ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED
ACN 092 708 364

FINANCIAL REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CORPORATE DIRECTORY

Directors

Mr Fred Bart (Chairman)
Dr Ben Greene (Chief Executive Officer)
Mr Ian Dennis
Lt Gen Peter Leahy AC
Air Marshall Geoff Brown
Ms Kate Lundy

Company Secretary

Mr Ian Dennis

Registered Office

Suite 3, Level 12
75 Elizabeth Street
Sydney NSW 2000
Australia

Telephone:- 612 9233 5015
Facsimile:- 612 9232 3411

Web site www.eos-aus.com

Share Registry

Computershare Investor Services Pty Limited
Level 3
60 Carrington Street
Sydney NSW 2000
Australia

GPO Box 7045
Sydney NSW 1115

Telephone:- 1300 855 080 or 613 9611 5711 outside Australia
Facsimile:- 1300 137 341

Auditors
Deloitte Touche Tohmatsu
Chartered Accountants
8 Brindabella Circuit
Brindabella Business Park
Canberra Airport ACT 2609
Australia

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

REVIEW OF OPERATIONS

1. RESULTS FOR FULL-YEAR ENDING 31 DECEMBER 2018

The consolidated entity ("EOS") reported an operating profit after tax of $15,081,372 for the 12 month period to 31 December 2018 [31 December 2017: $9,399,930 loss] based on revenues totalling $87,130,396 [31 December 2017: $23,259,794].

The consolidated entity reported net cash used by operations for the 12 month period totalling $15,686,202 [31 December 2017: $25,949,693]. At 31 December 2018, the consolidated entity held cash totalling $40,538,225 [31 December 2017: $9,989,953]. Cash of $119,025 [31 December 2017: $119,025] is restricted as it secures bank guarantees relating to performance on some contracts.

The operating profit after tax represents strong performance against all prior expectations, but requires expansion. The overall result was made up of four elements:

A.	Foreign Exchange Gains (Defence Segment):	$7.7 million
B.	Defence Segment Profit;	$10.1 million
C.	Space Segment Loss:	($2.2 million)
D.	Unallocated Holding Company Loss:	($0.5 million)
	Total	**$15.1 million**

EOS exports over 95% of current production and export contracts are generally denominated in US currency. The value of the Australian dollar fell from US$0.7805 at 31 December 2017 to US$0.7052 at 31 December 2018 and EOS consolidated entity booked foreign exchange gains of $7,712,222 (31 December 2017: $695,061 – losses) during the full-year period ended 31 December 2018.

The foreign exchange gains arose in the normal course of business as a result of performance bonds and cash reserves held in US currency, and currency exchange as revenue was received.

The operating profit after tax of $15.1 million included foreign exchange gains of $7.7m and is stronger than previously forecast. The table below shows the result in the context of earlier guidance.

$ millions	Forecast March 2018	Forecast August 2018	Segment Result Dec 2018
Foreign Exchange Gains	0	3.8	7.7
Defence Sector Operating profit	8.9	10.1	10.1
Space Sector Operating Loss	(3.8)	(3.8)	(2.2)
Unallocated Holding Company Loss		-	(0.5)
Full Year Result	5.1	10.1	15.1

The key elements in the evolution forecasts to results are:

Foreign exchange gains progressively increased through 2018;

Space sector performance was better than expected, with losses for 2018 settling at 60% of original expectations;

Defence sector performance progressively improved throughout 2018, ultimately exceeding initial expectations by 14%; and

Holding Company losses, previously allocated to operating sectors, falling at $0.5 million over the full year.

The individual sector performances are further discussed below.

2. EOS DEFENCE SYSTEMS

EOS Defence sector delivered a very strong performance in 2018. The full year result of $10.1 million profit is 14% higher than the expectation of $8.9 million in early 2018 and is consistent with the $10.1 million expected in Q3 2018 when forecasts were last revised.

This result was due to gradual performance improvement through 2018, and is particularly creditable because it was achieved during execution of a strategic process with a focus on longer term objectives.

The sector started the period with reasonable certainty that sector revenue would approximately double in 2019 and so building a robust platform for sustainable growth beyond 2018 was the highest priority. This priority energised specific activities relating to human resources, production processes, new sales and new products. None of these activities were optimised for operational performance in 2018 alone.

Human Resources

Initiating manufacture of a new product in a new plant required double the number of production staff, and training of all staff for new procedures, plant and equipment.

As well as the expansion of staff for operations, Defence sector leadership at executive and management levels was significantly deepened during 2018. The objective of this expansion was to reduce performance risk going forward as revenue doubles in 2019 and continues to grow into 2020.

This process has increased sector overhead costs, but the increases are within expectations.

Production

The new production facility in Hume [ACT] is performing ahead of expectations. A margin of 11.9% was achieved with the plant operating at 55% capacity for the full year.

Production processes, documentation, supply chain management, yield, and final quality all improved significantly through the period. The improvements achieved are substantial and are key factors driving the full year sector result for 2018.

Further improvement is required because during 2019 new complexity will be added in the form of new products, and specification variations on the current product.

New Product Development

For the initial 1,000 units ordered of EOS' revolutionary R-400S Mk2 weapon system, the product configuration was frozen to reduce risk and accelerate production. EOS now allows variants of this product to be ordered and engineering resources are being expanded to meet demand for these variants from existing and new customers.

In September 2018 EOS launched the R-150, a lightweight remote weapon station, to the market. This product has been well received. Further product releases are imminent.

These key activities were addressed to form a basis for further improvement in 2019, in the expectation of a doubling of 2018 revenue for 2019. This objective has been met.

3. EOS SPACE SYSTEMS

During this period EOS Space Sector executed its plan to achieve the following:

A. Operational Scale and International Credibility

EOS grew its operational space situational awareness [SSA] capability, as a company, to a level exceeding 10,000 high precision space tracks each week from low earth orbit to beyond geostationary orbit. This exceeds the capability of all entities except the five most active nations in space.

B. Performance

Long term, independent testing by the world leader in SSA operations was completed. This formally established the sensitivity, accuracy and applicable range for the EOS capability. These factors met EOS program objectives.

REVIEW OF OPERATIONS (cont)

C. Scaling

Using 12 months of SSA operations at a scale exceeded only by a few nations, the EOS capability has been subject to technical reviews to increase performance and reliability while reducing costs. This process is undertaken in parallel with commercial contract negotiations, because these involve tradeoffs among price, performance and scale.

EOS has established that its sensors can achieve sufficient throughput to meet customer data quantity requirements at a reasonable price. Against a nominal customer requirement of 100,000 space object tracks per week, under all weather conditions, EOS has deployed and operationally tested over many months at 10% of this scale.

EOS has successfully demonstrated compliance with all customer and space industry requirements and is now engaged in commercial discussions for data supply contracts.

This activity was performed on time and well within the allocated budget. The operating loss in this segment was $2.2 million, or around 60% of the loss expected at the commencement of the period.

4. FORECAST AND OUTLOOK

Defence

A strong positive outlook for the Defence Sector is based on key performance metrics:

Revenue, Backlog

In 2018 revenue in this sector grew in excess of 200% to $85 million, and the Company expects this to grow at 100% to exceed $170 million in 2019.

At 1 January 2018 EOS Defence Sector had a backlog of undelivered orders and customer commitments of around $581 million. At 1 January 2019 the contracted order backlog exceeded $667 million.

The current backlog of $667 million is sufficient for the sector to operate for almost two years from 2020 with a revenue of $250 million, with no new sales added from now. The Company expects that more sales will be secured during 2019 and beyond.

Orders and Pipeline

Demand for EOS defence products is tracking ahead of expectations. No competitor has yet offered a qualified product into the market created by EOS with the R-400S weapon system. In 2018 EOS released its R-150 lightweight weapon station which is expected to accrue sales from late in 2019. New product launches will continue in 2019. Each of these new products is designed with strong market differentiation.

REVIEW OF OPERATIONS (cont)

Market demand is growing. At 1 February 2019 the Company was participating in over $1.2 billion of procurements globally. The conversion delay from tenders to executed contracts is typically 18 months, and around 25% of this pipeline is expected to convert during 2019. A further $1 billion of tenders is expected to be submitted by EOS during 2019 for new EOS products.

Margins

The full-year result indicates a margin of 11.9% from current products. Further improvement is possible because in 2018 only 55% of nominal plant capacity was used. Plant utilisation will increase to 90% of nominal capacity in 2019. The US plant in Huntsville will add capacity to meet new orders from customers not presently serviced from the Hume plant. This is expected from late in 2019.

The following key challenges for the Defence Sector going forward are receiving close attention by management:

- **Human Resources** The skilled resource pool is nearing exhaustion in the Canberra region. The Company may have to establish an additional site for operations.
- **Export Licenses** This sector relies on the timely release of export licenses for each customer, usually by both Australia and the USA. This process is becoming more complex.
- **Sovereign Risk and Customer Diversification** The sector now services seven customers. The objective is for further diversification to over 10 customers by 2020 to further reduce sovereign risk.
- **US Program Delays** The ramp up of production from the US plant has been slowed in step with delays to US defence procurements.

Considering all aspects, the outlook for the EOS Defence Sector is very positive with business volume and margins both expected to grow going forward.

Space

EOS technology is creating a new market and somewhat disrupting existing capabilities and arrangements in space. This is the usual impact of new technology. At this point there is no longer any question on the price or performance of EOS' technology, or its scalability. The cost advantages of EOS' approach are very significant and likely to be essential to all customers the Company is addressing.

EOS' initial customers for space data are governments, and negotiations for contracts have been prolonged. This is partly caused because there are no direct competitors so normal tendering processes are not possible.

Discussions and negotiations with multiple government entities are well under way.

The outlook for the EOS Space Sector remains positive, and guidance is unchanged from earlier updates. The Company expects profitable operations in this sector from 2020.

REVIEW OF OPERATIONS (cont)

Full Year Forecast

Provided trading conditions remain close to current settings, the Company now expects revenue to grow to $170 million for 2019, with a profit expectation of around $20 million for the full year to 31 December 2019.

The forecast assumes no change in the exchange rate of AU$ against US$. However exchange rates can be volatile and both gains and losses can arise from normal operations.

Ben Greene
Chief Executive Officer

8 March 2019

DIRECTORS' REPORT

The directors of Electro Optic Systems Holdings Limited submit herewith the annual financial report of the company for the year ended 31 December 2018. In order to comply with the provisions of the Corporations Act 2001, the directors report as follows:

Directors

The names and particulars of the directors of the company during or since the end of the financial year are:

Name	**Particulars**
Fred Bart	Chairman (Age 64). He has been Chairman and Director of numerous public and private companies since 1980, specialising in manufacturing, property, technology and marketable securities. Mr Bart is a director of Immunovative Therapies Limited, an Israeli company involved in the manufacture of cancer vaccines for the treatment of most forms of cancer. He is also Chairman of Audio Pixels Holdings Limited and a director of Weebit Nano Limited. He is a member of the Remuneration Committee. Appointed to the Board on 8 May 2000.
Dr Ben Greene	BE (Hons), Phd in Applied Physics (Age 68) is the Chief Executive Officer of Electro Optic Systems. Dr Greene was involved in the formation of Electro Optic Systems. He is published in the subject areas of weapon system design, laser tracking, space geodesy, quantum physics, satellite design, laser remote sensing, and the metrology of time. Dr Greene is Deputy Chair of the Western Pacific Laser Tracking Network (WPLTN) and has recently served as member of Australia's Prime Ministers Science, Engineering and Innovation Council (PMSEIC) and CEO of the Cooperative Research Centre for Space Environment Management. Appointed to the Board on 11 April 2002.
Ian Dennis	BA, C.A. (Age 61) is a Chartered Accountant with experience as director and secretary in various public listed companies and unlisted technology companies in Australia and overseas. He has been involved in the investment banking industry and stockbroking industry for the past twenty five years. Prior to that, he was with KPMG, Chartered Accountants in Sydney. Appointed to the Board on 8 May 2000. He is also director and company secretary of Audio Pixels Holdings Limited. He is a member of the Audit Committee and Remuneration Committee. He is also company secretary of Electro Optic Systems Holdings Limited.

DIRECTORS' REPORT (cont)

Lt Gen Peter Leahy AC

Non-executive director (Age 66). Appointed to the Board on 4 May 2009. Peter Leahy AC retired from the Australian Army in July 2008 as a Lieutenant General in the position of Chief of Army. Among his qualifications he holds a BA (Military Studies) and a Master of Military Arts and Science. He is a Professor and the foundation Director of the National Security Institute at the University of Canberra. He is a director of Codan Limited, Citadel Group Limited and a member of the advisory board to Warpforge Limited. In other activities he is the Chairman of the charity Soldier On, the Red Shield Appeal Committee in the ACT and the Australian International Military Games, which brought the Invictus Games to Sydney in 2018. He is a member of the First Principles Review of the Department of Defence, a member of the Advisory Council of China Matters and the Strategic Defence Advisor – Land and Chief Defence Advisor to the Queensland Government. He is Chairman of the Audit Committee and Remuneration Committee.

Air Marshal Geoff Brown AO

Non-executive director (Age 60). Appointed to the Board on 21 April 2016. Geoff Brown AO retired from the Royal Australian Air Force in July 2015 as Air Marshal in the position of Chief of Air Force. Among his qualifications he holds a BEng (Mech), a Master of Arts (Strategic Studies), Fellow of the Institute of Engineering Australia and is a Fellow of the Royal Aeronautical Society. He is a Director of Lockheed Martin (Australia) Pty Limited, Chairman of the Sir Richard Williams Foundation and Chairman of the Advisory Board of CAE Asia Pacific. He is a member of the Audit Committee.

The Hon Kate Lundy (HonLittD, GAICD)

Non-Executive director (age 51) Appointed to the Board on 23 March 2018. Kate Lundy served as a Senator representing the Australian Capital Territory from 1996 to 2015. During this time she held various front bench positions in both Government and Opposition, including the Minister for Sport, Multicultural Affairs and Assisting on Industry and Innovation and the Digital Economy.

Kate continues to be passionate about technology and innovation. Her focus is the positive impact of technology on society, culture and the economy. In 2017, the Australian National University awarded her a Doctor of Letters (honorary doctorate) for her "exceptional contributions to advocacy and policy for information communications and technology, for the ACT and nationally."

In 2017 Ms Lundy was inducted into the Pearcey Hall of Fame for "distinguished achievement and contribution to the development and growth of the Information and Communication Technology

Industry". The Pearcey Foundation is named in honour of Dr Trevor Pearcey, an outstanding Australian ICT Pioneer, notable for his leadership of the project team that built one of the world's earliest digital computers, the CSIR Mark 1, later known as CSIRAC.

Kate is a non-executive director of the Australian Grand Prix Corporation, the National Roads and Motoring Association, the Cyber Security Research Centre and the National Youth Science Forum. Kate is also a member of ACT Defence Industry Advisory Board and ACT Defence Industry Ambassador.

The above named directors held office during and since the end of the financial year apart from Kate Lundy who was appointed on 23 March 2018.

Directorships of other listed companies

Directorships of other listed companies held by directors in the three years immediately before the end of the financial year were as follows:

Name	**Company**	**Period of directorship**
Fred Bart	Audio Pixels Holdings Limited	5 September 2000 to date
	Weebit Nano Limited	6 March 2018 to date
Ian Dennis	Audio Pixels Holdings Limited	5 September 2000 to date
Lt Gen Peter Leahy AC	Codan Limited	19 September 2008 to date
	Citadel Group Limited	27 June 2014 to date

Principal activities

The principal activities of the consolidated entity are in the space and defence systems business.

The company is listed on the Australian Securities Exchange.

Review of operations

A detailed review of operations is included on pages 3 to 8 of this financial report.

DIRECTORS' REPORT (cont)

Changes to the state of affairs

There was no significant changes in the state of affairs of the consolidated entity that occurred during the financial period.

Share Issues

On 6 February 2018, the Company announced a placement of 10,471,434 new ordinary shares at $2.91 to sophisticated and professional investor clients of Petra Capital Pty Limited raising a total of $30.5m. These new shares were allotted on 12 February 2018. These funds were used for working capital and to lodge performance bonds in respect of the new contract announced on 30 January 2018 and optimising the supply chain. Additionally in the same announcement the Company announced a further tranche of the placement of 10,147,123 new ordinary shares at $2.91 to sophisticated and professional investor clients of Petra Capital Pty Limited raising a total of $29.5m. These shares were issued on 16 March 2018 following shareholder approval at an Extraordinary General Meeting held on 13 March 2018 to refresh the 15% placement ability.

On 6 February 2018, the Company also announced a Share Placement Plan to all existing shareholders registered on 5 February 2018 at the same price as the institutional placement of $2.91 to raise a maximum of $5m. The Share Placement Plan closed on 14 March 2018 raising $1.4m resulting in the issue of 495,758 new ordinary shares on 21 March 2018. The Directors decided not to place any further shares up to the maximum of $5m.

The Company issued 5,180,000 new restricted fully paid ordinary shares under the Loan Funded Share Plan at an issue price of $2.99 on 20 June 2018 based on the 'Market Value' which was determined as the 20 day volume weighted average price of Shares up to and including the trading day immediately prior to the date of issue (that is, the 20 most recent trading days on the ASX). The issue of the 5,180,000 restricted fully paid ordinary shares at $2.99 created loans to Directors and staff under the LFSP of $15,488,200. Please refer to Note 16 for further details.

Subsequent events

There has not been any matter or circumstance that has arisen since the end of the financial year, that has significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations or the state of affairs of the consolidated entity in future financial years.

Deed of Cross Guarantee

On 29 March 2018, the parent entity, Electro Optic Systems Holdings Limited entered into a deed of cross guarantee with two of its Australian wholly-owned subsidiaries Electro Optic Systems Pty Limited and EOS Defence Systems Pty Limited.

DIRECTORS' REPORT (cont)

Future developments

The company will continue to operate in the space and defence systems business.

Please see the review of operations for further details.

Environmental Regulations

In the opinion of the directors the consolidated entity is in compliance with all applicable environmental legislation and regulations.

Dividends

The directors recommend that no dividend be paid and no amount has been paid or declared by way of dividend since the end of the previous financial year and up to the date of this report.

Share Options
Share options granted to directors and executives

No options were granted to any director or executive during the year. On 20 June 2018 the Company issued 220,000 unlisted options under the Employee Option Plan to overseas based employees at an exercise price of $2.99 expiring on or before 31 March 2023. These unlisted options have vesting conditions and performance criteria similar to those ordinary restricted shares issued under the Loan Funded Share Plan on 20 June 2018.

Share options on issue at year end or exercised during the year

There were 5,500,000 options at an exercise price of $3.00 per share and 220,000 options at an exercise price of $2.99 outstanding at year end. No options were exercised during the year. The 5,500,000 options with an exercise price of $3.00 expired on 31 January 2019 and were not exercised.

There were no shares or interests issued during the financial year as a result of exercise of an option.

Loan Funded Share Plan

Shareholders approved the issue of 5,180,000 restricted ordinary shares on 24 April 2018 to directors, senior executives and staff. The restricted ordinary shares were issued on 20 June 2018 at a price of $2.99, being the 20 day volume weighted average price up to an including the trading day immediately prior to the date of issue.

The Company provided an interest free loan to the Directors and Employees to enable them to acquire the shares under the Loan Funded Share Plan. The total amount of the loan is $15,488,200.

DIRECTORS' REPORT (cont)

Loan Funded Share Plan (cont)

Loan funds under LFSP are limited recourse in nature, which means that if at the date that the loan becomes repayable the Directors or Employees shares are worth less than the outstanding balance of the loan, the Company cannot recover the difference from the Director or Employee. Interest will not be payable on the outstanding balance of the loan.

All shares issued under the LFSP are held in an employee share trust, on behalf of all participants. The name of the Trust is Electro Optic Systems Holdings Limited as trustee for the Share Plan Trust. All shares under the LFSP are also subject to a holding lock until all conditions and the loan are satisfied.

The new ordinary shares issued under the LFSP were issued to an employee share trust on behalf of the following participants as follows:

Mr Fred Bart (Chairman)	200,000
Dr Ben Greene (CEO)	2,000,000
Mr Ian Dennis	200,000
Mr Peter Leahy	200,000
Mr Geoffrey Brown	200,000
Ms Kate Lundy	200,000
	3,000,000
Dr Craig Smith	250,000
Mr Grant Sanderson	250,000
Mr Peter Short	250,000
Mr Scott Lamond	250,000
Other Senior Employees	1,180,000
Total	5,180,000

The Shares issued to Directors will be subject to both 'Vesting Conditions' and 'Forfeiture Conditions'. Directors will be required to satisfy the Vesting Conditions in order for their Shares to vest. While Directors hold their Shares, they will be subject to Forfeiture Conditions and Directors will forfeit their Shares if either they fail to satisfy the Vesting Conditions or they cease to be employed or continue to provide services to EOS or a group company in certain circumstances.

Once the Vesting Conditions have been satisfied, removed or lifted, the Shares become vested and Directors may deal with them in accordance with the rules of the LFSP subject to sale restrictions and other legal restrictions (such as under the Company's trading policy).

DIRECTORS' REPORT (cont)

Loan Funded Share Plan (cont)

The Shares will vest at the end of each 'Vesting Period' in the manner set out in the tables below, provided that the following conditions are met:

(a) Directors continue to provide services to EOS on each of the vesting dates (or such other date on which the Board makes a determination as to whether the Vesting Condition has been met); and

(b) the performance hurdles set out below are satisfied, which relate to the Company's earnings before income tax (EBIT) and the Company's share price. Notably, EBIT and share price hurdles must both be achieved in order for Shares to vest under each Tranche.

To the extent Shares vest, they will be subject to sale restrictions for 6, 9, 12 and 15 months respectively as outlined in the tables.

Measures and hurdles	Vested Shares can be sold after:
(i) EBIT of $5m for 12 months ending 31 December 2018; and (ii) a Share Price Hurdle of $4.50 by 31 December 2019 (this hurdle must be reached on at least 30 trading days, not necessarily consecutive, by 31 December 2019)	30 June 2020 (25% of Vested Shares)
	30 September 2020 (50% of Vested Shares)
	31 December 2020 (75% of Vested Shares)
	31 March 2021 (100% of Vested Shares)

Measures and hurdles	Vested Shares can be sold after:
(i) EBIT of $15m for 12 months ending 31 December 2019; and (ii) a Share Price Hurdle of $7.50 by 31 December 2021 (this hurdle must be reached on at least 30 trading days, not necessarily consecutive, by 31 December 2021)	30 June 2022 (25% of Vested Shares)
	30 September 2022 (50% of Vested Shares)
	31 December 2022 (75% of Vested Shares)
	31 March 2023 (100% of Vested Shares)

If the above Vesting Conditions are not satisfied, or if the Board determines that they cannot be satisfied, Directors will forfeit their unvested Shares (unless the Board exercises its discretion to permit those Shares to vest in accordance with the terms of the LFSP).

Directors have also imposed additional vesting conditions for Senior Employees under the terms of the LFSP which specifically relate to the performance of their business sectors within EOS. These conditions as outlined in Note 16 are in addition to the above vesting conditions for Directors.

DIRECTORS' REPORT (cont)

Indemnification and Insurance of Officers and Auditors

During the financial year, the company paid a premium in respect of a contract insuring the Directors and Officers of the Company and any related body corporate against a liability incurred as such a Director or Officer to the extent permitted by the Corporations Act 2001. The contract of insurance prohibits disclosure of the nature of the coverage provided and the amount of the premium. The Company has agreed to indemnify the current Directors, Company Secretary and Executive Officers against all liabilities to other persons that may arise from their position as Directors or Officers of the Company and its controlled entities, except where to do so would be prohibited by law. The agreement stipulates that the Company will meet the full amount of any such liabilities, including costs and expenses.

The Company has not, during or since the financial year indemnified or agreed to indemnify an auditor of the company or of any related body corporate against any liability incurred as such an auditor.

Directors' meetings

The following table sets out the number of directors' meetings (including meetings of committees of directors) held during the financial year and the number of meetings attended by each director (while they were a director or committee member). During the financial year, 12 Board meetings, two Audit committee meetings and no Remuneration committee meetings were held.

	Board of directors		Audit committee		Remuneration committee	
Directors	**Held**	**Attended**	**Held**	**Attended**	**Held**	**Attended**
Mr Fred Bart	12	12	-	-	-	-
Dr Ben Greene	12	12	-	-	-	-
Mr Ian Dennis	12	11	2	2	-	-
Lt Gen Peter Leahy AC	12	12	2	2	-	-
Air Marshal Geoff Brown AO	12	12	2	2	-	-
The Hon Kate Lundy	7	7	-	-	-	-

DIRECTORS' REPORT (cont)

Directors' shareholdings

The following table sets out each Director's relevant interest in shares, restricted ordinary shares under the Loan Funded Share Plan and options of the company or a related body corporate as at the date of this report.

Directors	Fully paid ordinary shares	Fully paid ordinary shares – Loan Funded Share Plan	Unlisted Options
Mr Fred Bart	5,319,506	200,000	-
Dr Ben Greene	3,964,495	2,000,000	-
Mr Ian Dennis	90,180	200,000	-
Lt Gen Peter Leahy AC	38,755	200,000	-
Air Marshall Geoff Brown AO	5,000	200,000	-
The Hon Kate Lundy	3,325	200,000	-

Movement in Director shareholdings during the 2018 are set out in the Remuneration Report.

The unlisted options were exercisable at $3.00 each and expired on 31 January 2019. The fully paid ordinary restricted shares were issued on 20 June 2018 under the Loan Funded Share Plan at a price of $2.99 and are subject to vesting and performance criteria.

DIRECTORS' REPORT (cont)

Remuneration Report (Audited)

The key management personnel of Electro Optic Systems Holdings Limited during the year were:

Mr Fred Bart (Chairman, Non-executive director)
Dr Ben Greene (Chief Executive Officer and director)
Mr Ian Dennis (Non-executive director)
Lt Gen Peter Leahy AC (Non-executive director)
Air Marshall Geoff Brown (Non-executive director)
The Hon Kate Lundy (non-executive director) – Appointed 23 March 2018
Dr Craig Smith (Chief Executive Officer of EOS Space Systems Pty Limited)
Mr Grant Sanderson (Chief Executive Officer EOS Defence Systems Pty Limited)
Mr Scott Lamond (Chief Financial Officer – Electro Optic Systems Pty Limited)
Mr Peter Short (Chief Operating Officer – Electro Optic Systems Pty Limited)

This report outlines the remuneration arrangements in place for Directors and Executives of the Group.

The Directors are responsible for remuneration policies and packages applicable to the Board members and executives of the Group. The Group has a separate Remuneration Committee. The broad remuneration policy is to ensure the remuneration package properly reflects the persons duties and responsibilities.

<u>Remuneration structure</u>

In accordance with best practice corporate governance, the structure of Non-Executive Director and senior manager remuneration is separate and distinct.

<u>Non-Executive Director remuneration</u>

Objective

The Board seeks to set aggregate remuneration at a level which provides the Company with the ability to attract and retain directors of the highest calibre, whilst incurring a cost which is acceptable to shareholders.

Structure

The Company's Constitution and the Australian Securities Exchange Listing Rules specify the aggregate remuneration of Non- Executive Directors shall be determined from time to time by a General Meeting of shareholders. An amount not exceeding the amount determined is then divided between the Directors as agreed. The latest determination was at the Annual General Meeting held on 12 May 2017, when shareholders approved a maximum aggregate remuneration of $500,000 per year excluding options.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

The amount of aggregate remuneration approved by shareholders, the manner in which it is apportioned amongst Directors, and the policy of granting options to Directors, are reviewed by directors at least every two years.

Each Non-Executive Director receives a fee for serving as a Director of the Company. No additional fees are paid to any Director for serving on a committee of the Board. A company associated with Mr Ian Dennis receives a fee in recognition of additional services provided to the Group.

Executive Director and Senior Management remuneration

Objective

The Group aims to award Executives with a level and mix of remuneration commensurate with their position and responsibilities within the Group and so as to:

- reward Executives for Group and individual performance against targets set by reference to suitable benchmarks;
- align the interests of Executives with those of shareholders; and
- ensure that the total remuneration paid is competitive by market standards.

Structure

The remuneration paid to Executives is set with reference to prevailing market levels and typically comprises a fixed salary and option component. Options are granted to Executives in line with their respective levels of experience and responsibility. Details of the amounts paid and the number of options granted to Executives are disclosed elsewhere in the Directors' Report.

Employment contracts

There are no employment contracts in place with any Non-Executive Director of the Group. Executive Directors and Senior Management are employed under standard employment contracts which contain no unusual terms. Beyond accrued leave benefits, there are no other termination payments or golden parachutes for any directors or senior executives. The CEO has a 180 day notice period under his employment contract and the other senior management have 90 day notice periods under their employment contracts.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

Director remuneration

The following tables disclose the remuneration of the directors of the Company:

2018	Short term		Post Employment	Equity			Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Loan Funded Share Plan $	Options	Other Long Term Benefits $	$
Mr Fred Bart	70,150	-	6,664	8,450	2,101	-	87,365
Dr Ben Greene*	452,549	26,163	39,405	84,495	21,006	388,170	1,011,788
Mr Ian Dennis#	163,125	-	4,097	8,450	2,101	-	177,773
Lt Gen Peter Leahy AC	43,125	-	4,097	8,450	2,101	-	57,773
Air Marshall Geoff Brown AO	43,125	-	4,097	8,450	9,474	-	65,146
The Hon Kate Lundy	33,171		3,235	8,450	-	-	44,856
	805,245	26,163	61,595	126,745	36,783	388,170	1,444,701

* Executive Director during the financial year
# Includes fees for company secretarial and accounting consultancy services provided of $120,000 (2017: $120,000)

2017	Short term		Post Employ-ment	Equity			Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Loan Funded Share Plan $	Options $	Other Long Term Benefits $	$
Mr Fred Bart	61,000	-	5,795	-	22,901	-	89,696
Dr Ben Greene*	415,400	26,163	35,000	-	229,012	41,787	747,362
Mr Ian Dennis#	157,500	-	3,563	-	22,901	-	183,964
Mr Mark Ureda	17,031	-	-	-	22,901	-	39,932
Lt Gen Peter Leahy AC	37,500	-	3,563	-	22,901	-	63,964
Mr Kevin Scully	40,875	-	-	-	22,901	-	63,776
Air Marshall Geoff Brown AO	37,500	-	3,563	-	41,847	-	82,910
	766,806	26,163	51,484	-	385,364	41,787	1,271,604

* Executive Director during the financial year
# Includes fees for company secretarial and accounting consultancy services provided of $120,000 (2016: $120,000)
Other long term benefits include annual leave and long service leave expensed during the year.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

Executive remuneration

No executives are employed by the holding company. The following table discloses the remuneration of the executives of the consolidated entity:

2018	Short term		Post Employment	Equity			Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Loan Funded Share Plan $	Options $	Other Long Term Benefits $	$
Dr Craig Smith	230,772	-	21,923	9,646	4,202	34,659	301,202
Mr Scott Lamond	230,772	-	21,923	10,562	3,152	26,857	293,266
Mr Grant Sanderson	208,707	-	18,160	10,253	-	14,660	251,780
Mr Peter Short	227,218	-	19,905	10,562	-	10,607	268,292
	897,469	-	81,911	41,023	7,354	86,783	1,114,540

2017	Short term		Post Employment	Equity			Total
	Salary & Fees $	Non-monetary $	Super-annuation $	Loan Funded Share Plan $	Options $	Other Long Term Benefits $	$
Dr Craig Smith	212,960	-	20,231	-	34,352	9,137	276,680
Mr Scott Lamond	212,960	-	20,231	-	25,764	12,459	271,414
Dr Warwick Holloway	175,700	-	16,720	-	17,176	4,590	214,186
	601,620	-	57,182	-	77,292	26,186	762,280

No options were granted to, or exercised by any director or executive during 2017 and 2018. Ordinary shares in relation to the Loan Funded Share Plan were granted during 2018 as outlined earlier in the Directors' Report.

During the 2016 financial year, 3,000,000 options were granted to Directors on 5 February 2016 and 200,000 options on 30 May 2016 at an exercise price of $3.00 with an expiry date of 31 January 2019. All these options lapsed on 31 January 2019 unexercised.

During the 2016 financial year, 2,515,000 options were issued to staff on 5 February 2016 at an exercise price of $3.00 with an expiry date of 31 January 2019. 900,000 of these options were issued to senior executives included as part of the key management personnel. All these options lapsed on 31 January 2019 unexercised.

Other long term benefits include annual leave and long service leave expensed during the year.

Remuneration Report (cont)

The following table sets out each key management personnel's equity holdings (represented by holdings of fully paid ordinary shares in Electro Optic Systems Holdings Limited).

	Balance at 1/1/18	Granted as remuneration	Received on exercise of options	Net other change	Balance at 31/12/18
	No.	No.	No.	No.	No.
Mr Fred Bart	5,309,075	-	-	10,431	5,319,506
Dr Ben Greene	3,954,185	-	-	10,310	3,964,495
Mr Ian Dennis	170,050	-	-	(79,870)	90,180
Lt Gen Peter Leahy AC	33,600	-	-	5,155	38,755
Air Marshal Geoff Brown AO	-	-	-	5,000	5,000
The Hon Kate Lundy	-	-	-	3,325	3,325
Dr Craig Smith	89,450	-	-	-	89,450
Mr Scott Lamond	11,000	-	-	-	11,000
Mr Grant Sanderson	-	-	-	-	-
Mr Peter Short	-	-	-	-	-

The following table sets out each key management personnel's equity holdings (represented by holdings of restricted fully paid ordinary shares in Electro Optic Systems Holdings Limited issued on 20 June 2018 under the Loan Funded Share Plan).

	Balance at 1/1/18	Granted as remuneration	Received on exercise of options	Net other change	Balance at 31/12/18
	No.	No.	No.	No.	No.
Mr Fred Bart	-	200,000	-	-	200,000
Dr Ben Greene	-	2,000,000	-	-	2,000,000
Mr Ian Dennis	-	200,000	-	-	200,000
Lt Gen Peter Leahy AC	-	200,000	-	-	200,000
Air Marshal Geoff Brown AO	-	200,000	-	-	200,000
The Hon Kate Lundy	-	200,000			200,000
Dr Craig Smith	-	250,000	-	-	250,000
Mr Scott Lamond	-	250,000	-	-	250,000
Mr Grant Sanderson	-	250,000	-	-	250,000
Mr Peter Short	-	250,000	-	-	250,000

<u>Elements of remuneration related to performance</u>

There are no performance conditions other than service attached to the above option remuneration to directors and executives. Directors and senior executives receive options as disclosed which are not subject to specific performance conditions other than service.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

The overall performance of the company as measured by the share price will determine whether the options are exercised and whether the director or executive receives any benefit from these options. The time service condition has been chosen by the Board as an appropriate condition as it helps in the retention and motivation of staff. Options issued to certain directors and executives are also subject to vesting provisions as disclosed below.

As detailed above, 5,180,000 ordinary restricted shares were issued to directors, senior executives and senior staff on 20 June 2018 under the Loan Funded Share Plan. These ordinary restricted shares are subject to performance and vesting conditions detail above.

Key management personnel option holdings

There were 3,500,000 options outstanding at the end of the financial year to key management personnel. During 2016, 3,500,000 unlisted options exercisable at $3.00 each with an expiry date of 31 January 2019 were issued to the following key management personnel:

Directors	**Date of Issue**	**Unlisted Options at the end of the financial year held by KMP**
Mr Fred Bart	5 February 2016	200,000
Dr Ben Greene	5 February 2016	2,000,000
Mr Ian Dennis	5 February 2016	200,000
Lt Gen Peter Leahy AC	5 February 2016	200,000
Air Marshall Geoff Brown AO	30 May 2016	200,000
Senior Executives		
Dr Craig Smith	5 February 2016	400,000
Mr Scott Lamond	5 February 2016	300,000
		3,500,000

These options vest as to 50% of the number after one year with the balance of 50% vesting after two years from the date of issue. All the above options are fully vested at 31 December 2018 and have all expired unexercised on 31 January 2019.

Other transactions with key management personnel

During the year, the Company paid a total of $76,814 (2017: $66,795) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of directors fees and superannuation for Fred Bart.

During the year, the Company paid $47,222 (2017: $41,063) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of directors fees and superannuation for Ian Dennis.

DIRECTORS' REPORT (cont)

Remuneration Report (cont)

During the year, the Company paid $47,222 (2017: $41,063) to GCB Stratos Consulting Pty Limited, a company associated with Air Marshall Geoff Brown in respect of directors fees and superannuation for Geoff Brown.

During the year, the Company paid $120,000 (2017: $120,000) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of consulting fees for company secretarial and accounting services.

During the year, the Company paid $28,441 (2017: $22,955) to Audio Pixels Holdings Limited, a company of which Fred Bart and Ian Dennis are directors and shareholders in respect of shared Sydney office facilities.

The table below sets out summary information about the company's earnings and movements in shareholder wealth for the last 5 financial years.

	31 December 2018 $	31 December 2017 $	31 December 2016 $	31 December 2015 $	31 December 2014 $
Revenue	87,130,396	23,259,794	25,797,200	30,500,748	23,476,433
Net profit/ (loss) before tax	15,081,372	(9,319,930)	(2,918,477)	3,032,442	(3,017,546)
Net profit/ (loss) after tax	15,081,372	(9,319,930)	(886,692)	3,032,442	(3,017,546)

	31 December 2018 $	31 December 2017 $	31 December 2016 $	31 December 2015 $	31 December 2014 $
Share price at start of year	2.45	1.73	1.49	0.82	0.42
Share price at end of year	2.45	2.45	1.73	1.49	0.82
Dividends paid	-	-	-	-	-

Audit Committee

The Board appointed three non-executive directors to form the committee, with a majority of independent directors and the Chairman being an independent person. The current members of the Committee are Lt Gen Peter Leahy AC (Chairman), Mr Ian Dennis and Mr Geoff Brown.

Remuneration Committee

The Board appointed three non-executive directors to form the committee, with a majority of independent directors and the Chairman being an independent person. The current members of the Committee are Lt Gen Peter Leahy AC (Chairman), Mr Ian Dennis and Mr Fred Bart.

Non-audit services

The Directors are satisfied that the provision of non-audit services, during the year, by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The Directors have formed this view based on the fact that the nature and scope of each type of non-audit service provided means that the audit independence was not compromised.

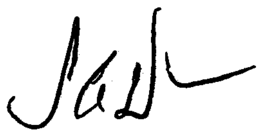
Details of amounts paid or payable to the auditor for non-audit services provided during the year by the auditor are contained in note 8 to the financial statements.

Auditor's independence declaration

The auditor's independence declaration is included on page 26 of the annual report.

Signed in accordance with a resolution of directors made pursuant to s.298(2) of the Corporations Act 2001.

On behalf of the Directors



I A Dennis
Director
Dated at Sydney this 8 day of March 2019

Deloitte.

Deloitte Touche Tohmatsu
ABN 74 490 121 060

8 Brindabella Circuit
Brindabella Business Park ACT 2609
GPO Box 823
Canberra ACT 2601 Australia

DX 5661
Tel: +61 (0) 2 6263 7000
Fax: +61 (0) 2 6263 7001
www.deloitte.com.au

The Board of Directors
Electro Optic Systems Holdings Limited
Suite 2, Level 12
75 Elizabeth Street
SYDNEY NSW 2000

8 March 2019

Dear Board Members

Auditor's Independence Declaration to Electro Optic Systems 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 Electro Optic Systems Holdings Limited.

As lead audit partner for the audit of the financial report of Electro Optic Systems Holdings Limited for the year ended 31 December 2018, 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 audit; and

(ii) any applicable code of professional conduct in relation to the audit.

Yours faithfully

DELOITTE TOUCHE TOHMATSU

DELOITTE TOUCHE TOHMATSU

David Salmon

David Salmon
Partner
Chartered Accountants

Deloitte.

Deloitte Touche Tohmatsu
ABN 74 490 121 060

8 Brindabella Circuit
Brindabella Business Park ACT 2609
GPO Box 823
Canberra ACT 2601 Australia

DX 5661
Tel: +61 (0) 2 6263 7000
Fax: +61 (0) 2 6263 7001
www.deloitte.com.au

Independent Auditor's Report to the members of Electro Optic Systems Holdings Limited

Report on the Audit of the Financial Report

Opinion

We have audited the financial report of Electro Optic Systems Holdings Limited (the "Company"), and its subsidiaries (the "Group"), which comprises the consolidated statement of financial position as at 31 December 2018, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

In our opinion the accompanying financial report of the Group, is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the Group's financial position as at 31 December 2018 and of its financial performance for the year then ended; and

(ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Report* section of our report. We are independent of the Group in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of the Company, would be in the same terms if given to the directors as at the time of this auditor's report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial report of the current period. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	How the scope of our audit responded to the Key Audit Matter
Availability of Working Capital As at 31 December 2018 the consolidated entity had net cash used in operations of $15,686,202 as disclosed in Note 1(v). The ability of the consolidated entity to pay its debts as and when they fall due is dependent upon a number of factors relating to future performance, including: • The continued ability of the consolidated entity to successfully deliver contracts on hand on time, to the required specification and within budgeted costs; • The likelihood of key military and government customers to make timely payments for goods supplied in accordance with contractual terms; • Export licences which the consolidated entity requires from governments in Australia and the USA continue and future export licences are not restricted; • The future trading prospects of the consolidated entity including obtaining the required export licences, lodgement of the required offset bonds in relation to executed contracts and successfully obtaining and negotiating commercial contract terms in relation to potential customers; and • The ability to raise capital from existing or new shareholders should the need arise.	Our procedures included, but were not limited to: • Challenging the underlying assumptions reflected in management's cash flow forecasts. This included agreeing assumptions to underlying documentation, sensitising key judgmental inputs and assessing cash inflows and outflows in relation to delivery of contracts and receipts from customers; • Assessing the historical accuracy of the forecasts prepared by management; and • Inquiring with management and the board as to knowledge of events and conditions that may impact the assessment on the consolidated entity's ability to pay its debts as and when they fall due. We also assessed the appropriateness of the disclosures in Note 1(v) to the financial statements.
Revenue recognition for significant contracts In the prior financial year, Electric Optic Systems Holdings (EOSH) entered into a significant new agreement for the sale of Remote Weapons Systems and related items. Revenues in relation to this agreement account for $69,069,594 (or approximately 79%) of total Group revenue. During the current financial year, EOSH has entered into further bespoke agreements with new customers. These contracts are complex, typically span over several years and the accounting implications thereof are of significance to the performance of the entity. In addition, AASB 15 *Revenue from Contracts with Customers* (AASB 15) became effective for periods beginning on or after 1 January 2018 and has a significant impact on the Group. There are complexities and judgements	Our procedures included, but were not limited to: • Testing key controls within the revenue recognition process; • Reviewing significant contracts and assessing revenue recognition against the requirements of the new accounting standard; • Testing, on a sample basis, revenue transactions recorded in relation to the significant contracts and assessing whether these have been appropriately accounted for with regard to the accounting policy adopted, including agreeing these to shipping and other underlying records; • Obtaining confirmations with regard to the variation of delivery terms from third party customers on bill and hold items at period end to assess cut-off; and • Recalculating unearned revenue recorded by management. We also assessed the appropriateness of the disclosures in Notes 1(c) and 2(a) to the financial statements.

Key Audit Matter	How the scope of our audit responded to the Key Audit Matter
associated with interpreting key revenue contracts entered into by the entity against the requirements of the new accounting standard. This results in a significant level of management judgement and estimation in relation to: • Interpreting and accounting for complex contractual terms, including multiple performance obligations, and clauses with regards to cancellations and warranties (amongst others); and • Accounting judgements and treatments in relation to the first time application of the new accounting standard including the assessment of performance obligations, allocation of revenue and consideration of revenue recognition as being at a point in time or over time.	
Inventory Obsolescence As at 31 December 2018 the carrying value of inventory totals $26,465,499 as disclosed in Note 6. The identification of and provision for obsolete inventory requires a significant level of management estimation due to: • The nature of the inventory held by the entity is specialised and highly technical and can be specific to individual contractual arrangements. This makes the inventory susceptible to obsolescence if excessive raw materials are purchased or if technological advancement occurs. • The computation of the provision requires judgement and estimation, the justification of which is complex due to the unique nature of the business.	Our procedures included, but were not limited to: • Testing controls relevant to the inventory obsolescence process; • Holding discussions with management regarding current inventory holdings and both contracted and potential future orders; • Obtaining current and future order 'bill of materials' worksheets to determine the inventory required to fill orders; and • Evaluating and challenging management's assessment of items that are not included in the inventory obsolescence provision based on our understanding of the parts required to complete orders. We also assessed the appropriateness of the disclosures in Note 6 to the financial statements.

Other Information

The directors are responsible for the other information. The other information comprises the information included in the Corporate Directory, Review of Operations, Directors' Report and ASX Additional Information, which we obtained prior to the date of this auditor's report, the other information also includes the annual report (but does not include the financial report and our auditor's report thereon) which is expected to be made available to us after that date.

Our opinion on the financial report does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to the directors and use our professional judgement to determine the appropriate action.

Responsibilities of the Directors for the Financial Report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

In preparing the financial report, the directors are responsible for assessing the ability of the Group to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

As part of an audit in accordance with the Australian Auditing Standards, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the financial report. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the financial report of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on the Remuneration Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 18 to 24 of the Directors' Report for the year ended 31 December 2018.

In our opinion, the Remuneration Report of Electro Optic Systems Holdings Limited, for the year ended 31 December 2018, complies with section 300A of the *Corporations Act 2001*.

Responsibilities

The directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

DELOITTE TOUCHE TOHMATSU

DELOITTE TOUCHE TOHMATSU

David Salmon

David Salmon
Partner
Chartered Accountants
Canberra, 8 March 2019

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

DIRECTORS' DECLARATION

The directors declare that:

(a) 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;

(b) in the directors' opinion, the attached financial statements are in compliance with International Financial Reporting Standards, as stated in Note 1 to the financial statements;

(c) in the directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the company and the consolidated entity; and

(d) the directors have been given the declarations required by s.295A of the Corporations Act 2001.

At the date of this declaration, the company is within the class of compliance affected by *ASIC Corporations (Wholly Owned Companies) Instrument 2016/785* . The nature of the deed of cross guarantee is such that each company which is party to the deed guarantees to each creditor payment in full of any debt in accordance with the deed of cross guarantee.

In the directors' opinion, there are reasonable grounds to believe that the company and the companies to which *ASIC Corporations (Wholly Owned Companies) Instrument 2016/785* applies, as detailed in Note 21 to the financial statements will, as a group, be able to meet any liabilities to which they are, or may become, subject because of the deed of cross guarantee.

Signed in accordance with a resolution of the directors made pursuant to s.295(5) of the Corporations Act 2001.

On behalf of the Directors

I A Dennis
Director

Dated at Sydney this 8 day of March 2019

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2018

	Note	**31 December 2018** $	**31 December 2017** $
Revenue	2(a)	87,130,396	23,259,794
Changes in inventories of work in progress		(2,842,202)	(2,699,765)
Raw materials and consumables used		(40,356,855)	(8,473,543)
Employee benefits expense	2(b)	(22,147,866)	(14,692,849)
Administration expenses		(9,502,730)	(4,304,914)
Finance costs	2(b)	(36,903)	(34,985)
Depreciation and amortisation of property, plant and equipment	2(b)	(633,235)	(193,325)
(Loss) on disposal of fixed assets	2(b)	-	(2,007)
Foreign exchange gains/ (losses)	2(b)	7,712,222	(695,061)
Occupancy costs		(3,440,347)	(1,188,969)
Other expenses		(801,108)	(374,306)
Profit/ (Loss) before income tax benefit		15,081,372	(9,399,930)
Income tax benefit	4	-	-
Profit/ (Loss) for the year		15,081,372	(9,399,930)
Attributable to:			
Owners of the Company	18	15,302,214	(9,399,930)
Non-controlling interests		(220,842)	-
		15,081,372	(9,399,930)
Other comprehensive income			
Items that may be reclassified subsequently to profit and loss			
Exchange differences arising on translation of foreign operations		(1,157,927)	363,703
Total comprehensive Profit/ (Loss) for the year		13,923,445	(9,036,227)
Attributable to:			
Owners of the Company		14,144,287	(9,036,227)
Non-controlling interests		(220,842)	-
		13,923,445	(9,036,227)
Profit/ (Loss) per share			
Basic (cents per share)	3	17.22	(15.1)
Diluted (cents per share)	3	17.22	(15.1)

Notes to the financial statements are included on pages 37 to 113.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2018

	Note	Consolidated December 2018 $	December 2017 $
CURRENT ASSETS			
Cash and cash equivalents	19	40,538,225	9,989,953
Trade and other receivables	5	26,819,746	11,662 007
Inventories	6	26,465,499	13,795,574
Other	7	12,713,727	2,390,931
TOTAL CURRENT ASSETS		106,537,197	37,838,465
NON-CURRENT ASSETS			
Security deposit	24	8,971,929	-
Property, plant and equipment	9	3,960,849	1,405,347
Trade and other receivables	5	7,146,990	609,864
Other	7	2,252,177	7,751,938
TOTAL NON-CURRENT ASSETS	19	22,331,945	9,767,149
TOTAL ASSETS		128,869,142	47,605,614
CURRENT LIABILITIES			
Trade and other payables	10	22,328,897	18,084,358
Provisions	11	6,366,891	5,091,560
TOTAL CURRENT LIABILITIES		28,695,788	23,175,918
NON-CURRENT LIABILITIES			
Provisions	11	3,891,770	859,076
TOTAL NON-CURRENT LIABILITIES		3,891,770	859,076
TOTAL LIABILITIES		32,587,558	24,034,994
NET ASSETS		96,281,584	23,570,620
EQUITY			
Issued capital	14	161,784,727	103,342,071
Reserves	17	8,472,791	9,344,928
Accumulated losses	18	(73,814,165)	(89,116,379)
Equity attributable to owners of the Company		96,443,353	23,570,620
Non-controlling interests		(161,769)	-
TOTAL EQUITY		96,281,584	23,570,620

Notes to the financial statements are included on pages 37 to 113.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2018

	Accumulated losses	Issued capital	Foreign currency translation reserve	Employee equity settled benefits reserve	Attributable to owners of the parent	Non-controlling interests	Total Equity
2018	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Balance at 1 January 2018	(89,116,379)	103,342,071	(241,137)	9,586,065	23,570,620	-	23,570,620
Profit for the year	15,302,214	-	-	-	15,302,214	(220,842)	15,081,372
Exchange differences arising on translation of foreign operations	-	-	(1,157,927)	-	(1,157,927)	-	(1,157,927)
Total comprehensive profit for the year	15,302,214	-	(1,157,927)	-	14,144,287	(220,842)	13,923,445
Issue of 10,471,434 new shares at $2.91 each	-	28,948,278	-	-	28,948,278	-	28,948,278
Issue of 10,147,123 new shares at $2.91 each	-	28,051,722	-	-	28,051,722	-	28,051,722
Issue of 495,858 new shares at $2.91 under the Share Purchase Plan	-	1,442,656	-	-	1442,656	-	1,442,656
Adjustment arising from change in non-controlling interest	-	-	-	-	-	59,073	59,073
Recognition of share based payments	-	-	-	285,790	285,790	-	285,790
Balance at 31 December 2018	(73,814,165)	161,784,727	(1,399,064)	9,871,855	96,443,353	(161,769)	96,281,584
2017	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Balance at 1 January 2017	(79,716,449)	75,383,567	(604,840)	8,984,721	-	-	4,046,999
(Loss) for the year	(9,399,930)	-	-	-	(9,399,930)	-	(9,399,930)
Exchange differences arising on translation of foreign operations	-	-	363,703	-	363,703	-	363,703
Total comprehensive (loss) for the year	(9,399,930)	-	363,703	-	(9,036,227)	-	(9,036,227)
Issue of 3,863,638 new shares at $2.20 each	-	8,075,004	-	-	8,075,004	-	8,075,004
Issue of 9,100,000 new shares at $2.30 each	-	19,883,500	-	-	19,883,500	-	19,883,500
Recognition of share based payments	-	-	-	601,344	601,344	-	601,344
Balance at 31 December 2017	(89,116,379)	103,342,071	(241,137)	9,586,065	23,570,620	-	23,570,620

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	31 December 2018 $	31 December 2017 $
Cash flows from operating activities			
Receipts from customers		63,870,012	22,253,859
Payments to suppliers and employees		(80,309,969)	(48,363,455)
Interest received		790,658	194,888
Interest and other costs of finance paid		(36,903)	(34,985)
Net cash (outflows) from operating activities	19(c)	(15,686,202)	(25,949,693)
Cash flows from investing activities			
Payment for property, plant and equipment		(3,188,913)	(1,140,947)
Security deposit for performance bond		(8,971,929)	-
Net cash (outflows) from investing activities		(12,160,842)	(1,140,947)
Cash flows from financing activities			
Proceeds from issue of new shares		58,442,656	27,958,504
Net cash inflows from financing activities		58,442,656	27,958,504
Net increase in cash and cash equivalents		30,595,612	867,864
Cash and cash equivalents at the beginning of the financial year		9,989,953	8,874,967
Effects of exchange rate fluctuations on the balances of cash held in foreign currencies		(47,340)	247,122
Cash and cash equivalents at the end of the financial year	19(a)	40,538,225	9,989,953

Notes to the financial statements are included on pages 37 to 113.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

1. Summary of Accounting Policies

1(a) Statement of compliance

The financial statements are general purpose financial statements which have been prepared in accordance with the Corporations Act 2001 and Accounting Standards and complies with other requirements of the law. The financial statements comprise the consolidated financial statements of the Group. For the purposes of preparing the consolidated financial statements, the Company is a for-profit entity. Accounting Standards include Australian equivalents to International Financial Reporting Standards ("AASB"). Compliance with AASB ensures that the financial statements and notes of the company and the consolidated entity comply with International Financial Reporting Standards ("IFRS").

The financial statements were authorised for issue by the Directors on 8 March 2019.

1(b) Basis of preparation

The financial report has been prepared on the basis of historical cost. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars, unless otherwise stated.

1(c) Adoption of new and revised Standards

New and amended IFRS Standards that are effective for the current year

The Group has adopted all of the new and revised Standards and Interpretations issued by the Australian Accounting Standards Board (the AASB) that are relevant to its operations and effective for an accounting period that begins on or after 1 January 2018.

New and revised Standards and amendments thereof and Interpretations effective for the current financial year, and which have been applied in the preparation of this general purpose financial report, that are relevant to the Group include:

- AASB 9 *Financial Instruments* and related amending Standards
- AASB 15 *Revenue from Contracts with Customers* and related amending Standards

1(c) Adoption of new and revised Standards (cont)

AASB 9 *Financial Instruments*

In the current year, the Group has applied AASB 9 *Financial Instruments* (as revised) and the related consequential amendments to other Accounting Standards for the first time. AASB 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting. Details of these new requirements as well as their impact on the Group's consolidated financial statements are described below.

The Group has applied AASB 9 in accordance with the transition provisions set out in AASB 9.

Classification and measurement of financial assets

The date of initial application (i.e. the date on which the Group has assessed its existing financial assets and financial liabilities in terms of the requirements of AASB 9) is 1 January 2018. Accordingly, the Group has applied the requirements of AASB 9 to instruments that have not been derecognised as at 1 January 2018 and has not applied the requirements to instruments that have already been derecognised as at 1 January 2018.

Subsequent to initial recognition, all recognised financial assets that are within the scope of AASB 9 are required to be measured at amortised cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.
Specifically:

- Debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, are subsequently measured at amortised cost,
- Debt investments that are held within a business model whose objective is both to collect the contractual cash flows and to sell the debt instruments, and that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, are subsequently measured at fair value through other comprehensive income (FVTOCI),
- All other debt investments and equity investments are subsequently measured at fair value through profit or loss (FVTPL).

1(c) Adoption of new and revised Standards (cont)

Despite the aforegoing, the Group may make the following irrevocable election/ designation at initial recognition of a financial asset:

- The Group may irrevocably elect to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which AASB 3 *Business Combinations* applies in other comprehensive income,
- The Group may irrevocably designate a debt investment that meets the amortised cost or FVTOCI criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch.

In the current year, the Group has not taken any of the elections above.

When a debt investment measured at FVTOCI is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment. In contrast, for an equity investment designated as measured at FVTOCI, the cumulative gain or loss previously recognised in other comprehensive income is not subsequently reclassified to profit or loss.
Debt instruments that are subsequently measured at amortised cost or at FVTOCI are subject to impairment.

The directors of the Company reviewed and assessed the Group’s existing financial assets as at 1 January 2018 based on the facts and circumstances that existed at that date and concluded that the initial application of AASB 9 has had the following impact on the Group’s financial assets as regards their classification and measurement:

- Financial assets classified as held-to-maturity and loans and receivables under AASB 139 that were measured at amortised cost continue to be measured at amortised cost under AASB 9 as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding.

As a result of the above, there was no impact on the Group’s financial position, profit or loss, other comprehensive income or total comprehensive income for the period.

Impairment of financial assets

In relation to the impairment of financial assets, AASB 9 requires an expected credit loss model as opposed to an incurred credit loss model under AASB 139. The expected credit loss model requires the Group to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

1(c) Adoption of new and revised Standards (cont)

Specifically, AASB 9 requires the Group to recognise a loss allowance for expected credit losses (‘ECL’) on i) trade receivables, ii) debt investments subsequently measured at amortised cost or at FVTOCI, iii) lease receivables, iv) contract assets and v) loan commitments and financial guarantee contracts to which the impairment requirements of AASB 9 apply.

In particular, AASB 9 requires the Group to measure the loss allowance for a financial instrument at an amount equal to the lifetime ECL if the credit risk on that financial instrument has increased significantly since initial recognition, or if the financial instrument is a purchased or originated credit-impaired financial asset. On the other hand, if the credit risk on a financial instrument has not increased significantly since initial recognition (except for a purchased or originated credit-impaired financial asset), the Group is required to measure the loss allowance for that financial instrument at an amount equal to 12m ECL.

The Group has taken a simplified approach for measuring the loss allowance at an amount equal to lifetime ECL for trade receivables, contract assets and lease receivables in certain circumstances. The expected credit losses on these financial assets are estimated using a provision matrix based on the Group’s historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date, including time value of money where appropriate.

As at 1 January 2018, the directors of the Company reviewed and assessed the Group’s existing financial assets, amounts due from customers and financial guarantee contracts for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of AASB 9 to determine the credit risk of the respective items at the date they were initially recognised:

Items existing as at 01/01/18 that are subject to the impairment provisions of AASB 9	Credit risk attributes at 01/01/18	Cumulative additional loss allowance recognised on 01/01/18
Trade and other receivables	The Group recognises 12m ECL for these assets using a provision matrix.	-
Cash and bank balances	All bank balances are assessed to have low credit risk at each reporting date as they are held with reputable banking institutions.	-

Classification and measurement of financial liabilities

The application of AASB 9 has had no impact on the classification and measurement of the Groups’ liabilities.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

1(c) Adoption of new and revised Standards (cont)

General hedge accounting

The Group does not undertake hedging activities and hence is not impacted by the changes in relation to hedging.

Disclosures in relation to the initial application of AASB 9

The table below illustrates the classification and measurement of financial assets and financial liabilities under AASB 9 and AASB 139 at the date of initial application, 1 January 2018.

Category	Original measurement category under AASB 139	New measurement category under AASB 9	Original carrying amount under AASB 139	Additional loss allowance	New carrying amount under AASB 9
Trade and other receivables	Loans and receivables	Financial assets at amortised cost	12,271,870	-	12,271,870
Cash and bank balances	Loans and receivables	Financial assets at amortised cost	9,989,952	-	9,989,952
Trade and other payables	Financial liabilities at amortised cost	Financial liabilities at amortised cost	(18,084,356)	-	(18,084,356)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

1. **Summary of Accounting Policies (cont)**

Financial impact of initial application of AASB 9

The tables below show the amount of adjustment for each financial statement line item affected by the application of AASB 9 for the current and prior periods.

Impact on profit or loss, other comprehensive income and total comprehensive income	**Initial adoption 01/01/18**	**Year ended 31/12/18**
Impact on profit (loss) for the year		
Decrease in other gains and losses	-	-
Increase in administration expenses	-	-
Decrease in income tax expenses	-	-
Decrease in profit for the year	-	-

The application of AASB 9 has had no impact on the consolidated cash flows and earnings per share of the Group

1. **Summary of Accounting Policies (cont)**

AASB 15 *Revenue from Contracts with Customers* and related amending Standards

AASB 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. AASB 15 supersedes the current revenue recognition guidance including AASB 118 *Revenue*, AASB 111 *Construction Contracts* and the related Interpretations.

The core principle of AASB 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the Standard introduces a 5-step approach to revenue recognition:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Under AASB 15, an entity recognises revenue when (or as) a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer.

Far more prescriptive guidance has been added in AASB 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by AASB 15.

In May 2016, the AASB issued AASB 2016-3 *Amendments to Australian Accounting Standards – Clarifications to AASB 15* in relation to the identification of performance obligations, principal versus agent considerations, as well as licensing application guidance.

Apart from providing more extensive disclosures on the Group’s revenue transactions, the application of AASB 15 has not had a significant impact on the financial position and/or financial performance of the Group. Following an assessment of all revenue streams no adjustments have been made to financial statement line items on first time application of AASB 15 as illustrated in the tables below.

The directors have used the modified retrospective method to transition to AASB 15.

1(c) Adoption of new and revised Standards (cont)

Financial impact of initial application of AASB 15

The tables below show the amount of adjustment for each financial statement line item affected by the application of AASB 15 for the current and prior periods.

Impact on profit or loss, other comprehensive income and total comprehensive income	**Initial adoption 01/01/18**	**Year ended 31/12/18**
Impact on profit (loss) for the year		
Decrease in Revenue	-	-
Increase in raw materials and consumables used	-	-
Decrease in income tax expenses	-	-
Decrease in profit for the year	-	-

The application of AASB 15 has had no impact on the consolidated cash flows and earnings per share of the Group.

Impact on assets, liabilities and equity	**Initial adoption 01/01/18**	**Year ended 31/12/18**
Trade and other Receivables	-	-
Unearned revenue	-	-
Total effect on net assets	-	-
Retained earnings	-	-
Total effect on equity	-	-

New and revised AASB Standards in issue but not yet effective

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

New and revised Standards and amendments thereof and Interpretations effective in future years that are relevant to the Group include:

- AASB 16 *Leases*
- Annual Improvements to AASB Standards 2015–2017 Cycle *Amendments to* AASB 3 *Business Combinations,* AASB 11 *Joint Arrangements,* AASB 12 *Income Taxes and* AASB 23 *Borrowing Costs*

1(c) Adoption of new and revised Standards (cont)

- Amendments to AASB 19 *Employee Benefits Plan Amendment, Curtailment or Settlement* AASB 10 *Consolidated Financial Statements* and AASB 28 (amendments) *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*
- IFRIC 23 *Uncertainty over Income Tax Treatments*

The directors do not expect that the adoption of the Standards listed above will have a material impact on the financial statements of the Group in future periods, except as noted below:

AASB 16 *Leases*

General impact of application of AASB 16 Leases

AASB 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements for both lessors and lessees. AASB 16 will supersede the current lease guidance including AASB 117 Leases and the related Interpretations when it becomes effective for accounting periods beginning on or after 1 January 2019. The date of initial application of AASB 16 for the Group will be 1 January 2019.

The Group has chosen the modified retrospective application of AASB 16 in accordance with AASB 16:C5(b). Consequently, the Group will apply the Standard retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application.

In contrast to lessee accounting, AASB 16 substantially carries forward the lessor accounting requirements in AASB 117.

Impact of the new definition of a lease

The Group will make use of the practical expedient available on transition to AASB 16 not to reassess whether a contract is or contains a lease. Accordingly, the definition of a lease in accordance with AASB 117 and IFRIC 4 will continue to apply to those leases entered or modified before 1 January 2019.

The change in definition of a lease mainly relates to the concept of control. AASB 16 distinguishes between leases and service contracts on the basis of whether the use of an identified asset is controlled by the customer. Control is considered to exist if the customer has:

– The right to obtain substantially all of the economic benefits from the use of an identified asset; and

– The right to direct the use of that asset.

1(c) Adoption of new and revised Standards (cont)

The Group will apply the definition of a lease and related guidance set out in AASB 16 to all lease contracts entered into or modified on or after 1 January 2019 (whether it is a lessor or a lessee in the lease contract). In preparation for the first time application of AASB 16, the Group has carried out an implementation assessment. The assessment has shown that the new definition in AASB 16 will not change significantly the scope of contracts that meet the definition of a lease for the Group.

Impact on Lessee Accounting

Operating leases

AASB 16 will change how the Group accounts for leases previously classified as operating leases under AASB 117, which were off balance sheet.

On initial application of AASB 16, for all leases (except as noted below), the Group will:

a) Recognise right of use assets and lease liabilities in the consolidated statement of financial position, initially measured at the present value of the future lease payments;

b) Recognise depreciation of right of use assets and interest on lease liabilities in the consolidated statement of profit or loss;

c) Separate the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the consolidated cash flow statement.

Lease incentives (e.g. rentfree period) will be recognised as part of the measurement of the right of use assets and lease liabilities whereas under AASB 117 they resulted in the recognition of a lease liability incentive, amortised as a reduction of rental expenses on a straight line basis.

Under AASB 16, right of use assets will be tested for impairment in accordance with AASB 136 Impairment of Assets.

This will replace the previous requirement to recognise a provision for onerous lease contracts.

For short term leases (lease term of 12 months or less) and leases of low value assets (such as personal computers and office furniture), the Group will opt to recognise a lease expense on a straight line basis as permitted by AASB 16.

1(c) Adoption of new and revised Standards (cont)

As at 31 December 2018, the Group has non cancellable operating lease commitments of $1,121,050. (See Note 24).

A preliminary assessment indicates that all of these arrangements relate to leases other than short term leases and leases of low value assets, and hence the Group will recognise a right of use asset of $5,565,434 and a corresponding lease liability of $5,565,434 in respect of all these leases. The impact on profit or loss is to decrease Other expenses by $2,346,048, to increase depreciation by $1,882, 845 and to increase interest expense by $463,203.

Under AASB 17, all lease payments on operating leases are presented as part of cash flows from operating activities. The impact of the changes under AASB 16 would be to reduce the cash generated by operating activities and to increase net cash used in financing activities.

1(d) Revenue Recognition

The Group recognises revenue from the following major sources:
- Sale of goods
- Providing services

The Group recognises revenue from the above two sources both over time and at a point in time depending on the nature and specifications of contracts entered into with its customers.

For the revenue recognised over time refer to note 2(a) which details the basis of revenue recognition for the current year.

For revenue recognised at a point in time, the Group recognises revenue when control transfers to the customer.

The Group considers the following requirements in order to assess whether control has passed:
(a) The Group has a present right to payment for the asset,
(b) The customer has legal title to the asset,
(c) The Group has transferred physical possession of the asset,
(d) The customer has the significant risks and rewards of ownership of the asset.
(e) The customer has accepted the asset.

Interest revenue is recognised on an accrual basis.

Sales-related warranties
Sales-related warranties cannot be purchased separately and they serve as an assurance that the products sold comply with agreed-upon specifications. Accordingly, the Group will continue to account for these warranties in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* consistent with its current accounting treatment.

1. **Summary of Accounting Policies (cont)**

1(e)(i) Financial assets

Classification

From 1 January 2018, the Group classifies its financial assets in the following measurement categories:

- Those to be measured subsequently at fair value (either through other comprehensive income, or through profit or loss), and
- Those to be measured at amortised cost.

The classification depends on the Group's business model for managing financial assets and the contractual terms of the cash flows. For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in debt instruments, this will depend on the business model in which the investment is held.

For investments in equity instruments that are not held for trading, this will depend on whether the Group has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income. The Group reclassifies debt investments when and only when its business model for managing those assets changes.

Measurement

At initial recognition, the Group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. Measurement of cash and cash equivalents and trade and other receivables remains at amortised cost consistent with the comparative period.

Debt instruments

Subsequent measurement of debt instruments depends on the Group's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the Group classifies its debt instruments:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. A gain or loss on a debt investment that is subsequently measured at amortised cost and is not part of a hedging relationship is recognised in profit or loss when the asset is derecognised or impaired. Interest income from these financial assets is included in finance income using the effective interest rate method.
- Fair value through other comprehensive income (FVOCI): Assets that are held for collecting contractual cash flows and through sale on specified dates. A gain or loss on a debt investment that is subsequently measured at FVOCI is recognised in other comprehensive income. No such assets are currently held by the Group.

1. **Summary of Accounting Policies (cont)**

- Fair value through profit or loss (FVPL): Assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value through profit or loss. A gain or loss on a debt investment that is subsequently measured at fair value through profit or loss and is not part of a hedging relationship is recognised in profit or loss and presented net in the statement of profit or loss within other gains/(losses) in the period in which it arises. No such assets are currently held by the Group.

Equity instruments
The Group subsequently measures all equity investments at fair value. Where the Group's management has elected to present fair value gains and losses on equity investments in other comprehensive income, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the investment. Dividends from such investments continue to be recognised in profit or loss as other income when the Group's right to receive payments is established. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value. Changes in the fair value of financial assets at fair value through profit or loss are recognised in other expenses in the statement of profit or loss and other comprehensive income as applicable.

Impairment
The Group assesses on a forward looking basis the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, and lease receivables, the Group applies the simplified approach permitted by AASB 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

1(e)(ii) Financial Liabilities
Interest bearing liabilities
All loans and borrowings are initially recognised at fair value, being the amount received less attributable transaction costs. After initial recognition, interest bearing liabilities are stated at amortised cost with any difference between cost and redemption value being recognised in the statement of profit or loss over the period of the borrowings on an effective interest basis.

Trade and other payables
Liabilities are recognised for amounts to be paid for goods or services received. Trade payables are settled on terms aligned with the normal commercial terms in the Group's countries of operation.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

1. **Summary of Accounting Policies (cont)**

(f) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, cash in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash and cash equivalents includes restricted cash to the extent it relates to operating activities.

(g) Employee benefits

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of short term employee benefits are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of long term employee benefits are measured as the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Defined contribution plans – Contributions to defined benefit contribution superannuation plans are expensed when incurred.

1. Summary of Accounting Policies (cont)

(h) Foreign currency

Foreign currency transactions

All foreign currency transactions during the financial year are bought to account using the exchange rate in effect at the date of the transaction. Foreign currency monetary items at reporting date are translated at the exchange rate existing at reporting date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined.

Exchange differences are recognised in profit or loss in the period they arise.

Foreign operations

On consolidation, the assets and liabilities of the consolidated entity's overseas operations are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are recognised in the foreign currency translation reserve, and recognised in profit or loss on disposal of the foreign operation.

(i) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except:

i. where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
ii. for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

Cash flows are included in the statement of cash flows on a gross basis. The GST component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority is classified as operating cash flows.

1. Summary of Accounting Policies (cont)

(j) Government grants

Government grants are assistance by the government in the form of transfers of resources to the consolidated entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. Government grants include government assistance where there are no conditions specifically relating to the operating activities of the consolidated entity other than the requirement to operate in certain regions or industry sectors.

Government grants relating to income are recognised as income over the periods necessary to match them with the related costs. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the consolidated entity with no future related costs are recognised as income in the period in which it becomes receivable.

(k) Impairment of assets

At each reporting date, the consolidated entity reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the consolidated entity estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually and whenever there is an indication that the asset may be impaired. An impairment of goodwill is not subsequently reversed. Recoverable amount is the higher of fair value less cost of disposal and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

1. Summary of Accounting Policies (cont)

(k) Impairment of assets (cont)

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit or loss immediately.

(l) Income tax

<u>Current tax</u>

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

<u>Deferred tax</u>

Deferred tax is recognised on temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities (other than as a result of business combination) which affects neither taxable income nor accounting profit. Furthermore, a deferred tax liability is not recognised in relation to taxable temporary differences arising from goodwill.

1. Summary of Accounting Policies (cont)

(l) Income tax (cont)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the consolidated entity is able to control the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets arising from deductible temporary differences associated with these investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the assets and liabilities giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the consolidated entity expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the company/consolidated entity intends to settles its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred tax is recognised as an expense or income in the statement of profit or loss and other comprehensive income, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity, or where it arises from the initial accounting for a business combination, in which case it is taken into account in the determination of goodwill or excess.

Tax consolidation

The company and all its wholly-owned Australian resident entities are part of a tax consolidated group under Australian taxation law. Electro Optic Systems Holdings Limited is the head entity in the tax-consolidated group. Tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the ‘separate taxpayer within the group’ approach.

1. Summary of Accounting Policies (cont)

(l) Income tax (cont)

Current tax liabilities and assets and deferred tax assets arising from unused tax losses and tax credits of the members of the tax-consolidated group are recognised by the company (as head entity in the tax-consolidated group).

There are no formal tax funding arrangements within companies within the tax-consolidated entity.

(m) Intangible assets

Research and development costs

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Where no internally-generated intangible assets can be recognised, development expenditure is recognised as an expense in the period as incurred.

Intangible assets acquired in a business combination

Intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair value can be measured reliably.
Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets acquired separately.

(n) Inventories

Inventories are measured at the lower of cost and net realisable value. Costs are assigned on a first-in first-out basis. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

1. Summary of Accounting Policies (cont)

(o) Leased assets

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Consolidated entity as lessee

Assets held under finance leases are initially recognised at their fair value or, if lower, at amounts equal to the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Finance leased assets are amortised on a straight line basis over the estimated useful life of the asset.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

Lease incentives

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefits of incentives are recognised as a reduction of rental expenses on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

1. Summary of Accounting Policies (cont)

(p) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company. Control is achieved when the Company:

- Has power over the investee;
- Is exposed, or has rights, to variable returns from its involvement with the investee; and
- Has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary.

All intra group assets and liabilities, equity, income, expenses, and cash flows relating to transactions between members of the group are eliminated in full on consolidation.

Non-controlling interest in subsidiaries are identified separately from the Group's equity therein. Those interest of non-controlling shareholders that are present ownership interest entitling these holders to a proportionate share of net assets upon liquidation may initially be measured at fair value or at the non-controlling interests' proportionate share of the fair value of the acquiree's identifiable net assets. The choice of measurement is made on and acquisition-by-acquisition basis. Other non-controlling interests are initially measured at fair value. Subsequent to acquisition, the carrying amount of non-controlling interest is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income is attributed to non-controlling interests even if this results in non-controlling interests having a deficit balance.

(q) Property, plant and equipment

Plant and equipment, leasehold improvements and equipment under finance lease are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of an item. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of acquisition.

Depreciation is provided on property, plant and equipment. Depreciation is calculated so as to write off the net cost or other revalued amount of each asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter, using the straight line method. The estimated useful lives, residual values and depreciation method is reviewed at the end of each annual accounting period.

The following estimated useful lives are used in the calculation of depreciation:

Plant and equipment	5 to 15 years
Leasehold improvements	3 to 5 years
Leased assets	3 to 5 years
Office equipment	5 to 15 years
Furniture, fixture and fittings	5 to 15 years
Motor vehicles	3 to 5 years

(r) Provisions

Provisions are recognised when the consolidated entity has a present obligation, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is probable that recovery will be received and the amount of the receivable can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Warranties – Provisions for warranty costs are recognised as agreed in individual sales contracts, at the directors best estimate of the expenditure required to settle the consolidated entity’s liability.

1. **Summary of Accounting Policies (cont)**

(r) Provisions (cont)

Contract losses – Present obligations arising under onerous contracts are recognised and measured as a provision. An onerous contract is considered to exist where the Group has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Decommissioning cost– a provision for decommissioning cost is recognised when there is a present obligation, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount of the provision can be measured reliably. The estimated future obligations include the costs of removing the facilities and restoring the premises.

(s) Share based payments to employees

Equity–settled share-based payments are measured at fair value at the date of the grant. Fair value is measured by use of the Black Scholes model. The expected life used in the model has been adjusted, based on management best estimates, for the effects of non-transferability, exercise restrictions and behavioural considerations. The fair value determined at the grant date of the equity-settled share based payments is expensed on a straight-line basis over the vesting period, based on the consolidated entity's estimate of shares that will eventually vest.

Ordinary shares issued under the Loan Funded Share Plan is accounted for as an in substance option and were initially measured using a Monte Carlo simulation model. Directors' reassess the non-market inputs and adjust throughout the life for likely eventuality.

(t) Interests in joint operations

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

1. **Summary of Accounting Policies (cont)**

(t) Interests in joint operations (cont)

When a group entity undertakes its activities under joint operations, the Group as a joint operator recognises in relation to its interest in a joint operation:

- its assets, including its share of any assets held jointly;
- its liabilities, including its share of any liabilities incurred jointly;
- its revenue from the sale of its share of the output arising from the joint operations;
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

The Group accounts for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the AASB's applicable to the particular assets, liabilities revenues and expenses.

When a group entity transact with a joint operation in which a group entity is a joint operator (such as a sale or contribution of assets), the Group is considered to be conducting the transaction with the other parties to the joint operation, and gains or losses resulting from the transactions are recognised in the Group's consolidated financial statements only to the extent of other parties' interest in the joint operation.

When a group entity transacts with a joint operation in which a group entity is a joint operator (such as a purchase of assets), the Group does not recognise its share of the gains and losses until it resells those assets to a third party.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

1. **Summary of Accounting Policies (cont)**

(u) Critical accounting judgements

In the application of the consolidated entity's accounting policies, management is required to make judgements, 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 various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making these judgements. 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.

Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

Recoverable amount of property, plant and equipment

The directors made a critical judgement in relation to the recoverable amount of property, plant and equipment included in Note 9. Judgement is made regarding the value of second hand manufacturing equipment and the future cash flows of the cash generating units.

Deferred tax

The directors made a critical judgement in relation to not recognising the deferred tax balances described in Note 4(b). The directors do not currently consider it probable that sufficient taxable amounts will be available against which deductible temporary differences can be utilised.

Inventory obsolescence

The directors made a critical judgement in relation to the net realisable value of inventory included in Note 6. Judgement is required in determining if inventory items can be utilised in projects, given the individual nature of the consolidated entity's contracts, and the specific nature of inventory items.

1. Summary of Accounting Policies (cont)

(u) Critical accounting judgements (cont)

Warranty provision

The directors made a critical judgement in relation to the valuation of the provision for warranty costs described in Note 12. The valuation is determined based on the director's best estimate of the expenditure required to settle the consolidated entity's liability under its warranty program.

Judgements in determining Revenue recognised in the period

There are complexities and judgements associated with interpreting key revenue contracts entered into by the entity against the requirements of the new accounting standard on Revenue (AASB 15). This results in a significant level of management judgement and estimation in relation to:

- Interpreting and accounting for complex contractual terms, including multiple performance obligations, and clauses with regards to cancellations and warranties (amongst others); and
- Accounting judgements and treatments in relation to the first time application including the assessment of performance obligations, allocation of revenue and consideration of revenue recognition as being at a point in time or over time.

(v) **Going concern**

The financial report has been prepared on the going concern basis which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

The consolidated entity generated a net profit during the year of $15,081,372 (2017: net loss of $9,399,930). Net cash used by operating activities was $15,686,202 (2017: $25,949,693). As at 31 December 2018, the consolidated entity had cash of $40,538,225 (2017: $9,989,953). Cash of $119,025 (2017: $119,025) is restricted as it secures bank guarantees relating to performance on some contracts.

(v) **Going concern (cont)**

In the opinion of the directors, the ability of the consolidated entity to continue as a going concern and pay its debts as and when they become due and payable is dependent upon:

- the continued ability of the consolidated entity to deliver current contracts on time, to the required specification and within budgeted costs;
- key military and government customers making timely payments for the goods supplied in accordance with contractual terms;
- the export licences which the Company has from governments in Australia and the USA continue and future export licences are not restricted;
- the future trading prospects of the consolidated entity including obtaining the required export licences, lodgement of the required offset bonds in relation to executed contracts and successfully obtaining and negotiating commercial contract terms in relation to potential customers; and
- the ability to raise funding should the need arise.

Given the current financial position, performance and prospects of the consolidated entity the directors believe the consolidated entity can continue as a going concern and pay its debts as and when they become due and payable and that it is therefore appropriate to prepare the financial report on the going concern basis.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

	Consolidated	
	31 December 2018 $	**31 December 2017 $**

2. Profit/ (Loss) from operations

(a) **Revenue**

Revenue from operations consisted of the following items:

Revenue from the sale of goods	84,299,210	19,290,114
Revenue from the rendering of services	2,040,120	1,648,412
Construction contract revenue	-	2,125,292
Total revenue	86,339,330	23,063,818

Disaggregation of Revenue

The Group derives its revenue from the transfer of goods and services over time and at a point in time in the following major segments.

Timing of revenue recognition
Over time

	Revenue $
Defence segment – Sale of goods	60,105,786
Defence segment – Providing services	-
Space segment – Sale of goods	-
Space segment – Providing services	-
Total Revenue recognise over time	60,105,786

	Consolidated	
	31 December 2018 $	31 December 2017 $

2. **Profit/ (Loss) from operations (cont)**

The Group recognises revenue for the overseas remote weapon system contract over time as the goods manufactured under this contract do not have an alternative use for the entity, and EOS has an enforceable right to payment for performance completed to date under the contract. AASB 15 takes a control-based approach to revenue recognition, where the transfer of a good or service happens as the customer obtains control of that good or service. Under our current contract, the control of the goods transfer when the goods are delivered. The output method, based on the delivery of goods to customer faithfully depicts our performance under the contract and best depicts the pattern of transfer of goods to the customer.

All other revenue is recognised at a point in time.

At a point in time

	Revenue
Defence segment – Sale of goods	23,743,572
Defence segment – Providing services	1,129,557
Space segment – Sale of goods	468,850
Space segment – Providing services	910,565
Total Revenue recognise at a point in time	26,233,544
Total Revenue	86,339,330

Other revenue		
Interest revenue:		
Bank deposits	790,658	194,888
Other	408	1,088
	87,130,396	23,259,794

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

	31 December 2018 $	31 December 2017 $
2 Profit/ (Loss) from operations (cont)		
(b) (Loss) before income tax has been arrived at after charging the following expenses:		
Borrowing costs		
Finance charges	36,903	34,985
Depreciation and amortisation – property, plant and equipment	633,235	193,325
Loss on sale of property, plant and equipment	-	2,007
Foreign exchange loss (gains)	(7,712,222)	695,061
Operating lease rental expenses:		
Minimum lease payments	2,053,962	801,986
Employee benefit expense:		
Share based payments:		
Equity settled	285,790	601,344
Contributions to defined contribution superannuation plans	1,530,708	1,171,747
Other employee benefits	20,331,368	12,919,758
	22,147,866	14,692,849

	31 December 2018 $	31 December 2017 $
3. **Profit/ (Loss) per Share**		
Basic profit/ (loss) per share	17.22 cents	(15.1 cents)
Basic Profit/ (Loss) per Share		
Profit/ (Loss) (a)	15,081,372	(9,399,930)
Weighted average number of ordinary shares (b), (c)	87,582,641	62,260,622

(a) Profit/ (Loss) used in the calculation of basic earnings per share are the same as the net profit/ (loss) in the statement of profit or loss and other comprehensive income.
(b) There are no potential ordinary shares and hence diluted earnings per share is the same as basic earnings per share. The unlisted options outstanding are not in the money at 31 December 2018 and are not considered dilutive.
(c) The 5,180,000 ordinary shares issued on 20 June 2018 at a price of $2.99 under the Loan Funded Share Plan are not included in the weighted average number of ordinary shares as they are treated as in substance options for accounting purposes. The conditions in relation to these in substance options have not all been met at the reporting date.

4. Income Tax

	Consolidated 31 December 2018 $	31 December 2017 $

(a) The prima facie income tax benefit on pre-tax accounting profit/ (loss) from operations reconciles to the income tax benefit in the financial statements as follows:

	31 December 2018 $	31 December 2017 $
Profit/ (Loss) from operations	15,081,372	(9,399,930)
Income tax (benefit) calculated at 30%	4,524,412	(2,818,979)
Effect of different tax rates of subsidiaries operating in other jurisdictions	(166,904)	(133,752)
Share based payments	85,737	180,403
Other non-deductible/ non assessable items	1,054,960	34,444
	5,498,205	(2,737,884)
Deferred tax assets not previously recognised now bought to account	(5,498,205)	-
Unused tax losses and tax offsets not recognised as deferred tax assets	-	2,737,884
Income tax benefit attributable to operating Profit/ (Loss)	-	-

The tax rate used in the above reconciliation is the corporate tax rate of 30% payable by Australian corporate entities on taxable profits under Australian tax law, 25% in Germany, 17% in Singapore and the federal tax rate applicable in the USA and the State of Arizona has been assumed to approximate a combined rate 40% as their tax rates apply on a sliding scale. There has been no change in the corporate tax rate when compared with the previous reporting period.

	Consolidated	
	31 December 2018 $	31 December 2017 $

4. Income Tax (Cont)

(b) Unrecognised deferred tax balances

The following deferred tax assets have not been bought to account as assets		
Tax losses – revenue	17,052,793	22,550,998
Temporary differences	2,954,843	1,647,998
	20,007,636	24,198,996

Tax consolidation

Relevance of tax consolidation to the consolidated entity

The company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 1 January 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Electro Optic Systems Holdings Limited. The members of the tax-consolidated entity group are identified in Note 21.

Nature of tax funding arrangements and tax sharing agreements

There are no formal tax funding or tax sharing arrangements within the tax-consolidated group.

5. Trade and other receivables

Current		
Trade receivables	26,228,489	11,389,405
GST receivable	571,575	228,825
Amounts due from customers under construction contracts (Note 28)	-	7,613
Other debtors	19,682	36,164
	26,819,746	11,662,007
Non-current		
Trade receivables	7,146,990	609,864

The average credit period on sales of goods is 45 days. No interest is charged on outstanding late receivables.

	Consolidated 31 December 2018 $	31 December 2017 $

5. Trade and other receivables (cont)

The Group always measures the loss allowance for trade receivables at an amount equal to lifetime ECL. The expected credit losses on trade receivables are estimated using a provision matrix by reference to past default experience of the debtor and an analysis of the debtor's current financial position, adjusted for factors that are specific to the debtors, general economic conditions of the industry in which the debtors operate and an assessment to both the current as well as the forecasted direction of conditions at the reporting date. The Group has not recognised any loss allowance.

There has been no change in the estimation techniques or significant assumptions made during the current reporting period.

The Group writes off a trade receivable when there is information indicating that the debtor is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the debtor has been placed under liquidation or has entered bankruptcy proceedings, or when the trade receivables are over two years past due, whichever occurs earlier. None of the trade receivables that have been written off is subject to enforcement activities.

Ageing of past due not impaired

	31 December 2018 $	31 December 2017 $
31-60 days	321,346	63,526
61-90 days	-	2,187
91-120 days	-	10,778
120 days +	19,060	12,239
	340,406	88,730

6. Inventories

	31 December 2018 $	31 December 2017 $
Raw materials – at net realisable value	20,356,864	10,529,141
Work in progress – at cost	6,108,635	3,266,433
	26,465,499	13,795,574

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

7. Other Assets

	Consolidated	
	31 December 2018 $	31 December 2017 $
Current		
Prepayments	12,713,727	2,390,931
Non-current		
Prepayment	2,252,177	7,751,938

These prepayments relates to a prepayment made to a supplier for the delivery of component parts in relation to a future order.

8. Auditor's Remuneration

(a) Auditor of the Parent Entity

Audit or review of the financial report	196,665	155,003
Taxation services	5,670	5,000
	202,335	160,003

(b) Other Auditor

Audit or review of the financial report	2,976	2,839
Taxation services	893	852
	3,869	3,691

The auditor of Electro Optic Systems Holdings Limited is Deloitte Touche Tohmatsu.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

	Consolidated	
	31 December 2018 $	31 December 2017 $
9. Property, Plant and Equipment		
(a) Plant and equipment – at cost	9,502,565	7,649,696
Less accumulated depreciation and impairment	(7,748,865)	(7,188,427)
	1,753,700	461,269
(b) Leased assets – at cost	26,066	23,551
Less accumulated amortisation and impairment	(26,066)	(23,551)
	-	-
(c) Office equipment – at cost	4,670,390	3,955,490
Less accumulated depreciation and impairment	(3,909,971)	(3,563,079)
	760,419	392,411
(d) Furniture, fixtures and fittings – at cost	1,560,332	826,911
Less accumulated depreciation and impairment	(679,155)	(585,429)
	881,177	241,482
(e) Leasehold improvements – at cost	1,499,424	1,205,945
Less accumulated depreciation and impairment	(1,118,477)	(940,851)
	380,947	265,094
(f) Motor vehicle –at cost	102,260	60,682
Less accumulated depreciation and impairment	(36,377)	(15,591)
	65,883	45,091
(g) Computer software – at cost	128,499	-
Less accumulated depreciation	(9,776)	-
	118,723	-
(h) Satellite – at cost	7,000,000	7,000,000
Less impairment	(7,000,000)	(7,000,000)
	-	-
Total net book value of Property, Plant and Equipment	3,960,849	1,405,347

	Consolidated	
	31 December 2018 $	31 December 2017 $

9. Property, Plant and Equipment (cont)

Cost

Plant and equipment

Balance at beginning of year	7,649,696	7,889,339
Additions	1,554,016	240,957
Disposals	(254,022)	(3,750)
Net foreign currency exchange differences	552,875	(476,850)
Balance at end of year	9,502,565	7,649,696

Leased assets

Balance at beginning of year	23,551	26,245
Net foreign currency exchange differences	2,515	(2,694)
Balance at end of year	26,066	23,551

Office equipment

Balance at beginning of year	3,955,490	4,306,943
Additions	542,589	338,623
Disposals	(124,401)	-
Net foreign currency exchange differences	296,712	(690,076)
Balance at end of year	4,670,390	3,955,490

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

9. Property, Plant and Equipment (cont)

	Consolidated 31 December 2018 $	Consolidated 31 December 2017 $
Furniture, fixtures and fittings		
Balance at beginning of year	826,911	646,962
Additions	675,373	242,131
Net foreign currency exchange differences	58,048	(62,182)
Balance at end of year	1,560,332	826,911
Leasehold improvements		
Balance at beginning of year	1,205,945	983,701
Additions	246,859	272,185
Net foreign currency exchange differences	46,620	(49,941)
Balance at end of year	1,499,424	1,205,945
Motor vehicle		
Balance at beginning of year	60,682	13,630
Additions	41,578	47,052
Balance at end of year	102,260	60,682
Computer software		
Balance at beginning of the year	-	-
Additions	128,499	-
Balance at end of year	128,499	-
Satellite		
Balance at beginning of year	7,000,000	7,000,000
Balance at end of year	7,000,000	7,000,000

	Consolidated	
	31 December 2018 $	31 December 2017 $

9. Property, Plant and Equipment (cont)

Accumulated Depreciation/Amortisation/ Impairment

Plant and equipment

Balance at beginning of year	(7,188,427)	(7,557,401)
Depreciation	(261,585)	(109,617)
Disposals	254,022	1,743
Net foreign currency exchange differences	(552,875)	476,848
Balance at end of year	(7,748,865)	(7,188,427)

Leased plant and equipment

Balance at beginning of year	(23,551)	(26,245)
Net foreign currency exchange differences	(2,515)	2,694
Balance at end of year	(26,066)	(23,551)

Office equipment

Balance at beginning of year	(3,563,079)	(4,180,466)
Depreciation	(174,834)	(72,631)
Disposals	124,401	-
Net foreign currency exchange differences	(296,459)	690,018
Balance at end of year	(3,909,971)	(3,563,079)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

9. Property, Plant and Equipment (cont)

	Consolidated 31 December 2018 $	31 December 2017 $
Furniture, fixtures and fittings		
Balance at beginning of year	(585,429)	(645,586)
Depreciation	(35,338)	(2,025)
Net foreign currency exchange differences	(58,388)	62,182
Balance at end of year	(679,155)	(585,429)
Leasehold improvements		
Balance at beginning of year	(940,851)	(983,701)
Depreciation	(131,005)	(7,091)
Net foreign currency exchange differences	(46,621)	49,941
Balance at end of year	(1,118,477)	(940,851)
Motor vehicle		
Balance at beginning of year	(15,591)	(13,630)
Depreciation	(20,697)	(1,961)
Net foreign currency exchange differences	(89)	-
Balance at end of year	(36,377)	(15,591)
Computer software		
Balance at beginning of the year	-	-
Depreciation	(9,776)	-
Balance at end of year	(9,776)	-
Satellite		
Balance at beginning of year	(7,000,000)	(7,000,000)
Balance at end of year	(7,000,000)	(7,000,000)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

9. Property, Plant and Equipment (cont)

Aggregate depreciation, impairment and amortisation allocated during the period is recognised as an expense and disclosed in Note 2 to the financial statements.

Impairment of property, plant and equipment

The consolidated entity has assessed the carrying amount of plant and equipment and determined an impairment (reversal) charge for the year of Nil (2017: Nil). The basis to assess for any potential impairment was fair value less cost for disposal and fair value determined by reference to an active market for second hand manufacturing equipment.

	Consolidated	
	31 December 2018 $	31 December 2017 $

10. Current trade and other payables

	31 December 2018 $	31 December 2017 $
Trade payables	11,277,520	5,905,060
Accruals	1,399,605	773,735
Unearned revenue	9,651,772	11,346,649
Amounts due to customers under construction contracts (Note 28)	-	58,914
	22,328,897	18,084,358

The average credit period on purchases of goods is 30 days and no interest is payable on goods purchased within agreed credit terms. The consolidated entity has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

11. Provisions

	31 December 2018 $	31 December 2017 $
Current		
Employee benefits (Note 13)	4,620,115	3,594,345
Provision for straight lining of rent	15,497	7,225
Decommissioning costs	250,000	250,000
Under utilised space	884,855	-
Warranty (Note 12)	596,424	1,239,990
	6,366,891	5,091,560
Non-current		
Employee Benefits (Note 13)	409,262	457,311
Make good of premises	132,776	80,000
Warranty (Note 12)	3,349,732	321,765
	3,891,770	859,076

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

	Consolidated	
	31 December 2018 $	31 December 2017 $

11. Provisions (cont)

Movement on decommissioning costs

Balance at 1 January	250,000	250,000
Balance as at 31 December	250,000	250,000

The provision for decommissioning costs relate to an obligation to dismantle and refurbish a telescope at a future date.

Movement in straight lining of rental

Balance at 1 January	7,225	-
Increase during the period from new lease	8,772	7,225
Balance as at 31 December	15,497	7,225

Movement in make good of premises

Balance at 1 January	80,000	-
Increase during the period from new lease	52,776	80,000
Balance as at 31 December	132,776	80,000

Movement in under utilised space

Balance at 1 January	-	-
Increases resulting from re-measurement	884,855	-
Balance as at 31 December	884,855	-

	Consolidated 31 December 2018 $	31 December 2017 $

12. Warranty Provisions

Movement in warranty provision

Balance at 1 January	1,561,755	2,121,545
Reductions resulting from re-measurement	(944,692)	(1,402,265)
Additional provisions recognised	3,329,093	842,475
Balance as at 31 December	3,946,156	1,561,755
Current (Note 11)	596,424	1,239,990
Non-Current (Note 11)	3,349,732	321,765

The provision for warranty claims represents the present value of the directors' best estimate of the future sacrifice of economic benefits that will be required under the consolidated entity's warranty program for military products and telescopes. The estimate has been made on the basis of historical industry accepted warranty trends and may vary as a result of new materials, altered manufacturing processes or other events affecting product quality.

13. Employee Benefits

The aggregate employee benefits liability recognised in the financial statements is as follows:
Provision for employee entitlements

Current (Note 11)	4,620,115	3,594,345
Non-Current (Note 11)	409,262	457,311

14. Issued capital

	Consolidated 31 December 2018 $	31 December 2017 $
Balance at the beginning of the financial year – Ordinary shares	103,342,071	75,383,567
Issue of 3,863,638 new shares at $2.20 each on 30 March 2017 at $2.20 each (net of issuance costs)	-	8,075,004
Issue of 9,100,000 new shares at $2.30 each on 22 September 2017 at $2.30 each (net of issuance costs)	-	19,883,500
Issue of 10,471,434 new shares at $2.91 on 9 February 2018 (net of issuance costs)	28,948,278	-
Issue of 10,147,123 new shares at $2.91 on 16 March 2018 (net of issuance costs)	28,051,722	-
Issue of 495,758 new shares at $2.91 on 21 March 2018 under the Small Shareholder Plan	1,442,656	-
Issue of 5,180,000 new shares at $2.99 on 20 June 2018 under the Loan Funded Share Plan	-	-
Balance at the end of the financial year	161,784,727	103,342,071

Changes to the then Corporations Law abolished the authorised capital and par value concept in relation to share capital from 1 July 1998. Therefore, the company does not have a limited amount of authorised capital and issued shares do not have a par value.

Fully Paid Ordinary Shares	Number	Number
Balance at the beginning of financial year	69,809,564	56,845,926
Issue of new shares at $2.20 each on 27 March 2017	-	3,863,638
Issue of new shares at $2.30 each on 22 September 2017	-	9,100,000
Issue of new shares at $2.91 on 9 February 2018	10,471,434	-
Issue of new shares at $2.91 on 16 March 2018	10,147,123	-
Issue on new shares at $2.91 on 21 March 2018 under the Small Shareholder Plan	495,758	-
Issue of new shares at $2.99 on 20 June 2018 under the Loan Funded Share Plan	5,180,000	-
Balance at end of financial year	96,103,879	69,809,564

Fully paid ordinary shares carry one vote per share and carry the right to dividends. The 5,180,000 ordinary shares issued on 20 June 2018 under the Loan Funded Share Plan are restricted shares subject to vesting and performance criteria under the Plan detailed in Note 16 to the financial statements and are treated as in substance options.

15. Directors and Employee Share Option Plan

The consolidated entity has an ownership-based compensation scheme for employees (including directors) of the company. In accordance with the provisions of the scheme, as approved by shareholders at a previous annual general meeting, employees with more than three months service with the company may be granted options to purchase ordinary shares at exercise prices determined by the directors based on market prices at the time the issue of options were made.

Each share option converts to one ordinary share in Electro Optic Systems Holdings Limited. No amounts are paid or payable by the recipient on receipt of the options. The options carry neither rights to dividends nor voting rights. Options may be exercised at any time from the date of vesting to the date of expiry.

The number of options granted is determined by the directors and takes into account the company's and individual achievements against both qualitative and quantitive criteria.

On 28 June 2002, shareholders approved the adoption of an Employee Share Option Plan.

(a) Unlisted Options issued under the Employee Share Option Plan

	2018		2017	
	Number	Weighted average exercise price $	Number	Weighted average exercise price $
Balance at the beginning of the financial year (i)	5,620,000	3.00	5,715,000	3.00
Granted during the year (ii)	220,000	2.99	-	
Exercised during the year (iii)	-	-	-	-
Lapsed during the year (iv)	(120,000)	3.00	(95,000)	3.00
Balance at the end of the financial year (v)	5,720,000	3.00	5,620,000	3.00
Exercisable at end of the year	5,500,000	3.00	2,810,000	3.00

15. Directors and Employee Share Option Plan (cont)

(i) Balance at the beginning of the year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
2018	5,620,000	Various	31/1/19	3.00	$1,892,410
2017	5,715,000	Various	31/1/19	3.00	$1,919,058

Staff and Director options carry no rights to dividends and no voting rights.

(ii) Granted during the year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
2018					
Staff options	220,000	20/6/18	31/3/2023*	2.99	$61,369
2017					
None	-	-	-	-	-

These staff options have similar vesting and forfeiture conditions as those issued under the Loan Funded Share Plan summarised in Note 16. The options issued were priced using the Monte Carlo Simulation method model. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, exercise restrictions and behavioural conditions. Expected volatility is based on the historical share price volatility.

The following inputs were used in the model for the option grants made on 20 June 2018:

Dividend yield	-
Expected volatility (linearly interpolated)	30.00%
Risk free interest rate	2.32%
Expected life of options	1,745 days *
Grant date share price	$2.91
Exercise price	$2.99

* These options commence to vest after 30 June 2020 on the basis of 12.5% of their number each quarter subject to share price and profitability hurdles being achieved.

15. Directors and Employee Share Option Plan (cont)

The Options issued during the financial year ended 31 December 2016 were priced using the Black Scholes model. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, exercise restrictions and behavioural conditions. Expected volatility is based on the historical share price volatility over a two year period.

The following inputs were used in the model for the option grants made on 5 February 2016:

Dividend yield	-
Expected volatility (linearly interpolated)	82.77%
Risk free interest rate	1.745%
Expected life of options	1,085 days
Grant date share price	$1.18
Exercise price	$3.00

The following inputs were used in the model for the option grant made on 30 May 2016:

Dividend yield	-
Expected volatility (linearly interpolated)	82.77%
Risk free interest rate	1.745%
Expected life of options	975 days
Grant date share price	$1.40
Exercise price	$3.00

(iii) Exercised during the year

There were no options exercised during the year.

(iv) Lapsed during the year

120,000 (2017: 95,000) Staff options lapsed during the year.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

15. Directors and Employee Share Option Plan (cont)

(v) Balance at the end of the financial year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
2018					
Staff options	2,300,000	5/2/16	31/1/19	$3.00	645,150
Staff options	220,000	20/6/18	31/3/23	$2.99	61,369
Director options	3,000,000	5/2/16	31/1/19	$3.00	1,122,000
Director options	200,000	30/5/16	31/1/19	$3.00	91,600
	5,720,000				1,920,119
2017					
Staff options	2,420,000	5/2/16	31/1/19	$3.00	678,810
Director options	3,000,000	5/2/16	31/1/19	$3.00	1,122,000
Director options	200,000	30/5/16	31/1/19	$3.00	91,600
	5,620,000				1,892,410

Staff and Director options carry no rights to dividends and no voting rights.

All options granted to directors and staff in 2016 vest on the basis of 50% after one year and 50 % after two years from the date of issue.

All options granted to staff on 20 June 2018 commence to vest after 30 June 2020 on the basis of 12.5% of their options each quarter subject to share price and profitability hurdles being achieved.

The difference between the total market value of the options issued during the financial year, at the date of issue, and the total amount received from the employees (nil) is recognised in the financial statements over the vesting period as disclosed in Note 17 to the financial statements.

16. Loan Funded Share Plan

The Board has established a new employee incentive scheme known as the Electro Optic Systems Holdings Limited Loan Funded Share Plan (**LFSP**), pursuant to which fully paid restricted ordinary shares in the Company (**Shares**) are acquired by Directors and selected employees of the Company using a loan made to them by the Company. Shareholders approved the establishment of the LFSP and the participation of directors in the LFSP at the Annual General Meeting held on 24 April 2018. The loans are limited recourse, interest and fee free and are repayable in full on the earlier of the termination date of the loan (5 years) or the date on which the shares are sold in accordance with the terms of the LFSP.

Under the applicable Accounting Standards, the LFSP shares are accounted for as options, which give rise to share based payments.

The Company issued 5,180,000 new restricted fully paid ordinary shares under the LFSP at an issue price of $2.99 on 20 June 2018 based on the 'Market Value' which was determined as the 20 day volume weighted average price of Shares up to and including the trading day immediately prior to the date of issue (that is, the 20 most recent trading days on the ASX). The issue of the 5,180,000 restricted fully paid ordinary shares at $2.99 created loans to Directors and staff under the LFSP of $15,488,200.

The 5,180,000 restricted fully paid ordinary shares were issued under the LFSP on 20 June 2018 as follows:

	Number of Shares	Fair Value at grant date
Directors and KMP's		
Mr Fred Bart	200,000	$55,790
Dr Ben Greene	2,000,000	$557,900
Mr Ian Dennis	200,000	$55,790
Lt Gen Peter Leahy AC	200,000	$55,790
Air Marshal Geoff Brown AO	200,000	$55,790
The Hon Kate Lundy	200,000	$55,790
Dr Craig Smith	250,000	$69,738
Mr Scott Lamond	250,000	$69,738
Mr Grant Sanderson	250,000	$69,738
Mr Peter Short	250,000	$69,738
	4,000,000	$1,115,800
Selected Employees	1,800,000	$329,161
	5,180,000	$1,444,961

16. Loan Funded Share Plan (cont)

The Shares issued to Directors and selected employees will be subject to both ‘Vesting Conditions’ and ‘Forfeiture Conditions’. The vesting conditions are split into two different tranches which are outlined in the table below. Directors and selected employees will be required to satisfy the Vesting Conditions in order for their Shares to vest. While Directors and selected employees hold their Shares, they will be subject to Forfeiture Conditions and Directors will forfeit their Shares if either they fail to satisfy the Vesting Conditions or they cease to be employed or continue to provide services to EOS or a Group company in certain circumstances.

Once the Vesting Conditions have been satisfied, removed or lifted, the Shares become vested and Directors and selected employees may deal with them in accordance with the rules of the LFSP subject to sale restrictions and other legal restrictions (such as under the Company’s trading policy).

The Shares will vest at the end of each ‘Vesting Period’ in the manner set out in the tables below, provided that the following conditions are met:

(a) Directors and selected continue to provide services to EOS on each of the vesting dates (or such other date on which the Board makes a determination as to whether the Vesting Condition has been met); and

(b) the performance hurdles set out below are satisfied, which relate to the Company’s earnings before income tax (EBIT) and the Company’s share price. Notably, EBIT and share price hurdles must both be achieved in order for Shares to vest under each Tranche.

To the extent Shares vest, they will be subject to sale restrictions for 6, 9, 12 and 15 months respectively as outlined in the tables.

TRANCHE A (applies to 50% of the total number of Shares to be issued to Directors)		
Measures and hurdles		**Vested Shares can be sold after:**
(i) EBIT of $5m for 12 months ending 31 December 2018; <u>and</u> (ii) a Share Price Hurdle of $4.50 by 31 December 2019 (this hurdle must be reached on at least 30 trading days, not necessarily consecutive, by 31 December 2019)		30 June 2020 (25% of Vested Shares)
		30 September 2020 (50% of Vested Shares)
		31 December 2020 (75% of Vested Shares)
		31 March 2021 (100% of Vested Shares)

16. Loan Funded Share Plan (cont)

TRANCHE B (applies to 50% of the total number of Shares to be issued to Directors)		
Measures and hurdles		**Vested Shares can be sold after:**
(i) EBIT of $15m for 12 months ending 31 December 2019; and (ii) a Share Price Hurdle of $7.50 by 31 December 2021 (this hurdle must be reached on at least 30 trading days, not necessarily consecutive, by 31 December 2021)		30 June 2022 (25% of Vested Shares)
		30 September 2022 (50% of Vested Shares)
		31 December 2022 (75% of Vested Shares)
		31 March 2023 (100% of Vested Shares)

Over and above the above conditions, KMP and employees who work for Space and Defence Systems have to meet the additional hurdles summarised below:

Tranche A

i) Defence Systems profit exceeds A$8m for 2018 and A$20m for 2019;
ii) Space Systems loss does not exceed A$3m for 2018 and A$2m for 2019;
iii) Defence Systems production exceeds 275 units for 2018 and 480 units for 2019.

Tranche B

i) Defence Systems profit exceeds A$20m for 2020;
ii) Space Systems profit exceeds $1M for 2020 and $3M for 2021;
iii) Defence Systems production exceeds 480 units or 2020.

If the above Vesting Conditions are not satisfied, or if the Board determines that they cannot be satisfied, Directors and selected employees will forfeit their unvested Shares (unless the Board exercises its discretion to permit those Shares to vest in accordance with the terms of the LFSP).

The 5,180,000 ordinary restricted fully paid shares issued on 20 June 2018 were valued using the Monte Carlo Simulation method model as the shares have a share price hurdle in the vesting conditions. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, vesting restrictions and behavioural conditions. Expected volatility is based on the historical share price volatility.

16. Loan Funded Share Plan (cont)

The following inputs were used in the model for the option grants made on 20 June 2018:

Dividend yield	-
Expected volatility (linearly interpolated)	30.00%
Risk free interest rate	2.32%
Expected life of options	1,745 days
Grant date share price	$2.91
Issue price	$2.99

Other features of the LFSP structure

Shares are held in an employee share trust, on behalf of Participants, until all Vesting Conditions are satisfied in accordance with their terms of issue and the Loan relating to the Shares is repaid in full.

If the Company pays dividends or make capital distributions, the after-tax value of any dividends paid or distributions made to a Participant will be applied to repay the Loan. The balance (i.e., the estimated value of the tax payable by the Participant on the dividend or distribution) is paid to the Participant to allow them to fund their tax liability on the dividend or distribution.

At the end of the period for the Vesting Conditions and subject to continuous employment or engagement of services with the Company, the Participants are able to dispose of their Shares on repayment of any outstanding Loan balance. However, the Board may impose sale restrictions on the Shares for a period of time after vesting.

All unvested Shares will automatically vest in the event of a change in control of the Company.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

	Consolidated 31 December 2018 $	31 December 2017 $
17. Reserves		
Foreign currency translation	(1,399,064)	(241,137)
Employee equity-settled benefits	9,871,855	9,586,065
	8,472,791	9,344,928
Foreign currency translation		
Balance at beginning of financial year	(241,137)	(604,840)
Translation of foreign operations	(1,157,927)	363,703
Balance at end of financial year	(1,399,064)	(241,137)

Exchange differences relating to the translation from US dollars, being the functional currency of the consolidated entity's foreign controlled entities in the USA, Euros, being the functional currency of the consolidated entity's foreign controlled entity in Germany, Singaporean dollars, being the functional currency of the consolidated entity's foreign controlled entity in Singapore and Dirham being the functional currency in the United Arab Emirates, into Australian dollars are brought to account by entries made directly to the foreign currency translation reserve. Exchange differences previously accumulated in the foreign currency translation reserve (in respect to translating the net assets of foreign operations) are reclassified to profit or loss on disposal of the foreign operation.

Employee equity-settled benefits		
Balance at beginning of financial year	9,586,065	8,984,721
Share based payment	285,790	601,344
Balance at end of financial year	9,871,855	9,586,065

The employee equity-settled benefits reserve arises on the grant of share options to directors and executives under the Employee Share Option Plan and Loan Funded Share Plan. Further information about share-based payments to employees is made in Note 15 to the financial statements. Items included in employee equity-settled benefits reserve will not be reclassified subsequently to profit or loss.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

18. Accumulated Losses

	Consolidated 31 December 2018 $	31 December 2017 $
Balance at beginning of financial year	(89,116,379)	(79,716,449)
Net profit/ (loss) attributable to members of the parent entity	15,302,214	(9,399,930)
Balance at end of financial year	(73,814,165)	(89,116,379)

19. Notes to the Cash Flow Statement

(a) Reconciliation of Cash and cash equivalents

For the purposes of the statement of cash flows, cash includes cash on hand and at call deposits with banks or financial institutions, investments in money market instruments maturing within less than two months and net of bank overdrafts. Cash at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:

	31 December 2018 $	31 December 2017 $
Cash and cash equivalents - current	40,538,225	9,989,953

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

	Consolidated 31 December 2018 $	31 December 2017 $
19. Notes to the Cash Flow Statement (Cont)		
(b) Restricted cash		
Cash held as security for performance bonds and leases	119,025	119,025
(c) Reconciliation of profit/ (loss) for the year to net cash flows from operating activities		
Profit/ (Loss) for the year	15,081,372	(9,399,930)
Loss on disposal of fixed assets	-	2,007
Equity settled share-based payments	285,790	601,344
Depreciation of fixed assets	633,235	193,325
Foreign exchange movements	(1,110,411)	116,640
(Increase)/decrease in assets		
Current receivables	(21,694,865)	(8,466,311)
Inventories	(12,669,925)	(10,316,578)
Other current assets	(4,763,962)	(9,683,641)
Increase/(decrease) in liabilities		
Provisions	4,308,025	95,662
Trade and other payables	5,998,330	4,693,161
Deferred income and amounts due to customers under construction contracts	(1,753,791)	6,214,628
Net cash (outflows) from operating activities	(15,686,202)	(25,949,693)

20. Related party disclosures

(a) Equity interests in related parties

Details of the percentage of ordinary shares held in subsidiaries are disclosed in Note 21.

(b) Key management personnel compensation

The aggregate compensation of the key management personnel of the consolidated entity is set out below:

	31 December 2018 $	31 December 2017 $
Short term benefits	1,728,877	1,394,589
Post-employment benefits	143,506	108,666
Share based payments	211,905	462,656
Long term benefits	474,953	67,973
	2,559,241	2,033,884

20. Related party disclosures (cont)

(c) Transactions with other related parties

Other related parties includes:
- the parent entity;
- entities with significant influence over the consolidated entity; and
- subsidiaries.

(d) Other transactions with key management personnel

During the year, the Company paid a total of $76,814 (2017: $66,795) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of directors fees and superannuation for Fred Bart.

During the year, the Company paid $47,222 (2017: $41,063) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of directors fees and superannuation for Ian Dennis.

During the year, the Company paid $47,222 (2017: $41,063) to GCB Stratos Consulting Pty Limited, a company associated with Mr Geoff Brown in respect of directors fees and superannuation for Geoff Brown.

During the year, the Company paid $120,000 (2017: $120,000) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of consulting fees for company secretarial and accounting services.

During the year, the Company paid $28,441 (2017: $22,955) to Audio Pixels Holdings Limited, a company of which Fred Bart and Ian Dennis are directors and shareholders in respect of shared Sydney office facilities.

(e) Parent entity

The parent entity in the consolidated group is Electro Optic Systems Holdings Limited.

21. Controlled Entities

Name of Entity	Country of Incorp-oration	December 2018 %	December 2017 %
Parent Entity			
Electro Optic Systems Holdings Limited (i), (ii)	Australia		
Controlled Entities			
Electro Optic Systems Pty Limited (ii), (iii)	Australia	100	100
EOS Defence Systems Pty Limited (formerly Fire Control Systems Pty Limited) (ii), (iii)	Australia	100	100
FCS Technology Holdings Pty Limited (ii)	Australia	100	100
EOS Space Systems Pty Limited (ii)	Australia	100	100
EOS UAE Holdings Pty Limited (ii)	Australia	100	100
EOS Advanced Technologies LLC (iv)	UAE	49	-
EOS Optronics GmbH	Germany	100	100
EOS Defense Systems Pte Limited	Singapore	100	100
EOS USA, Inc. (Inc in Nevada)	USA	100	100
EOS Technologies, Inc. (Inc in Arizona)	USA	100	100
EOS Defense Systems, Inc (Inc in Arizona)	USA	100	100
EOD Defense Systems USA Inc (Inc in Alabama)	USA	100	-

(i) Electro Optic Systems Holdings Limited is the head entity within the tax-consolidated group.

(ii) These companies form part of the Australian consolidated tax entity.

(iii) These wholly owned subsidiaries have entered into a deed of cross guarantee with Electro Optic Systems Holdings Limited pursuant to *ASIC Corporations (Wholly-owned Companies) Instrument 2016/875* and are relieved from the requirement to prepare and lodge an audited financial report.

On 29 March 2018, the parent entity, Electro Optic Systems Holdings Limited entered into a deed of cross guarantee with two of its Australian wholly-owned subsidiaries Electro Optic Systems Pty Limited and EOS Defence Systems Pty Limited.

21. Controlled Entities (cont)

(iv) Whilst the Group owns less than 50% of the shares, pursuant to the shareholder and related agreements, it has existing rights that give it the ability to direct the relevant activities of the company and is entitled to 80% of company distributions.

Deloitte Touche Tohmatsu is the auditor of the Group. EOS Defense Systems Pte Limited is the only entity with a separately appointed statutory auditor.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

21(b) Consolidated income statement, consolidated statement of financial position and movements in consolidated retained earnings of entities party to the deed of cross guarantee

The consolidated income statement of the entities which are parties to the deed of cross guarantee are:

	31 December 2018 $
Revenue	85,444,179
Changes in inventories of work in progress	(2,842,202)
Raw materials and consumables used	(39,709,340)
Employee benefits expense	(16,461,267)
Administration expenses	(8,352,985)
Finance costs	(29,472)
Depreciation and amortisation of property, plant and equipment	(600,082)
Foreign exchange gains	7,708,137
Occupancy costs	(945,491)
Other expenses	(943,862)
Provision for loss on loans to subsidiaries	(11,822,666)
Profit before income tax benefit	11,444,949
Income tax benefit	-
Profit for the year	11,444,949

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

21(b) Consolidated income statement, consolidated statement of financial position and movements in consolidated retained earnings of entities party to the deed of cross guarantee (cont)

The consolidated statement of financial position of the entities which are parties to the deed of cross guarantee are:

	Consolidated December 2018 $
CURRENT ASSETS	
Cash and cash equivalents	37,938,141
Trade and other receivables	26,326,301
Inventories	25,213,232
Other	11,448,915
TOTAL CURRENT ASSETS	100,926,589
NON-CURRENT ASSETS	
Security deposit	8,971,929
Property, plant and equipment	3,792,113
Other	9,399,167
TOTAL NON-CURRENT ASSETS	22,163,209
TOTAL ASSETS	123,089,798
CURRENT LIABILITIES	
Trade and other payables	16,855,009
Provisions	4,099,587
TOTAL CURRENT LIABILITIES	20,954,596
NON-CURRENT LIABILITIES	
Provisions	3,849,314
TOTAL NON-CURRENT LIABILITIES	3,849,314
TOTAL LIABILITIES	24,803,910
NET ASSETS	98,285,888
EQUITY	
Issued capital	161,784,727
Reserves	9,871,855
Accumulated losses	(73,370,694)
TOTAL EQUITY	98,285,888

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

21(b) Consolidated income statement, consolidated statement of financial position and movements in consolidated retained earnings of entities party to the deed of cross guarantee (cont)

The consolidated retained earnings/(accumulated losses) of the entities which are party to the deed of cross guarantee are:

	31 December 2018 $
Balance at the start of the year	(84,815,643)
Add	
Net profit for the year	11,444,949
Balance at end of the year	(73,370,694)

22. Joint Operations

The group is party to a joint operation. The group has a share in the operation based on capital contributions that entitles it to a proportionate share of revenue earnt from the operation.

The operation is not yet active.

23. Contingent Liabilities

Entities within the consolidated entity are involved in contractual disputes in the normal course of contracting operations. The directors believe that the entities within the consolidated entity can settle any contractual disputes with customers and should any customers commence legal proceedings against the company, the directors believe that any actions can be successfully defended. As at the date of this report no legal proceedings have been commenced against any entity within the group.

Under the terms of a contract in the Defence sector, the Company has an obligation to enter into and execute an offset agreement with the overseas Government Authority. Once the agreement is executed, the Company will be required to lodge an offset bond of approximately US$16m with the overseas Government Authority to ensure that local content requirements are met. The final terms of the offset bond are still being negotiated.

	Consolidated	
	31 December 2018 $	31 December 2017 $

24. Commitments

(a) Capital commitments and guarantees

On 14 July 2015, the parent entity provided a guarantee to the Commonwealth of Australia for $2,750,000 in respect of advance payments received of $3,950,000 GST inclusive in relation to a space sector project.

During the year, the Group provided a performance bond in respect of a contract in the Defence sector for US$31,635,147. The performance bond was provided by Efic under a Bond Facility Agreement and is secured by a cash security deposit of A$8,791,929.

(b) Operating lease commitments

	31 December 2018 $	31 December 2017 $
Non-cancellable operating leases contracted for but not recognised in the financial statements:		
Payable:		
not later than one year	1,882,845	629,070
later than one year and not later than five years	4,145,792	946,009
later than five years	-	-
	6,028,637	1,575,079

24. Commitments (cont)

Operating Leases

Leasing arrangements - Operating leases relate to:

Premises at 2500 N. Tucson Boulevard, Suite 100, Tucson Arizona with a lease term which expires on 30 April 2019. There is an option to renew on a monthly basis after 30 April 2019. There is no option to purchase the property.

Premises at 2112 N. Dragoon, Units 6 and 18, Tucson Arizona are subject to an expired lease. The company occupies the property on a month to month basis and there is no make good requirement.

Premises in Queanbeyan, Australia for a 5 year period to 31 December 2008 with a 5 year option. The Company has the first right of refusal in respect of the purchase of the property. The Company is on a month to month basis whilst a new lease is negotiated.

Premises at 46 Bayldon Road, Queanbeyan with a lease term which expired on 2 August 2016. The company occupies the property on a month to month basis. There is no make good provision or option to purchase the property.

Premises at 90 Sheppard Street, Hume, ACT for a period to 31 March 2021. There is no option to purchase this property. There is a make good provision in the lease, however EOS has made significant improvements to the property which will reduce any make good costs.

Shared premises in Sydney which are on a month to month arrangement with Audio Pixels Holdings Limited, a company associated with directors Mr Fred Bart and Mr Ian Dennis.

The Commonwealth and EOS Space Systems Pty Limited (EOS) have entered into a Services Agreement (executed 10 June 2015) to provide Space Situational Awareness (SSA) Tracking Data to the Commonwealth. In addition to the Services Agreement the Commonwealth and EOS have also entered into a Lease Agreement for Defence property in Learmonth WA on which EOS is permitted to build SSA Tracking Infrastructure in order to deliver SSA Tracking Services. The term of the lease is for ten years from 26 November 2015 at an annual rental of $1 per annum.

Premises at 2865 Wall Triana Highway, Huntsville, Alabama for a period to 28 February 2023. The company has an option to purchase the property for US$6.5m prior to the expiry of the lease.

On 1 October 2018 the Company entered into a lease of premises at Tawazun Industrial Park, Al Ajban , Abu Dhabi, United Arab Emirates for a period of 1 year.

25. Subsequent Events

The Directors are not aware of any significant subsequent events since the end of the financial period and up to the date of this report.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

26. Financial risk management objectives and policies

The Group's principal financial instruments comprise receivables, payables, borrowings, finance leases, cash and short term deposits.

Due to the small size of the group significant risk management decisions are taken by the board of directors. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

The Group does not use derivative financial instruments to hedge these risk exposures.

The directors consider that the carrying amount of financial assets and liabilities recognised in these financial statements approximate their fair values.

Risk Exposures and Responses

(a) Interest rate risk

The Group's exposure to market interest rates relates primarily to the Group's cash holdings.

At balance date, the Group had the following mix of financial assets and liabilities exposed to interest rate risk that are not designated in cash flow hedges:

	Consolidated	
	2018	2017
	$	$
Financial assets		
Cash and cash equivalents	40,538,225	9,989,953
Security deposit	8,971,929	-
	49,510,154	9,989,953

The Group constantly analyses its interest rate exposure. Within this analysis consideration is given to potential renewals of existing positions, alternative financing and the mix of fixed and variable interest rates.

26. Financial risk management objectives and policies (cont)

At 31 December 2018, if interest rates had moved, as illustrated in the table below, with all other variables held constant, post tax (loss) and equity would have been affected as follows:

Judgements of reasonably possible movements	Post Tax (Loss) Higher/(Lower)		Equity Higher/(Lower)	
	2018 $	2017 $	2018 $	2017 $
Consolidated				
+1% (100 basis points)	495,116	99,900	495,116	99,900
-.5% (50 basis points)	(247,588)	(49,950)	(247,588)	(49,950)

The movements in profits are due to lower interest rates on cash balances. The cash balances were higher in 2018 than in 2017 and accordingly the sensitivity is higher.

(b) Foreign currency risk

As a result of purchases of inventory denominated in United States Dollars, the Group’s statement of financial position can be affected significantly by movements in the US$/A$ exchange rates. Exchange rates are managed within approved policy parameters using natural hedges and no derivatives are used.

The Group also has transactional currency exposures. Such exposures arise from sales or purchases by an operating entity in currencies other than the functional currency.

The policy of the Group is to convert surplus foreign currencies to Australian dollars. The group also holds cash deposits in US dollars to secure US dollar bank guarantees and performance bonds to overseas customers.

26. Financial risk management objectives and policies (cont)

At 31 December 2018, the Group had the following exposure to US$ foreign currency:

	Consolidated 2018 $	Consolidated 2017 $
Financial assets		
Cash and cash equivalents	3,642,504	571,773
Security deposit	8,971,929	-
Trade and other receivables	40,562,230	10,367,157
	53,176,663	10,938,930
Financial liabilities		
Trade and other payables	2,168,101	730,696
Net exposure	51,008,562	10,208,234

All US$ denominated financial instruments were translated to A$ at 31 December 2018 at the exchange rate of 0.7052 (2017: 0.7805).

At 31 December 2018 and 2017, had the Australian Dollar moved, as illustrated in the table below, with all other variables held constant, post tax profit and equity would have been affected as follows:

Judgements of reasonably possible movements	Post Tax Profit Higher/(Lower)		Equity Higher/(Lower)	
	2018 $	2017 $	2018 $	2017 $
Consolidated				
AUD/USD +10%	(4,267,142)	(928,021)	(4,267,142)	(928,021)
AUD/USD -5%	2,684,661	537,275	2,684,661	537,275

26. Financial risk management objectives and policies (cont)

Management believes the balance date risk exposures are representative of risk exposure inherent in financial instruments.

As noted, foreign currency transactions entered into during the financial year are managed within approved policy parameters using natural hedges. The director's do not consider that the net exposure to foreign currency transactions is material after considering the effect of natural hedges.

(c) Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in a financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties which are continuously monitored.

The credit risk on liquid funds is limited because the counterparties are banks with high credit-ratings assigned by international credit agencies.

(d) Liquidity risk management

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due.

Ultimate responsibility for liquidity risk management rests with the board of directors, who has built an appropriate risk management framework for the management of the Group's short, medium and long term funding and liquidity requirements. The Group manages liquidity by maintaining adequate cash reserves by continuously monitoring forecast and actual cash flows and managing maturity profiles of financial assets.

Liquidity and interest tables

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

26. Financial risk management objectives and policies (cont)

(d) Liquidity risk management (cont)

Consolidated	Weighted average effective interest rate %	Less than 1 month $	1-3 months $	3 months to 1 year $	1-5 years $
2018					
Other non-interest bearing liabilities	-	6,678,795	-	-	-
2017					
Other non-interest bearing liabilities	-	7,724,391	-	-	-

The following tables detail the Group's remaining contractual maturity for its non-derivative financial assets. The tables have been drawn up based on the undiscounted contractual maturities of the financial assets including interest that will be earned on these assets except where the Company/Group anticipates that the cash flow will occur in a different period.

Consolidated	Weighted average effective interest rate %	Less than 1 month $	1-3 months $	3 months to 1 year $	1-5 years $
2018					
Non-interest bearing	-	12,168,586	-	-	-
Receivables	-	26,248,171	-	-	7,146,990
Fixed interest rate instruments	1.56	9,001,059	28,427,519	-	-
		47,417,816	28,427,519	-	7,146,990
2017					
Non-interest bearing	-	641,004	-	-	-
Receivables	-	12,035,434	-	-	-
Fixed interest rate instruments	1.78	9,345,768	-	17,050	-
		22,022,206	-	17,050	-

26. Financial risk management objectives and policies (cont)

(e) Price risk

The Group's exposure to commodity price risk is minimal. The Group does not make investments in equity securities.

27. Segment Information

AASB 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess performance.

The identification of the Group's reportable segments has not changed from those disclosed in the previous 2017 Annual Report. The Group's reportable segments are Defence Systems and Space.

The consolidated entity operates in Australia, USA, Singapore and Germany in the development, manufacture and sale of telescopes and dome enclosures, laser satellite tracking systems and the manufacture of electro-optic fire control systems.

Product and Services within each Segment

Space

EOS's laser-based space surveillance systems have been demonstrated in customer trials and EOS is now well-placed to be a major contributor to the next generation of space tracking capability. Future business is dependent on large government contracts being awarded in the space sector.

In addition, EOS has substantial space resources in its own right, and may enter the market for space data provision in the future.

The space sector also manufactures and sells telescopes and dome enclosures for space projects.

Defence Systems

EOS develops, manufactures and markets advanced fire control, surveillance, and weapon systems to approved military customers. These products either replace or reduce the role of a human operator for a wide range of existing and future weapon systems in the US, Australasia, Middle East and other markets.

27. Segment Information (Cont)

Segment Revenues

	Consolidated	
	31 December 2018 $	31 December 2017 $
Space	1,379,421	3,472,975
Defence systems	84,960,317	19,591,931
Total of all segments	86,339,738	23,064,906
Unallocated interest received	790,658	194,888
Total	87,130,396	23,259,794

Segment Results

Space	(2,153,278)	(2,893,122)
Defence systems	17,766,199	(5,701,590)
Total of all segments	15,612,921	(8,594,712)
Unallocated holding company costs	(531,549)	(805,218)
Profit/ (Loss) before income tax expense	15,081,372	(9,399,930)
Income tax benefit	-	-
Profit/ (Loss) for the year	15,081,372	(9,399,930)

The revenue reported above represents revenue from external customers. There were no intersegment sales during the period. There were no discontinued operations during the period. The consolidated entity had one customer who provided in excess of 10% of consolidated revenue. The customer is within the Defence segment and provided combined revenue of $68,847,875.

27. Segment Information (cont)

Segment Assets and Liabilities

	Assets		Liabilities	
	31 December 2018 $	31 December 2017 $	31 December 2018 $	31 December 2017 $
Space	726,984	552,047	5,504,682	6,189,379
Defence systems	78,632,004	37,063,614	27,082,876	17,845,565
Total all segments	79,358,988	37,615,661	32,587,558	24,034,944
Unallocated cash and security deposit	49,510,154	9,989,953	-	-
Consolidated	128,869,142	47,605,614	32,587,558	24,034,944

Assets used jointly by reportable segments are allocated on the basis of the revenue earned by the individual reportable segments.

Other Segment Information

	Depreciation, impairment and amortization of segment assets		Acquisition of segment assets	
	31 December 2018 $	31 December 2017 $	31 December 2018 $	31 December 2017 $
Space	18,935	23,353	30,551	41,422
Defence systems	527,787	136,371	3,158,912	1,099,525
Total all segments	546,722	159,724	3,188,913	1,140,947
Unallocated management	86,513	33,601	-	-
Consolidated	633,235	193,325	3,188,913	1,140,947

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

27. Segment Information (cont)

Information on Geographical Segments

31 December 2018

Geographical Segments	Revenue from External Customers $	Segment Assets $	Acquisition of Segment Assets $
Australasia	87,130,166	124,104,603	3,043,380
Middle East	-	582,556	114.982
North America	-	4,178,267	30,551
Germany	230	3,716	-
Total	87,130,396	128,869,142	3,188,913

31 December 2017

Geographical Segments	Revenue from External Customers $	Segment Assets $	Acquisition of Segment Assets $
Australasia	23,258,706	46,484,717	1,140,075
North America	-	1,116,897	-
Germany	1,088	4,000	872
Total	23,259,794	47,605,614	1,140,947

28. Construction Contracts

	Consolidated 31 December 2018 $	Consolidated 31 December 2017 $
Construction work in progress	-	24,716,854
Less		
Provision for losses		-
Progress billings	-	(24,768,155)
	-	(51,301)
Recognised and included in the financial statements as amounts due:		
From customers under construction contracts:		
Current (note 5)	-	7,613
To customers under construction contracts:		
Current (note 10)	-	(58,914)
	-	(51,301)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018 (cont)

29. **Parent entity disclosure**

	31 December 2018 $	31 December 2017 $
Financial position		
Assets		
Current assets	33,973,209	7,403,521
Non-current assets	-	-
Total assets	33,973,209	7,403,521
Liabilities		
Current liabilities	95,790	70,698
Non-current liabilities	-	-
Total liabilities	95,790	70,698
Net assets	33,877,419	7,332,823
Equity		
Issued capital	161,784,727	103,342,071
Reserves	9,871,855	9,141,068
(Accumulated losses)	(137,779,163)	(105,150,316)
Total equity	33,877,419	7,332,823
Financial performance		
(Loss) for the period	(32,628,847)	(25,410,783)
Other comprehensive income	-	-
	(32,628,847)	(25,410,783)

Guarantees entered into by the parent entity in relation to the debts of its subsidiaries

Guarantee provided under the deed of cross guarantee (i)	24,708,119	-

(i) Electro Optic Systems Holdings Limited has entered into a deed of cross guarantee on 29 March 2018 with two of its wholly owned subsidiaries. Electro Optic Systems Pty Limited and EOS Defence Systems Pty Limited

30. Additional Company Information

Electro Optic Systems Holdings Limited is a listed public company in Australia, incorporated in Australia. The company and its subsidiaries operate in Australia, North America, Middle East, Singapore and Germany.

Registered Office

Suite 3, Level 12
75 Elizabeth Street
Sydney NSW 2000
Australia
Tel: 02 9233 3915
Fax: 02 9232 3411

Principal Place of Business

90 Sheppard Street
Hume
ACT 2620
Australia
Tel: 02 6222 7900
Fax: 02 6299 7687

USA Operations Tucson

2500 N. Tucson Boulevard
Suite 114
Tucson, Arizona 85716
USA
Tel: +1 (520) 624 6399
Fax: +1 (520) 624 1906

German Operations

Ulrichsberger Str. 17
D-94469 Deggendorf
Germany
Tel: +49 991 3719 1883
Fax: +49 991 3719 1884

USA Operations Alabama

2865
Wall Triana Hwy SW
Huntsville
AL 35824 USA

Singapore Operations

4 Shenton Way #28-01
SGX Centre II
Singapore 068807

Tel: +65 6224 0100
Fax: +65 6227 6002

United Arab Emirates Operations

Tawazun Industrial Park (TIP)
Zone 2, Hangar 5,
Al Ajban Area,
Abu Dhabi,
UAE
Tel: +971 2 492 7112
Fax: +971 2 492 7110

ASX ADDITIONAL INFORMATION

Additional information required by the Australian Stock Exchange Listing Rules and not disclosed elsewhere in this report.

HOME EXCHANGE

The Company's ordinary shares are quoted on the Australian Stock Exchange Limited under the trading symbol "EOS". The Home Exchange is Sydney.

SUBSTANTIAL SHAREHOLDERS

At 7 March 2019 the following substantial shareholders were registered:

	Ordinary Shares	**Percentage of total Ordinary shares**
Fred Bart Group	5,319,506	5.54%
Industry Super Holdings Pty Limited	6,402,783	6.66%
Northrop Grumman Space and Mission Systems Corp.	5,000,000	5.20%

VOTING RIGHTS

At 7 March 2019 there were 3,130 holders of fully paid ordinary shares.

Rule 74 of the Company's Constitution stipulates the voting rights of members as follows:

"Subject to any rights or restrictions for the time being attached to any class or classes of shares and to this Constitution:

(a) on a show of hands every person present in the capacity of a Member or a proxy, attorney or representative (or in more than one of these capacities) has one vote; and

ASX ADDITIONAL INFORMATION (Cont)

(b) On a poll every person present who is a Member or proxy, attorney or Representative has member present has:

(i) For each fully paid share that the person holds or represents – one vote; and

(ii) For each share other than a fully paid share that the person holds or represents – that proportion of one vote that the amount paid (not credited) on the shares bears to the total amount paid and payable on the share (excluding amounts credited)."

OTHER INFORMATION

In accordance with Listing Rule 4.10.19, the Company has used the cash and assets in a form readily convertible to cash that it had at the time of admission in a way consistent with its business objectives.

The Company has a sponsored Level 1 American Depositary Receipt (ADR) program on the Over-The-Counter (OTC) market in the USA with the ADR ticker symbol of EOPSY. The ration of ADR's to Ordinary shares is 1:5 and the CUSIP Number is 28520B1070. The local custodian is National Australia Bank Limited and the US Depositary Bank is BNY Mellon.

DISTRIBUTION OF SHAREHOLDINGS

At 7 March 2019 the distribution of shareholdings were:

Range	Ordinary Shareholders	Number of Shares
1-1,000	1,201	628,053
1,001 – 5,000	1,115	2,750,230
5,001 – 10,000	314	2,506,630
10,001 – 100,000	408	12,803,100
100,001 and over	92	77,415,866
	3,130	96,103,879

There were 145 ordinary shareholders with less than a marketable parcel.

There is no current on-market buy-back.

TWENTY LARGEST ORDINARY SHAREHOLDERS

At 7 March 2019 the 20 largest ordinary shareholders held 60.61% of the total issued fully paid quoted ordinary shares of 96,103,879.

Shareholder	Fully Paid Ordinary Shares	Percentage of Total
1. Citicorp Nominees Pty Limited	9,149,269	9.52%
2. JP Morgan Nominees Australia Limited	6,833,905	7.12%
3. Electro Optic Systems Holdings Limited <Share Plan A/C>	5,180,000	5.39%
4. HSBC Custody Nominees (Australia) Limited	4,352,935	4.53%
5. N & J Properties Pty Limited	4,090,000	4.26%
6. Washington H. Soul Pattinson and Company	3,816,207	3.97%
7. HSBC Custody Nominees (Australia) Limited A/C 2	3,785,929	3.94%
8. Technology Transformations Pty Limited	2,759,340	2.87%
9. Emichrome Pty Limited	2,603,236	2.71%
10. Link Traders (Aust) Pty Limited	1,939,100	2.02%
11. Warbont Nominees Pty Ltd <Unpaid Entrepot A/C>	1,905,932	1.98%
12. Brazil Farming Pty Ltd	1,704,139	1.77%
13. Capitol Enterprises Limited	1,550,000	1.61%
14. National Nominees Limited	1,460,310	1.52%
15. A & D Wire Limited	1,457,276	1.52%
16. UBS Nominees Pty Ltd	1,447,266	1.51%
17. Technology Investments Pty Limited	1,205,155	1.25%
18. Emichrome Pty Limited <Super Fund A/C>	1,097,450	1.14%
19. Landed Investments NZ Limited	1,010,000	1.05%
20. BNP Paribus Noms Pty Ltd <DRP>	896,800	0.93%
	58,244,249	60.61%