

FRESHTEL HOLDINGS LTD

And Controlled Entities

ACN 111 460 121

FINANCIAL STATEMENTS

FOR THE HALF YEAR ENDED 31 DECEMBER 2009

FRESHTEL HOLDINGS LTD
ACN 111 460 121

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DIRECTORS' REPORT

The directors present their report on the consolidated entity consisting of Freshtel Holdings Limited and the entities it controlled at the end of, or during the half year ended 31 December 2009. In order to comply with the provisions of the Corporations Act 2001, the directors report as follows

The names of the directors of Freshtel Holdings Limited during or since the end of the half year are:

Dr Allan Sullivan PhD Elec.Eng., BElec.Eng, BSc:	Non-Executive Chairman
Mr Andy Dewhurst:	Non-Executive Director
Mr Sean Wilkins BA, ACMA:	Non-Executive Director – resigned 21 February 2010
Mr Ken Carr PhD Bus.Adm., Masters Bus.Adm, BSc:	Non-Executive Director – appointed 19 February 2010

Principle activities

The principal activity of the consolidated entity during the period was the development and commercialisation of Voice over Internet Protocol products and services.

Freshtel has altered its focus to concentrate on its wholesale network with a focus on PBX customers serviced using a 3rd party software platform, portal suite, calling card and licensing of services and mobile offerings on the Voicedot network, whilst still providing support and innovation for its existing white label customers.

Review of operations

The six months to 31 December 2009 saw the delivery of several key milestones which ultimately led to improved financial results. These included further cost reductions and simplifying the technology platforms.

To further improve the consolidated entity's profit and maximise shareholder value, it is intended to make significant changes to the technology platform and actively pursue the business market for host PBX solutions. This will be marketed through dedicated specialist channels.

Operating results

The group incurred an after tax loss attributed to members of \$1,936,507 for the six months to 31 December 2009 which represents a 60% improvement on the corresponding period last year.

Total revenue from continuing operations for the six months was \$726,657, a decrease of 41% over the prior corresponding period mainly to a decline in customer projects revenue received from Freshtel's main customer in the United Kingdom, Tesco Plc. and the cessation of Freshtel's core product offering; an end-to-end white label solution.

As at 31 December 2009, Freshtel had cash balances of \$401,355.

Dividends

No dividends were paid or recommended by the directors.

Auditor's independence declaration

The auditor's independence declaration is included on page 4 of the half-year financial statements.

This directors' report is signed in accordance with a resolution of directors made pursuant to s.298(2) of the Corporations Act 2001.

This report is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the directors by:



Dr Allan Sullivan

Chairman

Melbourne, 23rd day of February 2010

DECLARATION OF INDEPENDENCE BY JUSTIN OWEN TO THE DIRECTORS OF FRESHTEL HOLDINGS LIMITED

As lead auditor for the review of Freshtel Holdings Limited for the half-year ended 31 December 2009, I declare that to the best of my knowledge and belief, there have been:

- no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and
- no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Freshtel Holdings Limited and the entities it controlled during the period.

BDO

BDO Audit (NSW-VIC) Pty Ltd

Justin Owen

Justin Owen

Director

Melbourne, 23rd day of February 2010

FRESHTEL HOLDINGS LTD
ACN 111 460 121

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE HALF YEAR ENDED 31 DECEMBER 2009

	Notes	Consolidated Entity	
		6 months to 31.12.2009	6 months to 31.12.2008
		\$	\$
Revenue from continuing operations	3	726,657	1,223,291
Other Income		71,536	289,011
Raw materials and consumables used		(346,905)	(441,281)
Employee benefits expense		(1,216,622)	(2,815,929)
Administrative expense		(791,079)	(1,803,898)
Marketing expenses		-	(94,075)
Depreciation and amortisation expenses	4	(346,630)	(1,050,118)
Occupancy and facilities expenses		(164,780)	(291,737)
Finance costs		(3,010)	(1,313)
Other expenses		-	(78,439)
Impairments	5	-	(185,000)
Loss before income tax	2	(2,070,833)	(5,249,488)
Income tax benefit		134,326	441,419
Loss from continuing activities after income tax		(1,936,507)	(4,808,069)
Net loss for the half year		(1,936,507)	(4,808,069)
Other comprehensive income			
Foreign currency translation		(61,444)	164,186
Total comprehensive income for the half year		(1,997,951)	(4,643,883)
Loss for the half year attributable to: Owners of Freshtel Holdings Limited		(1,936,507)	(4,808,069)
Total comprehensive income for the half year is attributable to: Owners of Freshtel Holdings Limited		(1,997,951)	(4,643,883)
Loss per share attributable to: Owners of Freshtel Holdings Limited			
Basic loss per share (cents per share)		(0.52)	(2.65)
Diluted loss per share (cents per share)		(0.52)	(2.65)

The above should be read in conjunction with the accompanying notes.

FRESHTEL HOLDINGS LTD
ACN 111 460 121

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2009

	Notes	Consolidated Entity	
		31.12.2009	30.06.2009
		\$	\$
Current Assets			
Cash and cash equivalents		401,355	2,366,630
Trade and other receivables		647,483	947,176
Inventories		5,000	5,000
Other current assets		97,724	131,180
Total Current Assets		1,151,562	3,449,986
Non-Current Assets			
Trade and other receivables		31,897	168,224
Plant and equipment		465,385	551,317
Total Non-Current Assets		497,282	719,541
Total Assets		1,648,844	4,169,527
Current Liabilities			
Trade and other payables		861,791	872,662
Short-term provisions		82,448	275,786
Total Current Liabilities		944,239	1,148,448
Non-Current Liabilities			
Trade and other payables		-	154,940
Long-term provisions		-	163,583
Total Non-Current Liabilities		-	318,523
Total Liabilities		944,239	1,466,971
Net Assets		704,605	2,702,556
Equity			
Contributed equity		37,096,277	37,096,277
Reserves		2,586,906	2,648,350
Accumulated losses		(38,978,578)	(37,042,071)
Total equity attributable to owners of Freshtel Holdings Limited		704,605	2,702,556

The above should be read in conjunction with the accompanying notes.

FRESHTEL HOLDINGS LTD
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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE HALF YEAR ENDED 31 DECEMBER 2009

	Contributed equity	Retained earnings	Foreign currency translation reserve	Share based payments reserve	Total equity
	\$	\$	\$	\$	\$
At 1 July 2008	34,976,979	(26,860,598)	2,658,715	406,566	11,181,662
Loss for the half-year	-	(4,808,069)	-	-	(4,808,069)
Foreign currency translation difference	-	-	164,186	-	164,186
Total comprehensive loss for the half-year	-	(4,808,069)	164,186	-	(4,643,883)
Transactions with owners in their capacity as owners					
Ordinary shares issued	130,000	-	-	-	130,000
Employee options exercised	179,692	-	-	(179,692)	-
Employee options expensed	-	-	-	143,753	143,753
	309,692	-	-	(35,939)	273,753
At 31 December 2008	35,286,671	(31,668,667)	2,822,901	370,627	6,811,532
Loss for the half-year	-	(5,373,404)	-	-	(5,373,404)
Foreign currency translation difference	-	-	(174,551)	-	(174,551)
Total comprehensive loss for the half-year	-	(5,373,404)	(174,551)	-	(5,547,955)
Transactions with owners in their capacity as owners					
Ordinary shares issued	1,899,791	-	-	-	1,899,791
Transaction costs arising on share issue	(90,185)	-	-	-	(90,185)
Employee options lapsed	-	-	-	(370,627)	(370,627)
	1,809,606	-	-	(370,627)	1,438,979
At 30 June 2009	37,096,277	(37,042,071)	2,648,350	-	2,702,556
At 1 July 2009	37,096,277	(37,042,071)	2,648,350	-	2,702,556
Loss for the half-year	-	(1,936,507)	-	-	(1,936,507)
Foreign currency translation difference	-	-	(61,444)	-	(61,444)
Total comprehensive loss for the half-year	-	(1,936,507)	(61,444)	-	(1,997,951)
Balance at 31 December 2009	37,096,277	(38,978,578)	2,586,906	-	704,605

The above should be read in conjunction with the accompanying notes.

FRESHTEL HOLDINGS LTD
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STATEMENT OF CASH FLOWS
FOR THE HALF YEAR ENDED 31 DECEMBER 2009

	Consolidated Entity	
	6 months to 31.12.2009	6 months to 31.12.2008
	\$	\$
Cash Flows from Operating Activities		
Receipts from customers	827,777	1,436,443
Payments to suppliers and employees	(2,717,396)	(5,435,304)
Interest received	17,226	202,328
Finance costs	(3,010)	(1,313)
Taxation	474,058	363,519
Net cash used in operating activities	(1,401,345)	(3,344,327)
Cash Flows from Investing Activities		
Purchase of plant and equipment	(347,546)	(31,517)
Capitalised development costs	-	(799,184)
Net cash used in investing activities	(347,546)	(830,701)
Cash Flows from Financing Activities		
Repayment of borrowings	-	(18,982)
Net cash used in financing activities	-	(18,982)
Net decrease in cash held	(1,748,891)	(4,194,010)
Cash and cash equivalents at the beginning of the period	2,366,630	8,159,114
Effects of exchange rate changes on the balance of cash held in foreign currencies	(216,384)	-
Cash and cash equivalents at the end of the period	401,355	3,965,104

The above should be read in conjunction with the accompanying notes.

FRESHTEL HOLDINGS LTD
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NOTES TO THE FINANCIAL STATEMENTS

Note 1: Statement of Significant Accounting Policies

(a) Statement of compliance

These half-year financial statements are general purpose financial statements prepared in accordance with the *Corporations Act 2001* and AASB 134 *Interim Financial Reporting*. Compliance with AASB 134 ensures compliance with the International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. The half-year financial statements do not include notes of the type normally included in the annual financial statements and shall be read in conjunction with the most recent annual financial statement and any public announcements made by Freshtel Holdings Limited during the half-year reporting period.

(b) Basis of preparation

The condensed consolidated financial statements have been prepared on an accruals basis under the historical cost convention, except for certain financial instruments which are measured at fair value.

The accounting policies and methods of computation adopted in the preparation of the half-year financial statements are consistent with those adopted and disclosed in the company's 2009 annual financial statements for the financial year ended 30 June 2009, except for the impact of the Standards and Interpretations described below. These accounting policies are consistent with Australian Accounting Standards and with International Financial Reporting Standards.

(c) Critical accounting estimates, judgements and assumptions

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity and that are believed to be reasonable under the circumstances. The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(i) Onerous contract

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. During the period, the onerous contract was terminated and settled with no further obligations. The provision was then reversed after the cost of termination was deducted.

(d) Segment reporting

The Group has applied AASB 8 *Operating Segments* from 1 July 2009. AASB 8 requires a 'management approach' under which segment information is presented on the same basis as that used for internal reporting purposes. This has resulted in an increase in the number of reportable segments presented, as the previously reported single business segment has been disaggregated into four separate segments for products [Fixed VoIP and White Label]. These business segments are reported by geographic location being Australia and the United Kingdom.

Operating segments are reported in a manner that is consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker has been identified as the Board and management team that makes strategic decisions.

The Group has early adopted the amendment to AASB 8 *Operating Segments* that is included in AASB 2009-5 *Further Amendments to Australian Accounting Standards arising from the Annual Improvements Process* from 1 July 2009. The effect of this is explained in Note 2.

(e) Going concern

The financial statements have been prepared on the basis that the consolidated entity is a going concern, which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business. The consolidated entity has a net asset position of \$704,605 as at 31 December 2009 and has incurred a loss of \$1,936,507 for the six months ended 31 December 2009.

The directors are of the view that the going concern basis is appropriate due to the following factors:

- cash reserves in place at the date of this report and the budgeted business plan to which the Board is fully committed, demonstrate that the consolidated entity will be able to pay its debts as and when they fall due.
- the Company has restructured its business model and upgraded their VoIP platform to allow the business to interact with a comprehensive range of PBX solutions for businesses of all types as well as catering for the traditional residential products currently offered.
- the entity has taken significant steps to reduce overheads and simplify the business. Additional cost reduction steps have been identified and are currently being implemented over the second half of the current financial year.
- the Company intends raising some \$2M of capital to pay down the Custodial Capital Management loan and to provide working capital to grow the business in 2010. For the entity to continue as a going concern it is dependant on a successful rights issue.

If the entity is unable to continue as a going concern, it may be required to realise its assets and extinguish its liabilities other than in the normal course of business and at amounts different to those in the financial report.

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NOTES TO THE FINANCIAL STATEMENTS

Note 2: Segment information

(a) Description of segments

Management has determined the operating segments based on the reports reviewed by the Board and management team that are used to make strategic decisions. The Board and management team currently consists of all Board members, the chief financial officer and the head of operations and technology.

The Board and management team considers the business from both a product and a geographic perspective and has identified four reportable segments. Fixed VoIP consists of call termination revenue sold both in Australia and the United Kingdom. White label consists of licence fees, capacity contribution, service management, active subscribers, hardware royalties and change request fees sold predominately in the United Kingdom. The Board and management team monitors the performance of those business segments by geographical location. All other segments consist of the non-material remainder of the business.

No information is disclosed for segment assets as no measure of segment assets is regularly provide to the chief operating decision maker. This is permitted by an amendment to AASB 8 that is included in AASB 2009-5 as explained in Note 1.

(b) Segment information provided to the Board and management team

The segment information provided to the Board and management team for the reportable segments for the half-year ended 31 December 2009 is as follows:

	Fixed VoIP		White label		All other segments	Total
	Australia	UK	Australia	UK		
Half-year 2009	\$	\$	\$	\$	\$	\$
Total segment revenue	228,995	177,282	318	295,797	7,040	709,432
Inter-segment revenue	-	-	-	-		
Revenue from external customers	228,995	177,282	318	295,797	7,040	709,432
Adjusted gross profit	45,480	15,316	180	294,511	7,040	362,527
Half-year 2008						
Total segment revenue	230,866	280,689	-	338,048	159,869	1,009,472
Inter-segment revenue	-	-	-	-		
Revenue from external customers	230,866	280,689	-	338,048	159,869	1,009,472
Adjusted gross profit	67,192	53,862	-	338,048	109,089	568,191

The Board and management team assesses the performance of the operating segments based on a measure of adjusted gross profit. This measurement basis excludes the effects of non-recurring expenditure from the operating segments such as restructuring costs, legal expenses. Furthermore, the measure excludes the effects of equity-settled share-based payments and unrealised gains/losses on financial instruments. Interest income and expenditure are not allocated to segments, as this type of activity is driven by the central treasury function, which manages the cash position of the group. The central treasury function is not a reportable segment.

	Consolidated Entity	
	2009	2008
	\$	\$
Adjusted gross profit	362,527	568,191
Depreciation and amortisation expense	(346,630)	(1,050,118)
Finance expenses	(313,648)	(215,951)
Interest revenue	17,226	213,819
Legal expenses	(15,252)	(17,853)
Management costs	(280,224)	(737,954)
Operational expenses	(776,042)	(2,037,281)
Research and development expenses	(718,790)	(1,972,341)
Loss before income tax from continuing operations	(2,070,833)	(5,249,488)

FRESHTEL HOLDINGS LTD
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NOTES TO THE FINANCIAL STATEMENTS

	Consolidated Entity	
	6 months to 31.12.2009	6 months to 31.12.2008
	\$	\$
Note 3: Revenue from continuing operations		
Sales revenue		
Provision of services	709,432	1,009,472
Interest revenues		
Other corporations	17,225	213,819
Total revenue from continuing operations	726,657	1,223,291
Note 4: Expenses		
Loss before income tax includes the following expenses		
Depreciation		
Plant and equipment	346,630	456,699
Total depreciation	346,630	456,699
Amortisation of intangible asset		
Development costs	-	593,419
Total amortisation	-	593,419
Total depreciation and impairment	346,630	1,050,118
Note 5: Impairments		
Impairment of intangible assets	-	185,000

Note 6: Key management personnel

Remuneration arrangements of key management personnel are disclosed in the annual financial report.

Note 7: Contingencies

The consolidated entity had contingent liabilities at 31 December 2009 in respect of bank guarantees given to Optus Pty Limited to the maximum of \$50,000. No material losses are anticipated in respect of the above liability.

Note 8: Subsequent events

No matters or circumstances have arisen since the end of the financial year which significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations, or the state of the consolidated entity in future financial years except for:

- The implementation of an advanced technology platform made it possible to significantly reduce staff levels. These redundancies whilst costing approx \$250k, will give a monthly cost reduction of approx \$150k.
- An agreement has been reached for Vixtel and other suppliers to market an end-to-end PBX solution to businesses based on the new platform. Seven corporate contracts for PBX applications have been secured since December 2009 covering over 700 seats, with a further 900 under negotiation.
- An agreement has been reached with Tesco in the UK to terminate the service agreement under which Freshtel Holdings Limited provides services to Tesco. This has allowed a further reduction in costs and removed the need to continue support the operating platform. It is our intention to reach a similar agreement with PTCL.
- Drawdown of the current loan facility between Freshtel Holdings Limited and Custodial Capital Management Pty Ltd has occurred to the value of \$750k, with \$250k remaining available on an as needs basis.

FRESHTEL HOLDINGS LIMITED AND ITS CONTROLLED ENTITIES


ACN 111 460 121

DECLARATION BY DIRECTORS

The directors of the company declare that:

1. The financial statements, comprising the statement of comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows, accompanying notes, are in accordance with the Corporations Act 2001 and:
 - (a) comply with Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
 - (b) give a true and fair view of the financial position as at 31 December 2009 and of the performance for the half-year ended on that date of the consolidated entity.
2. In the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the directors by:



Director

Melbourne, 23rd day of February 2010

INDEPENDENT AUDITOR'S REVIEW REPORT

To the members of Freshtel Holdings Limited

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Freshtel Holdings Limited, which comprises the statement of financial position as at 31 December 2009, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, a statement of accounting policies and other selected explanatory notes and the directors' declaration of the consolidated entity comprising the disclosing entity and the entities it controlled at the half-year end or from time to time during the half-year.

Directors' Responsibility for the Half-Year Financial Report

The directors of the disclosing entity are responsible for the preparation and fair presentation of the half-year financial report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the half-year financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of Interim and Other Financial Reports Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 31 December 2009 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Freshtel Holdings Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

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

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001* would be in the same terms if it had been given to the directors at the time that this auditor's review report was made.

Conclusion

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

- (a) giving a true and fair view of the consolidated entity's financial position as at 31 December 2009 and of its performance for the half-year ended on that date; and
- (b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and Corporations Regulations 2001.

Material Uncertainty Regarding Continuation as a Going Concern

Without qualifying our conclusion, we draw attention to Note 1(e) in the interim financial statements which indicates that Freshtel Holdings Limited incurred a net loss of \$1,936,507 during the half-year ended 31 December 2009 and, as of that date, the consolidated entity has a net asset position of \$704,605. The entity has restructured its business model which is subject to significant risk due to the inherent uncertainty surrounding the success of this model. Further to this, the adoption of the going concern basis is also dependent on a successful rights issue. These conditions, along with other matters as set forth in Note 1(e), indicate the existence of a material uncertainty which may cast significant doubt about the consolidated entity's ability to continue as a going concern.

BDO

BDO Audit (NSW-VIC) Pty Ltd

Justin Owen

Justin Owen

Director

Melbourne, 23rd day of February 2010