

**ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES**  
**ABN 88 092 266 067**

**ASX APPENDIX 4D**  
**HALF YEAR ENDED 31 DECEMBER 2010**

**RESULTS FOR ANNOUNCEMENT TO THE MARKET**

| <b>OPERATING PERFORMANCE</b>   | <b>31 December<br/>2010<br/>\$,000</b> | <b>31 December<br/>2009<br/>\$,000</b> | <b>Change<br/>\$,000</b> | <b>Change<br/>%</b> |
|--|--|--|--------------------------|---------------------|
| Revenue from ordinary activities   | 3,226                                  | 7,839                                  | (4,613)                  | Down 59%            |
| Profit/(Loss) from ordinary activities after tax attributable to members | (13,818)                               | (19,936)                               | 6,118                    | Up 30%              |
| Profit / Loss) for the half year attributable to members                 | (13,818)                               | (19,936)                               | 6,118                    | Up 30%              |

**DIVIDEND INFORMATION**

There are no dividend or distribution reinvestment plans in operation and there have been no dividend or distribution payments during the financial half year ended 31 December 2010.

**EXPLANATION OF RESULTS**

**Financial**

Revenue for the half year amounted to \$3.104 million compared with \$7.434 million in the previous corresponding period. Revenue was derived principally from pearl sales of \$1.953 million and deferred management fees recognised for the Arafura Pearl Projects 2009 & 2010 of \$1.153million. During the corresponding period, revenue included income from the newly issued Arafura Pearl Project 2010, for which sales were accelerated due to a tax incentive which lapsed at 31 December 2009. This factor brought MIS sales forward into the 2009 half year by \$4.46 million, which has not been repeated in the current period.

Operating expenditures were in line with expectations and were 8% lower than the previous corresponding period.

A tax benefit of \$6.1 million in the corresponding half year was not repeated in December 2010.

As highlighted in 2010 Annual Report, the Company is required to value biological assets. This requires a view to be taken on a number of variables including production assumptions, future pearl markets and the future economic environment. The directors are required to re-evaluate such assumptions, on an ongoing basis. For the half year to 31 December 2010 the directors have again reviewed all assumptions. Revisions have been adopted for selling price peromme and exchange rates and accordingly a conservative view has been taken based on present market conditions. This has resulted in a reduction in the carrying value of stock for accounting purposes from \$27.3 million at 30 June 2010 to \$18 million at 31 December 2010. Part of this reduction is due to the 2010 pearl harvest which was conducted during the period. Sales of the pearl harvest also occurred during the period, and the balance of pearls currently on hand is accounted for as Inventories, rather than as the Biological Assets that they were included as in the 30 June 2010 financial report. The final values and prices achieved for sale of future harvests may vary materially from the assumptions presently used particularly as the pearl market recovers.

## ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES

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The non cash revaluation of biological assets (oysters and pearls) required under AASB141 represented \$9.0 million of the group net loss after tax of \$13.8m for the December half year. The net cash outflow required for operating activities was \$3.7 million, which was funded by equity raisings and net borrowings.

At the present stage of development, it is typical for the majority of the Company's revenue to be derived in the second half of the financial year. This is expected to be the case in 2011. Pearls on hand at 31 December were valued at approximately \$1.2 million. The MIS sales & marketing programme will begin shortly and will continue through to mid June 2011.

### Operational

Farming operations were successfully restructured, with the closure of Beagle Bay, Western Australia and relocation of all the seeded shell to the new farm site at Point David, Croker Island in Northern Territory. This enabled the consolidation of all pearling activities to the NT where the company holds pearling quota and can better manage for efficiency and scale without the restrictive regulation in WA.

As part of the company's efficiency drive all the seeded shells at Elizabeth Bay have been x-rayed and placed in new panels on new cross tide long lines. As part of this process shells have been relocated from the distant outer island leases back to the home farm where the shell cleaning program can be better monitored and maintained.

The Point David site is a "finishing farm" where the focus is on superior shell husbandry for the final year of pearl production which historically has resulted in better pearl weight and quality. This development has taken pressure off Elizabeth Bay where hatchery propagation, spat grow out and pearl seeding of the virgin oysters takes place along with pearl production.

The seeding program completed in late September was the most successful to date with excellent quality shell and donor tissue being utilized in record numbers.

### Growth

The table below summarises the growth that the company has achieved to date and the further increases anticipated for production in 2011.

|                  | 2005   | 2006   | 2007    | 2008      | 2009      | 2010      | 2011(est) |
|------------------|--------|--------|---------|-----------|-----------|-----------|-----------|
| Quota            | 40,000 | 80,000 | 220,000 | 235,000   | 235,000   | 235,000   | 260,000   |
| Shell seeded     | 57,000 | 65,000 | 68,000  | 155,000 * | 185,000 * | 187,000 * | 220,000 * |
| Pearls harvested | 7,000  | 11,000 | 25,000  | 35,000    | 62,000    | 87,000    | 110,000   |
| Saleable pearls  | 4,000  | 7,000  | 16,000  | 28,000    | 59,000    | 64,000    | 90,000    |

\* note - the above figures include MIS activity

## OTHER INFORMATION

### NET TANGIBLE ASSETS PER SECURITY

|   | Half year ended<br>31 December 2010 | Half year ended<br>31 December 2009 |
|---|-------------------------------------|-------------------------------------|
| Net tangible assets                         | \$17,357,958                        | \$31,572,977                        |
| Number of shares on issue at reporting date | 858,215,939                         | 257,037,838                         |
| Net tangible assets per security            | 2c                                  | 12c                                 |

### CONTROL GAINED OR LOST OVER ENTITIES

The company did not gain or lose control of any entities during the half year ended 31 December 2010.

**ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES**  
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**ASSOCIATES AND JOINT VENTURES**

In June 2007, Arafura Pearls entered into a joint venture agreement with Arrow Pearl Co Pty Ltd and associates to manage its pearling operation at Beagle Bay on the Dampier Peninsula in WA for an initial term of 2.5 years, with options at the Company's election to extend the arrangement for a further 12.5 years. As the Company did not elect to extend the term, pearling operations at Beagle Bay was decommissioned during the half year ended 31 December 2010.

In September 2010, the Company entered into arrangements to lease the pearling farm located at Croker Island in the Northern Territory. Seeded shell from the Beagle Bay farm was transferred to Croker Island, together with seeded shell from the Elizabeth Bay farm.

**AUDIT STATUS**

The Appendix 4D and the attached interim financial report are based on accounts of Arafura Pearls Holdings Limited and its controlled entities for the half-year ended 31 December 2010. The financial report was reviewed by Stantons International. Refer to the 31 December 2010 half-year financial report for the independent review report.

The attached interim financial report for the half-year ended 31 December 2010 forms part of this Appendix 4D. The half-year report for 31 December 2010 is to be read in conjunction with the Arafura Pearls Holdings Limited 2010 annual financial report.



**ARAFURA PEARLS HOLDINGS LTD**

**CONSOLIDATED HALF YEAR REPORT**

**31 DECEMBER 2010**

# **ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES**

**ABN 88 092 266 067**

## **DIRECTORS' REPORT**

Your directors submit the financial statement of the economic entity for the half-year ended 31 December 2010.

### **DIRECTORS**

The names of directors who held office during or since the end of the half-year:

Andrew Malcolm Rupert Hewitt

Dr Francis Lung (appointed 21 December 2010)

Jonathan Warrant (appointed 2 February 2011)

Jeffrey Arthur Sydney Mews (resigned 2 February 2011)

Mark Joseph Ceglinski (resigned 21 December 2010)

Edwin James Taylor (appointed 6 July 2010, resigned 2 February 2011)

### **REVIEW OF OPERATIONS**

The operations of the group are the continued development and operation of a pearl oyster hatchery and farms at Elizabeth Bay, in Arnhem Land, and Croker Island, near Darwin, to produce Australian South Sea pearls.

### **2010 Pearl Harvest**

The 2010 pearl harvest at Beagle Bay was completed in July 2010. The seeding operations at Elizabeth Bay commenced during July 2010 and was completed in September 2010. The 2010 pearl harvest was also completed in September 2010. At the Elizabeth Bay farm, over 140,000 first operation shell were seeded, and a further 41,000 second and third operation shell were re-seeded.

Pearls are predominately sold in Japanese Yen (JPY) and the continued weakening of the JPY against the Australian dollar (AUD) has given rise to realised and unrealised currency losses in relation to pearl prices. Pearl sales totalling \$1.9m have been made during the half year.

### **Inventory Valuation**

As highlighted in the 2010 Annual Report, the Company is required to determine and value biological assets. This requires a view to be taken on a number of variables including production assumptions, future pearl markets and the future economic environment. The directors are required to re-evaluate such assumptions on an ongoing basis. For the half year to 31 December 2010 the directors have again reviewed all assumptions. The final values and prices achieved for sale of future harvests may vary materially from these assumptions particularly as the pearl market recovers.

### **Capital Raising**

The company raised \$130,500 from the issue of \$0.02 shares from a placement in July 2010, together with \$4.9m (net of capital raising costs) through the issue of \$0.015 shares from a Placement & a Rights Issue during the period to 31 December 2010.

**ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES**

**ABN 88 092 266 067**

**AUDITOR'S DECLARATION**

The lead auditor's independence declaration under section 307C of the *Corporations Act 2001* is set out on page 3 for the half year ended 31 December 2010.

This report is signed in accordance with a resolution of the Board of Directors.



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**Andrew M R Hewitt**  
Director

Dated this 28<sup>th</sup> day of February 2011

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(ABN 84 144 581 519) trading as

**Stantons International**  
Chartered Accountants and Consultants

28 February 2011

Board of Directors  
Arafura Pearls Holdings Limited  
Level 3, 22 Railway Road  
SUBIACO WA 6008

Dear Directors

**RE: ARAFURA PEARLS HOLDINGS LIMITED**

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Arafura Pearls Holdings Limited.

As Review Director for the review of the financial statements of Arafura Pearls Holdings Limited for the half-year ended 31 December 2010, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- (i) the auditor independence requirements of the Corporations Act 2001 in relation to the review; and
- (ii) any applicable code of professional conduct in relation to the audit.

Yours sincerely

**STANTONS INTERNATIONAL AUDIT AND CONSULTING PTY LTD**  
**(Trading as Stanton International)**  
**(An Authorised Audit Company)**



**J P Van Dieren**  
Director

# ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES

ABN 88 092 266 067

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE HALF YEAR ENDED 31 DECEMBER 2010

|  | Economic Entity     |                     |
|--|---------------------|---------------------|
|  | 31 Dec 10           | 31 Dec 09           |
|  | \$                  | \$                  |
| Revenue  | 3,103,802           | 7,533,752           |
| Net Increase / (Decrease) in Market Value                          | (9,012,959)         | (25,303,548)        |
| Cost of Sales  | (264,030)           | (170,350)           |
| <b>Gross Profit</b>  | <b>(6,173,187)</b>  | <b>(17,940,146)</b> |
| Employee expenses  | (3,011,341)         | (3,518,647)         |
| Consulting & Technician fees                                       | (649,050)           | (570,260)           |
| Boats & Charter expenses   | (315,433)           | (284,203)           |
| Fuels  | (308,088)           | (349,610)           |
| Freight  | (86,679)            | (82,982)            |
| Insurances   | (311,992)           | (373,271)           |
| Quota lease/ management fee  | (420,177)           | (441,839)           |
| Stores expenses  | (199,810)           | (164,145)           |
| Travel and accommodation expenses                                  | (247,783)           | (269,872)           |
| Australian South Sea Pearl Project                                 | (127,135)           | (100,644)           |
| <b>Operating Result</b>  | <b>(11,850,675)</b> | <b>(24,095,619)</b> |
| Other operating income   | 120,237             | 271,580             |
| Other operating expenses   | (541,507)           | (709,736)           |
| <b>Earnings before interest and taxes and amortization (EBITA)</b> | <b>(12,271,945)</b> | <b>(24,533,775)</b> |
| Amortisation   | (144,979)           | (168,479)           |
| Depreciation   | (635,609)           | (510,884)           |
| <b>Earnings before interest and taxes (EBIT)</b>                   | <b>(13,052,533)</b> | <b>(25,213,138)</b> |
| Net financial expense  | (856,101)           | (855,039)           |
| <b>Earnings before taxes</b>                                       | <b>(13,908,634)</b> | <b>(26,068,177)</b> |
| Income Tax   | 90,995              | 6,132,165           |
| <b>Net income / (Loss) after tax</b>                               | <b>(13,817,639)</b> | <b>(19,936,012)</b> |
| Comprehensive Income   | -                   | -                   |
| <b>Comprehensive Income for the period</b>                         | <b>(13,817,639)</b> | <b>(19,936,012)</b> |
| Attributable to shareholders of Arafura Pearls Holdings Limited    | (13,817,639)        | (19,936,012)        |
| <b>Basic earnings per share ( cents per share)</b>                 | <b>(0.02)</b>       | <b>(0.07)</b>       |

Diluted earnings per share are not shown because potential ordinary shares on issue at the comparative balance dates are not considered dilutive.

The accompanying notes form part of these financial statements



**ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES****ABN 88 092 266 067****CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
AS AT 31 DECEMBER 2010**

|                                      | <b>Economic Entity</b> |                   |
|--------------------------------------|------------------------|-------------------|
|                                      | <b>31 Dec 10</b>       | <b>30 June 10</b> |
| <b>ASSETS</b>                        |                        |                   |
| <b>CURRENT ASSETS</b>                |                        |                   |
| Cash and cash equivalents            | 156,128                | 171,704           |
| Trade and other receivables          | 2,102,670              | 2,240,959         |
| Biological Assets                    | -                      | 6,964,319         |
| Inventories                          | 1,350,620              | 1,125,687         |
| Other Assets                         | 94,556                 | 92,801            |
| <b>TOTAL CURRENT ASSETS</b>          | <b>3,703,974</b>       | <b>10,595,470</b> |
| <b>NON-CURRENT ASSETS</b>            |                        |                   |
| Biological Assets                    | 18,087,159             | 20,413,176        |
| Property, plant and equipment        | 6,938,812              | 7,274,924         |
| Intangible assets                    | 5,174,882              | 5,316,354         |
| Other                                | 609,676                | 560,589           |
| <b>TOTAL NON-CURRENT ASSETS</b>      | <b>30,810,529</b>      | <b>33,565,043</b> |
| <b>TOTAL ASSETS</b>                  | <b>34,514,503</b>      | <b>44,160,513</b> |
| <b>CURRENT LIABILITIES</b>           |                        |                   |
| Payables                             | 3,021,244              | 3,489,366         |
| Interest bearing liabilities         | 4,826,721              | 3,707,936         |
| Provisions                           | 54,919                 | 43,600            |
| Other                                | 1,122,647              | 2,245,295         |
| <b>TOTAL CURRENT LIABILITIES</b>     | <b>9,025,531</b>       | <b>9,486,197</b>  |
| <b>NON-CURRENT LIABILITIES</b>       |                        |                   |
| Interest Bearing Liabilities         | 1,960,377              | 2,230,616         |
| Other                                | 1,093,582              | 1,093,582         |
| <b>TOTAL NON-CURRENT LIABILITIES</b> | <b>3,053,959</b>       | <b>3,324,198</b>  |
| <b>TOTAL LIABILITIES</b>             | <b>12,079,490</b>      | <b>12,810,395</b> |
| <b>NET ASSETS</b>                    | <b>22,435,013</b>      | <b>31,350,118</b> |
| <b>EQUITY</b>                        |                        |                   |
| Contributed equity                   | 54,691,950             | 49,789,416        |
| Reserves                             | 818,092                | 818,092           |
| Accumulated Profits / (Losses)       | (33,075,029)           | (19,257,390)      |
| <b>TOTAL EQUITY</b>                  | <b>22,435,013</b>      | <b>31,350,118</b> |

The accompanying notes form part of these financial statements

# ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES

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## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE HALF YEAR ENDED 31 DECEMBER 2010

|   | \$               | \$                   | \$                        | \$              |
|---|------------------|----------------------|---------------------------|-----------------|
|   | Share<br>Capital | Retained<br>Earnings | Share Options<br>Reserves | Total<br>Equity |
| <b>Balance at 1 July 2010</b>                                 | 49,789,416       | (19,257,390)         | 818,092                   | 31,350,118      |
| <b>Total comprehensive income for the period</b>              |                  |                      |                           |                 |
| Profit or loss  | -                | (13,817,639)         | -                         | (13,817,639)    |
| <i>Other comprehensive income</i>                             |                  |                      |                           |                 |
| Foreign currency translation differences                      | -                | -                    | -                         | -               |
| Total Other Comprehensive Income                              | -                | -                    | -                         | -               |
| Total Comprehensive Income for the period                     | -                | (13,817,639)         | -                         | (13,817,639)    |
| <b>Transactions with owners recorded directly into equity</b> |                  |                      |                           |                 |
| <i>Contributions by and distributions to owners</i>           |                  |                      |                           |                 |
| Shares issued during the year                                 | 5,209,090        | -                    | -                         | 5,209,090       |
| Transaction costs   | (306,556)        | -                    | -                         | (306,556)       |
| Share-based payment transactions                              | -                | -                    | -                         | -               |
| Share options exercised                                       | -                | -                    | -                         | -               |
| Total Contributions by / Distributions to Owners              | 4,902,534        | -                    | -                         | 4,902,534       |
| <b>Balance at 31 December 2010</b>                            | 54,691,950       | (33,075,029)         | 818,092                   | 22,435,013      |
| <br><b>Balance at 1 July 2009</b>                             | <br>44,020,922   | <br>10,325,149       | <br>445,554               | <br>54,791,625  |
| <b>Total comprehensive income for the period</b>              |                  |                      |                           |                 |
| Profit or loss  | -                | (19,936,012)         | -                         | (19,936,012)    |
| <i>Other comprehensive income</i>                             |                  |                      |                           |                 |
| Foreign currency translation differences                      | -                | -                    | -                         | -               |
| Total Other Comprehensive Income                              | -                | -                    | -                         | -               |
| Total Comprehensive Income for the period                     | -                | (19,936,012)         | -                         | (19,936,012)    |
| <b>Transactions with owners recorded directly into equity</b> |                  |                      |                           |                 |
| <i>Contributions by and distributions to owners</i>           |                  |                      |                           |                 |
| Shares issued during the year                                 | 1,427,500        | -                    | -                         | 1,427,500       |
| Transaction costs   | (74,464)         | -                    | -                         | (74,464)        |
| Share-based payment transactions                              | -                | -                    | 372,538                   | 372,538         |
| Share options exercised                                       | -                | -                    | -                         | -               |
| Total Contributions by / Distributions to Owners              | 1,353,036        | -                    | 372,538                   | 1,725,574       |
| <b>Balance at 31 December 2009</b>                            | 45,373,958       | (9,610,863)          | 818,092                   | 36,581,187      |

The accompanying notes form part of these financial statements

# ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES

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## CONSOLIDATED STATEMENT OF CASH FLOW FOR THE HALF YEAR ENDED 31 DECEMBER 2010

|   | Economic Entity |             |
|---|-----------------|-------------|
|   | 31 Dec 10       | 31 Dec 09   |
|   | \$              | \$          |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>         |                 |             |
| Receipts from customers                             | 2,810,683       | 9,439,102   |
| Payments to suppliers and employees                 | (5,703,370)     | (6,335,993) |
| Interest received                                   | 2,156           | 2,868       |
| Borrowing costs                                     | (858,288)       | (858,168)   |
| Net cash provided by (used in) operating activities | (3,748,819)     | 2,247,809   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>         |                 |             |
| Purchase of non-current assets                      | (352,091)       | (287,038)   |
| (Payments)/Proceeds to/from Security Deposits       | (1,755)         | -           |
| Net cash provided by (used in) investing activities | (353,846)       | (287,038)   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>         |                 |             |
| Proceeds from borrowings                            | 1,600,634       | 93,955      |
| Repayment of borrowings                             | (284,062)       | (6,919)     |
| Repayments under hire purchase agreements           | (309,715)       | (282,049)   |
| Proceeds from issue of shares                       | 3,080,232       | 1,392,650   |
| Net cash provided by (used in) financing activities | 4,087,089       | 1,197,637   |
| Net increase (decrease) in cash held                | (15,576)        | 3,158,408   |
| Cash at <b>1 July 2010</b>                          | 171,704         | (4,542,726) |
| Cash at <b>31 December 2010</b>                     | 156,128         | (1,384,318) |

The accompanying notes form part of these financial statements

# **ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES**

**ABN 88 092 266 067**

## **NOTE 1: BASIS OF PREPARATION**

These general purpose financial statements for the interim half-year reporting period ended 31 December 2010 have been prepared in accordance with requirements of the Corporations Act 2001 and Australian Accounting Standards including AASB 134: Interim Financial Reporting. Compliance with Australian Accounting Standards ensures that the financial statements and notes also comply with International Financial Reporting Standards.

This interim financial report is intended to provide users with an update on the latest financial statements of the economic entity of Arafura Pearls Holdings Limited (the Company) and controlled entities (Consolidated Entity). As such, it does not contain information that represents relatively insignificant changes occurring during the half-year within the Company. It is therefore recommended that this financial report be read in conjunction with the annual financial statements of the Company for the year ended 30 June 2010, together with any public announcements made during the half-year.

The half year report does not include full disclosures of the type normally included in an annual financial report.

The accounting policies and methods of computation adopted in the preparation of the half-year financial report are consistent with those adopted and disclosed in the Consolidated Entity's annual financial report for the year ended 30 June 2010, except for the impact of the Standards and Interpretations described below. These accounting policies are consistent with the Australian Accounting Standards and with International Financial Reporting Standards.

### **Accounting Standards not previously applied**

The Company has adopted all of the new and revised Standards and Interpretations issued by the Australian Accounting Standards Boards (AASB) that are relevant to their operations and effective for the current reporting period.

New and revised Standards and amendments thereof and Interpretations effective in the current reporting period that are relevant to the Group include:

- Amendments to AASB 5, 8, 101, 107, 118, 136 and 139 as a consequence of AASB 2009-5 Further amendments to Australian Accounting Standards arising from the Annual Improvements Project

AASB 2009-5 introduces amendments into Accounting Standards that are equivalent to those made by the IASB under its program of annual improvements to its standards. A number of the amendments are largely technical, clarifying particular items, or eliminating unintended consequences. Other changes are more substantial, such as the classification of expenditures on unrecognized assets in the statement of cash flows.

The adoption of these amendments has not resulted in any changes to the Group's accounting.

Arafura Pearls Holdings Ltd is a listed public company, incorporated and domiciled in Australia.

These half year financial statements were approved by the Board of Directors on 28 February 2011.

### **Reporting Basis and Conventions**

The half year report has been prepared on an accruals basis and is based on historical costs modified by the revaluation of selected non-current assets, financial assets and financial liabilities for which the fair value basis of accounting has been applied.

### **Accounting Policies**

The accounting policies adopted in the preparation of the half year consolidated financial statements are consistent with those set out in the 30 June 2010 annual financial report.

## **ARAFURA PEARLS HOLDINGS LTD and CONTROLLED ENTITIES**

**ABN 88 092 266 067**

### **NOTE 2: DIVIDENDS**

No dividends were declared or paid from the end of the previous financial year until the date of this report.

### **NOTE 3: CONTINGENT LIABILITIES**

The company has a contingent liability, in the form of a Bank Guarantee facility totalling \$50,998, for security deposit guarantees for the leasing of office premises in Perth and a warehouse in Darwin. The Bank Guarantees are cash backed and are offset by term deposits for each of the Guarantees.

There are no other contingent liabilities at the date of this report other than a requirement under the Australian South Sea Pearl Projects to guarantee the provision of sufficient live shell by 6 months prior to seeding to enable registered growers to seed their allocated number of shell. Initial spat numbers selected per grower investment are in accordance with normal production projections which should allow for normal mortality levels and expected seeding numbers. The parent entity will transfer the right to seed shell from its own sources to a grower if required. Any surplus shell from growers that is not seeded will be available for return to the parent entity and seeded for the parent entity's benefit.

### **NOTE 4: EVENTS SUBSEQUENT TO REPORTING DATE**

On 1<sup>st</sup> February 2011, the Company issued 213,214,696 shares for the placement of approximately \$3.2m of shares at 1.5c each,

The Company also had a loan facility of up to \$2m approved, to be used for working capital purposes. The loan is for a term of 12 months at an interest rate margin of 5% above the prevailing 90 day bank bill rate, and will be secured by a fixed and floating charge over the Company's assets, with priority over all existing security except pre-existing fixed charges.

On 16<sup>th</sup> February 2011, ATO Product Ruling PR 2011/3 was issued for the Managed Investment Scheme 'Arafura Pearl Project 2011'. The sales and marketing campaign for the MIS will commence shortly.

### **NOTE 5: BIOLOGICAL ASSETS**

Oysters are considered to be self-generating and re-generating assets and have been valued in accordance with AASB 141 Agriculture as detailed below:

Oysters are measured at net market value having regard for:

- Net present value of expected future cash flows
- The best indicators of the net amount which could be received from the disposal of the oysters in an active and liquid market
- The cost of replacing the oysters

The shell in the water are required to be recorded in the Balance Sheet at the value reflecting the current age and stage of development of the oyster, in accordance with Australian Accounting Standard 141 Agriculture. The value of a shell will vary and depend on the age and stage it is at. A juvenile shell that is less than one year old will have a small value allocated to it, compared to a production shell which is nearly ready for harvest which will have a value similar to that of the pearl expected to be harvested from that shell. The AASB141 valuation is a calculation based on a combination of the cost of producing the shell, the market value of the shell, and a discounted NPV of the estimated future harvest income expected.

The expanded production from the hatchery and grow out program, together with increased production (seeded) shell in recent years has meant a significant increase in the valuation of inventory & biological asset stocks. The net increase/(decrease) in value is recognized as a non-cash accounting profit/(loss) item in the Income Statement (Statement of Comprehensive Income). In due course, this will turn into a cash item as pearls are harvested & sold, and the shell inventory stocks decrease by a corresponding value. Once the Company is at full production, the increase in shell value each year should be reduced by a similar value of pearls being harvested and sold.

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Increments and decrements in the values of oysters are recognized in the Statement of Comprehensive Income in the reporting period in which increments or decrements occur.

Inventories of pearls are measured at estimated net realizable value.

Key estimates - Determination of net market value of inventories

Pearl shell, spat and pearl oysters under cultivation are measured at net market value which is determined based on the net present value model of expected future cash flows attributable to these inventories. Assumptions used in the model are regularly reviewed and amended as considered appropriate. Key assumptions used in the model at balance date include;

|  | 31 Dec 2010        | 30 June 2010       |
|--|--------------------|--------------------|
| Sale price (Yen per momme) – Stock on hand         | Assessed           | Assessed           |
| Sale price (Yen per momme) – Biological assets     | 12,000             | 12,000             |
| JPY/AUD (on stock on hand at year end)             | 82.85              | 75.93              |
| JPY/AUD (on projected 2011 harvest sales)          | 85                 | 85                 |
| JPY/AUD (on projected future dated sales)          | 85                 | 85                 |
| Average yield in momme (first seeding)             | 0.70               | 0.70               |
| Average yield in momme (second seeding)            | 1.00               | 1.00               |
| Average yield in momme (third seeding)             | 1.15               | 1.15               |
| Management costs                                   | Actual costs       | Actual costs       |
| Effective Yield as a percentage of shell harvested | 56-80%             | 56-80%             |
| Discount rate applied to cash flows                | 15%                | 15%                |
| Mortality and rejection rates                      | Industry standards | Industry standards |

Biological Assets are valued using estimated future yen rates. Biological Assets recognised as Current Assets on the balance sheet (Statement of Financial Position) represent the estimated value of the pearls to be harvested within the next twelve months. Biological Assets recognised as Non Current Assets in the balance sheet represent pearl shell, spat and pearl oysters under cultivation, which will produce annual pearl harvests from the 2011/2012 financial year onwards.

The sale prices assumed for valuation of inventory and biological assets were as follows:

- a) Current Assets
  - Stock of pearls on hand – assessed current value.
  - Estimated pearl revenue from oysters to be harvested within one year – 12,000 yen/momme
- b) Non Current Assets
  - Estimated pearl revenue from oysters to be harvested in the next 2 to 4 years – 12,000 yen/momme

The longer term yen/momme price is expected to improve as both the pearl market recovers and the Company's production matures.

The exchange rates used to calculate inventory value at 31 December 2010 were:

- a) Current Assets
  - Stock of pearls on hand – the 31 December 2010 exchange rate of 82.85 JPY/AUD.
- b) Non-Current Assets
  - Oysters to be harvested in the next 2 to 4 years – 85 JPY/AUD.

The values of inventory and biological assets are substantially affected by the assumptions used particularly the pearl price and the exchange rate as set out above. It is also affected by the discount rate used to calculate the net present value. The directors have used a discount rate of 15%.

At 31 December 2010, the directors have classified all biological assets as non-current. As per directors' estimate, the next harvest is not due for the next 8-9 months and therefore, management are not able to reliably assess the portion of biological assets as current.

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### NOTE 6: INCOME TAX EXPENSE

Income tax expense/(benefit) is (\$90,995) for the period ended 31 December 2010 (31 December 2009: (\$6,132,164)). The Consolidated Entity has not elected to tax consolidate the group. The deferred tax asset attributable to tax losses arising in the parent entity has been brought to account as at 31 December 2010, to the extent of offsetting the deferred tax liability that has previously been brought to account. A deferred tax asset of \$4,152,081 in relation to carry forward tax losses has not been brought to account at 31 December 2010.

At balance date the Consolidated Entity has \$25,697,597 of prior year Australian sourced income tax losses that are available for recoupment and a current year tax loss of \$10,211,709.

Deferred tax assets and liabilities have been recognised, and deferred tax assets have been offset against deferred tax losses. The benefit from taxation losses will only be obtained if:

- (i) the Parent Entity derives future assessable income of a nature and of an amount sufficient to enable the benefit from the deductions for the losses to be realised, or
- (ii) the Parent Entity continues to comply with the conditions for deductibility imposed by tax legislation; and
- (iii) no changes in tax legislation adversely affect the Parent Entity in realising the benefit from the deductions for the losses.

### NOTE 7: OPERATING SEGMENTS

The Group has identified its operating segments based on the internal reports that are reviewed and used by the executive management team (the chief operating decision makers) in assessing performance and in determining the allocation of resources.

The operating segments are identified by management based on the manner in which resources are allocated and revenues earned. Management have identified that the economic entity operates a pearl oyster hatchery and farming operation in Australia.

### NOTE 8: CONTRIBUTED EQUITY

|   | 31 Dec 2010 | 30 June 2010 |
|---|-------------|--------------|
|   | \$          | \$           |
| 858,215,941 (30 June 2010: 511,744,954) ordinary fully paid shares        | 54,691,950  | 49,789,416   |
| (a) Movements during the period   |             |              |
| Ordinary Issued and fully paid Share Capital                              | 5,209,090   | 6,501,642    |
| Ordinary fully paid shares to be issued                                   | -           | 20,600       |
| Share issue expenses  | (306,556)   | (753,748)    |
| Opening balance at the beginning of the reporting period                  | 49,789,416  | 44,020,922   |
| Closing balance at the end of the reporting period 858,215,941 FPO shares | 54,691,950  | 49,789,416   |

Included in the share capital issued during the period is \$898,898 shares issued but were not paid for at the reporting date. At the date of this report, \$358K has not been received from the shareholders.

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### **NOTE 9: GOING CONCERN**

The financial report has been prepared on the going concern basis, which contemplates continuity of normal business activities and realization of assets and settlement of liabilities in the ordinary course of business. As at 31 December 2010, the consolidated entity had a net working capital deficiency of \$5.32 million. The Company had a net operating cash outflow of \$3.74 million during the half year then ended.

The ability of the consolidated entity to continue as a going concern is dependent upon it deriving sufficient funds for its operations and commitments. The directors continue to actively monitor the ongoing funding requirements of the company and the consolidated entity. The directors are confident that sufficient funds can be derived as and when required so as to enable the consolidated entity to continue as a going concern, and as such are of the opinion that the financial report has been appropriately prepared on a going concern basis.

The Directors consider the going concern basis to be appropriate for the following reasons:

- Approximately \$10.3 million proceeds from share issues has been received in the past 12 months
- A further \$3.2 million of equity was raised in February 2011 through a private placement
- Approximately \$1.2 million of pearls on hand are available for sale, with the sales program for the 2010 pearl harvest re-commencing in late February 2011
- As mentioned in Note 4, the 2011 MIS sales program will commence shortly and will continue through to mid June 2011.
- The demonstrated ability to obtain funding through debt and equity issues despite difficult conditions in the equities market.

Because of these reasons, the Directors believe that the consolidated entity will be able to continue to pay its debts as and when they become due and payable and that the basis of preparation of the financial report on a going concern basis is appropriate.



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**DIRECTORS' DECLARATION**

The directors of the company declare that:

1. The financial statements and notes, as set out on pages 3-12:
  - a. comply with Accounting Standard AASB 134: Interim Financial Reporting and the Corporations Regulations; and
  - b. give a true and fair view of the economic entity's financial position as at 31 December 2010 and of its performance for the half year ended on that date.
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.



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**Andrew M R Hewitt**

Director

Dated this 28<sup>th</sup> day of February 2011.

## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ARAFURA PEARLS HOLDINGS LIMITED**

### **Report on the Half-Year Financial Report**

We have reviewed the accompanying half-year financial report of Arafura Pearls Holdings Limited, which comprises the condensed statement of financial position as at 31 December 2010, the condensed statement of comprehensive income, condensed statement of changes in equity, and condensed statement of cash flows for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration for Arafura Pearls Holdings Limited ("the consolidated entity"). The consolidated entity comprises Arafura Pearls Holdings Limited ("the company") and the entities it controlled during the half year.

#### *Directors' Responsibility for the Half-Year Financial Report*

The directors of Arafura Pearls Holdings Limited 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* and for such control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement, whether due to fraud or error.

#### *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 a Financial Report 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 2010 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 Arafura Pearls 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.

Whilst we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

Our review did not involve an analysis of the prudence of business decisions made by the directors or management.

#### *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*, has been provided to the directors of Arafura Pearls Holdings Limited on 28 February 2011.

#### *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 Arafura Pearls 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 2010 and of its performance for the half-year ended on that date; and
- (b) complying with Accounting Standards AASB 134 Interim Financial Reporting and Corporations Regulations 2001.

#### **Inherent Uncertainty Regarding Carrying Value of Biological Assets and Going Concern**

Without qualification to the conclusion expressed above, attention is drawn to the following matters:


AASB 141 - "Agriculture" requires biological assets to be measured at each reporting date at fair value less estimated point of sale costs. Fair value is required to reflect the current market value in which a willing buyer and a willing seller would enter into a transaction. Arafura Pearls Holdings Limited has biological assets at 31 December 2010 with a carrying value of \$18,087,159. As disclosed in note 5 of the half year financial statements, the valuation of the company's biological assets (pearls under cultivation) is based on the discounted net present value (NPV) of cash flows expected to be earned from the eventual sale of these assets (being pearls available for sale). Critical to this NPV calculation are the assumptions made by management. These assumptions include inter-alia, future selling prices of pearls, discount rates, exchange rate of the Australian dollar against the Japanese Yen and recovery rates.

These critical assumptions have been disclosed in note 5. It is important to appreciate that assumptions used in the NPV computation cannot, by their nature be determined precisely and that in reality they would lie in a range of acceptable outcomes. It is noted that the fair value methodology of accounting required to be adopted by AASB141 - "Agriculture", requires assumptions used in NPV computations to be reviewed and altered, if appropriate, at each reporting date to reflect market conditions at that time. The fair value methodology may result in significant changes to values adopted at each reporting date in line with prevailing economic, industry and market conditions. Thus values can be volatile and fluctuate significantly from year to year. The recoverability of the carrying value of the Biological Assets at their stated amounts is dependent on the Company meeting production targets and assumes that the key assumptions are reasonable and achievable.

As referred to in Note 9 to the half-year financial report, the financial statements have been prepared on the going concern basis. At 31 December 2010 the consolidated entity had a working capital deficiency of \$5,321,557 and had incurred a loss after tax for the half-year of \$13,817,639.

The ability of the entity to continue as a going concern is subject to the successful recapitalisation of the Company by way of a capital raising and/or increasing revenue from sale of the Company's products to cover operating expenses. In the event that the Board is not successful in recapitalising the Company and in raising further funds, the entity may not be able to continue as a going concern, the current and non-current assets may not necessarily realise book values and non current liabilities may become current.

**STANTONS INTERNATIONAL AUDIT AND CONSULTING PTY LTD**  
**(Trading as Stantons International)**  
**(An Authorised Audit Company)**

*Stantons International Audit and Consulting 15/2/11*  


**John P Van Dieren**  
**Director**

West Perth, Western Australia  
28 February 2011