

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED
ACN 092 708 364

FINANCIAL REPORT FOR THE FINANCIAL YEAR ENDED
31 DECEMBER 2019

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 Marshal Geoffrey Brown AO
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
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Auditors

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

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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REVIEW OF OPERATIONS

1. RESULTS FOR FULL-YEAR ENDED 31 DECEMBER 2019

The consolidated entity (“EOS”) reported an operating profit after income tax of \$18,058,758 for the twelve month period to 31 December 2019 [31 December 2018: \$15,081,372] based on revenues from ordinary activities totalling \$165,985,563 [31 December 2018: \$87,130,396].

The consolidated entity reported net cash used by operations for the twelve month period totalling \$33,829,630 [31 December 2018: \$15,686,202]. At 31 December 2019, the consolidated entity held cash totalling \$77,881,766 [31 December 2018: \$40,538,225]. Cash of \$102,025 [31 December 2018: \$119,025] is restricted as it secures bank guarantees on premises.

The profit after tax was based on EBIT of \$22,354,491 and tax expense of \$3,911,516. Foreign exchange movements did not make a substantial contribution to this result.

The full year EBIT of \$22,354,491 [31 December 2018: \$15,118,275] is a substantial improvement over the corresponding prior period and exceeds prior guidance of \$20 million.

These financial results are in line with management expectations. The individual sector performances are further discussed below

2. DEFENCE SYSTEMS SECTOR: STATUS AND OUTLOOK

The EOS Defence sector operated to expectations through 2019. An increase in production plant utilisation to beyond 50% of capacity drove a three-fold increase in overall sector EBIT from \$7.4m to \$22.3m (excluding foreign exchange gains). This sector will again be the driving force behind a forecast 70% growth in EBIT from 2019 to 2020.

From 2016-2019 EOS expanded annual RWS production capacity from \$50 million to around \$300 million. The key factors limiting growth were supply chain limitations and shortages of skilled staff. These factors were progressively overcome and in 2020 annual production will rise to \$250 million, close to current capacity.

This expansion has established scalable production in Australia as a template for replication globally. The Company is currently expanding annual output capacity from \$300 million to \$900 million by adding capacity in the USA (\$300 million), Singapore (\$150 million) and UAE (\$150 million).

This capacity will come on line from mid-2020 at a rate dictated by market demand. All of the new capacity could be available by 2024 if needed.

A key requirement for future competitiveness and profitability is the Company’s global supply chain which allows stable pricing along with offset management and maximising natural currency hedging through flexible supply chain arrangements. The new EOS plants are evolving to serve as hubs for regional supply chain coordination as part of a global supply effort.

EOS now estimates the global RWS market for its current product mix to exceed \$12 billion over the period 2021-2030. This estimate is achieved by discounting the broader RWS market to remove heavy weapons, lower technology requirements, and potential customers not allied with the US or Australia, with a history of corrupt practice or unreliable finances.

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REVIEW OF OPERATIONS (cont)

Applying a similar discounting process results in an estimated \$12 billion addressable market over the same period for the Company's CUAS [counter unmanned aerial system] products.

The total addressable market for EOS Defence sector products is therefore expected to be around \$24 billion over the decade 2021-2030, increasing from around \$1.2 billion in 2021 at a compound annual growth rate of approximately 15%. This market estimate based on discounted industry models is supported by the observation that EOS is presently participating in competitive processes for \$3 billion in contracts (approximately) equally distributed across three continents with awards due over the next 34 months.

EOS is actively positioning product variants and plant capacity to meet the identified market requirements. Because EOS is only addressing a market segment for which its products and practices are reasonably suited, the Company expects its success rate will be around 40% corresponding to the performance previously achieved in this sector in recent years.

The outlook for the Defence Systems business is very strong.

3. SPACE SYSTEMS SECTOR: STATUS AND OUTLOOK

The EOS Space Sector was marginally profitable for 2019, as expected.

Space Sector is undertaking a pivot from Australian space program revenue to direct export sales. This is required because the Commonwealth first delayed and then effectively cancelled the budgeted programs for indigenous space domain activity which EOS had been addressing, with supporting funding from the customer.

Foreign customers which had been expected to coordinate requirements through the Commonwealth programs are now negotiating directly with EOS for access to equipment and data. These activities have government support where required and are expected to provide growing revenue from both products and data services.

One international contract award which had been expected in 2019 was delayed by protests from local competitors in that market. These protests are expected to be overcome by the customer during 2020.

The business model which permits customers to acquire significant quantities of EOS equipment also establishes a firm requirement among those customers for supporting observations from Australian locations. EOS expects to expand its Australian tracking resources in the near term to meet this demand.

The company announced late in 2019 a major technology breakthrough in the control of laser energy in space, for ground-based lasers. This new technology has placed EOS in the forefront of companies competing for market share in the next generation of space communications. This breakthrough provided the underlying competitive advantages allowing EOS to announce the establishment of the new Communications Sector, which will contribute to EOS profits from the near term.

The sector also contributed significant technology and materiel to the Defence Sector CUAS products, and in particular the high power lasers which are used to destroy drones.

The outlook for the EOS Space Sector is improving. As forecast this sector transitioned from loss to profit in 2019 and the sector is expected to be profitable going forward.

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REVIEW OF OPERATIONS (cont)

4. EOS COMMUNICATION SYSTEMS: STATUS AND OUTLOOK

The space economy is valued at \$550 billion annually with communication services, excluding broadcast, comprising around \$100 billion. Future capacity requirements for space communications cannot be met using existing technology, because the microwave spectrum is saturated and no more operating licenses can be issued by the ITU (International Telecommunications Union).

EOS has invested substantial resources to develop key elements for the next generation of space communications. In September 2019 EOS announced it had achieved a breakthrough in the transmission of data to and from satellites using lasers, opening the way to 1,000-fold increases in capacity.

This breakthrough is of limited commercial value as the \$100 billion space communication market is entirely dependent on infrastructure to support microwave technology. This infrastructure, with almost \$1 trillion in sunk costs if customer equipment is included, is not compatible with optical communication technology and therefore forms an almost-impenetrable barrier to market entry.

EOS intends to enter this market by offering novel technologies in the microwave domain, to leverage the existing infrastructure, before progressively offering hybrid (optical-microwave) capabilities and finally optical communications.

On 1 October 2019 EOS announced it had acquired EM Solutions, an Australian company specialising in high performance ground terminals and antennae for microwave communications. This acquisition is closed and is already profitable.

On 28 January 2020 EOS announced it will purchase assets of Audacy Corporation, a US entity specialising in the operation of constellations of microwave communication satellites, subject to the approval of the US Federal Communications Commission (FCC) and Committee on Foreign Investment in the US (CFIUS). FCC granted its consent to the transfer of 5 March 2020.

EOS has filed for approval of the US purchase with CFIUS on 9 March 2020. Approval from both of these US government entities is required before that purchase can close.

Upon closing of the US asset purchase, EOS will have all of the ground segment and space segment elements necessary to provide space communication customers with end-to-end cost-effective communication solutions using microwave technology. EOS intends to expand this market channel to delivery increasingly larger capacity through hybrid and later optical communications using satellites.

The outlook for the EOS Communications Sector is good, and provided both US government approvals are obtained for the US purchase.

5. FORECAST

EOS' fundamental objective is still reliable long term profit growth.

Relying only on contracts already in hand, the company expects EBIT to grow around 75% to exceed \$36 million for the full year to 31 December 2020. This guidance is unchanged since it was last upgraded by the Company in November 2019.

The 2020 guidance is based on the company achieving 75% growth in output to around \$275 million in revenue across all three business sectors. Capacity has been successfully tested at the levels required for this forecast.

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REVIEW OF OPERATIONS (cont)

The Company believes that new orders, particularly in the defence sector, will be received during 2020 and beyond. However there is limited scope to increase output before Q4 2020 because the current forecast of 70-75% growth will consume most available resources.

EOS revenue is predominantly derived from contracts denominated in US\$. Forecasts assume no substantial 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.

6. SUBSEQUENT EVENTS

Subsequent to the end of the financial year there have been considerable economic impacts in Australia and globally arising from the outbreak of COVID-19 virus and the respective Government actions to reduce the spread of the virus.

As this economic impact occurred after the reporting period, the Consolidated entity believes it constitutes a “Non-Adjusting Subsequent Event” as defined in AASB 110 Events after the Reporting Period.

- In March 2020, the consolidated entity implemented its Business Continuity Plan where most staff not directly involved in production will work from home to limit the potential spread of the virus and to enable the consolidated entity to continue to operate and serve our customers.
- The initial impacts on Consolidated entity’s operations have been limited by a very strong inventory of production parts, and the fact that almost all EOS debtors are ultimately sovereign entities. The Consolidated entity’s early adoption of virus-impeding practices may mitigate future impacts on business operations.
- The Consolidated entity will continue to monitor the impact of COVID-19 on the business as a whole including any impact on the supply chain, production capacity, logistic operations including product delivery, and collection of receivables. Therefore, at the date of signing the financial report the Consolidated entity is unable to determine what financial effects the outbreak of the virus could have on the Consolidated entity in the coming financial period.

Ben Greene
Chief Executive Officer

31 March 2020

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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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 2019. 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 65). 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. Appointed to the Board on 8 May 2000 (Length of service – 19 years).
Dr Ben Greene	BE (Hons), Phd in Applied Physics (Age 69) is the Chief Executive Officer of Electro Optic Systems. Dr Greene was involved in the formation of Electro Optic Systems Pty Limited. 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 (Length of service - 17 years). He is a member of the Nominations and Remuneration Committee.
Ian Dennis	BA, C.A. (Age 62) 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 (Length of service – 19 years). He is also director and company secretary of Audio Pixels Holdings Limited. He is a member of the Audit and Risk Committee and the Nominations and Remuneration Committee. He is also company secretary of Electro Optic Systems Holdings Limited.

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DIRECTORS' REPORT (cont)

Lt Gen Peter Leahy AC Non-executive director (Age 67). Appointed to the Board on 4 May 2009 (Length of service 10 years). 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, the Australian International Military Games, which brought the Invictus Games to Sydney in 2018, the Australian Student's Veterans Association and is a member of the Advisory Council of China Matters. He is Chairman of the Audit and Risk Committee and a member of the Nominations and Remuneration Committee. He was Chairman of the Nominations and Remuneration Committee until 6 February 2020.

Air Marshal Geoffrey Brown AO

Non-executive director (Age 61). Appointed to the Board on 21 April 2016 (Length of service – 3 years). Geoffrey Brown 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 Chairman of the Nominations and Remuneration Committee from 6 February 2020 and a member of the Audit and Risk Committee.

The Hon Kate Lundy (HonLittD, GAICD)

Non-Executive director (age 52) Appointed to the Board on 23 March 2018 (Length of service – 2 years). 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.”

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DIRECTORS' REPORT (cont)

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. She is a member of the Audit and Risk Committee and a member of the Nominations and Remuneration Committee.

The above named directors held office during and since the end of the financial year.

Ian Dennis, Peter Leahy, Geoffrey Brown and Kate Lundy are considered independent directors.

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, defence systems and communications business.

The company is listed on the Australian Securities Exchange.

Review of operations

A detailed review of operations is included on pages 3 to 6 of this financial report.

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DIRECTORS' REPORT (cont)

Changes to the state of affairs

On 11 October 2019, the consolidated entity acquired all the issued capital of EM Solutions Pty Limited and created a new business sector of communications.

Apart from the above, there were no significant changes in the state of affairs of the consolidated entity that occurred during the financial period.

Share Issues

On 11 October 2019, the Company issued 4,271,357 new ordinary shares at an issue price of \$7.31 to the vendors of EM Solutions Pty Ltd as part consideration for the acquisition of 100% of the shares in EM Solutions Pty Ltd. 3,600,112 of these new ordinary shares are subject to voluntary escrow restrictions until 30 March 2020.

On 21 November 2019, the Company announced a fully underwritten placement of 10,144,224 new ordinary shares at \$6.66 to sophisticated and professional investor clients of Citigroup Global Markets Australia Pty Limited raising a total of \$68m. These new shares were allotted on 27 November 2019. These funds were used to support revised EBIT guidance and to fund ongoing growth initiatives and for working capital.

On 21 November 2019, the Company also announced a Share Placement Plan to all existing shareholders registered on 20 November 2019 at the lower of the same price as the institutional placement of \$6.66 or the price (rounded down to the nearest cent) which is equal to the volume weighted average price (VWAP) of EOS shares traded on the Australian Securities Exchange (ASX) over the 5 trading days up to, and including, the date that the offer closes, to raise a maximum of \$10m. The Share Placement Plan closed on 9 December 2019 raising \$17.0m resulting in the issue of 2,558,753 new ordinary shares on 13 December 2019 at \$6.66 per share. The Directors decided accept all applications above the \$10m limit.

Subsequent events

On 26 December 2019, Electro Optic Systems Holdings Limited ("EOS" or "Company") (ASX: EOS), acting through its wholly-owned US subsidiary EOS Defense Systems USA, Inc. ("EOSDS"), executed an agreement to purchase certain assets of Audacy Corporation, a space communications company based in the US ("Purchase") subject to mandatory Federal Communications Commission ("FCC") approval. EOSDS will outlay approximately A\$10 million in cash for the Purchase including substantial costs associated with securing mandatory US government spectrum licenses and other costs.

The transfer of control of Audacy Corporation's spectrum licenses to EOSDS is subject to review and approval by the FCC. The FCC application was lodged on 28 January 2020 and an announcement was made to the ASX at that time. On 5 March 2020 the FCC granted its consent to the transfer. EOSDS has also filed for review of the Acquisition by the US Committee on Foreign Investment in the US ("CFIUS") on 9 March 2020.

Although the Company believes the Purchase is compliant with all statutory and regulatory requirements, approval of the Purchase by CFIUS cannot be assured. In the normal course, and subject to those government approvals and other customary conditions, EOS anticipates the Purchase to close in mid-2020 ("Completion").

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DIRECTORS' REPORT (cont)

31. Subsequent Events (cont)

EOSDS is not required to make any material payment for the Purchase until Completion has occurred. EOS will fund the A\$10 million required during 2020 for the Purchase and related activities from its cash holdings.

Subsequent to the end of the financial year there have been considerable economic impacts in Australia and globally arising from the outbreak of COVID-19 virus and the respective Government actions to reduce the spread of the virus.

As this economic impact occurred after the reporting period, the Consolidated entity believes it constitutes a "Non-Adjusting Subsequent Event" as defined in AASB 110 Events after the Reporting Period.

- In March 2020, the consolidated entity implemented its Business Continuity Plan where most staff not directly involved in production will work from home to limit the potential spread of the virus and to enable the consolidated entity to continue to operate and serve our customers.
- The initial impacts on Consolidated entity's operations have been limited by a very strong inventory of production parts, and the fact that almost all EOS debtors are ultimately sovereign entities. The Consolidated entity's early adoption of virus-impeding practices may mitigate future impacts on business operations.
- The Consolidated entity will continue to monitor the impact of COVID-19 on the business as a whole including any impact on the supply chain, production capacity, logistic operations including product delivery, and collection of receivables. Therefore, at the date of signing the financial report the Consolidated entity is unable to determine what financial effects the outbreak of the virus could have on the Consolidated entity in the coming financial period.
- No financial effects arising from the economic impacts of the virus have been included in the financial results for the year ended 31 December 2019.
- Should this emerging macro-economic risk continue for a prolonged period, there could be potentially adverse financial impacts to the Consolidated entity, including slower revenue growth and obstruction to the plan towards increased profitability.

There have been no other transactions or events of a material and unusual nature between the end of the reporting period and the date of the report likely, in the opinion of the Directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations, or state of affairs of the consolidated entity in future 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. On 28 November 2019, EM Solutions Pty Limited entered into an Assumption Deed and became a party to the Deed of Cross Guarantee.

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DIRECTORS' REPORT (cont)

Future developments

The company will continue to operate in the space, defence systems and communications businesses.

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.

Diversity

The Company values diversity and recognises the benefits it can bring to the organisation's ability to achieve its goals. Accordingly, The Company's diversity policy ("Diversity Policy") was updated on 23 March 2020 and outlines its diversity objectives in relation to gender, age, cultural background, ethnicity, employment of veterans and other factors to leverage the widest pool of available talent. A copy of the Company's Diversity Policy is available on the Company's website.

Section 6 of the Diversity Policy states that the Company will establish appropriate and meaningful objectives for achieving gender and other forms of diversity.

The Company's current objectives are to:

- (i) improve the participation of women in the workforce by measuring the percentage of female employees and the percentage of those females in management positions;
- (ii) reduce the number of workplace harassment complaints by measuring annual occurrences and reducing these to zero;
- (iii) improve retention of staff by measuring the percentage of employees who access flexible workplace arrangements including flexible hours and alternative work cycles; and
- (iv) encourage retention of staff by measuring the number of staff who access company education and study assistance to enhance personal and corporate development opportunities.

The Company was not in the S & P/ ASX 300 at the commencement of 1 January 2020.

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DIRECTORS' REPORT (cont)

Diversity (cont)

As at 31 December 2019, the Group's gender diversity mix is as follows:

	Number	Female	Female (%)	Male	Male (%)
Total staff	234	45	19.2	189	80.2
Senior Management	5	0	0.0	5	100.0
Board	6	1	16.7	5	83.3

“Senior Management” is defined as a manager who has a relatively high leadership role in the day-to-day responsibilities of managing the Company.

Section 8 of the Diversity Policy requires the Company to disclose in each of its annual reports a summary of the Diversity Policy and the achievement of the objectives of the Diversity Policy. The Company achievements in meeting the objectives are as follows:

- (i) EOS continues to improve the participation of women in the workforce, noting that 19.2% of staff are female and the total number of women has increased from 36 (2018) to 45 (2019);
- (ii) EOS is committed to reduce the number of harassment complaints to zero noting only one incident reported for 2019 which was investigated with no case to answer;
- (iii) Flexible working arrangements are offered to staff with 7.3% (2019) and 7.6 % (2018) of the workforce taking advantage of the arrangements;
- (iv) There are 19 staff in total accessing the EOS company education and study assistance programs in 2019 compared to 18 in 2018.

It is noted that the Company currently has a moderate level of both gender and general diversity, however given the relatively small number of total employees, a change of one or a few employees may have a significant impact on the measurable diversity objectives.

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DIRECTORS' REPORT (cont)

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.

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

There were 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 and 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.

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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 EOS Loan Plan 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 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	<u>200,000</u>
	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	<u>1,180,000</u>
Total	<u>5,180,000</u>

The Shares issued to Directors are subject to both 'Vesting Conditions' and 'Forfeiture Conditions'. Directors are 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 consolidated entity or 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).

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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; <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)

Measures and hurdles	Vested Shares can be sold after:
(i) EBIT of \$15m for 12 months ending 31 December 2019; <u>and</u> (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 22 are in addition to the above vesting conditions for Directors.

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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, 15 Board meetings, three Audit and Risk Committee meetings and two Nominations and Remuneration Committee meetings were held.

Directors	Board of directors		Audit and Risk committee		Nominations and Remuneration committee	
	Held	Attended	Held	Attended	Held	Attended
Mr Fred Bart	15	15	-	-	2	2
Dr Ben Greene	15	15	-	-	-	-
Mr Ian Dennis	15	15	3	3	2	2
Lt Gen Peter Leahy AC	15	15	3	3	2	2
Air Marshal Geoff Brown AO	15	14	3	1	-	-
The Hon Kate Lundy	15	15	-	-	-	-

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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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	5,324,010	200,000	-
Dr Ben Greene	3,973,503	2,000,000	-
Mr Ian Dennis	35,025	200,000	-
Lt Gen Peter Leahy AC	43,259	200,000	-
Air Marshal Geoffrey Brown AO	11,501	200,000	-
The Hon Kate Lundy	4,826	200,000	-

Movement in Director shareholdings during the 2019 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.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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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 Marshal Geoffrey Brown AO (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 consolidated entity.

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

Remuneration structure

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

Non-Executive Director remuneration

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.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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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 consolidated entity.

Executive Director and Senior Management remuneration

Objective

The consolidated entity aims to award Executives with a level and mix of remuneration commensurate with their position and responsibilities within the consolidated entity 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 consolidated entity. 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.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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DIRECTORS' REPORT (cont)

Remuneration Report (cont)

Director remuneration

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

2019	Short term		Post Employment	Equity		Other Long Term Benefits \$	Total
	Salary & Fees \$	Non-monetary \$	Super-annuation \$	Loan Funded Share Plan \$	Options		\$
Mr Fred Bart	70,150	-	6,664	18,698	-	-	95,512
Dr Ben Greene*	498,257	26,163	45,250	186,982	-	952,137	1,708,789
Mr Ian Dennis#	184,196	-	4,097	18,698	-	-	206,991
Lt Gen Peter Leahy AC	43,125	-	4,097	18,698	-	-	65,920
Air Marshal Geoffrey Brown AO	43,125	-	4,097	18,698	-	-	65,920
The Hon Kate Lundy	<u>43,125</u>	<u>-</u>	<u>4,097</u>	<u>18,698</u>	<u>-</u>	<u>-</u>	<u>65,920</u>
	<u>881,978</u>	<u>26,163</u>	<u>68,302</u>	<u>280,472</u>	<u>-</u>	<u>952,137</u>	<u>2,209,052</u>

* Executive Director during the financial year

Includes fees for company secretarial and accounting consultancy services provided of \$141,073 (2018: \$120,000)

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

2018	Short term		Post Employment	Equity		Other Long Term Benefits \$	Total
	Salary & Fees \$	Non-monetary \$	Super-annuation \$	Loan Funded Share Plan \$	Options \$		\$
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 Marshal Geoffrey Brown AO	43,125	-	4,097	8,450	9,474	-	65,146
The Hon Kate Lundy	<u>33,171</u>	<u>-</u>	<u>3,235</u>	<u>8,450</u>	<u>-</u>	<u>-</u>	<u>44,856</u>
	<u>805,245</u>	<u>26,163</u>	<u>61,595</u>	<u>126,745</u>	<u>36,783</u>	<u>388,170</u>	<u>1,444,701</u>

* Executive Director during the financial year

Includes fees for company secretarial and accounting consultancy services provided of \$120,000 (2017: \$120,000)

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

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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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:

2019	Short term		Post Employment	Equity		Other Long Term Benefits \$	Total
	Salary & Fees \$	Non-monetary \$	Super-annuation \$	Loan Funded Share Plan \$	Options \$		\$
Dr Craig Smith	240,742	-	26,287	22,244	-	191,001	480,274
Mr Scott Lamond	242,969	-	23,167	23,373	-	108,967	398,476
Mr Grant Sanderson	242,969	-	23,167	23,091	-	8,332	297,559
Mr Peter Short	<u>243,862</u>	<u>-</u>	<u>23,167</u>	<u>23,373</u>	<u>-</u>	<u>52,243</u>	<u>342,645</u>
	<u>970,542</u>	<u>-</u>	<u>95,788</u>	<u>92,081</u>	<u>-</u>	<u>360,543</u>	<u>1,518,954</u>

2018	Short term		Post Employment	Equity		Other Long Term Benefits \$	Total
	Salary & Fees \$	Non-monetary \$	Super-annuation \$	Loan Funded Share Plan \$	Options \$		\$
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	<u>227,218</u>	<u>-</u>	<u>19,905</u>	<u>10,562</u>	<u>-</u>	<u>10,607</u>	<u>268,292</u>
	<u>897,469</u>	<u>-</u>	<u>81,911</u>	<u>41,023</u>	<u>7,354</u>	<u>86,783</u>	<u>1,114,540</u>

No options were granted to, or exercised by any director or executive during 2018 and 2019. 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.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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DIRECTORS' REPORT (cont)

Remuneration Report (cont)

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

	Balance at 1/1/19	Granted as remuneration	Received on exercise of options	Net other change	Balance at 31/12/19
	No.	No.	No.	No.	No.
Mr Fred Bart	5,319,506	-	-	4,504	5,324,010
Dr Ben Greene	3,964,495	-	-	9,008	3,973,503
Mr Ian Dennis	90,180	-	-	4,504	94,684
Lt Gen Peter Leahy AC Air Marshal Geoffrey Brown AO	38,755	-	-	4,504	43,259
The Hon Kate Lundy	5,000	-	-	6,501	11,501
Dr Craig Smith	3,325	-	-	1,501	4,826
Mr Scott Lamond	89,450	-	-	4,504	93,954
Mr Grant Sanderson	11,000	-	-	2,252	13,252
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 1/1/19	Granted as remuneration	Received on exercise of options	Net other change	Balance at 31/12/19
	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 Air Marshal Geoffrey 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

Elements of remuneration related to performance

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. In relation to the Loan Funded Share Plan there are market and non-market conditions.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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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 previous financial year to key management personnel. These 3,500,000 unlisted options exercisable at \$3.00 each expired on 31 January 2019 unexercised:

Directors	Date of Issue	Unlisted Options at the end of the financial year held by KMP
Mr Fred Bart	5 February 2016	-
Dr Ben Greene	5 February 2016	-
Mr Ian Dennis	5 February 2016	-
Lt Gen Peter Leahy AC	5 February 2016	-
Air Marshal Geoffrey Brown AO	30 May 2016	-
Senior Executives		
Dr Craig Smith	5 February 2016	-
Mr Scott Lamond	5 February 2016	-
		-

Other transactions with key management personnel

During the year, the Company paid a total of \$76,814 (2018: \$76,814) 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 (2018: \$47,222) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of directors fees and superannuation for Ian Dennis.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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DIRECTORS' REPORT (cont)

Remuneration Report (cont)

During the year, the Company paid \$47,222 (2018: \$47,222) to GCB Stratos Consulting Pty Limited, a company associated with Air Marshal Geoffrey Brown in respect of directors fees and superannuation for Geoff Brown.

During the year, the Company paid \$141,073 (2018: \$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 \$30,441 (2018: \$28,441) 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 2019 \$	31 December 2018 \$	31 December 2017 \$	31 December 2016 \$	31 December 2015 \$
Revenue	165,985,563	87,130,396	23,259,794	25,797,200	30,500,748
Net profit/ (loss) before tax	21,970,274	15,081,372	(9,319,930)	(2,918,477)	3,032,442
Net profit/ (loss) after tax	18,058,758	15,081,372	(9,319,930)	(886,692)	3,032,442

	31 December 2019 \$	31 December 2018 \$	31 December 2017 \$	31 December 2016 \$	31 December 2015 \$
Share price at start of year	2.45	2.45	1.73	1.49	0.82
Share price at end of year	7.42	2.45	2.45	1.73	1.49
Dividends paid	-	-	-	-	-

Audit and Risk Committee

The Board appointed four 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, Air Marshal Geoffrey Brown AO and Ms Kate Lundy (Joined 26 February 2020).

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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DIRECTORS' REPORT (cont)

Nominations and Remuneration Committee

The Board appointed four non-executive directors plus the CEO to form the committee, with a majority of independent directors and the Chairman being an independent person. The current members of the Committee are Air Marshal Geoffrey Brown AO (Chairman – appointed 6 February 2020), Lt Gen Peter Leahy AC, Mr Ian Dennis, Ms Kate Lundy and Mr Ben Greene. Lt Gen Peter Leahy was Chairman until 6 February 2020.

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 9 to the financial statements.

Auditor's independence declaration

The auditor's independence declaration is included on page 27 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 31 day of March 2020

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

31 March 2020

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 2019, 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

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 "Consolidated entity"), which comprises the consolidated statement of financial position as at 31 December 2019, 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 Consolidated entity, is in accordance with the Corporations Act 2001, including:

- (i) giving a true and fair view of the Consolidated entity's financial position as at 31 December 2019 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 Consolidated entity 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.

Material Uncertainty Related to Going Concern

We draw attention to Note 1 in the financial report, which indicates that the Consolidated entity had a net cash outflow from operating activities of \$33,829,630, during the year ended 31 December 2019.

As stated in Note 1, these events or conditions, along with other matters as set forth in Note 1, indicate that a material uncertainty exists that may cast significant doubt on the Consolidated entity's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Our procedures in relation to going concern included, but were not limited to:

- Challenging the underlying assumptions reflected in management's cash flow forecasts, including the timing of expected cash flows sensitized for the uncertainty in relation to the impact of COVID-19 on the business;
- Assessing the historical accuracy of the forecasts prepared by management;
- 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; and
- Assessed the adequacy of the disclosures in Note 1(c) to the financial statements.

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
<p>Revenue recognition for significant contracts</p> <p>Electric Optic Systems Holdings (EOSH) has two significant agreements with customers for the sale of Remote Weapons Systems and related items. Revenues in relation to these agreements account for \$142,634,267 (or approximately 86%) of total Group revenue. During the current financial year, EOSH has entered into further bespoke agreements with new customers.</p> <p>These contracts are complex, span over several years and the accounting implications thereof are of significance to the performance of the entity.</p> <p>There are judgements associated with interpreting key revenue contracts entered into by the entity against the requirements of AASB 15 Revenue from Contracts with Customers. This results in a significant level of management judgement and estimation in relation to:</p> <ul style="list-style-type: none"> • Interpreting and accounting for complex contractual terms, including multiple performance obligations, clauses with regards to cancellations, penalties for late delivery and warranties (amongst others); and • Accounting judgements and treatments in relation to the application of AASB 15 including the assessment of performance obligations, allocation of revenue, variable consideration and consideration of revenue recognition as being at a point in time or over time. 	<p>Our procedures included, but were not limited to:</p> <ul style="list-style-type: none"> • Making enquiries and performing a walkthrough of the process for recording revenue and assessing judgements applied to the key contracts to identify and test relevant internal controls; • Testing key controls within the revenue recognition process in relation to significant contracts; • Reviewing significant contracts and assessing revenue recognition against the requirements of the relevant 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 underlying records, including shipment and milestone documentation; • 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; • Assessing the application of any adjustments in relation to variable elements of revenue recognition, including the application of the late delivery clauses; and • Recalculating contract assets recorded by management. <p>We also assessed the appropriateness of the disclosures in Notes 1(e) and 2(a) to the financial statements.</p>

Key Audit Matter	How the scope of our audit responded to the Key Audit Matter
<p>Accounting for new subsidiary</p> <p>EOSH obtained control of EM Solutions Pty Limited on 11 October 2019 in exchange for EOSH shares and a cash payment.</p> <p>There are complexities and judgements associated with the acquisition accounting, specifically in relation to:</p> <ul style="list-style-type: none"> • identifying separately identifiable intangible assets; • valuing separately identifiable intangible assets, including the estimation of valuation inputs including (amongst others): <ul style="list-style-type: none"> ○ future cash flow forecasts; ○ costs to recreate; ○ inflation rates; ○ obsolescence rates; and ○ discount rates. • determining goodwill generated on the acquisition 	<p>Our procedures included, but were not limited to:</p> <ul style="list-style-type: none"> • Making enquiries and performing a walkthrough of the process for identifying and valuing separately identifiable intangible assets as well as the calculation of consideration on acquisition date.; • Testing key controls within the acquisition accounting process in relation to the subsidiary acquired; • Evaluating and challenging management’s assessment of the fair value of separately identified intangible assets including evaluating the competence, objectivity and independence of management’s expert; • Engaging with our valuations experts to assess the reasonableness of the key assumptions in estimating the fair value of separately identifiable intangibles; • Tracing the transfer of cash and/or shares to supporting documentation; • Engaging with our financial reporting specialists on interpretation of relevant accounting standards . <p>We also assessed the appropriateness of the disclosures of the acquisition in Note 28 to the financial statements.</p>
<p>Accounting for associate</p> <p>During the financial year, EOSH obtained significant influence over an entity, AEI Air (Holdings) Limited (AEI), domiciled in the United Kingdom.</p> <p>EOSH has a loan to the associate as a result of a series of convertible note payments as disclosed in Note 10. Note 10 also discloses the nature of the other arrangements in place between the entities.</p> <p>Management judgement is applied in determining the nature of the relationship (control vs significant influence) and the related financial statement disclosures.</p>	<p>Our procedures included, but were not limited to:</p> <ul style="list-style-type: none"> • Assessing the documents in place between EOSH and AEI, including evaluating and challenging management’s application of AASB 128 Investments in Associates and Joint Ventures and AASB 3 Business Combinations in concluding on the nature of the relationship (control vs significant influence); • Assessing the legal advice received by management in relation to the nature of the relationship; • Reconciling the balance of the loan in associate to supporting documentation; • Engaging with our financial reporting specialists on interpretation of relevant accounting standards. <p>We also assessed the appropriateness of the disclosures in relation to the interest held in the associate in Notes 10 and 33 to the financial statements.</p>
<p>Recoverability of goodwill relating to new subsidiary acquired</p> <p>AASB 136 Impairment states if ‘some or all of the goodwill allocated to a cash-generating unit (CGU) was acquired in a business combination during the current annual period, that unit shall be tested for impairment before the end of the current</p>	<p>Our procedures included, but were not limited to:</p> <ul style="list-style-type: none"> • Making enquiries and performing a walkthrough of the process to compute management’s cash flow forecasts to identify and test relevant internal controls; • Assessing the appropriateness of the allocation of goodwill between CGUs;

Key Audit Matter	How the scope of our audit responded to the Key Audit Matter
<p>annual period'.</p> <p>The determination of the recoverable amount requires management judgement in determining and applying:</p> <ul style="list-style-type: none"> o Cash flow projections; o Expected future growth in the product market; and o Discount rates. <p>Management also apply judgement when determining the elements of goodwill to be allocated to the individual CGUs</p>	<ul style="list-style-type: none"> • Challenging management' assessment paper on the underlying inputs and assumptions applied when making key judgements and estimates; • Assessing the status of any new/ongoing contracts based on discussions with management and external research (where available); • Performing an independent sensitivity analysis to determine whether reasonably foreseeable changes to the key inputs and assumptions would trigger a material impairment; • Engaging internal valuation specialists to assist in the evaluation of management's assumptions applied in their assessment paper in calculating the recoverable amount of the identified CGUs, including future cash flows, growth rates, discount rates and terminal value calculations; and • Comparing the recoverable amount of the CGUs to the carrying value to determine whether impairment is necessary <p>We also assessed the appropriateness of the disclosures in Note 12 to the financial statements.</p>
<p>Taxation</p> <p>Due to EOSH now being in a tax paying position, there is an identified risk due to the inherent complexities and judgement applicable to:</p> <ul style="list-style-type: none"> • The calculation of taxation amounts including consideration of the subsidiaries acquired during the year; and • Recognition of deferred tax balances. 	<p>Our procedures included, but were not limited to:</p> <ul style="list-style-type: none"> • Making enquiries and performing a walkthrough of the process for the tax computation and assessment of the deferred tax balances to identify and test relevant internal controls; • Challenging management on their assessment paper regarding recoverability of deferred tax assets recognised; • Reviewing treatment of cross border tax losses; and • Engaging internal tax specialists for the review of compliance with relevant tax legislation. <p>We also assessed the appropriateness of the disclosures in Note 4 to the financial statements.</p>

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 19 to 25 of the Directors' Report for the year ended 31 December 2019.

In our opinion, the Remuneration Report of Electro Optic Systems Holdings Limited, for the year ended 31 December 2019, 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, 31 March 2020

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 27 to the financial statements will, as a consolidated entity, 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 31 day of March 2020

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 2019

	Note	31 December 2019 \$	31 December 2018 \$
Revenue	2(a)	165,985,563	87,130,396
Changes in inventories of work in progress		(5,740,505)	(2,842,202)
Raw materials and consumables used		(84,357,111)	(40,356,855)
Employee benefits expense	2(b)	(33,697,340)	(22,147,866)
Administration expenses		(14,133,068)	(9,502,730)
Amortisation of intangibles		(354,299)	-
Interest paid – other	2(b)	-	(36,903)
Interest expense on right-of-use-assets	2(b)	(384,217)	-
Depreciation and amortisation of property, plant and equipment	2(b)	(1,694,948)	(633,235)
Depreciation of right-of-use-assets	2(b)	(2,083,154)	-
Foreign exchange gains/ (losses)	2(b)	610,019	7,712,222
Occupancy costs		(524,816)	(3,440,347)
Other expenses		<u>(1,655,850)</u>	<u>(801,108)</u>
Profit before income tax benefit		21,970,274	15,081,372
Income tax expense	4	<u>(3,911,516)</u>	-
Profit for the year		<u>18,058,758</u>	<u>15,081,372</u>
Attributable to:			
Owners of the Company	24	18,435,425	15,302,214
Non-controlling interests		<u>(376,667)</u>	<u>(220,842)</u>
		<u>18,058,758</u>	<u>15,081,372</u>
Other comprehensive income			
Items that may be reclassified subsequently to profit and loss			
Exchange differences arising on translation of foreign operations		<u>337,858</u>	<u>(1,157,927)</u>
Total comprehensive Profit for the year		<u>18,396,616</u>	<u>13,923,445</u>
Attributable to:			
Owners of the Company		18,773,283	14,144,287
Non-controlling interests		<u>(376,667)</u>	<u>(220,842)</u>
		<u>18,396,616</u>	<u>13,923,445</u>
Profit/ (Loss) per share			
Basic (cents per share)	3	19.43	17.22
Diluted (cents per share)	3	19.38	17.22

Notes to the financial statements are included on pages 39 to 127.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2019

		Consolidated	
	Note	December 2019	December 2018
		\$	\$
CURRENT ASSETS			
Cash and cash equivalents	25	77,881,766	40,538,225
Trade and other receivables	5	27,056,202	26,819,746
Contract asset	6	44,772,583	-
Inventories	7	53,491,173	26,465,499
Other	8	<u>14,737,600</u>	<u>12,713,727</u>
TOTAL CURRENT ASSETS		<u>217,939,324</u>	<u>106,537,197</u>
NON-CURRENT ASSETS			
Trade and other receivables	5	12,055,798	7,146,990
Other	8	7,800,037	2,252,177
Deferred tax asset	4	2,838,900	-
Security deposit	30	9,021,823	8,971,929
Loan to associate	10	2,632,783	-
Right of use assets	11	13,961,128	-
Goodwill	12	14,878,316	-
Intangible assets	13	17,235,701	-
Property, plant and equipment	14	<u>8,061,509</u>	<u>3,960,849</u>
TOTAL NON-CURRENT ASSETS		<u>88,485,995</u>	<u>22,331,945</u>
TOTAL ASSETS		<u>306,425,319</u>	<u>128,869,142</u>
CURRENT LIABILITIES			
Trade and other payables	15	36,970,003	22,328,897
Current tax payable		8,352,728	-
Lease liabilities	16	2,613,223	-
Provisions	17	<u>12,882,819</u>	<u>6,366,891</u>
TOTAL CURRENT LIABILITIES		<u>60,818,773</u>	<u>28,695,788</u>
NON-CURRENT LIABILITIES			
Lease liabilities	16	11,386,647	-
Provisions	17	<u>6,513,467</u>	<u>3,891,770</u>
TOTAL NON-CURRENT LIABILITIES		<u>17,900,114</u>	<u>3,891,770</u>
TOTAL LIABILITIES		<u>78,718,887</u>	<u>32,587,558</u>
NET ASSETS		<u>227,706,432</u>	<u>96,281,584</u>
EQUITY			
Issued capital	20	274,311,590	161,784,727
Reserves	23	9,312,018	8,472,791
Accumulated losses	24	<u>(55,378,740)</u>	<u>(73,814,165)</u>
Equity attributable to owners of the Company		228,244,868	96,443,353
Non-controlling interests		<u>(538,436)</u>	<u>(161,769)</u>
TOTAL EQUITY		<u>227,706,432</u>	<u>96,281,584</u>

Notes to the financial statements are included on pages 39 to 127.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2019

	Accumulated losses	Issued capital	Foreign currency translation reserve	Employee equity settled benefits reserve	Attributable to owners of the parent	Non- controlling interests	Total Equity
	\$	\$	\$	\$	\$	\$	\$
2019							
Balance at 1 January 2019	<u>(73,814,165)</u>	<u>161,784,727</u>	<u>(1,399,064)</u>	<u>9,871,855</u>	<u>96,443,353</u>	<u>(161,769)</u>	<u>96,281,584</u>
Profit for the year	<u>18,435,425</u>	-	-	-	<u>18,435,425</u>	<u>(376,667)</u>	<u>18,058,758</u>
Exchange differences arising on translation of foreign operations	-	-	<u>337,858</u>	-	<u>337,858</u>	-	<u>337,858</u>
Total comprehensive profit for the year	<u>18,435,425</u>	-	<u>337,858</u>	-	<u>18,773,283</u>	<u>(376,667)</u>	<u>18,396,616</u>
Issue of 4,271,357 new ordinary shares at \$7.31 as part consideration for the acquisition of EM Solutions Pty Ltd	-	31,223,620	-	-	31,223,620	-	31,223,620
Issue of 10,144,224 new shares at \$6.66 each under the institutional placement	-	64,261,948	-	-	64,261,948	-	64,261,948
Issue of 2,558,753 new shares at \$6.66 under the Share Purchase Plan	-	17,041,295	-	-	17,041,295	-	17,041,295
Recognition of share based payments	-	-	-	<u>501,369</u>	<u>501,369</u>	-	<u>501,369</u>
Balance at 31 December 2019	<u>(55,378,740)</u>	<u>274,311,590</u>	<u>(1,061,206)</u>	<u>10,373,224</u>	<u>228,244,868</u>	<u>(538,436)</u>	<u>227,706,432</u>
2018							
Balance at 1 January 2018	<u>(89,116,379)</u>	<u>103,342,071</u>	<u>(241,137)</u>	<u>9,586,065</u>	<u>23,570,620</u>	-	<u>23,570,620</u>
Profit for the year	<u>15,302,214</u>	-	-	-	<u>15,302,214</u>	<u>(220,842)</u>	<u>15,081,372</u>
Exchange differences arising on translation of foreign operations	-	-	<u>(1,157,927)</u>	-	<u>(1,157,927)</u>	-	<u>(1,157,927)</u>
Total comprehensive profit for the year	<u>15,302,214</u>	-	<u>(1,157,927)</u>	-	<u>14,144,287</u>	<u>(220,842)</u>	<u>13,923,445</u>
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	-	-	1,442,656	-	1,442,656
Adjustment arising from change in non-controlling interest	-	-	-	-	-	59,073	59,073
Recognition of share based payments	-	-	-	<u>285,790</u>	<u>285,790</u>	-	<u>285,790</u>
Balance at 31 December 2018	<u>(73,814,165)</u>	<u>161,784,727</u>	<u>(1,399,064)</u>	<u>9,871,855</u>	<u>96,443,353</u>	<u>(161,769)</u>	<u>96,281,584</u>

Notes to the financial statements are included on pages 39 to 127

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2019

	Note	31 December 2019 \$	31 December 2018 \$
Cash flows from operating activities			
Receipts from customers		109,149,110	63,870,012
Payments to suppliers and employees		(141,283,329)	(80,309,969)
Income tax paid		(1,881,111)	-
Interest received		569,917	790,658
Interest and other costs of finance paid		<u>(384,217)</u>	<u>(36,903)</u>
Net cash (outflows) from operating activities	25(c)	<u>(33,829,630)</u>	<u>(15,686,202)</u>
Cash flows from investing activities			
Payment for property, plant and equipment		(4,599,841)	(3,188,913)
Payment to acquire entity		(1,253,836)	-
Loan to associate		(2,780,265)	-
Security deposit for performance bond		-	<u>(8,971,929)</u>
Net cash (outflows) from investing activities		<u>(8,633,942)</u>	<u>(12,160,842)</u>
Cash flows from financing activities			
Proceeds from issue of new shares		81,303,243	58,442,656
Repayment of lease liabilities		<u>(1,722,923)</u>	-
Net cash inflows from financing activities		<u>79,580,320</u>	<u>58,442,656</u>
Net increase in cash and cash equivalents		37,116,748	30,595,612
Cash and cash equivalents at the beginning of the financial year		40,538,225	9,989,953
Effects of exchange rate fluctuations on the balances of cash held in foreign currencies		<u>226,793</u>	<u>(47,340)</u>
Cash and cash equivalents at the end of the financial year	25(a)	<u>77,881,766</u>	<u>40,538,225</u>

Notes to the financial statements are included on pages 39 to 127.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

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 consolidated entity. 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 31 March 2020.

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) 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 had net cash outflows from operating activities during the year of \$33,829,630.

Subsequent to the end of the financial reporting period, as outlined in Note 31, COVID-19 was declared as a worldwide pandemic. This has resulted in increasing the uncertainty in capital markets as well as challenges in delivering contracted services across jurisdictions, and related uncertainties regarding capital market and business liquidity in the short term.

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; and
- the ability to raise funding should the need arise.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1(c) Going concern (cont)

If the consolidated entity is unable to achieve successful outcomes in relation to the above matters, significant uncertainty would exist as to the ability of the consolidated entity to continue as a going concern and therefore, it may be required to realise its assets and extinguish its liabilities other than in the normal course of business and at amounts different from those stated in the financial report.

No adjustments have been made to the financial report relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the consolidated entity not continue as a going concern.

1(d) Adoption of new and revised Standards

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

The consolidated entity 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 2019.

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 consolidated entity:

- AASB 16 *Leases*

In the current year, the consolidated entity has applied AASB 16 Leases for the first time. AASB 16 introduces new or amended requirements with respect to lease accounting. It introduces significant changes to the lessee accounting by removing the distinction between operating and finance leases and requiring the recognition of a right-of-use asset and a lease liability at the lease commencement for all leases, except for short-term leases and leases of low value assets. In contrast to lessee accounting, the requirements for lessor accounting have remained largely unchanged. Details of these new requirements and the impact of the adoption of AASB 16 on the consolidated entity's statements are described below.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

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

The date of initial application of AASB 16 for the consolidated entity is 1 January 2019.

The consolidated entity has applied AASB 16 using the modified retrospective approach with the cumulative effect of initially applying the Standard recognised at the date of initial application in Accumulated Losses.

Impact on Lessee Accounting

Former operating leases

AASB 16 changes how the consolidated entity accounts for leases previously classified as operating leases under AASB 117, which were off-balance-sheet.

Applying AASB 16, for all leases (except as noted below), the consolidated entity:

- a) recognises right-of-use assets and lease liabilities in the consolidated statement of financial position, initially measured at the present value of future lease payments;
- b) recognises depreciation of right-of-use assets and interest on lease liabilities in the consolidated statement of profit or loss and other comprehensive income;
- c) separates the total amount of cash paid into a principal portion (presented within financing activities) and interest (presented within operating activities) in the consolidated statement of cash flows.

Lease incentives (e.g. free rent period) are 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 incentive liability, amortised as a reduction of rental expense on a straight-line basis.

Under AASB 16, right-of-use assets are tested for impairment in accordance with AASB 136 Impairment of Assets. This replaces 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, the consolidated entity has opted to recognise a lease expense on a straight-line basis as permitted by AASB 16. This expense is presented within other expenses in the consolidated statement of profit or loss as applicable.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

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

Financial impact of initial application of AASB 16

The initial application of AASB 16 resulted in:-

- i. The creation of a right-of-use asset of \$5,278,362 and a lease liability of \$5,278,362 as at 1 January 2019.
- ii. A difference of \$287,072 between the operating lease commitments disclosed in applying AASB 117 in the 31 December 2018 annual report, discounted using the incremental borrowing rate implicit in (iii) below and the lease liability in (i) above. This difference is primarily attributable to the inclusion of certain leases as part of the opening adjustment that were previously not disclosed as operating lease commitments.
- iii. When measuring lease liabilities, the consolidated entity discounted lease payments using the rate implicit in the lease. Where this could not be determined, the consolidated entity's incremental borrowing rate was used. The weighted average rate applied is 4.75%.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

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

New and revised AASB Standards in issue but not yet effective

At the date of authorisation of the financial statements, the consolidated entity has not applied the following new and revised Australian Accounting Standards, Interpretations and amendments that have been issued but are not yet effective:

Standard/amendment	Effective for annual reporting periods beginning on or after
AASB 2014-10 <i>Amendments to Australian Accounting Standards – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture [AASB 10 & AASB 128]</i> , AASB 2015-10 <i>Amendments to Australian Accounting Standards – Effective Date of Amendments to AASB 10 and AASB 128</i> and AASB 2017-5 <i>Amendments to Australian Accounting Standards – Effective Date of Amendments to AASB 10 and AASB 128 and Editorial Corrections</i>	1 January 2022 (Editorial corrections in AASB 2017-5 applied from 1 January 2018)
AASB 2018-6 <i>Amendments to Australian Accounting Standards - Definition of a Business</i>	1 January 2020
AASB 2018-7 <i>Amendments to Australian Accounting Standards – Definition of Material</i>	1 January 2020
AASB 2019-1 <i>Amendments to Australian Accounting Standards – References to the Conceptual Framework</i>	1 January 2020
AASB 2019-3 <i>Amendments to Australian Accounting Standards – Interest Rate Benchmark Reform</i>	1 January 2020
AASB 2019-5 <i>Amendments to Australian Accounting Standards – Disclosure of the Effect of New IFRS Standards Not Yet Issued in Australia</i>	1 January 2020

The Directors do expect these new and revised standards issued but not effective to have a material effect on the financial statements.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1(e) Revenue Recognition

The consolidated entity recognises revenue from the following major sources:

- Sale of goods
- Providing services

The consolidated entity 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 consolidated entity recognises revenue when control transfers to the customer.

The consolidated entity considers the following requirements in order to assess whether control has passed:

- (a) The consolidated entity has a present right to payment for the asset,
- (b) The customer has legal title to the asset,
- (c) The consolidated entity 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 consolidated entity will continue to account for these warranties in accordance with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* consistent with its current accounting treatment.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

ACN 092 708 364

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

1(f)(i) Financial assets

Classification

The consolidated entity classifies its financial assets in the following measurement categories:

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

The classification depends on the consolidated entity'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 consolidated entity 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 consolidated entity reclassifies debt investments when and only when its business model for managing those assets changes.

Measurement

At initial recognition, the consolidated entity 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 consolidated entity's business model for managing the asset and the cash flow characteristics of the asset. There are two measurement categories into which the consolidated entity 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1(f). 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.

Equity instruments

The consolidated entity subsequently measures all equity investments at fair value. Where the consolidated entity 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 consolidated entity'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 consolidated entity or group assesses on a forward looking basis the expected credit losses associated with its debt instruments carried at amortised cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, and lease receivables, the consolidated entity applies the simplified approach permitted by AASB 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

1(f)(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 consolidated entity's countries of operation.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(g) 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.

(h) 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(i) 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.

(j) 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(k) 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.

(l) 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 and intangible assets with indefinite useful lives 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(l) 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.

(m) Income tax

Current tax

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).

Deferred tax

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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(m) 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 settle 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 consolidated entity approach.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(m) 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 as at 31 December 2019. Since 31 December 2019, the consolidated entity has entered into tax funding and tax sharing agreements with all the entities within the tax consolidated group.

(n) 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.

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

Core technology (not patented)	10 years
Patented technology	15 years
Software	5 years
Customer contracts and relationships	15 years

Intangible assets were valued by an independent valuer as part of the Purchase Price Acquisition Valuation as at 11 October 2019.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(o) Inventories

Inventories are measured at the lower of cost and net realisable value. Costs are assigned on a weighted average cost basis for raw material inventory and standard cost for finished goods. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

(p) Leased assets

Policies applicable from 1 January 2019 (See Note 1(d))

The consolidated entity assesses whether a contract is or contains a lease, at inception of a contract. The consolidated entity recognises a right-of-use asset and a corresponding lease liability with respect to all lease agreements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets. For these leases, the consolidated entity recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted by using the rate implicit in the lease. If this rate cannot be readily determined, the consolidated entity uses its incremental borrowing rate.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(p) Leased assets (cont)

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments (including in-substance fixed payments), less any lease incentives;
- variable lease payments that depend on an index or rate, initially measured using the index or rate at the commencement date;
- the amount expected to be payable by the lessee under residual value guarantees;
- the exercise price of purchase options, if the lessee is reasonably certain to exercise the options; and
- payments of penalties for terminating the lease, if the lease term reflects the exercise of an option to terminate the lease.

The lease liability is presented as a separate line in the consolidated statement of financial position.

The lease liability is subsequently measured by increasing the carrying amount to reflect interest on the lease liability (using the effective interest method) and by reducing the carrying amount to reflect the lease payments made.

The consolidated entity remeasures the lease liability (and makes a corresponding adjustment to the related right-of-use asset) whenever:

- the lease term has changed or there is a change in the assessment of exercise of a purchase option, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.
- the lease payments change due to changes in an index or rate or a change in expected payment under a guaranteed residual value, in which cases the lease liability is remeasured by discounting the revised lease payments using the initial discount rate (unless the lease payments change is due to a change in a floating interest rate, in which case a revised discount rate is used).
- a lease contract is modified and the lease modification is not accounted for as a separate lease, in which case the lease liability is remeasured by discounting the revised lease payments using a revised discount rate.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Significant accounting policies (cont)

(p) Leased assets (cont)

The consolidated entity did not make any such adjustments during the period.

The right-of-use assets comprise the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day and any initial direct costs. They are subsequently measured at cost less accumulated depreciation and impairment losses.

Whenever the consolidated entity incurs an obligation for costs to dismantle and remove a leased asset, restore the site on which it is located or restore the underlying asset to the condition required by the terms and conditions of the lease, a provision is recognised and measured under AASB 137. The costs are included in the related right-of-use asset, unless those costs are incurred to produce inventories.

Right-of-use assets are depreciated over the shorter period of lease term and useful life of the underlying asset. If a lease transfers ownership of the underlying asset or the cost of the right-of-use asset reflects that the consolidated entity expects to exercise a purchase option, the related right-of-use asset is depreciated over the useful life of the underlying asset. The depreciation starts at the commencement date of the lease.

The right-of-use assets are presented as a separate line in the consolidated statement of financial position.

The consolidated entity applies AASB 136 Impairment of Assets (as per Note 1(I) to determine whether a right-of-use asset is impaired and accounts for any identified impairment loss per the accounting policy disclosed in the 31 December 2018 annual report.

Variable rents that do not depend on an index or rate are not included in the measurement the lease liability and the right-of-use asset. The related payments are recognised as an expense in the period in which the event or condition that triggers those payments occurs and are included in the line “other expenses” in the statement of profit or loss.

As a practical expedient, AASB 16 permits a lessee not to separate non-lease components, and instead account for any lease and associated non-lease components as a single arrangement. The consolidated entity has not used this practical expedient.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Significant accounting policies (cont)

(p) Leased assets (cont)

Policies applicable prior to 1 January 2019

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.

The consolidated entity as lessor

Income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

The consolidated entity as lessee

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 asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred. In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(q) 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 consolidated entity are eliminated in full on consolidation.

Non-controlling interest in subsidiaries are identified separately from the consolidated entity'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 an 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

(r) 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

(s) 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(s) 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 consolidated entity 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.

(t) 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.

(u) 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(u) Interests in joint operations (cont)

When a group entity undertakes its activities under joint operations, the consolidated entity 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 consolidated entity 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 consolidated entity transact with a joint operation in which a consolidated entity is a joint operator (such as a sale or contribution of assets), the consolidated entity 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 consolidated entity's consolidated financial statements only to the extent of other parties' interest in the joint operation.

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

(v) Goodwill

Goodwill is initially recognised and measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquire, and the fair value of the acquirer's previously held equity interest (if any) over the net of the acquisition-date amount of the identifiable assets acquired and liabilities assumed.

Goodwill is not amortised but is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to each of the consolidated entity or group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(w) 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 judgement and 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 goodwill

The directors made a critical judgement in relation to the recoverable amount of goodwill in Note 12 and the allocation of goodwill to the three cash generating units. Judgement is made regarding the future cash flows of the three cash generating units.

Deferred tax

The directors made a critical judgement in relation to recognising the deferred tax balances described in Note 4(b). The directors currently consider it probable that sufficient taxable amounts will be available against which deductible temporary differences can be utilised in the Australian tax consolidated entity. No deferred tax assets have been recognised in the foreign subsidiaries.

Warranty provision

The directors made a critical judgement in relation to the valuation of the provision for warranty costs described in Note 18. 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(w) Critical accounting judgements (cont)

Loan to associate

The directors made a critical judgement in relation to the treatment of the loan to associate. The directors determined that based on the disclosure in Note 10 that treating the advances under the Unsecured Convertible Note deed as a loan in associate was appropriate based on the facts pertaining to the loan.

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 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).

(x) Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of assets transferred by the consolidated entity, liabilities incurred by the consolidated entity to the former owners of the acquiree and the equity interest issued by the consolidated entity in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(x) Business combinations (cont)

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date, except that:

- deferred tax assets or liabilities and assets or liabilities related to employee benefit arrangements are recognised and measured in accordance with IAS 12 and IAS 19 respectively;
- liabilities or equity instruments related to share-based payment arrangements of the acquiree or share-based payment arrangements of the consolidated entity entered into to replace share-based payment arrangements of the acquiree are measured in accordance with IFRS 2 at the acquisition date (see below); and
- assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 are measured in accordance with that Standard.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

When the consideration transferred by the consolidated entity in a business combination includes a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Other contingent consideration is remeasured to fair value at subsequent reporting dates with changes in fair value recognised in profit or loss.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

1. Summary of Accounting Policies (cont)

(x) Business combinations (cont)

When a business combination is achieved in stages, the consolidated entity's previously held interests (including joint operations) in the acquired entity are remeasured to its acquisition-date fair value and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other comprehensive income are reclassified to profit or loss, where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the consolidated entity reports provisional amounts for the items for which the accounting is incomplete.

Those provisional amounts are adjusted during the measurement period (see above), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised as of that date.

(y) Derivative liabilities

Derivative liabilities are initially recognised at fair value on issue. After initial recognition, they are subsequently measured at fair value through profit or loss.

(z) Investments in associates

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial operating policy decisions of the investee but is not control or joint control over these policies.

The Group measures the interest in an associate at fair value through profit and loss from the date which significant influence is obtained.

The Group applies IFRS9, including the impairment requirements, to long-term interests in an associate or joint venture to which the equity method is not applied and which form part of the net investment in the investee.

Furthermore, in applying IFRS 9 to long-term interests, the Group does not take into account adjustments to their carrying amount required by IAS 28 (i.e. adjustments to the carrying amount of long-term interests arising from the allocation of losses of the investee or assessment of impairment in accordance with IAS 28).

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$

2. Profit from operations

(a) Revenue

Revenue from operations consisted of the following items:

Revenue from the sale of goods	159,170,211	84,299,210
Revenue from the rendering of services	<u>6,214,808</u>	<u>2,040,120</u>
Total revenue	<u>165,385,019</u>	<u>86,339,330</u>

Disaggregation of Revenue

The consolidated entity 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	Revenue
	\$	\$
Defence segment – Sale of goods	135,025,200	60,105,786
Communication segment – Sale of goods	1,265,438	-
Communication segment – Providing services	113,984	-
Total Revenue recognised over time	<u>136,404,622</u>	<u>60,105,786</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

Consolidated	
31 December 2019 \$	31 December 2018 \$

2. Profit from operations (cont)

The consolidated entity recognises revenue for the overseas remote weapon system contracts over time as the goods manufactured under these contracts do not have an alternative use for the entity, and EOS has an enforceable right to payment for performance completed to date under the contracts. 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 significant contracts, the control of the goods transfer when the goods are delivered, or when a milestone is met. The output method, based on the delivery of goods to customers or the achievement of contract milestones faithfully depicts our performance under the contracts and best depicts the pattern of transfer of goods to the customers. Revenue in relation to a contract earned on a milestone basis has been adjusted for a variable element.

All other revenue is recognised at a point in time.

At a point in time

	Revenue	Revenue
Communications segment – Sale of goods	488,201	-
Communications segment – Providing services	23,805	-
Defence segment – Sale of goods	22,335,015	23,724,572
Defence segment – Providing services	1,114,122	1,129,557
Space segment – Sale of goods	-	468,850
Space segment – Providing services	5,019,254	910,565
Total Revenue recognised at a point in time	28,980,397	26,233,544
 Total Revenue	 165,385,019	 86,339,330
 Other revenue		
Interest revenue:		
Bank deposits	569,917	790,658
 Other	 30,627	 408
	165,985,563	87,130,396

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	31 December 2019	31 December 2018
	\$	\$
2. Profit from operations (cont)		
(b) Profit before income tax has been arrived at after charging the following expenses:		
Borrowing costs		
Interest paid	<u>-</u>	<u>36,903</u>
Interest expense on right of use assets	<u>384,217</u>	<u>-</u>
Amortisation of intangibles	<u>354,299</u>	<u>-</u>
Depreciation and amortisation – property, plant and equipment	1,694,948	633,235
Depreciation on right of use assets	2,083,154	-
Foreign exchange (gains)	(610,019)	(7,712,222)
Operating lease rental expenses:		
Minimum lease payments	<u>-</u>	<u>2,053,962</u>
Employee benefit expense:		
Share based payments:		
Equity settled	501,369	285,790
Contributions to defined contribution superannuation plans	2,160,445	1,530,708
Other employee benefits	<u>31,035,526</u>	<u>20,331,368</u>
	<u>33,697,340</u>	<u>22,147,866</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	31 December 2019 \$	31 December 2018 \$
3. Profit per Share		
Basic EPS	<u>19.43 cents</u>	<u>17.22 cents</u>
Diluted EPS	<u>19.38 cents</u>	<u>17.22 cents</u>
Basic Profit per Share		
Profit (a)	<u>18,058,758</u>	<u>15,081,372</u>
Weighted average number of ordinary shares used in the calculation of basic earnings per share(b), (c)	<u>92,942,896</u>	<u>87,582,641</u>
Weighted average number of ordinary shares used in the calculation of diluted earnings per share(b), (c)	<u>93,162,896</u>	<u>87,582,641</u>

- (a) Profit used in the calculation of basic earnings per share are the same as the net profit in the statement of profit or loss and other comprehensive income.
- (b) There are potential ordinary shares and hence diluted earnings per share is different to basic earnings per share. The 220,000 unlisted options exercisable at \$2.99 outstanding are in the money at 31 December 2019 and are 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 Loan Funded Share Plan shares are not considered dilutive as all performance conditions in relation to these shares have not all been met at balance date. The first vesting date of 12.5% of these shares is 30 June 2020.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31 December 2019	31 December 2018
	\$	\$
4. Income Tax		
Corporation income tax		
Current year	<u>3,911,516</u>	-
(a) The prima facie income tax expense on pre-tax accounting profit from operations reconciles to the income tax expense in the financial statements as follows:		
Profit from operations	<u>21,970,274</u>	<u>15,081,372</u>
Income tax expense calculated at 30%	6,591,082	4,524,412
Effect of different tax rates of subsidiaries operating in other jurisdictions	203,428	(166,904)
Tax fair value adjustments on acquisition	339,726	-
Tax rate difference of subsidiary acquired	(101,064)	-
Share based payments	150,411	85,737
Other non-deductible/ non assessable items	<u>(328,209)</u>	<u>1,054,960</u>
	6,855,374	5,498,205
Deferred tax assets now brought to account	(4,233,732)	-
Adjustment in respect of prior years	24,530	-
Unused Australian tax losses and tax offsets now brought to account	(1,770,284)	(5,498,205)
Unused tax losses and tax offsets not recognised as deferred tax assets	<u>3,035,628</u>	-
Income tax expense attributable to Operating Profit	<u>3,911,516</u>	-

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, 0% in United Arab Emirates 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.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

Consolidated
31 **31**
December **December**
2019 **2018**
\$ **\$**

4. Income Tax (cont)

(b) Deferred tax balances

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the consolidated entity intends to settle current tax assets and liabilities on a net basis.

The following are the major deferred tax liabilities and assets recognised by the consolidated entity and movements thereon during the current and prior period.

Deferred tax assets	2018	Charge/ (credit) to profit and loss	Acquisition of subsidiary	2019
Accruals	-	83,926	429,044	512,970
Section 40-880 deduction	-	1,199,328	65,494	1,264,822
Provision for annual leave	-	1,298,488	121,978	1,420,466
Provision for long service leave	-	894,210	128,063	1,022,273
Provision for estimated credit losses	-	40,282	-	40,282
Provision for decommissioning costs	-	75,000	-	75,000
Provision for obsolete stock	-	-	6,186	6,186
Provision for make good costs	-	89,087	12,980	102,067
Provision for warranty	-	2,679,651	24,341	2,703,992
Other	-	10,909	(10,909)	-
Income tax losses	-	<u>(100,983)</u>	<u>334,520</u>	<u>233,537</u>
	-	<u>6,269,898</u>	<u>1,111,697</u>	<u>7,381,595</u>
Deferred tax liabilities				
Foreign exchange gain arising from tax fair value adjustment	-	(51,439)	-	(51,439)
Prepaid insurance	-	(183,353)	-	(183,353)
Right of use assets	-	(11,760)	-	(11,760)
Provision for deferred tax liabilities on acquired intangible assets	-	<u>93,085</u>	<u>(4,389,228)</u>	<u>(4,296,143)</u>
Total	-	<u>6,116,431</u>	<u>(3,277,531)</u>	<u>2,838,900</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

Consolidated	
31 December 2019	31 December 2018
\$	\$

4. Income Tax (Cont)

At the reporting date, the consolidated entity has unused tax losses emanating from its non-Australian entities.

No deferred tax asset has been recognised in respect of these balances as it is not considered probable that there will be future taxable profits available in these jurisdictions.

(c) Unrecognised deferred tax balances

The following deferred tax assets have not been bought to account as assets

Tax losses – revenue	23,129,161	17,052,793
Temporary differences	<u>322,854</u>	<u>2,954,843</u>
	<u>23,452,015</u>	<u>20,007,636</u>

(d) Franking account balance

Adjusted franking account balance	<u>1,881,111</u>	<u>-</u>
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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 27.

Nature of tax funding arrangements and tax sharing agreements

As at 31 December 2019, there were no formal tax funding or tax sharing arrangements within the tax-consolidated or group. Since the end of the financial year, the consolidated entity has entered into tax funding and tax sharing arrangements with entities in the Australian tax consolidated group.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
5. Trade and other receivables		
Current		
Trade receivables	25,688,863	26,228,489
GST receivable	1,022,437	571,575
Employee receivables	166,434	-
Other debtors	<u>178,468</u>	<u>19,682</u>
	<u>27,056,202</u>	<u>26,819,746</u>
Non-current		
Trade receivables	<u>12,055,798</u>	<u>7,146,990</u>

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

The consolidated entity 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 consolidated entity 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 consolidated entity 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

0-30 days	95,967	-
31-60 days	275,617	321,346
61-90 days	420,324	-
91-120 days	-	-
120 days +	<u>-</u>	<u>19,060</u>
	<u>791,908</u>	<u>340,406</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$

6. Contract asset

Unbilled revenue	<u>44,772,583</u>	<u>9,777</u>
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Being amounts reflected in revenue on a milestone basis but not billed to the customer in the defence segment.

The consolidated entity always measures the loss allowance for unbilled revenue at an amount equal to lifetime ECL. The expected credit losses on unbilled revenue are estimated using a provision matrix by reference to past known default experience of the customer, being a government, and an analysis of the customer's current financial position, adjusted for factors that are specific to the customer, general economic conditions of the industry in which the customers operate and an assessment to both the current as well as the forecasted direction of conditions at the reporting date. The consolidated entity has not recognised any loss allowance as the customer is a government customer secured by a letter of credit.

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

7. Inventories

Raw materials – at net realisable value	41,642,033	20,356,864
Work in progress – at cost	<u>11,849,140</u>	<u>6,108,635</u>
	<u>53,491,173</u>	<u>26,465,499</u>

8. Other Assets

Current

Prepayments	<u>14,737,600</u>	<u>12,713,727</u>
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Non-current

Prepayments	<u>7,800,037</u>	<u>2,252,177</u>
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These prepayments relate to prepayments made to suppliers for the delivery of component parts in relation to current orders.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31 December 2019 \$	31 December 2018 \$
9. Auditor's Remuneration		
(a) Auditor of the Parent Entity		
Audit or review of the financial report	247,800	196,665
Taxation services	<u>8,925</u>	<u>5,670</u>
	<u>256,725</u>	<u>202,335</u>
(b) Other Auditor		
Audit or review of the financial report	12,568	2,976
Taxation services	<u>1,266</u>	<u>893</u>
	<u>13,834</u>	<u>3,869</u>

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

10. Loan to associate

Unsecured convertible note to associate - AEI Air (Holdings) Limited	<u>2,632,783</u>	<u>-</u>
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On 23 April 2019 the consolidated entity entered into an Unsecured Convertible Note deed with a supplier AEI Air (Holdings) Limited ("supplier"). The terms of the deed require the supplier to issue to the consolidated entity up to five convertible notes, subject to certain conditions, of which \$2,780,265 has been paid. All five notes were convertible, in aggregate, into such number of shares which represents 51% of the issued share capital of the supplier at the date of conversion. Following payment of the first note the consolidated entity appointed two out of five directors of the supplier and had the right to appoint, remove or replace such number of directors which represent 50% of the board of directors (equivalent to 50% of directors' voting rights under the revised articles of association). The meeting of certain conditions, including product specifications would enable the consolidated entity to request the issuance of the remaining notes at their discretion, and convert these into equity. The convertible notes are redeemable upon an event of default or at the maturity date (being 36 months after date of issue of the first note above – 23 April 2019), and on redemption the supplier must repay the face value of the notes to the consolidated entity.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

Consolidated	
31 December 2019	31 December 2018
\$	\$

10. Loan to associate (cont)

On 23 April 2019 the consolidated entity also entered into a Put and Call Option deed with the shareholders of the supplier. This deed allows the consolidated entity to call the remaining 49% of the shareholding in the supplier at an aggregate exercise price based on an adjusted Net Profit after Tax (NPAT) multiple. The shareholders also have a put option over the same interest. Further, under this agreement, should certain conditions be met, the shareholders are able to request the draw down of loan advances to a maximum of GBP1,714,500, payable to the shareholders in four equal tranches. As at the date of this report the vendors have elected not to make any draw down of the loans under the agreement. Should the loans be called the agreement contains an offset clause under which the consolidated entity can offset against amounts payable should the put and call options be exercised. The put and call options can be exercised by the consolidated entity (or the shareholders) at any time up to and including 30 June 2022 but are conditional on the exercise of the Unsecured Convertible Notes as referred to above. The put and call option liability (in relation to the option) is carried at fair value through profit and loss.

Following initial assessment of these arrangements, a subsequent event was disclosed in the half-year report outlining that the consolidated entity controlled the supplier from the date of the payment of the second note. Subsequent to the issuance of the half-year report the directors sought legal advice in relation to the arrangements. As a result in the second half of the year the directors have reassessed these arrangements and now consider that the conclusion that the consolidated entity controlled the supplier from the date of the second note (as disclosed as a subsequent event in the half-year report) is not appropriate, and that the nature of the arrangement with the supplier should be disclosed as an associate as the nature of the Group's interest is that of significant influence rather than accounting control.

On 30 December 2019, the consolidated entity entered into an agreement with an entity in the United Arab Emirates (who is a joint venture partner to EOS) to acquire a 2% interest in the supplier should the consolidated entity exercise its Unsecured Convertible Note to acquire 51% of the supplier, leaving the consolidated entity with a potential 49% interest. The consolidated entity also formally rescinded its right to appoint, remove or replace such number of directors which represent 50% of the board of directors (equivalent to 50% of directors' voting rights under the revised articles of association) via deed poll.

Refer to the commitments note (Note 30) for potential commitments under the shareholder loans arrangements.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated 31 December 2019 \$	31 December 2018 \$
11. Right of use assets		
(a) Office premises – at cost	15,345,320	-
Less accumulated depreciation and impairment	<u>(1,805,748)</u>	-
	<u>13,539,572</u>	-
(b) Office equipment – at cost	531,391	-
Less accumulated depreciation and impairment	<u>(109,835)</u>	-
	<u>421,556</u>	-
	<u>13,961,128</u>	-
<u>Cost</u>		
Office premises		
Balance on transition	5,236,070	-
Additions	10,255,750	-
Disposals	(170,979)	-
Net foreign exchange differences	<u>24,479</u>	-
Balance at end of year	<u>15,345,320</u>	-
Office equipment		
Balance on transition	42,292	-
Additions	<u>489,099</u>	-
Balance at end of year	<u>531,391</u>	-

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
11. Right of use assets		
Accumulated Depreciation/Amortisation/ Impairment		
Office premises		
Balance on transition		-
Depreciation	(1,973,319)	-
Disposals	170,979	-
Net foreign exchange differences	<u>(3,408)</u>	<u>-</u>
Balance at end of year	<u>(1,805,748)</u>	<u>-</u>
Office equipment		
Balance on transition		-
Depreciation	<u>(109,835)</u>	<u>-</u>
Balance at end of year	<u>(109,835)</u>	<u>-</u>

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$

12. Goodwill

Being goodwill in relation to the purchase of EM Solutions Pty Ltd as at 11 October 2019

	<u>14,878,316</u>	<u>-</u>
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The consolidated entity acquired all the issued capital of EM Solutions Pty Ltd on 11 October 2019 as detailed in Note 28.

The carrying amount of goodwill has been allocated to cash generating units ("CGUs") as follows:

Defence	2,504,938	-
Space	2,504,938	-
Communications	<u>9,868,440</u>	<u>-</u>
	<u>14,878,316</u>	<u>-</u>

A description of each of the CGUs is outlined in Note 34.

The consolidated entity tests goodwill annually for impairment or more frequently if there are indicators that goodwill might be impaired.

The recoverable amount of each cash-generating unit is determined based on the fair value less costs of disposal arrived by discounting a cash flow forecast with the weighted average cost of capital of each CGU. The cash flow forecast for each CGU which were approved by the directors consists of detailed projections for a five-year period included a terminal value calculation for the final year assuming a growth rate assumption in the range of 2.5% to 4.0%.

The weighted average cost of capital takes into account the risk free rate, equity market risk and the specific risk premium for each CGU. Discount rates used in the calculation are given below:

Defence	14.1%	-
Space	23.7%	-
Communications	18.5%	-

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

Consolidated	
31 December 2019	31 December 2018
\$	\$

12. Goodwill (cont)

The consolidated entity conducted an analysis of the sensitivity of the impairment test to changes in key assumptions used to determine the recoverable amount for each of the group of CGUs to which goodwill is allocated. The directors believe that any reasonably possible change in the key assumptions on which the recoverable amount of the three CGU's would not cause the aggregate carrying amount to exceed the aggregate recoverable amount of the related CGUs.

A 1% increase in the discount rate is considered reasonably possible based on recent experience and would reduce the headroom in the "Communication" CGU but not result in an impairment charge.

13. Intangible assets

Being intangible assets identified in the purchase of EM Solutions Pty Ltd as at 11 October 2019

Core technology (not patented)	10,772,000	-
Patented technology	3,556,000	-
Software	486,000	-
Customer contracts and relationships	<u>2,776,000</u>	-
	17,590,000	-
Less		
Amortisation of intangibles	<u>354,299</u>	-
	<u>17,235,701</u>	-

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated 31 December 2019 \$	31 December 2018 \$
14. Property, Plant and Equipment		
(a) Plant and equipment – at cost	12,051,766	9,502,565
Less accumulated depreciation and impairment	<u>(8,751,221)</u>	<u>(7,748,865)</u>
	<u>3,300,545</u>	<u>1,753,700</u>
(b) Leased assets – at cost	26,066	26,066
Less accumulated amortisation and impairment	<u>(26,066)</u>	<u>(26,066)</u>
	-	-
(c) Office equipment – at cost	5,879,604	4,670,390
Less accumulated depreciation and impairment	<u>(4,320,255)</u>	<u>(3,909,971)</u>
	<u>1,559,349</u>	<u>760,419</u>
(d) Furniture, fixtures and fittings – at cost	1,711,437	1,560,332
Less accumulated depreciation and impairment	<u>(803,502)</u>	<u>(679,155)</u>
	<u>907,935</u>	<u>881,177</u>
(e) Leasehold improvements – at cost	2,025,460	1,499,424
Less accumulated depreciation and impairment	<u>(1,362,124)</u>	<u>(1,118,477)</u>
	<u>663,336</u>	<u>380,947</u>
(f) Motor vehicle – at cost	370,810	102,260
Less accumulated depreciation and impairment	<u>(86,764)</u>	<u>(36,377)</u>
	<u>284,046</u>	<u>65,883</u>
(g) Computer software – at cost	436,726	128,499
Less accumulated depreciation	<u>(152,441)</u>	<u>(9,776)</u>
	<u>284,285</u>	<u>118,723</u>
(h) Test equipment – at cost	2,790,535	-
Less accumulated depreciation	<u>(1,728,522)</u>	-
	<u>1,062,013</u>	-
(i) Satellite – at cost	7,000,000	7,000,000
Less impairment	<u>(7,000,000)</u>	<u>(7,000,000)</u>
	-	-
Total net book value of Property, Plant and Equipment	<u>8,061,509</u>	<u>3,960,849</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated	
	31 December 2019 \$	31 December 2018 \$
14. Property, Plant and Equipment (cont)		
<u>Cost</u>		
Plant and equipment		
Balance at beginning of year	9,502,565	7,649,696
Additions	2,549,914	1,554,016
Disposals	-	(254,022)
Net foreign currency exchange differences	<u>(713)</u>	<u>552,875</u>
Balance at end of year	<u>12,051,766</u>	<u>9,502,565</u>
Leased assets		
Balance at beginning of year	26,066	23,551
Net foreign currency exchange differences	-	<u>2,515</u>
Balance at end of year	<u>26,066</u>	<u>26,066</u>
Office equipment		
Balance at beginning of year	4,670,390	3,955,490
Additions	1,261,347	542,589
Transfers	(8,818)	-
Disposals	(43,848)	(124,401)
Net foreign currency exchange differences	<u>533</u>	<u>296,712</u>
Balance at end of year	<u>5,879,604</u>	<u>4,670,390</u>
Furniture, fixtures and fittings		
Balance at beginning of year	1,560,332	826,911
Additions	157,510	675,373
Disposals	(6,405)	-
Net foreign currency exchange differences	-	<u>58,048</u>
Balance at end of year	<u>1,711,437</u>	<u>1,560,332</u>
Leasehold improvements		
Balance at beginning of year	1,499,424	1,205,945
Additions	526,036	246,859
Net foreign currency exchange differences	-	<u>46,620</u>
Balance at end of year	<u>2,025,460</u>	<u>1,499,424</u>

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
14. Property, Plant and Equipment (cont)		
Motor vehicle		
Balance at beginning of year	102,260	60,682
Additions	268,380	41,578
Net foreign currency exchange differences	<u>170</u>	<u>-</u>
Balance at end of year	<u>370,810</u>	<u>102,260</u>
Computer software		
Balance at beginning of the year	128,499	-
Additions	299,243	128,499
Transfers	8,818	-
Net foreign currency exchange differences	<u>166</u>	<u>-</u>
Balance at end of year	<u>436,726</u>	<u>128,499</u>
Test equipment –at cost		
Balance at beginning of the year	-	-
Additions	<u>2,790,535</u>	<u>-</u>
Balance at end of year	<u>2,790,535</u>	<u>-</u>
Satellite		
Balance at beginning of year	7,000,000	7,000,000
Balance at end of year	<u>7,000,000</u>	<u>7,000,000</u>

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
14. Property, Plant and Equipment (cont)		
Accumulated Depreciation/Amortisation/ Impairment		
Plant and equipment		
Balance at beginning of year	(7,748,865)	(7,188,427)
Depreciation	(769,031)	(261,585)
Acquired from EM Solutions Pty Ltd	(231,677)	-
Disposals	-	254,022
Net foreign currency exchange differences	<u>(1,648)</u>	<u>(552,875)</u>
Balance at end of year	<u>(8,751,221)</u>	<u>(7,748,865)</u>
Leased plant and equipment		
Balance at beginning of year	(26,066)	(23,551)
Net foreign currency exchange differences	<u>-</u>	<u>(2,515)</u>
Balance at end of year	<u>(26,066)</u>	<u>(26,066)</u>
Office equipment		
Balance at beginning of year	(3,909,971)	(3,563,079)
Depreciation	(365,127)	(174,834)
Transfers	8,842	-
Acquired from EM Solutions Pty Ltd	(101,909)	-
Disposals	43,848	124,401
Net foreign currency exchange differences	<u>4,062</u>	<u>(296,459)</u>
Balance at end of year	<u>(4,320,255)</u>	<u>(3,909,971)</u>
Furniture, fixtures and fittings		
Balance at beginning of year	(679,155)	(585,429)
Depreciation	(91,045)	(35,338)
Acquired from EM Solutions Pty Ltd	(40,047)	-
Disposals	6,405	-
Net foreign currency exchange differences	<u>340</u>	<u>(58,388)</u>
Balance at end of year	<u>(803,502)</u>	<u>(679,155)</u>

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
14. Property, Plant and Equipment (cont)		
Leasehold improvements		
Balance at beginning of year	(1,118,477)	(940,851)
Depreciation	(243,647)	(131,005)
Net foreign currency exchange differences	<u>-</u>	<u>(46,621)</u>
Balance at end of year	<u>(1,362,124)</u>	<u>(1,118,477)</u>
Motor vehicle		
Balance at beginning of year	(36,377)	(15,591)
Depreciation	(36,533)	(20,697)
Acquired from EM Solutions Pty Ltd	(13,480)	-
Net foreign currency exchange differences	<u>(374)</u>	<u>(89)</u>
Balance at end of year	<u>(86,764)</u>	<u>(36,377)</u>
Computer software		
Balance at beginning of the year	(9,776)	-
Depreciation	(134,141)	(9,776)
Transfers	(8,842)	-
Net foreign currency exchange differences	<u>318</u>	<u>-</u>
Balance at end of year	<u>(152,441)</u>	<u>(9,776)</u>
Test equipment		
Balance at beginning of the year	-	-
Depreciation	(55,482)	-
Acquired from EM Solutions Pty Ltd	<u>(1,673,040)</u>	<u>-</u>
Balance at end of year	<u>(1,728,522)</u>	<u>-</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$

14. Property, Plant and Equipment (cont)

Satellite

Balance at beginning of year	(7,000,000)	(7,000,000)
Balance at end of year	<u>(7,000,000)</u>	<u>(7,000,000)</u>

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 no impairment charge for the year of Nil (2018: Nil).

15. Current trade and other payables

Trade payables	18,338,094	11,277,520
Accruals	16,245,406	1,399,605
Unearned revenue	<u>2,386,503</u>	<u>9,651,772</u>
	<u>36,970,003</u>	<u>22,328,897</u>

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.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
16. Leases		
Analysed as follows:		
Non-current	11,386,647	-
Current	<u>2,613,223</u>	-
	<u>13,999,870</u>	-
 Maturity analysis		
Year 1	3,221,803	-
Year 2	2,933,866	-
Year 3	2,789,806	-
Year 4	1,774,389	-
Year 5	1,438,046	-
Onwards	<u>4,139,070</u>	-
	<u>16,296,980</u>	-
Less: unearned interest	<u>2,297,110</u>	-
	<u>13,999,870</u>	-

The consolidated entity does not face a significant liquidity risk with regard to its lease liabilities. All lease obligations in Australia are denominated in Australian dollars and leases in overseas entities are based in the currencies of the country concerned.

Disclosure required by AASB 17

Non-cancellable operating lease payables

Not longer than 1 year	-	1,882,845
Longer than 1 year and not longer than 5 years	-	4,145,792
Longer than 5 years	-	-
	<u>-</u>	<u>6,028,637</u>

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
17. Provisions		
Current		
Employee benefits (Note 19)	8,688,573	4,620,115
Provision for straight lining of rent	-	15,497
Provision for make good	43,919	-
Decommissioning costs	250,000	250,000
Under utilised space	212,715	884,855
Warranty (Note 18)	<u>3,687,612</u>	<u>596,424</u>
	<u>12,882,819</u>	<u>6,366,891</u>
Non-current		
Employee Benefits (Note 19)	757,199	409,262
Make good of premises	296,302	132,776
Estimated credit losses	134,273	-
Warranty (Note 18)	<u>5,325,693</u>	<u>3,349,732</u>
	<u>6,513,467</u>	<u>3,891,770</u>

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
17. Provisions (cont)		
Movement on decommissioning costs		
Balance at 1 January	250,000	250,000
Balance as at 31 December	<u>250,000</u>	<u>250,000</u>
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	15,497	7,225
(Decrease)/ Increase during the period	<u>(15,497)</u>	<u>8,272</u>
Balance as at 31 December	<u>-</u>	<u>15,497</u>
Movement in make good of premises		
Balance at 1 January	132,776	80,000
Increase during the period from new lease	<u>163,526</u>	<u>52,776</u>
Balance as at 31 December	<u>296,302</u>	<u>132,776</u>
Movement in under utilised space		
Balance at 1 January	884,855	-
(Decreases)/ Increases resulting from re-measurement	<u>(672,140)</u>	<u>884,855</u>
Balance as at 31 December	<u>212,715</u>	<u>884,855</u>
Movement in estimated credit losses		
Balance at 1 January	-	-
(Decreases)/ Increases resulting from re-measurement	<u>134,273</u>	<u>-</u>
Balance as at 31 December	<u>134,273</u>	<u>-</u>

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31 December 2019 \$	31 December 2018 \$
18. Warranty Provisions		
Movement in warranty provision		
Balance at 1 January	3,946,156	1,561,755
Reductions resulting from expiry	(1,248,966)	(944,692)
Additional provisions recognised	<u>6,316,115</u>	<u>3,329,093</u>
Balance as at 31 December	<u>9,013,305</u>	<u>3,946,156</u>
Current (Note 17)	<u>3,687,612</u>	<u>596,424</u>
Non-Current (Note 17)	<u>5,325,693</u>	<u>3,349,732</u>

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.

19. Employee Benefits

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

Provision for employee entitlements

Current (Note 17)	<u>8,688,573</u>	<u>4,620,115</u>
Non-Current (Note 17)	<u>757,199</u>	<u>409,262</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

	Consolidated	
	31 December 2019 \$	31 December 2018 \$
20. Issued capital		
Balance at the beginning of the financial year – Ordinary shares	161,784,727	103,342,071
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	-	-
Issue of 4,271,357 new shares at \$7.31 as part of the acquisition cost of EM Solutions Pty Ltd on 11 October 2019	31,223,620	-
Issue of 10,144,224 new shares at \$6.66 on 27 November 2019 (net of issuance costs)	64,261,948	-
Issue of 2,558,753 new shares at \$6.66 on 13 December 2019 under the Share Purchase Plan	<u>17,041,295</u>	<u>-</u>
Balance at the end of the financial year	<u>274,311,590</u>	<u>161,784,727</u>

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.

	Number	Number
Fully Paid Ordinary Shares		
Balance at the beginning of financial year	96,103,879	69,809,564
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
Issue of new shares at \$7.31 on 11 October 2019	4,271,357	-
Issue of new shares at \$6.66 on 27 November 2019	10,144,224	-
Issue of new shares at \$6.66 under the Share Purchase Plan	<u>2,558,753</u>	<u>-</u>
Balance at end of financial year	<u>113,078,213</u>	<u>96,103,879</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

Consolidated	
31	31
December	December
2019	2018
\$	\$

20. Issued capital (cont)

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 22 to the financial statements and are treated as in substance options.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

21. 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 quantitative 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

	2019		2018	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Balance at the beginning of the financial year (i)	5,720,000	3.00	5,620,000	3.00
Granted during the year (ii)	-	-	220,000	2.99
Exercised during the year (iii)	-	-	-	-
Lapsed during the year (iv)	(5,500,000)	3.00	(120,000)	3.00
Balance at the end of the financial year (v)	220,000	3.00	5,720,000	3.00
Exercisable at end of the year	-	3.00	5,500,000	3.00

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

21. 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
2019	5,720,000	Various	31/1/19	3.00	\$1,920,119
2018	5,620,000	Various	31/1/19	3.00	\$1,892,410

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
2019					
Staff options	-	-	-	-	-
2018					
Staff options	<u>220,000</u>	20/6/18	31/3/2023*	2.99	<u>\$61,369</u>

These staff options have similar vesting and forfeiture conditions as those issued under the Loan Funded Share Plan summarised in Note 22. 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

21. 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

5,500,000 (2018: 120,000) Staff options lapsed during the year.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)****21. 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
2019					
Staff options	<u>220,000</u>	20/6/18	31/3/23	\$2.99	<u>61,369</u>
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	<u>200,000</u>	30/5/16	31/1/19	\$3.00	<u>91,600</u>
	<u>5,720,000</u>				<u>1,920,119</u>

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 22 to the financial statements.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

22. Loan Funded Share Plan

The Board has established an 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:

	<u>Number of Shares</u>	<u>Fair Value at grant date</u>
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	<u>250,000</u>	<u>\$69,738</u>
	4,000,000	\$1,115,802
Selected Employees	<u>1,180,000</u>	<u>\$329,161</u>
	<u>5,180,000</u>	<u>\$1,444,963</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

22. Loan Funded Share Plan (cont)

The Shares issued to Directors and selected employees are 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 are 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 consolidated entity or 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)

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

22. 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 400 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

22. 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.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
23. Reserves		
Foreign currency translation	(1,061,206)	(1,399,064)
Employee equity-settled benefits	<u>10,373,224</u>	<u>9,871,855</u>
	<u>9,312,018</u>	<u>8,472,791</u>
Foreign currency translation		
Balance at beginning of financial year	(1,399,064)	(241,137)
Translation of foreign operations	<u>337,858</u>	<u>(1,157,927)</u>
Balance at end of financial year	<u>(1,061,206)</u>	<u>(1,399,064)</u>

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	9,871,855	9,586,065
Share based payment	<u>501,369</u>	<u>285,790</u>
Balance at end of financial year	<u>10,373,224</u>	<u>9,871,855</u>

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 22 to the financial statements. Items included in employee equity-settled benefits reserve will not be reclassified subsequently to profit or loss.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
24. Accumulated Losses		
Balance at beginning of financial year	(73,814,165)	(89,116,379)
Net profit attributable to members of the parent entity	<u>18,435,425</u>	<u>15,302,214</u>
Balance at end of financial year	<u>(55,378,740)</u>	<u>(73,814,165)</u>

25. 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:

Cash and cash equivalents - current	<u>77,881,766</u>	<u>40,538,225</u>
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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

	Consolidated	
	31	31
	December	December
	2019	2018
	\$	\$
25. Notes to the Cash Flow Statement (Cont)		
(b) Restricted cash		
Cash held as security for performance bonds and leases	<u>102,025</u>	<u>119,025</u>
(c) Reconciliation of profit for the year to net cash flows from operating activities		
Profit for the year	21,970,274	15,081,372
Amortisation of intangibles	354,299	-
Equity settled share-based payments	501,369	285,790
Depreciation of property, plant and equipment	1,694,948	633,235
Depreciation of right of use assets	2,083,154	-
Net assets acquired from acquisition	4,392,972	-
Tax paid	(1,881,111)	-
Foreign exchange movements	61,171	(1,110,411)
(Increase)/decrease in assets		
Current receivables	(4,997,782)	(21,694,865)
Contract assets	(44,772,583)	-
Inventories	(27,025,674)	(12,669,925)
Other current assets	(7,571,733)	(4,763,962)
Increase/(decrease) in liabilities		
Provisions	9,137,625	4,308,025
Trade and other payables	19,488,710	5,998,330
Deferred income	<u>(7,265,269)</u>	<u>(1,753,791)</u>
Net cash (outflows) from operating activities	<u>(33,829,630)</u>	<u>(15,686,202)</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

26. Related party disclosures

(a) Equity interests in related parties

Details of the percentage of ordinary shares held in subsidiaries are disclosed in Note 27.

(b) Key management personnel compensation

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

	31 December 2019	31 December 2018
	\$	\$
Short term benefits	1,878,683	1,728,877
Post-employment benefits	164,090	143,506
Share based payments	372,553	211,905
Long term benefits	<u>1,312,680</u>	<u>474,953</u>
	<u>3,728,006</u>	<u>2,559,241</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

26. Related party disclosures (cont)

(c) Transactions with other related parties

Other related parties includes:

- the parent entity;
- associates;
- Joint venture partners;
- entities with significant influence over the consolidated entity; and
- subsidiaries.

On 30 December 2019, the consolidated entity entered into an agreement to sell 2% of its convertible note to acquire 51% of AEI Air (Holdings) Limited for GBP78,431 should the consolidated entity exercise its convertible note. The purchaser was Alebtekar Remote Control Systems Manufacturing Of United Arab Emirates who is the 51% shareholder in EOS Advanced Technologies LLC.

(d) Other transactions with key management personnel or director related entities

During the year, the Company paid a total of \$76,814 (2018: \$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 (2018: \$47,222) 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 (2018: \$47,222) 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 \$141,073 (2018: \$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 \$30,441 (2018: \$28,441) 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 group is Electro Optic Systems Holdings Limited.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

27. Controlled Entities

Name of Entity	Country of Incorp- oration	December 2019 %	December 2018 %
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 (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	49
EOS Optronics GmbH	Germany	100	100
EM Solutions Pty Ltd (ii), (iii), (v)	Australia	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.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

27. Controlled Entities (cont)

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. On 28 November 2019, the parent entity Electro Optic Systems Holdings Limited entered into a Deed of Assumption which joined EM Solutions Pty Limited as part of the Deed of Cross Guarantee from the effective date of acquisition which was 11 October 2019.

- (iv) Whilst the consolidated entity 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.
- (v) On 11 October 2019, the consolidated entity acquired 100% of the issued share capital of EM Solutions Pty Ltd, obtaining control of EM Solutions Pty Ltd.

Deloitte Touche Tohmatsu is the auditor of the consolidated entity. EOS Defense Systems Pte Limited is audited by Assurance Affiliates, Chartered Accountants in Singapore and EOS Advanced Technologies LLC is audited by M A International Consulting LLC in UAE and are the only entities with a separately appointed statutory auditor.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)****27(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 2019	31 December 2018
	\$	\$
Revenue	160,841,154	85,444,179
Changes in inventories of work in progress	(5,740,505)	(2,842,202)
Raw materials and consumables used	(82,358,595)	(39,709,340)
Employee benefits expense	(22,895,466)	(16,461,267)
Administration expenses	(13,969,054)	(8,352,985)
Amortisation of intangibles	(354,299)	-
Interest paid - other	-	(29,472)
Interest paid on right of use assets	(155,570)	-
Depreciation and amortisation of property, plant and equipment	(1,472,602)	(600,082)
Depreciation of right of use assets	(738,249)	-
Foreign exchange gains	644,402	7,708,137
Occupancy costs	(720,119)	(945,491)
Other expenses	(1,424,097)	(943,862)
Provision for loss on loans to subsidiaries	<u>(17,156,416)</u>	<u>(11,822,666)</u>
Profit before income tax	14,500,584	11,444,949
Income tax	<u>(3,911,516)</u>	-
Profit for the year	<u>10,589,068</u>	<u>11,444,949</u>

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)****27(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 2019	Consolidated December 2018
	\$	\$
CURRENT ASSETS		
Cash and cash equivalents	75,555,109	37,938,141
Trade and other receivables	26,306,652	26,326,301
Contact assets	44,772,583	-
Inventories	48,772,856	25,213,232
Other	<u>13,753,650</u>	<u>11,448,915</u>
TOTAL CURRENT ASSETS	<u>209,160,850</u>	<u>100,926,589</u>
NON-CURRENT ASSETS		
Trade and other receivables	12,055,798	-
Other	7,800,038	9,399,167
Deferred tax assets	2,838,900	-
Security deposit	9,021,823	8,971,929
Loan to associate	2,632,783	-
Right of use asset	8,510,087	-
Goodwill	14,878,316	-
Intangible assets	17,235,701	-
Property, plant and equipment	<u>6,688,302</u>	<u>3,792,113</u>
TOTAL NON-CURRENT ASSETS	<u>81,661,748</u>	<u>22,163,209</u>
TOTAL ASSETS	<u>290,822,598</u>	<u>123,089,798</u>
CURRENT LIABILITIES		
Trade and other payables	34,248,144	16,855,009
Current tax liabilities	8,352,728	-
Lease liabilities	1,175,021	-
Provisions	<u>11,399,119</u>	<u>4,099,587</u>
TOTAL CURRENT LIABILITIES	<u>55,175,012</u>	<u>20,954,596</u>
NON-CURRENT LIABILITIES		
Lease liabilities	7,295,865	-
Provisions	<u>6,448,533</u>	<u>3,849,314</u>
TOTAL NON-CURRENT LIABILITIES	<u>13,744,398</u>	<u>3,849,314</u>
TOTAL LIABILITIES	<u>68,919,410</u>	<u>24,803,910</u>
NET ASSETS	<u>221,903,188</u>	<u>98,285,888</u>
EQUITY		
Issued capital	274,311,590	161,784,727
Reserves	10,373,224	9,871,855
Accumulated losses	<u>(62,781,626)</u>	<u>(73,370,694)</u>
TOTAL EQUITY	<u>221,903,188</u>	<u>98,285,888</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

27(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 2019 \$	31 December 2018 \$
Balance at the start of the year	(73,370,694)	(84,815,643)
Add		
Net profit for the year	<u>10,589,068</u>	<u>11,444,949</u>
Balance at end of the year	<u>(62,781,626)</u>	<u>(73,370,694)</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

28. Acquisition of subsidiary

On 11 October 2019, the consolidated entity acquired 100% of the issued share capital of EM Solutions Pty Ltd, obtaining control of EM Solutions Pty Ltd. EM Solutions Pty Ltd specialises in innovative optical, microwave and on-the-move radio and satellite products that help deliver high speed, resilient and assured telecommunications anywhere in the world. The business of EM Solutions Pty Limited has potential synergies with both the Space and Defence segments of the consolidated entity.

The amounts recognised in respect of the identifiable assets acquired and liabilities assumed are set out in the table below:

Tangible assets	
Property, plant and equipment	1,195,767
Working capital	1,997,934
Deferred tax assets	1,111,697
Other assets and liabilities	131,750
Net cash	<u>277,313</u>
Net tangible operating assets	<u>4,714,461</u>
Intangible assets	
Core technology (not patented)	10,772,000
Patented technology	3,556,000
Software	486,000
Customer contracts and relationships	<u>2,776,000</u>
Total identifiable intangibles	17,590,000
Deferred tax on newly identified intangible assets	(4,389,228)
Goodwill	<u>14,878,316</u>
Total intangible assets	<u>28,079,088</u>
Total net assets acquired	<u>32,793,549</u>

Satisfied by:

Cash paid and payable	1,485,000
Equity issued	31,223,620
Completion adjustments	<u>84,929</u>
Total consideration for shares	<u>32,793,549</u>

The Goodwill of \$14,878,316 arising from the acquisition has been determined from the Purchase Price Allocation from Leadenhall Valuations Pty Limited as at 11 October 2019.

The fair value of the 4,271,357 ordinary shares issued as part of the consideration paid for EM Solutions Pty Ltd was determined on the basis of fair market value on the date of issue of the shares being \$7.31.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

28. Acquisition of subsidiary (cont)

Acquisition-related costs (included in administrative expenses) amounted to \$37,556.

EM Solutions Pty Ltd contributed \$1,891,428 revenue and a loss of \$202,821 to the consolidated entity's profit before tax for the period between 11 October 2019 (Date of acquisition) and the reporting date.

29. Joint Operations

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

The operation is not yet active.

30. Contingent Liabilities and Commitments

- (a) 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 consolidated entity.
- (b) 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\$17m with the overseas Government Authority to ensure that local content requirements are met. The final terms of the offset bond are still being negotiated.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

30. Contingent Liabilities and Commitments

- (c) The consolidated entity provided a performance bond in respect of a contract in the Defence sector for US\$31,635,147 in relation to an overseas defence sector contract. The performance bond was provided by Efic under a Bond Facility Agreement and is secured by a cash security deposit of A\$9,021,823 and a fixed and floating charge over the assets of the consolidated entity.
- (d) Electro Optic Systems Holdings Limited entered into a deed of cross guarantee on 6 April 2018 with two of its wholly-owned subsidiaries, Electro Optic Systems Pty Limited and EOS Defence Systems Pty Limited, pursuant to ASIC Corporations (Wholly-owned Companies) Instrument 2016/785 and relieved from the requirement to prepare and lodge an audited financial report. On 28 November 2019, EM Solutions Pty Ltd entered into an Assumption Deed and became a party to the Deed of Cross Guarantee.
- (e) Electro Optic Systems Pty Limited, a wholly owned subsidiary of Electro Optic Systems Holdings Limited, has entered into an Unsecured Convertible Note Deed with the vendors of AEI Air (Holdings) Limited and others to advance funds up to GBP2,000,000 as a series of convertible notes which will entitle Electro Optic Systems Pty Limited to convert these convertible notes, when advanced in full, to acquire 49% of the equity in AEI Air (Holdings) Limited. Electro Optic Systems Pty Limited has also entered into a Put and Call Option Deed with the vendors of AEI Air (Holdings) Limited to acquire a further 49% from the vendors of AEI Air (Holdings) Limited based on a profitability formula over the four year period from 1 January 2019 to 31 December 2022 and meeting various milestones. The Put and Call Option Deed also includes provisions for Electro Optic Systems Pty Limited to make vendor loans of up to GBP1,714,500 to the vendors of AEI Air (Holdings) Limited which are fully repayable should the Put and Call Option not be exercised. Where the Put and Call Option is exercised the loans are able to offset the exercise price on settlement. At the date of this report GBP1,500,000 has been advanced under the Unsecured Convertible Note Deed and no amounts have been advanced to the vendors under the Put and Call Option Deed at their request. Electro Optic Systems Pty Limited hold no direct equity in AEI Air (Holdings) Limited at the date of this report.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

31. Subsequent Events

On 26 December 2019, Electro Optic Systems Holdings Limited (“EOS” or “Company”) (ASX: EOS), acting through its wholly-owned US subsidiary EOS Defense Systems USA, Inc. (“EOSDS”), executed an agreement to purchase certain assets of Audacy Corporation, a space communications company based in the US (“Purchase”) subject to mandatory Federal Communications Commission (“FCC”) approval. EOSDS will outlay approximately A\$10 million in cash for the Purchase including substantial costs associated with securing mandatory US government spectrum licenses and other costs.

The transfer of control of Audacy Corporation’s spectrum licenses to EOSDS is subject to review and approval by the FCC. The FCC application was lodged on 28 January 2020 and an announcement was made to the ASX at that time. On 5 March 2020 the FCC granted its consent to the transfer. EOSDS has also filed for review of the Acquisition by the US Committee on Foreign Investment in the US (“CFIUS”) on 9 March 2020.

Although the Company believes the Purchase is compliant with all statutory and regulatory requirements, approval of the Purchase by CFIUS cannot be assured. In the normal course, and subject to those government approvals and other customary conditions, EOS anticipates the Purchase to close in mid-2020 (“Completion”).

EOSDS is not required to make any material payment for the Purchase until Completion has occurred. EOS will fund the A\$10 million required during 2020 for the Purchase and related activities from its cash holdings.

Subsequent to the end of the financial year there have been considerable economic impacts in Australia and globally arising from the outbreak of COVID-19 virus and the respective Government actions to reduce the spread of the virus.

As this economic impact occurred after the reporting period, the Consolidated entity believes it constitutes a “Non-Adjusting Subsequent Event” as defined in AASB 110 Events after the Reporting Period.

- In March 2020, the consolidated entity implemented its Business Continuity Plan where most staff not directly involved in production will work from home to limit the potential spread of the virus and to enable the consolidated entity to continue to operate and serve our customers.
- The initial impacts on Consolidated entity’s operations have been limited by a very strong inventory of production parts, and the fact that almost all EOS debtors are ultimately sovereign entities. The Consolidated entity’s early adoption of virus-impeding practices may mitigate future impacts on business operations.
- The Consolidated entity will continue to monitor the impact of COVID-19 on the business as a whole including any impact on the supply chain, production capacity, logistic operations including product delivery, and collection of receivables. Therefore, at the date of signing the financial report the Consolidated entity is unable to determine what financial effects the outbreak of the virus could have on the Consolidated entity in the coming financial period.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

31. Subsequent Events (cont)

- No financial effects arising from the economic impacts of the virus have been included in the financial results for the year ended 31 December 2019.
- Should this emerging macro-economic risk continue for a prolonged period, there could be potentially adverse financial impacts to the Consolidated entity, including slower revenue growth and obstruction to the plan towards increased profitability.

There have been no other transactions or events of a material and unusual nature between the end of the reporting period and the date of the report likely, in the opinion of the Directors of the Company, to affect significantly the operations of the consolidated entity, the results of those operations, or state of affairs of the consolidated entity in future years.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

32. Financial risk management objectives and policies

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

Due to the small size of the consolidated entity 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 consolidated entity 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 consolidated entity's exposure to market interest rates relates primarily to the consolidated entity's cash holdings.

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

	Consolidated	
	2019	2018
	\$	\$
Financial assets		
Cash and cash equivalents	77,881,766	40,538,225
Security deposit	<u>9,021,823</u>	<u>8,971,929</u>
	<u>86,903,589</u>	<u>49,510,154</u>

The consolidated entity 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.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

32. Financial risk management objectives and policies (cont)

At 31 December 2019, 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)	
	2019 \$	2018 \$	2019 \$	2018 \$
Consolidated				
+1% (100 basis points)	608,325	495,116	608,325	495,116
-.5% (50 basis points)	<u>(304,163)</u>	<u>(247,588)</u>	<u>(304,163)</u>	<u>(247,588)</u>

The movements in profits are due to lower interest rates on cash balances. The cash balances were higher in 2019 than in 2018 and accordingly the sensitivity is higher.

(b) Foreign currency risk

As a result of purchases of inventory denominated in United States Dollars, the consolidated entity's statement of financial position can be affected significantly by movements in the US\$/A\$ exchange rates. There are also exposures to Singapore dollars from operations in that country. Exchange rates are managed within approved policy parameters using natural hedges and no derivatives are used.

The consolidated entity 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 consolidated entity is to convert surplus foreign currencies to Australian dollars. The consolidated entity also holds cash deposits in US dollars to secure US dollar bank guarantees and performance bonds to overseas customers.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

32. Financial risk management objectives and policies (cont)

At 31 December 2019, the consolidated entity had the following exposure to US\$ foreign currency:

	Consolidated	
	2019	2018
	\$	\$
Financial assets		
Cash and cash equivalents	9,945,796	3,642,504
Security deposit	9,021,823	8,971,929
Contract asset	44,692,332	-
Trade and other receivables	<u>43,879,390</u>	<u>40,562,230</u>
	<u>107,539,341</u>	<u>53,176,663</u>
Financial liabilities		
Accruals	12,527,901	-
Lease liabilities	5,368,188	-
Trade and other payables	<u>5,001,530</u>	<u>2,168,101</u>
	<u>22,897,619</u>	<u>2,168,101</u>
Net exposure	<u>84,641,722</u>	<u>51,008,562</u>

All US\$ denominated financial instruments were translated to A\$ at 31 December 2019 at the exchange rate of 0.7013 (2018: 0.7052).

At 31 December 2019 and 2018, 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)	
	2019	2018	2019	2018
	\$	\$	\$	\$
Consolidated				
AUD/USD +10%	(5,386,291)	(4,267,142)	(5,386,291)	(4,267,142)
AUD/USD -5%	<u>3,118,379</u>	<u>2,684,661</u>	<u>3,118,379</u>	<u>2,684,661</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

Financial risk management objectives and policies (cont)

At 31 December 2019, the consolidated entity had the following exposure to Singapore \$ foreign currency:

	Consolidated	
	2019	2018
	\$	\$
Financial assets		
Cash and cash equivalents	28,262	34,031
Trade and other receivables	<u>1,721</u>	<u>24,964</u>
	<u>29,983</u>	<u>58,995</u>
Financial liabilities		
Trade and other payables	23,544	32,954
Lease liabilities	<u>160,795</u>	<u>-</u>
	<u>184,339</u>	<u>32,954</u>
Net exposure	<u>(154,356)</u>	<u>26,041</u>

All Singapore \$ denominated financial instruments were translated to A\$ at 31 December 2019 at the exchange rate of 0.9437 (2018: 0.9614).

At 31 December 2019 and 2018, 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)	
	2019	2018	2019	2018
	\$	\$	\$	\$
Consolidated				
AUD/SING +10%	5,661	(1,417))	5,661	(1,417))
AUD/SING -5%	<u>(17,817)</u>	<u>2,471</u>	<u>(17,817)</u>	<u>2,471</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

32. 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 counterparty will default on its contractual obligations resulting in a financial loss to the consolidated entity. The consolidated entity 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 consolidated entity or 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 consolidated entity's short, medium and long term funding and liquidity requirements. The consolidated entity 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 consolidated entity'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 consolidated entity can be required to pay. The table includes both interest and principal cash flows.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)**

32. 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 \$
2019					
Other non-interest bearing liabilities	-	35,262,877	-	-	-
2018					
Other non-interest bearing liabilities	-	12,676,855	-	-	-

The following tables detail the consolidated entity'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/Consolidated entity 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 \$
2019					
Non-interest bearing	-	5,194,169	-	-	-
Receivables	-	25,867,331	-	-	12,055,798
Contract asset	-	-	-	44,772,583	
Fixed interest rate instruments	1.04	<u>42,724,165</u>	<u>30,077,466</u>	-	-
		<u>73,785,665</u>	<u>30,077,466</u>	<u>44,772,583</u>	<u>12,055,798</u>
2018					
Non-interest bearing	-	12,168,586	-	-	-
Receivables	-	26,248,171	-	-	7,146,990
Fixed interest rate instruments	1.56	<u>9,001,059</u>	<u>28,427,519</u>	-	-
		<u>47,417,816</u>	<u>28,427,519</u>	-	<u>7,146,990</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

32. Financial risk management objectives and policies (cont)

(e) Price risk

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

33. Details of Associates

Name of Entity:	AEI Air (Holdings) Limited
Place of incorporation:	United Kingdom
Principal place of business:	1 Kings Ride Park Ascot Berkshire SL5 8AP UK
Principal activity:	Defence products
Deemed percentage holding:	The consolidated entity holds unsecured convertible notes, which are convertible into shares representing a 49% equity interest.
Aggregate share of net profits/ (losses)	Nil – The investment in the associate is debt in nature and therefor the consolidated entity does not have a share in any profit/(loss).

Please refer to Note 10 for additional information.

The above associate is accounted for using the policy outlined in Note 1(z).

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

34. Segment Information

AASB 8 requires operating segments to be identified on the basis of internal reports about components of the consolidated entity 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 consolidated entity's reportable segments has changed from those disclosed in the previous 2018 Annual Report with the addition of the Communication Systems segment following the acquisition of EM Solutions Pty Ltd. The consolidated entity's reportable segments are Defence Systems, Space Systems and Communication Systems.

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

Product and Services within each Segment

Space Systems

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.

Communication Systems

EMS specializes in innovative optical, microwave and on-the-move radio and satellite products that help deliver high speed, resilient and assured telecommunications anywhere in the world.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)****34. Segment Information (Cont)****Segment Revenues**

	Consolidated	
	31 December 2019 \$	31 December 2018 \$
Communication	1,891,778	-
Space	5,020,183	1,379,421
Defence	<u>158,503,685</u>	<u>84,960,317</u>
Total of all segments	165,415,646	86,339,738
Unallocated interest received	<u>569,917</u>	<u>790,658</u>
Total	<u>165,985,563</u>	<u>87,130,396</u>

Segment Results

Communications	(202,821)	-
Space	414,318	(2,153,278)
Defence	<u>22,217,435</u>	<u>17,766,199</u>
Total of all segments	22,428,932	15,612,921
Unallocated holding company costs	<u>(458,658)</u>	<u>(531,549)</u>
Profit before income tax expense	21,970,274	15,081,372
Income tax expense	<u>(3,911,516)</u>	<u>-</u>
Profit for the year	<u>18,058,758</u>	<u>15,081,372</u>

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 two customers who each provided in excess of 10% of consolidated revenue. The customers are within the Defence segment and provided combined revenue of \$142,634,267.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

34. Segment Information (cont)

Segment Assets and Liabilities

	Assets		Liabilities	
	31 December 2019 \$	31 December 2018 \$	31 December 2019 \$	31 December 2018 \$
Communications	17,822,705	-	7,882,435	-
Space	2,126,387	726,984	4,612,872	5,504,682
Defence	<u>199,572,638</u>	<u>78,632,004</u>	<u>66,223,580</u>	<u>27,082,876</u>
Total all segments	219,521,730	79,358,988	78,718,887	32,587,558
Unallocated cash and security deposit	<u>86,903,589</u>	<u>49,510,154</u>	-	-
Consolidated	<u>306,425,319</u>	<u>128,869,142</u>	<u>78,718,887</u>	<u>32,587,558</u>

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 2019 \$	31 December 2018 \$	31 December 2019 \$	31 December 2018 \$
Communications	754,517	-	3,730,639	-
Space	26,087	18,935	122,570	30,551
Defence	<u>3,115,360</u>	<u>527,787</u>	<u>3,999,756</u>	<u>3,158,362</u>
Total all segments	3,895,964	546,722	7,852,965	3,188,913
Unallocated management	<u>236,437</u>	<u>86,513</u>	-	-
Consolidated	<u>4,132,401</u>	<u>633,235</u>	<u>7,852,965</u>	<u>3,188,913</u>

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

34. Segment Information (cont)

Information on Geographical Segments

31 December 2019

Geographical Segments	Revenue from External Customers \$	Segment Assets \$	Acquisition of Segment Assets \$
Australasia	23,351,295	55,486,937	6,649,144
Middle East	44,913,294	3,053,274	1,041,462
North America	97,720,974	3,396,402	162,360
Germany	<u>-</u>	<u>77</u>	<u>-</u>
Total	<u>165,985,563</u>	<u>61,936,690</u>	<u>7,852,966</u>

31 December 2018

Geographical Segments	Revenue from External Customers \$	Segment Assets \$	Acquisition of Segment Assets \$
Australasia	18,060,761	3,826,473	3,043,380
Middle East	-	109,603	114,982
North America	69,069,405	2,276,550	30,551
Germany	<u>230</u>	<u>400</u>	<u>-</u>
Total	<u>87,130,396</u>	<u>6,213,026</u>	<u>3,188,913</u>

Management allocated 'Revenue from External Customers' on the basis of the jurisdiction in which the counterparty to the revenue contract resides. The comparative balance in relation to the 'Revenue from External Customers' reported in 2018 has been amended to reflect the reclassification of an amount of \$69,069,405 previously reported in the 'Australasia' segment which should have been reported under the 'North America' segment, being the geographic segment in which the external customer resides.

The comparative figures in relation to 'Segment Assets' have also been restated to reflect the requirements of AASB 8.33 (b) and reflect only non-current assets other than financial instruments and deferred tax assets.

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**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)****35. Parent entity disclosure**

	31 December 2019	31 December 2018
	\$	\$
Financial position		
Assets		
Current assets	72,132,587	33,973,209
Non-current assets	<u>76,260,951</u>	<u>-</u>
Total assets	<u>148,393,538</u>	<u>33,973,209</u>
Liabilities		
Current liabilities	<u>8,739,410</u>	<u>95,790</u>
Total liabilities	<u>8,739,410</u>	<u>95,790</u>
Net assets	<u>139,654,128</u>	<u>33,877,419</u>
Equity		
Issued capital	274,311,590	161,784,727
Reserves	10,373,224	9,871,855
(Accumulated losses)	<u>(145,030,686)</u>	<u>(137,779,163)</u>
Total equity	<u>139,654,128</u>	<u>33,877,419</u>
Financial performance		
(Loss) for the period	(7,251,523)	(32,628,847)
Other comprehensive income	<u>-</u>	<u>-</u>
	<u>(7,251,523)</u>	<u>(32,628,847)</u>

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

Guarantee provided under the deed of cross guarantee (i)	<u>68,919,410</u>	<u>24,803,910</u>
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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. On 28 November 2019, EM Solutions Pty Limited entered into an Assumption Deed and became a party to the Deed of Cross Guarantee.

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NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019 (cont)

36. 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
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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

2122 n Dragoon Street
Unit 6
Tucson, Arizona 85745
USA
Tel: +1 (520) 624 6399
Fax: +1 (520) 624 1906

German Operations

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D-94469 Deggendorf
Germany
Tel: +49 991 2892 1964
Fax: +49 991 3719 1884

USA Operations Alabama

2865
Wall Triana Hwy SW
Huntsville
AL 35824 USA

Singapore Operations

10, Pandon Crescent
#06-01
Singapore 128466

Tel: +65 6304 3055

United Arab Emirates Operations

Tawazun Industrial Park (TIP)
Zone 2, Facility 15,
Al Ajban Area,
Abu Dhabi,
UAE

Tel: +971 2 492 7112

Fax: +971 2 492 7110

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

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AND CONTROLLED ENTITIES

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 17 March 2020 the following substantial shareholders were registered:

	Ordinary Shares	Percentage of total Ordinary shares
Regal Funds Management Pty Ltd	8,484,152	7.50%

VOTING RIGHTS

At 17 March 2020 there were 7,367 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

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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 17 March 2020 the distribution of shareholdings were:

Range	Ordinary Shareholders	Number of Shares
1-1,000	3,619	1,701,460
1,001 – 5,000	2,440	5,973,718
5,001 – 10,000	598	4,536,594
10,001 – 100,000	608	16,942,586
100,001 and over	<u>102</u>	<u>83,923,855</u>
	<u>7,367</u>	<u>113,078,213</u>

There were 127 ordinary shareholders with less than a marketable parcel.

There is no current on-market buy-back.

TWENTY LARGEST ORDINARY SHAREHOLDERS

At 17 March 2020 the 20 largest ordinary shareholders held 54.05% of the total issued fully paid quoted ordinary shares of 113,078,213.

Shareholder	Fully Paid Ordinary Shares	Percentage of Total
1. Citicorp Nominees Pty Limited	13,423,306	11.87%
2. EOS Loan Plan Pty Ltd	5,180,000	4.58%
3. JP Morgan Nominees Australia Limited	4,856,309	4.29%
4. Washington H. Soul Pattinson and Company	4,576,046	4.05%
5. N & J Properties Pty Limited	4,090,000	3.62%
6. HSBC Custody Nominees (Australia) Limited	4,050,427	3.58%
7. HSBC Custody Nominees (Australia) Limited A/C 2	3,686,390	3.26%
8. Technology Transformations Pty Limited	2,763,844	2.44%
9. Merrill Lynch (Australia) Nominees Pty Limited	2,311,754	2.04%
10. Brazil Farming Pty Ltd	2,217,129	1.96%
11. UBS Nominees Pty Ltd	2,122,810	1.88%
12. National Nominees Limited	1,561,501	1.38%
13. Capitol Enterprises Limited	1,550,000	1.37%
14. A & D Wire Limited	1,457,276	1.30%
15. Warbont Nominees Pty Ltd <Accum Entrepot A/C>	1,452,551	1.28%
16. CS Fourth Nominees Pty Limited <11 A/C>	1,399,305	1.24%
17. Technology Investments Pty Limited	1,209,659	1.07%
18. CS Fourth Nominees Pty Limited <13 A/C>	1,175,379	1.04%
19. Emichrome Pty Limited	1,029,449	0.91%
20. Landed Investments NZ Limited	<u>1,010,000</u>	<u>0.89%</u>
	<u>61,123,135</u>	<u>54.05%</u>