assets of the Group are \$7,300,580, up from last year's figure of \$4,816,762.
- The closing cash position of the Company is sound.

Accordingly we do not anticipate the need for further capital raising by Windflow in the coming year.

Our American Depositary Receipts (ADR) programme went live in November 2005, allowing investors in the U.S. to invest in Windflow and improve the liquidity and international profile of our shares. Small volumes have been traded to date.

The only market risk facing us here is some uncertainty about climate change policy, now that the proposed carbon tax has been cancelled. This raises the question of whether Windflow will be adversely affected.

The short answer is no, because Windflow is a manufacturer, not a wind farm developer now. A slightly longer answer is that NZ Windfarms, which has previously been awarded a contract for 519,000 carbon credits for the Te Rere Hau wind farm from the Government through its Projects to Reduce Emissions, should not be affected either. This is because the carbon credits:

- a) have always been separate from the carbon tax as a policy measure
- b) will probably increase in value if, as is likely, the NZ Government is in a debit situation and has to buy credits, thus putting up their value in a market situation.

But the most important point to be made in answering this question is that the Kyoto Protocol is still in force, New Zealand is still a party to it, and we do not think it likely that any New Zealand government will withdraw from it. The concern about climate change is becoming more widespread, not less, as is international resolve to take action. Therefore we believe the recent decision on the carbon tax was a case of rejecting one type of price mechanism, not a case of rejecting all price mechanisms. In fact it seems increasingly likely that the NZ Government will follow the lead of its Kyoto Protocol partners, and the private sector in Australia, the USA and elsewhere by moving straight to the establishment of some sort of carbon trading market. This would be positive both for the liquidity of any wind farm carbon credits and for the long term security of all renewable energy industries.

Therefore, while it leaves a policy void for the moment, we do not believe it will affect our immediate project at Te Rere Hau.

Engineering Progress

The prototype at Gebbies Pass was reinstalled in August 2005 and we have since commissioned the various design improvements. In particular the sophisticated new software has been stunningly successful at minimising loads on the low speed shaft during adverse shut-down situations. We now view the progress made last year as being comparable to the original breakthrough in 2-bladed design which was made in England in 1988.

Since early October we have been maintaining availability statistics for Neil (the Gebbies Pass prototype). It has been consistently working well, averaging over 95% availability.

We have also been working towards our IEC certification which will give the turbine an internationally recognised Class 1A rating (for strongest winds and turbulent conditions). We are working with Garrad Hassan, one of the most reputable wind energy consultants world wide, who is doing a preliminary review of our design before we submit documentation to Lloyds Register, our certification body.

The Windflow design continues to stimulate strong interest from within New Zealand and particularly from international markets as the number of wind turbines on the market is outstripped by the escalating demand. Gearbox problems and grid integration issues are high on many agendas so the unique aspects of the Windflow turbine are starting to get more attention.

In February 2005, we were awarded a \$130,000 Business Growth from Technology New Zealand to fund half the research which would prove the suitability of the Windflow 500 turbine for use in small, isolated networks such as islands or remote communities. The research will involve refining the torque limiting feature of our unique gearbox to include a dynamic control system that will respond to both the varying demands of a small network and the available wind energy simultaneously. The technology produced will be a wind turbine capable of operating successfully in tandem with a diesel generator, in an isolated situation. It will also help prove the fault ride-through capability of the turbine, an important advantage

of our system in grid-connected wind farm applications. We are now starting work on this project.

As reported previously, our work in 2004 to reduce gearbox noise resulted in a remarkable breakthrough which has made our gearbox one of the quietest in the industry. We have applied for patents for this quiet gearbox innovation, and in October 2005 we presented a paper on it at the first Wind Turbine Noise Conference in Berlin. The Banks Peninsula District Council has performed further sound monitoring and just before Christmas 2005 confirmed that we comply fully with our resource consent.

As a result we were able to claim a grant of \$74,000 by NZTE towards the costs of last year's remedial noise work. This grant has now been recognised as a revenue item in the Financial Statements.

In last year's review we mentioned we had claimed against AH Gear's design insurance for costs due to the gearbox thrust ring redesign work in early 2004. We have also claimed against AH Gear's design insurance for costs due to the failure of the Stage 4 planet bearings in the gearbox in late 2004. We have decided to wait until the thrust ring claim is settled before finalising and progressing this second claim. While the insurance company has acknowledged the first claim has merit, progress towards settling a figure was deferred due to other priorities. We anticipate settling these claims before the end of the current financial year.

To sum up

Our immediate plan going forward is:

- to continue monitoring and documentation of the Windflow 500 for certification purposes (to IEC WT-01)
- to build the first production batch of five turbines
- to commission five turbines on the Te Rere Hau site in 2006 and establish a track record for the technology

Finally, we would like to acknowledge the ongoing support of Windflow shareholders who participated strongly in the NZ Windfarms IPO. We look forward to much exciting progress in the coming year.