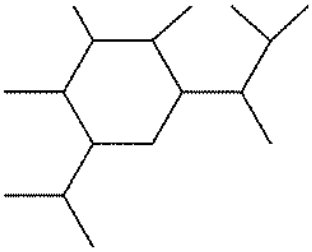
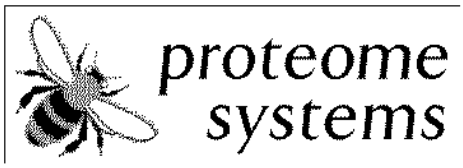




Dear Shareholders,

We would like to update you on our progress across our various programmes following our last report at the Annual General Meeting in November 2006. Since that time we have focused our energies on our commitment to accelerate the development of our lead programmes and to identify partners for the commercialisation of our most advanced products. We are pleased to provide you with an overview of our performance in key areas of the business, Tuberculosis and Prostate Cancer diagnostics, Topical and Radiation therapeutics and our DiagnostIQ platform.

Diagnostic test for active Tuberculosis (TB)
The company has continued to make good progress in its programme to develop a rapid diagnostic test for active TB. We remain on target to produce a prototype test for clinical evaluation in 2007.

Since announcing demonstration of "proof of concept" of a diagnostic test for active TB in September 2006 we have isolated several new antibodies for use in the test. These antibodies can detect very low levels of TB proteins (antigens) in clinical and laboratory strains of TB, indicating that they will allow the detection of active TB in humans, even at low levels of infection.

Antibodies are currently being tested for optimal sensitivity and specificity in the detection of TB antigens, using a standard ELISA test format. Once the conditions for each antibody:antigen detection assay have been optimised in the ELISA format, the assay is transferred to a point-of-care test format. This transfer is being undertaken in collaboration with Diagnostic Consulting Network, Carlsbad, USA, using Proteome Systems' proprietary flow-through (DiagnostIQ™) format for point-of-care detection of active TB.

We have filed several patent applications relating to novel antibodies produced for the test and for methods of diagnosis of active TB.

Working with partners in South Africa, Cameroon and Thailand, we are collecting additional clinical samples to determine test specifications. With these samples we will investigate the feasibility of using particular antibodies to detect TB in people from different geographic locations.

We are continuing our discussions relating to the commercial partnering of this programme and expect to be in a position to update you on this in the near future.

Prostate Cancer Diagnostic Test
The current broadly accepted test for prostate cancer measures elevated levels of a protein (Prostate Specific Antigen, or PSA) in blood. However, while PSA is produced by the

1/35-41 Waterloo Road North Ryde Sydney NSW 2113 Australia
locked bag 2073 North Ryde Sydney NSW 1670 Australia
phone +61 2 9889 1830 fax +61 2 9889 1805 www.proteomesystems.com
Proteome Systems Ltd ACN 080 277 998

prostate gland, it is not specific for cancer. An elevated level of PSA is only approximately 30% specific, meaning that there are a high number of false-positive diagnoses from the current test, which results in many unnecessary prostate biopsies.

Proteome Systems has partnered with Egenix Inc. to utilise our expertise in glycoproteomics to develop cancer diagnostic tests based on the detection of human carcinoma antigen (HCA), focusing initially on a test for prostate cancer. We have made significant progress in developing the components of a semen-based HCA test for highly specific and non-invasive detection of prostate cancer.

HCA is a sugar structure that exists on various glycoproteins (i.e. proteins with sugars attached) in different tissues. Egenix Inc patented the HCA biomarker after demonstrating that it is over-expressed in malignant epithelial tissue of numerous organs, making HCA a strong candidate for use in cancer diagnostic tests. Further work by Egenix indicated that HCA is elevated in prostatic cancer tissue, as compared to normal or benign prostatic tissue. We have expertise in the characterisation of glycoproteins and the sugars attached to them, therefore we are well placed to develop a test using HCA as a biomarker for prostate cancer.

Our scientists have identified a glycoprotein that is specific to prostatic fluid in semen and contains the HCA sugar. We now have antibodies that recognise either the glycoprotein or HCA, and these will be used to develop a highly specific semen-based prostate cancer test.

We have recently filed a patent application directed to this diagnostic test.

Our clinical partners in this programme, Drs Andrew Brooks and Manish Patel, Clinical Urologists at Westmead Hospital, have recently been granted ethics approval to recruit prostate cancer patients and non-cancer patients for the collection of semen, blood and urine samples. These samples will be used in our diagnostic assay and the results validated against prostate cancer diagnoses determined independently from biopsies.

Dr Nicolle Packer, who led this programme during 2006, has recently been appointed as Professor of Functional Proteomics at Macquarie University, one of Australia's premier life science research institutions. Dr Packer continues to act as an expert advisor on glycoproteomics for this programme and to collaborate with our scientists for other cancer related diagnostic applications.

While Prostate Cancer is our initial focus for HCA detection, we believe HCA may be a general marker for many epithelial cancers. We expect our work in prostate cancer will be a valuable basis to expand the use of our antibodies to create tests for other cancers.

Topical Therapeutic Programme

As announced last September we successfully completed our first "proof of concept" study in humans using one of our Eukarion compounds EUK-189 as a topical application to protect the skin from the harmful effects relating to UV irradiation. This programme is an extension of the earlier trials conducted by Estee Lauder on an earlier analogue of EUK-189, EUK-134, which they now utilise as the active ingredient in a range of cosmetics.

We are currently in advanced negotiations with a US company seeking to license our topical Eukarion compounds for development and commercialisation for both cosmeceutic

and therapeutic indications. We expect to be in a position to announce details of this opportunity imminently.

Our existing license agreement with Atrium is beginning to generate royalties in the order of over $100,000 per annum. In 2006 we saw demand for EUK-134 increase 20-fold, driven primarily through sales to Estee Lauder, which utilise EUK-134 in its Daywear Plus line of skincare cosmetics.

Radiation Therapeutics

Our studies with the Center for Medical Countermeasures Against Radiation (CMCR), funded by the National Institutes of Health (NIH), are continuing to show the potential of our EUK-200 series compounds as drugs for treatment of internal radiation damage.

In collaboration with the investigators at the CMCR, we have undertaken an additional project to determine the radiation protective effects of the orally available EUK 400-series compounds on radiation-induced cell death. This project was funded by a grant under the NIH.

In a study presented at the recent Annual Meeting of the Society of Free Radical Biology and Medicine, low doses of our 400 series Eukarion compounds were shown to prevent up to 87% of the cell death when given to cells after exposure to ionizing radiation. This is an important outcome of our study because there are currently no effective orally available therapies to protect organ damage after radiation exposure. It is assumed that an orally available therapeutic would be the most effective way to deliver treatment for radiation damage to populations exposed to radiation, e.g., after a dirty bomb attack. The successful outcome of this research project should generate interest in these compounds as potential mitigators of radiation injury and their further study, *in vivo*, by CMCR investigators.

DiagnostIQ

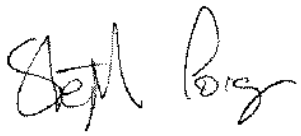
Proteome Systems has recently been granted patents in Europe and USA to its DiagnostIQ™ assay platform. The DiagnostIQ™ platform is a vertical-flow through assay platform consisting of both assay devices and processes for the identification or quantification of analytes in biological samples, for example using antibodies as detection reagents.

DiagnostIQ™ is particularly suited to assaying particulate or viscous samples from plants, microbes, humans and other animals, including sputum, mucous, saliva, blood, and semen. Such viscous samples may be difficult to assay using other flow through formats, or by employing lateral flow formats. The company has further patent applications pending in other jurisdictions directed to the core DiagnostIQ™ platform, and developments and improvements.

In September 2006 we announced an international licensing deal with Bayer CropSciences for the manufacture and distribution of the first products using this technology, in the agricultural diagnostic field. Bayer is continuing its extensive evaluation of the Wheatrite test, an agricultural diagnostic test for wheat quality, with selected customers and grain quality boards and plans to commence commercial scale manufacturing and release to selected markets following completion of this evaluation process. We look forward to earning royalties on sales of the Wheatrite test and subsequent products.

Summary

We have provided this update on the company's key activities to share management's confidence that our recent achievements augur well for the future success of the company. Thank you for your continued support and we look forward to reporting the next steps towards product development and commercialisation.



Stephen Porges
CEO Proteome Systems

Jenny Harry
Deputy CEO Proteome Systems

1/35-41 Waterloo Road North Ryde Sydney NSW 2113 Australia
locked bag 2073 North Ryde Sydney NSW 1670 Australia
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