

APPENDIX 4D
HALF YEARLY REPORT

Name of Entity: Advanced Engine Components Limited
 ABN: 67 009 081 770
 Reporting Period: Half year ended 31 December 2010
 Previous corresponding period: Half year ended 31 December 2009

Results for Announcement to the Market:

		<i>Movement</i>		<i>2010</i>
		<i>%</i>		<i>\$'000</i>
Revenue from ordinary activities	Up	46.5%	to	1,036
(Loss) from ordinary activities after tax attributable to members	Up	77.9%	to	3,093
(Loss) for the period attributable to members	Down	77.9%	to	3,093
Dividends		Amount per security		Franked amount per security
Interim Dividend		Nil ¢		Nil ¢
Previous corresponding period		Nil ¢		Nil ¢

Results Commentary

Refer commentary in the attached Half Year Financial Report.

Net Tangible assets per security

	\$
Net tangible assets per security as at 31 December 2010	(0.044)
Net tangible assets per security as at 30 June 2010	(0.032)

Details of entities over which control has been gained or lost during the period, including the following.

N/A

Details of individual and total dividends or distributions and dividend or distribution payments.

N/A

Details of any dividend or distribution reinvestment plans in operation

N/A

Details of associates and joint venture entities including the name of the associate or joint venture entity and details of the reporting entity's percentage holding in each of these entities.

Monika AEC Joint Venture – 26%

This report is based on:

The accounts have been subject to review.

Sign here:

A handwritten signature in black ink, appearing to read 'A Middleton', written in a cursive style.

Date: 28 February 2010

Print Name: A Middleton (Managing Director)

HALF-YEAR FINANCIAL REPORT

**For the 6 months ended
31 December 2010**

Advanced Engine Components Limited
and its Controlled Entities

ABN 67 009 081 770

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Directors' Report

The Directors of Advanced Engine Components Limited (the "Company") and its controlled entities submit herewith the financial report for the six months ended 31 December 2010 ("half year").

Details of Directors

The names of the Directors of the Company during or since the end of the half-year are:

Mr Graham Keys
Mr Antony Middleton
Mr Albert Pun
Mr Vivekananthan MV Nathan
Mr Manharlal Bhaichand Gathani Jain
Mr Arnold Chan (Resigned 24 September 2010)

Financial Review

Sales for the six months to 31 December 2010 are 47% higher than the corresponding period in 2009 and 63% of the sales for the full 12 months to 30 June 2010. The improved sales figures are the result of increasing sales from Australia particularly to India. Australian sales increased by 30% in the six months to 30 June 2010 and a further 50% in the six months to 31 December 2010. China sales have remained fairly consistent throughout these periods.

The Gross Margin for the six month period is 13%. The previous two 6 month periods have had negative Gross Margin results due to inventory write downs and the Weichai settlement. The 13% Margin is low compared to historical margins and reflects the predicted high volumes, low margins and other direct costs associated with sales to India.

Distribution Expenses are high due to the sales arrangements for India.

Overheads for Marketing, Occupancy, Corporate and Administration have been well maintained. These costs are \$316,088 lower than the corresponding period in 2009.

Development expenses are higher than the corresponding period in 2009. This is due to all technical staff returning to a five day week and less costs being capitalised as Research and Development.

Non-cash expenses of \$1,298,302, for depreciation; amortisation; and impairment of capitalised development expenditure, have been charged in the period. This is \$989,243 higher than the amount charged for the corresponding 2009 period. The majority of this relates to the write off of all capitalised expenditure related to the Isuzu engine development work in Australia. Technically this development was very successful. Vehicles sold, with Isuzu/AEC natural gas engines, are still in operation and performing beyond the required standard. Discussions with a number of potential customers are in progress. However, without the availability of required refuelling infrastructure in Australia and without any Government support there is no certainty as to what immediate future sales of the Isuzu/AEC natural gas engines will occur.

The strong Australian dollar has had a negative impact on AEC's result for the six months with an additional \$499,814 foreign exchange loss being expensed in this period compared to the corresponding period in 2009.

Overall the loss from continuing operations before income tax is \$1,289,790 higher than the corresponding period in 2009 despite the improved sales and improved gross margin. This deteriorated position can be related to the non-cash items referred to above.

However, the on-going cash loss is not acceptable to the Company and not sustainable. The Board is assessing strategic steps to change management and cost structures; change the operations and possibly ownership of AEC in China; renegotiate the India contracts; and address AEC's highly leveraged position to borrowings from related parties.

Working Capital and Cash Flow

AEC had a negative net cash flow from operating activities of \$633,065 for the six months to 31 December 2010. The major cause of this negative position has been the purchase of components and cost of labour associated, in particular, with the development; set up; and delivery of electronic control units and injectors to India. Higher sales receipts associated with this development; set up; and delivery will commence in the second six months of the 2011 financial year.

Funding of the development; set up; and purchases has come from the Australian Taxation Office research and development tax rebate and borrowings from parties associated with the two major shareholders of AEC.

With part of the additional borrowings funding the capitalised research and development; \$3,267,383 of related party borrowings due for repayment on 31 December 2011 being reclassified as current liabilities; accrual of finance costs associated with related party borrowings; and the cash loss incurred, the working capital position has deteriorated by \$5,650,167.

Improving this overall working capital position forms part of the strategic review being undertaken by the Board.

Summary

The 6 months has seen an improved level of sales, improved margins, further development of increased sales opportunities and significant increases in the price of oil (a major sales driver for AEC products). However, the strong Australian dollar is detrimental, margins earned on Indian sales are not satisfactory and the growth in China sales do not reflect the cost incurred or the opportunities available.

Technically and commercially AEC's products remain very competitive. Key business drivers including the price of oil; concern for the security of energy supply; environmental concerns; and economic growth in AEC's major markets, remain strong.

AEC's key focus in the short term is to achieve sales growth with minimum cash dilution and less reliance on related party borrowings. To achieve this will require strategic changes for AEC's operations in key markets.

Tony Middleton
Managing Director
28 February 2011

Independence Review by Auditor

Section 307C of the Corporations Act 2001 requires our auditors, *BDO Audit (WA) Pty Ltd* to provide the Directors of the Company with an Independence Declaration in relation to the review of the half-year financial report.

This independence declaration is on page 16 and forms part of this Directors' Report.

Signed in accordance with a resolution of Directors



A Middleton

Director

Perth, Western Australia, 28 February 2010

Directors' Declaration

In accordance with a resolution of the Directors of *Advanced Engine Components Limited*, I state that:

In the opinion of the Directors:

- (a) the financial statements and notes of the consolidated entity, set out on pages 7 to 15, are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the consolidated entity's financial position as at 31 December 2010 and its the performance for the half-year ended on that date; and
 - (ii) complying with Australian Accounting Standards: AASB 134 Interim Financial Reporting and the Corporations Regulations 2001 and other mandatory professional requirements; and
- (b) subject to the matters referred to in Note 3 to the financial statements, there are reasonable grounds to believe that Advanced Engine Components Limited will be able to pay its debts as and when they become due and payable.

On behalf of the Board



A Middleton
Director
Perth, Western Australia, 28 February 2010

Advanced Engine Components Limited
Half-Year Report – 31 December 2010

Consolidated Statement of Comprehensive Income
for the half-year ended 31 December 2010

	Notes	Consolidated 31 Dec 10 \$	31 Dec 09 \$
Sales revenue from continuing operations		1,036,267	707,069
Cost of goods sold		(901,621)	(728,569)
Gross profit		134,646	(21,500)
Other revenue from continuing operations		17,994	50,459
Distribution expenses		(63,008)	(15,861)
Marketing expenses		(3,212)	(22,000)
Occupancy expenses		(123,309)	(134,112)
Corporate expenses		(199,434)	(252,805)
Administration expenses		(943,692)	(1,176,818)
Development expenses		(651,467)	(269,949)
Finance costs		(495,545)	(474,598)
Impairment loss	2	(930,806)	(150,673)
Foreign exchange gains/(loss)		(397,332)	102,482
Loss from continuing operations before income tax expense		(3,655,165)	(2,365,375)
Income tax benefit		561,203	626,904
Loss after income tax from continuing operations		(3,093,962)	(1,738,471)
Net Loss for the half year attributable to owners of Advanced Engine Components Limited		(3,093,962)	(1,738,471)
Other comprehensive income			
- Exchange difference on translation of foreign operations		(289,478)	106,695
Total comprehensive loss for the half year attributable to owners of Advanced Engine Components Limited		(3,383,440)	(1,631,776)
Basic loss per share		Cents (1.52)	Cents (1.17)

The above Consolidated Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

Advanced Engine Components Limited
Half-Year Report – 31 December 2010

Consolidated Statement of Financial Position
as at 31 December 2010

	Notes	Consolidated	
		31 Dec 10 \$	30 Jun 10 \$
ASSETS			
Current Assets			
Cash and cash equivalents		354,561	828,891
Trade and other receivables		1,455,673	1,955,560
Inventories		1,480,272	1,704,617
Total Current Assets		3,290,506	4,489,068
Non-Current Assets			
Investment accounted for using the equity method		40,317	40,317
Property, plant and equipment		287,682	275,300
Intangible assets	6	3,696,175	4,557,337
Total Non-Current Assets		4,024,174	4,872,954
Total Assets		7,314,680	9,362,022
LIABILITIES			
Current Liabilities			
Trade and other payables	7	2,133,129	1,420,887
Borrowings	8	10,054,142	6,323,935
Provisions		333,769	324,613
Total Current Liabilities		12,521,040	8,069,435
Non-Current Liabilities			
Borrowings	8	-	3,120,082
Provisions		123,694	119,119
Total Non-Current Liabilities		123,694	3,239,201
Total Liabilities		12,644,734	11,308,636
Net Liabilities		(5,330,054)	(1,946,614)
EQUITY			
Contributed equity		21,193,635	21,193,635
Reserves		1,143,793	1,433,271
Accumulated losses		(27,667,482)	(24,573,520)
Total Equity / (Deficiency in Equity)		(5,330,054)	(1,946,614)

The above Consolidated Statement of Financial Position should be read in conjunction with the accompanying notes.

Advanced Engine Components Limited
Half-Year Report – 31 December 2010

Consolidated Statement of Changes in Equity
for the half-year ended 31 December 2010

	Issued Capital \$	Convertible Note \$	Asset Revaluation Reserve \$	Share Based Payments Reserve \$	Foreign Exchange Translation Reserve \$	Accumulated Losses \$	Total Equity / (Deficiency in Equity) \$
As at 1 July 2009	18,208,020	158,000	750,000	494,940	62,473	(20,777,624)	(1,104,191)
Net loss for the period	-	-	-	-	-	(1,738,471)	(1,738,471)
Foreign exchange translation.	-	-	-	-	106,695	-	106,695
Total	-	-	-	-	106,695	(1,738,471)	(1,631,776)
Comprehensive Income for the half year.							
Share Issue.	15,061	-	-	-	-	-	15,061
Share based payments.	-	-	-	41,621	-	-	41,621
SUB TOTAL	15,061	-	-	41,621	-	-	56,682
At 31 December 2009	18,223,081	158,000	750,000	536,561	169,168	(22,516,095)	(2,679,285)
As at 1 July 2010	21,193,635	-	750,000	603,280	79,991	(24,573,520)	(1,946,614)
Net loss for the period	-	-	-	-	-	(3,093,962)	(3,093,962)
Foreign exchange translation.	-	-	-	-	(289,478)	-	(289,478)
Total	-	-	-	-	(289,478)	(3,093,962)	(3,383,440)
Comprehensive Income for the half year.							
Share Issue.	-	-	-	-	-	-	-
Share based payments.	-	-	-	-	-	-	-
SUB TOTAL	-	-	-	-	-	-	-
At 31 December 2010	21,193,635	-	750,000	603,280	(209,487)	(27,667,482)	(5,330,054)

The above Consolidated Statement of Changes in Equity should be read in conjunction with the accompanying notes.

Consolidated Statement of Cash Flows
for the half-year ended 31 December 2010

	Consolidated	
	31 Dec 10	31 Dec 09
	\$	\$
Cash Flows from Operating Activities		
Receipts from customers	965,426	2,662,994
Payments to suppliers and employees	(1,966,065)	(2,936,869)
Income tax refund	395,947	676,904
Interest received	1,954	458
Interest paid and borrowing costs	(30,327)	(88,620)
Net cash inflow/(outflow) from operating activities	(633,065)	314,867
Cash Flows from Investing Activities		
Payments for property, plant and equipment	(1,835)	(3,739)
Payment for capitalised development costs	(327,278)	(560,819)
Net cash inflow/(outflow) from investing activities	(329,113)	(564,558)
Cash Flows from Financing Activities		
Additions of borrowings	597,045	547,175
Repayment of borrowings	(109,197)	(456,883)
Proceeds from issue of equity securities	-	61
Net cash inflow from financing activities	487,848	90,353
Net increase/(decrease) in cash held	(474,330)	(159,338)
Cash at the beginning of the half-year	828,891	279,955
Cash at the end of the half-year	354,561	120,617

The above Consolidated Statement of Cash Flows should be read in conjunction with the accompanying notes.

1 Basis of Preparation of Half-year Report

These general purpose financial statements for the interim half-year reporting period ended 31 December 2010 have been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Act 2001.

These interim financial statements do not include all the notes of the type normally included within the annual financial statements. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2010 and any public announcements made by Advanced Engine Components Limited during the interim reporting period in accordance with the continuous disclosure requirements of the Corporations Act 2001.

The accounting policies and methods of computation adopted are consistent with those of the previous financial year and corresponding interim reporting period.

2 Critical Accounting Estimates and Judgements

In the application of AEC's accounting policies, management is required to make judgments, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

(i) Estimated impairment of intangible assets

In accordance with AASB 136 Impairment of Assets, AEC assesses at each reporting date whether there is an indication that an asset may be impaired. An asset is impaired if its carrying amount exceeds its recoverable amount which is the amount to be recovered through use or sale of the asset. The recoverable amount of AEC's various cash generating units (CGU's) have been determined based on value-in-use calculations of these units.

An impairment charge of \$930,806 has been recorded during the half year period.

a) Key assumptions used for value-in-use calculations

Value-in-use calculations use cash flow projections based on financial budgets approved by management covering a 5 year period to determine a unit's recoverable amount that is then compared with the carrying value of the assets of that unit.

In calculating the value-in-use for each CGU, the following key assumptions were used:

- A pre-discount rate of 11.24% is applied, which represents the Group's average cost of debt
- Gross margin 26%
- Growth rate 10%

Based on current contract negotiations the Directors expect to meet the forecast sales growth and growth margins, as indicated above.

b) Impact of possible changes in key assumptions

As indicated above, the impairment testing process utilised a range of key assumptions. Recoverability of the amounts capitalised as development costs are dependent upon AEC being able to achieve the key assumptions as stated above.

Given the volatility of the current economic climate, it is possible that market conditions could occur that fall outside the range of sensitivity analysis conducted, the impact of which will continue to be monitored.

3 Going Concern Basis

The consolidated entity incurred a loss after income tax from continuing operations for the half year of \$3,093,962 (2009: half year loss of \$1,738,471). The loss is after charging non-cash depreciation, amortisation, impairment and unrealised foreign exchange charges of \$1,695,634 (2009: \$707,552). In addition, finance costs of \$495,545 (2009: \$474,598) have been incurred that principally relate to interest accruals on the major shareholder loans which do not require immediate cash payment.

At 31 December 2010 the consolidated entity had cash assets of \$354,561 (30 June 2010: \$828,891), negative working capital of \$9,230,534 (30 June 2010: \$3,580,367) and liabilities exceeding total assets by \$5,330,054 (30 June 2010: \$1,946,614).

The increase in the negative working capital is a result of the loss incurred, additional funding by related parties and reclassification of related party borrowings from non-current to current.

Excluding related entities and entities associated with the Directors, from current liabilities, the working capital would be a positive \$823,608 at 31 December 2010. The amounts owing to related entities include \$8,078,355 owing to 698 Capital Asia Pacific Ltd which is a related party of AEC's major shareholder, 698 Capital International Limited. 698 Capital International Limited has resolved to provide financial support so that AEC will not be unable to pay its debts as and when they fall due, for a period of at least one year from the signature of the Directors' Declaration of the 31 December 2010 Financial Statements. The financial support is subject to 698 Capital International Limited remaining the major shareholder of AEC holding not less than 35% of the ordinary shares in AEC.

Based on 698 Capital International Limited's support; existing financial support of other related or director associated companies; on-going discussions with customers, potential customers and potential business partners in India and China; and recent sales trends, the Directors consider it appropriate that the financial report be prepared on a going concern basis.

4 Segment Information

a) Description of segments

Management has determined the operating segments based on the reports reviewed by the Board in making strategic decision. The Board considers the business from a geographic and product perspective. There are two key geographic segments, Australia and China, which produce, procure and sell AEC products to their own and other geographic regions. AEC Australia supplies products to Australia, China, France and India. AEC China supplies products to China, Australia and South East Asia.

AEC has four product segments. Namely, sale of spares and services, sale of NGVS kits and components, sale of completed engines purchased from original equipment manufacturers incorporating AEC NGVS and research and development of new products. The Australian segment is responsible for research and development.

The Board considers the performance of the two key geographic segments in making strategic decision. All geographic segments for the three product segments, other than research and development, are considered both jointly and separately for revenue and direct costs as there is considerable integration of all segments. Research and development does not have revenue of its own as it contributes and assists all segments.

In the strategic decision making process, assets and liabilities are only considered by the two key geographical segments.

b) Segment information provided to the strategic steering committee.

The segment information provided to the Board for the reportable segments for the 6 months ended 31 December 2010 was as follows:

Reporting segments	Australia	China	TOTAL
Half Year 2010	\$	\$	\$
Revenue			
Total Segment Revenue	653,033	414,547	1,067,580
Inter-Segment Revenue	(16,213)	(15,100)	(31,313)
Revenue from External Customers	636,820	399,447	1,036,267
Adjusted EBITDA	(644,137)	(638,409)	(1,282,546)
Total Segment Assets	4,437,767	1,823,525	6,261,292
Total Segment Liabilities	(11,606,676)	(4,772,084)	(16,378,760)

The segment information provided to the Board for the reportable segments for the 6 months ended 31 December 2009 was as follows:

Reporting segments	Australia	China	TOTAL
Half Year 2009	\$	\$	\$
Revenue			
Total Segment Revenue	361,103	402,185	763,288
Inter-Segment Revenue	(46,691)	(9,528)	(56,219)
Revenue from External Customers	314,412	392,657	707,069
Adjusted EBITDA	(612,434)	(480,435)	(1,092,869)
Total Segment Assets	4,324,142	2,919,298	7,243,440
Total Segment Liabilities	(2,890,341)	(3,773,732)	(6,664,073)

c) **Other segment information – Adjusted EBITDA**

The Board assesses the performance of the operating segments on a measure of adjusted EBITDA. The measurement basis excludes other income, corporate costs, financing costs, unrealised foreign exchange movements, depreciation, amortisation and intangible asset impairment expenses. A reconciliation of adjusted EBITDA to operating profit before income tax is provided as follows:

	Consolidated	
	31 Dec 10	31 Dec 09
	\$	\$
Adjusted EBITDA	(1,282,546)	(1,092,869)
Other Income	17,994	68,613
Corporate Costs	(199,434)	(261,451)
Finance Costs	(495,545)	(474,598)
Unrealised Foreign Exchange Movements	(397,332)	(398,493)
Depreciation	(15,021)	(2,932)
Amortisation	(352,475)	(155,453)
Impairment of intangible assets	(930,806)	(150,674)
Loss Before Income Tax from Continuing Operations	(3,655,165)	(2,467,857)

5 Dividends

No dividend has been paid or proposed in respect of the current or previous half year.

6 Intangible Assets

At December 2010 \$930,806 (Dec 09: \$150,674) was written of for Isuzu and Motive projects.

7 Trade and Other Payables

	Consolidated	
	31 Dec 10	30 June 10
	\$	\$
Trade payables (i)	1,808,027	523,379
Other payables (ii)	325,102	747,846
Non-hedging foreign currency payable	-	149,662
	<u>2,133,129</u>	<u>1,420,887</u>

- (i) Trade payables are non-interest bearing and are predominantly settled on 60-day terms.
- (ii) Other payables includes accruals for annual leave. The entire obligation is presented as current, since the Group does not have an unconditional right to defer settlement. However, based on past experience, the Group does not expect all employees to take the full amount of accrued leave within the next 12 months.

Advanced Engine Components Limited
Half-Year Report – 31 December 2010
Notes to the Financial Statements

8 Borrowings

	Consolidated	
	31 Dec 10	30 June 10
	\$	\$
Current:		
Insurance premiums finance	37,345	149,381
Loan from CCM Global Limited	603,746	1,010,393
Loan from 698 Capital Asia Pacific Ltd (A)	4,810,972	4,435,284
Loan from Syndicate (B)	729,173	728,877
Loan from Accord Ocean Investment Ltd	454,142	-
Loan from Vivekananthan MV Nathan (C)	151,381	-
Loan from 698 Capital Asia Pacific Ltd (A)	3,267,383	-
	10,054,142	6,323,935
Non-Current:		
Loan from 698 Capital Asia Pacific Ltd (A)	-	3,120,082
	-	3,120,082
Total Borrowings	10,054,142	9,444,017

(A) 698 Capital Asia Pacific Ltd is a related party.

(B) The Syndicate consists of parties related to Directors of the Company

(C) Mr Nathan is a Director of the Company

9 Commitments and Contingencies

Since the last annual reporting date, there have been no material changes to any contingent liabilities or contingent assets.

10 Related Party Transactions

On 19 November 2010, Mr Vivekananthan M.V. Nathan (Director of AEC) provided a working capital facility of \$150,000 to AEC. The facility is repayable on or before 31 December 2011 with interest payable at 8% quarterly in arrears.

11 Subsequent Events

There are no matters or circumstances that have arisen since 31 December 2010 that have or may significantly affect the operations, results, or state of affairs of the consolidated entity in future financial years.

28 February 2011

Chairman of the Audit Committee
Advanced Engine Components Limited
11 Energy Street
MALAGA WA 6090

Dear Sirs,

**DECLARATION OF INDEPENDENCE BY PETER TOLL TO THE CHAIRMAN OF THE AUDIT COMMITTEE
OF ADVANCED ENGINE COMPONENTS LIMITED**

As lead auditor of Advanced Engine Components Limited for the period ended 31 December 2010, 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
- any applicable code of professional conduct in relation to the review.

This declaration is in respect of Advanced Engine Components Limited and the entities it controlled during the period.



Peter Toll
Director



BDO Audit (WA) Pty Ltd
Perth, Western Australia

INDEPENDENT AUDITOR'S REVIEW REPORT TO THE MEMBERS OF ADVANCED ENGINE COMPONENTS LIMITED

Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Advanced Engine Components Limited, which comprises the statement of financial position as at 31 December 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, notes comprising a statement of accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company 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 of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards 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 Advanced Engine Components 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*, which has been given to the directors of Advanced Engine Components Limited, would be in the same terms if given to the directors as at the time of this auditor's report.

Basis for Qualified Conclusion

Attention is drawn to the recoverability of the consolidated entity's trade and other receivables with a carrying value of \$1,455,673. We have not been able to obtain sufficient audit evidence to support the recoverability of \$244,475 of these receivables. Due to this limitation of scope, we have not been able to determine if an impairment provision against these trade receivables is necessary or the amount of the effect, if any, that an impairment provision would have on the consolidated statement of financial position and statement of comprehensive income.



Attention is drawn to the recoverability of the consolidated entity's intangible asset relating to engine development costs with a carrying value of \$3,696,175. The entity has forecast sales based upon their best estimates and have utilised this information for assessing the asset for impairment in accordance with AASB 136. Due to the inherent uncertainties of future sales forecasts we have not been unable to obtain sufficient appropriate evidence to support the likelihood of the sales being achieved nor have we been able to perform sufficient appropriate alternative procedures to support the sales forecasts to assess the recoverability of the asset.

Due to this limitation of scope, we have not been able to determine if an impairment provision against this intangible asset is necessary or the amount of the effect, if any, that an impairment provision would have on the consolidated statement of financial position and statement of comprehensive income.

Qualified Conclusion

Based on our review, which is not an audit, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves on the matters referred to in the proceeding paragraphs, we have not become aware of any matter that makes us believe that the half-year financial report of Advanced Engine Components 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 Standard AASB 134 *Interim Financial Reporting* and *Corporations Regulations 2001*.

Emphasis of Matter

Without qualifying our conclusion, we draw attention to Note 3 in the financial report which indicates that the consolidated entity incurred a net loss of \$3,093,962 during the year ended 31 December 2010 and, as of that date, the entity's current liabilities exceeded its current assets by \$9,230,534. These conditions, along with other matters as set forth in Note 3, indicate the existence of a material uncertainty that may cast significant doubt about the consolidated entity's ability to continue as a going concern and therefore the consolidated entity may be unable to realise its assets and discharge its liabilities in the normal course of business and at the amounts stated in the financial report.

BDO Audit (WA) Pty Ltd

A handwritten signature in blue ink, appearing to read 'Peter Toll', with the BDO logo above it.

Peter Toll
Director

Perth, Western Australia
Dated this 28th day of February 2011