



ABN 73 122 948 805

ASX RELEASE

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General Manager
The Company Announcements Office
Australian Securities Exchange

MARKET UPDATE

Island Sky Australia Limited (ASX:ISK) ('ISK') is pleased to provide a market update in relation to the current position of its 'air to water' products business owned by its wholly-owned subsidiary Island Sky Corporaiton Inc ('ISK Inc')

1. COMMERCIALISATION UPDATE

The company has a strategy to continue the process of commercialisation:

- (a) In the immediate term, driving sales growth in relation to its Skywater® 14 and Skywater® 300 units, principally targeting residential, commercial and light-industrial markets, through increased marketing, promotion and distributor support; and
- (b) Over the coming 12 to 18 months, undertaking further product development by leveraging off of its existing product designs to create a new range of products for use in other applications (e.g. Skywater Marine for yachts and boats, Skywater Solar with solar energy capabilities and continued development of Skywater Military, Skywater Oil Rig, Skywater Light Industrial, and Skywater World Unit).

2. SALES & MARKETING UPDATE

The company's Skywater® 14 and Skywater® 300 machines both received USA product certifications UL & ETL during 2010. This has been a challenging and time consuming process however it independently verifies the soundness and merchantability of ISK's machines.

The wholesale distribution model originally envisaged has not yet produced the substantial growth sought by the Company. . Some of the original distributors who were appointed in various countries have shown some ineptitude in promoting the Company's products and have

Registered Office

Level 3, 100 Pirie Street, Adelaide SA 5000

www.islandsky.com

t +61 8 8232 2550 f +61 8 8232 2540



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failed to place orders, despite having obligations to do so. ISK believes that this is not the result of the performance of its products, but more the historical tardiness of consumers to relate to new products on the market and the ongoing impact in some countries of the global financial crisis.

However, ISK Inc continues to implement its wholesale distribution model in relation to the Skywater 14 and 300 machines. The Company is still growing its network of distributors around the globe, with two new agents added in Saudi Arabia and the Philippines. A number of original distributors have therefore been replaced. The Company will however need to give attention to non-complying distributors and it is anticipated that a number will need to be replaced.

ISK Inc booked its first commercial sales of approximately US\$466,000 for the calendar year ending 31 December (excluding licensing royalties).

ISK Inc intends to pursue this market by continuing to work with distributors who have demonstrated their competency and with established networks in key regions, undertaking direct sales activities and participating in event sponsorship and tradeshow.

The Internet continues to play a large role in the overall marketing campaign as the revamp of islandsky.com to optimize on the worldwide web and register and rank at the top of search engines in major markets saw 2009 website traffic increase from several hundred first time visitors per month to several thousand in 2010 as a result of the optimization.

2.1 Key target markets – Skywater® 300

The Skywater® 300 has the capacity to produce approximately 1,100 litres per day in optimal conditions, enough to meet all of the water demands of an average household.

The product is targeted principally at homes that are "off the grid" from public water sources. The machines may also be bundled together to provide point of use water service for larger housing developments, greenhouse irrigation, and light industrial use, saving thousands of dollars in infrastructure.

ISK Inc is initially targeting the Skywater® 300 at a number of specific markets, including:

- Developing regions around the world where clean drinking water and/or infrastructure is limited or nonexistent;
- Residential property developments;
- Remote mining camps;
- Greenhouse irrigation;

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- Light industrial businesses;
- Humanitarian and emergency relief; and
- Government and military.

As the company continues to improve the energy efficiency of the Skywater® 300, and as the world's water resources continue to be depleted (thereby increasing the price of water), Island Sky® believes that there will be a significant increase in mainstream demand for the units as a substitute for mains water.

At the appropriate price point, the 'point of use generation' method offered by the Skywater® 300 will present a very compelling alternative to traditional water supply as it avoids the associated inhibitive infrastructure costs without diminishing existing water supplies and without creating a toxic by-product (i.e. brine).

ISK Inc may be able to further penetrate these markets through the continued up-scaling of its technology into larger and more efficient machines (see further below).

2.2 Key Regional Developments for Skywater 300

- (a) **Europe** – Island Sky's Italian distributor Veragon srl, has made significant inroads with the Italian military that recently purchased 4 Skywater 300 machines and began immediate field trial tests in Senegal. The Italian military has said it will conduct additional field trial tests in other regions such as Afghanistan in the spring.



Skywater® 300 unit on display at Italian military base

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- (b) **Latin America** – With many regions in Latin America facing critical water shortages and infrastructure constraints, Island Sky is well positioned to be able to provide water solutions for this market. The company has appointed Great Eco Solutions as a distributor for Venezuela, Colombia and Ecuador, and has shipped over 100 Skywater 14 units to the Caracas region. In November, the Venezuelan Army distributed water from a mobile Skywater 300 unit in Caracas following the recent severe flooding there. A second Skywater 300 mobile unit is being prepared for the military for purchasing evaluation.



Venezuelan Army distributing water from Skywater[®] mobile unit after heavy flooding that left thousands homeless

In Ecuador, Great Eco Solutions has reported that testing of the Skywater 14 there has been very successful and orders are pending for both Skywater 14s and 300 with various branches of the government and the military.

In Colombia machines are also being tested and evaluated by the Petroleum Industry as well as the government and have passed the required government water testing.

(c) **Middle East** – A new distribution agreement has been signed for Saudi Arabia with MBA Trading. Initial first container orders of Skywater 14 have been placed with deposits as well as a Skywater 300 to begin demonstrations. There is significant demand for water in the region. Existing resources have been taxed beyond their capabilities by new development. Alternative means of water delivery are constantly being employed, which, in most cases involves trucking large quantities of water at great expense to the end user. Island Sky has additionally placed successful pilot demonstrations of both the Skywater 14s and the Skywater 300 in the UAE.

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(d) Philippines – A new distributor, iMarketing, has been appointed and orders for both Skywater 14 and Skywater 300 products are anticipated. The Philippines suffers from severe ground water contamination and clean drinking water is in high demand.

(e) Asia – Skywater India continues to make inroads in to the Indian market. To date over 40 pilot demonstrations have been setup around the Subcontinent, including off-the-grid test models running from electricity generating “Gasifiers” (photo below). Talks with the military and local governments are ongoing.



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3. NEW PRODUCT VARIATIONS

Utilizing Island Sky's patented technology as a foundation, the Company is in the process of developing several new products for specific target markets:

- **Skywater Marine** – a 125 gallon per day water maker that will replace the need to transport bottled water on Yachts and boats. First phase prototype is complete and has been drawing the attention of Yacht captains for immediate trial;
- **Skywater® World Unit** – a very basic, low-cost, version of the Skywater® 14 without many of the more discretionary features of the original design (such as heating/cooling facilities, electronic display screen etc.) for use in low socio-economic regions. First phase drawings are now complete;
- **Skywater® Solar Unit** – A compacted size water-maker providing 125 gallons per day, designed to run on solar energy. First phase of product development is complete, product is now ready for manufacturing quotation and immediate production;
- **Skywater® MilSpec Unit** – a version of the Skywater® 300, built to the specifications of the US Military for use in remote locations during deployment, where the transportation of water is logistically difficult and/or dangerous. The Italian military has recently purchased and successfully tested the Skywater 300 in actual field trials in Senegal.
- **Skywater® Oil Rig Unit** – an explosive-proof version of the Skywater®300 which meets the safety requirements of offshore oil and gas drilling rigs.

3.1 Up-scaling of the technology

The Skywater® technology has already proved to be scalable – the development of the Skywater® 300 off the back of the Skywater® 14 unit resulted in demonstrable improvements in the efficiency of the technology – the energy consumption per litre of water produced has been significantly reduced.

The development of an even larger machine, the Skywater®1000, which has production capacity of approximately 3,800 litres per day, is demonstrating further gains in efficiency. The larger machine will target industrial, building, construction, mining and agricultural markets.

Island Sky® will continue to up-scale the technology into larger and larger machines until the energy efficiency of the machines begins to plateau. At that point, the company will begin to implement a strategy of 'bundling' the machines to work collaboratively.

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4. THE FUTURE

As at 31 December 2010 (Financial Year End) the group did not have sufficient funding to drive the sales growth and product development referred to above.

During 2010 the Company began restructuring its management and operational divisions initiating staff and overhead burn-rate reductions while refining contract manufacturing improvements. During 2010 the following reductions took place:

- Management salary deferrals
- Reductions in discretionary marketing costs
- Reductions in professional fees
- Salary & wage furloughs
- Headcount reductions

The Board has confidence in the company's products and is very encouraged by the 'beachhead' sales of the Skywater 300 to the Italian military (whilst recognizing that field trials remain to be completed). Although distribution and cashflow from sales has been (and will probably continue to be) slow for some time, the Management of ISK Inc remains confident that sales will improve as the world recovers from the global financial crisis and distributors are better able to perform their obligations. In this regard some of the Company's distributors who have proven to be inept in generating sales, will need to be replaced.

As a buffer against decreasing cashflow, the Board is also examining whether it would be in the company's best interest to seek a joint venture partner or investor who can take an interest in ISK Inc and provide the funds and sales expertise necessary to grow the business. If as a consequence, ISK reduces its shareholding in its USA subsidiary, the Board may consider additional avenues for investment in an effort to produce better value for shareholders in the medium term.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Richard Groden", is written over a light grey rectangular background.

Richard Groden
President and CEO
Island Sky Australia Limited
Tel: 954 922 3507
rgroden@islandsky.com