

Appendix 4E
For the year ended 31 December 2020

DroneShield Limited
ABN 26 608 915 859

1. Reporting period

The financial information contained in the attached consolidated financial report is for the year ended 31 December 2020. The previous corresponding period was the year ended 31 December 2019.

Results for announcement to the market				
	Up/ Down	% Movement		2020 \$
Revenue from continuing activities	Up	58%	to	5,557,736
Loss from continuing activities after tax attributable to members	Down	24%	to	(5,866,990)
Net loss attributable to members	Down	24%	to	(5,866,990)
Dividends: No dividends are being proposed or have been paid	Nil	Nil		Nil

Additional information:

2. Commentary related to the above results

Refer to Directors Report in the attached Annual Report.

3. Net Tangible Assets/(Liabilities) per share *(includes right-of-use assets and lease liabilities):*

31 December 2020: \$0.06; 31 December 2019: \$0.03

4. There was no change of control during the year

5. There were no payments of dividends during the year

6. There is no dividend reinvestment plan in operation

7. There are no associates or joint venture entities

8. This report is based on the consolidated financial report which has been audited by HLB Mann Judd Assurance (NSW) Pty Ltd.

Further information regarding the company and its business activities can be obtained by visiting the company's website at www.droneshield.com



DRONESHIELD

Annual Report

For the Year Ended
31 December 2020



Image: DroneSentry-X™ C-UAS system mounted on a vehicle

DroneShield Limited (ASX:DRO)

ASX Release

ABN 26 608 915 859

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Corporate Information

Directors & Management

Peter James Independent Non-Executive Chairman
Jethro Marks Independent Non-Executive Director
Oleg Vornik CEO and Managing Director

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Auditors

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Stock Exchange Listing

DroneShield Limited (ASX code DRO) shares are quoted on the Australian Securities Exchange.

Chairman's Review



*Peter James,
Independent Non-
Executive Chairman*

Dear Fellow Shareholders,

2020 has seen DroneShield Ltd ("DroneShield" or the "Company") continue to rapidly grow as a leader and early mover in the C-UAS / counterdrone industry, despite the COVID-19 disruptions.

Highlights for the year included:

- DroneShield generated total customer revenue of \$5.6 million for the calendar year 2020 (in addition to R&D and other incentives, such as grants). This is an approximately 58% increase on 2019 revenues, and continues the trend of the Company generating record revenues each year of its existence.
- Importantly, a substantial majority of these sales were to blue chip customers such as defence and government agencies of the Five Eyes community, including repeat contracts.
- DroneShield raised a record \$17 million of new capital, enabling its continued rapid expansion.
- Strong sales pipeline with approx. \$100 million¹ in active contract discussions, and total sales opportunities of approx. \$200 million¹.
- Substantial tailwinds for the defence industry, with an increase in Government spending in Australia and globally.

During the year, the Company focussed on solidifying its established core product lines, rapidly evolving the software for the products, and scaling its supply chain for growing customer orders. Artificial Intelligence/Machine Learning has been a core focus for the business, both within the C-UAS sector and other defence work, with DroneShield winning its first defence contract outside of the C-UAS space to continue developing its AI capabilities.

Despite the COVID-19 slowdown, drones continued to present a rapidly growing threat, both across State-level warfare (as seen with China and Russia both heavily investing in drone warfare and the Nagorno-Karabakh conflict featuring extensive use of drones), and non-State actors continuing to use drones for nefarious applications at airports, prisons, critical infrastructure and other situations. Last month in the U.S. (the largest defence market globally), the Pentagon released a new strategy to counter increasingly complex small drone threats, that focuses on establishing a common threat picture, architecture and protocol across the services. The new strategy, emphasising the importance of the C-UAS sector to the U.S. Government, also sets up stronger coordination between other federal agencies in the homeland as well as with allies and partners abroad.

At the macro level, international tensions and greyzone warfare (which C-UAS, EW and related areas are a key part of) continue to rise, driving increases in security and national defence budgets. The Company currently offers its products in over 100 countries and the diversity of its pipeline is one of its key strengths. Importantly, with a wide distribution network and a history of orders from a variety of customers, DroneShield is not dependent on any one customer or any one existing or potential contract for its success.

On the partnerships side, DroneShield has continued to grow its relationships with key defence primes in Australia and globally, and is a part of their global supply chain processes. This is expected to bring further cash receipts (in the form of outright sales and paid R&D contracts) in 2021.

The Australian Government continues to strongly encourage the growth of the domestic defence industry, with DroneShield having received and delivered (and in the process of delivering) several contracts with various Australian Government agencies. Importantly, there may from time to time appear attractive acquisition opportunities in the defence industry space, and the Company will seek to capitalise on those opportunities when appropriate, to complement its strong organic growth.

On behalf of the Board, I would like to thank our executive team for their significant contributions for the past year.

I would also like to thank our fellow shareholders for your support and look forward to continued growth of the Company.

Peter James
Independent Non-Executive Chairman



Image: A Chinese UAS/drone fires from a launcher mounted to a Dongfeng Mengshi light tactical vehicle

¹ Necessarily, not all (and there can be no assurance that any) of the Company's sales opportunities will result in sales.

About DroneShield

DroneShield (ASX:DRO) is an Australian publicly listed company with its head office in Sydney and teams in the U.S. and UK, specialising in C-UAS, Electronic Warfare, RF sensing, Artificial Intelligence and Machine Learning, Sensor Fusion, rapid prototyping and MIL-SPEC manufacturing. Our capabilities are used to protect military, Government, law enforcement, critical infrastructure, commercial and VIPs throughout the world.

Through our team of Australian based engineers, we offer customers bespoke solutions and off-the-shelf products designed to suit a variety of terrestrial, maritime or airborne platforms. DroneShield is proudly exporting Australian capability to customers throughout the world and supporting Australia's defence, national security and other organisations protect people, critical infrastructure and vital assets.

History of DroneShield

Founded on 10 January 2014, the DroneShield business began as DroneShield LLC in the U.S. On 4 November 2015, DroneShield Limited was incorporated in Australia for the primary purpose of listing on the ASX and engaging in the business of offering products manufactured by DroneShield globally, as well as managing and operating DroneShield's business.

DroneShield Limited listed on the ASX on 22 June 2016, raising \$7 million through the issue of 35 million shares at \$0.20 per share in an oversubscribed initial public offer ('IPO'). Most recently, DroneShield raised \$17 million in August and September 2020 via a placement and Share Purchase Plan.

DroneShield has grown from a small start-up to a global leader in C-UAS detection and mitigation.

Business Model and Products

Affordable consumer-grade drones ("UAS") have become popular around the world, but they present unique and frequent threats to privacy, physical security and public safety in a wide variety of environments. DroneShield offers products that detect and defeat such drones to civil infrastructure operators, militaries, and other government and commercial users globally. DroneShield's distribution channels focus on third party distributors, as well as direct relationships with various key customers. With offices in Australia, the United States and the United Kingdom, DroneShield has an experienced salesforce with distribution partners across over 100 countries. The ultimate end-users and potential end-users of DroneShield's products come from a diverse array of global sectors, including the following:

- Defence agencies.
- Airports and other civil defence users.
- Utilities such as power plants, electricity grids and gas pipelines.
- Ports and other critical infrastructure asset owners.
- Intelligence and national security agencies.
- Prisons.
- Stadiums and other public event venues and organisers.
- Media production sites.
- Real estate owners including hotels, commercial offices and manufacturing plants.
- Executive protection including ultra-high net worth individuals and government officials.

DroneShield offers a comprehensive solution to drone threats with a suite of detection and countermeasure products.

Please see below for additional detail on the Company's current product range.



DroneGun Tactical™

- Portable rifle shape drone disruptor, causing the drone (or swarm) to safely land, or fly back to the starting point (potentially identifying the pilot)
- 7kg weight, no backpack
- Best-in-breed effective range
- 70 units ordered by a Middle Eastern Ministry of Defence in 2018
- Additional units sold to Australian, Asian, Latin American, and Western Governments

 <p>DroneGun MKIII™</p>	<ul style="list-style-type: none"> • Pistol shaped drone disruptor, up to 1km range • Best-in-breed effective range • Released in mid-2019 • Only 2kg weight including battery • Unique patented design enabling to affect a wide range of drones with compact design • Suitable for mobile deployments, patrols, law enforcement and special forces types of customers • During 2020, Five Eyes special forces and intelligence agencies purchased the product
 <p>RfPatrol MKII™</p>	<ul style="list-style-type: none"> • Body-worn drone detection device • Best-in-breed detection range • Can be used with a directional accessory (DAU™) to determine direction of the threat • Completely passive (no RF emissions) • Deployed with Australian military and other high-profile users
 <p>RfZero™</p>	<ul style="list-style-type: none"> • Rapidly deployable omni-directional drone detector • Completely passive, no emissions • Vehicle or fixed site mountable • Cost effective • Best-in-breed detection range • Utilises DroneShield's proprietary DroneSentry-C2™ counterdrone software engine • During 2020, DroneShield conducted numerous RfZero™ deployments both as stationary and vehicle system, including U.S., Europe, and Australia
 <p>DroneSentry™</p>	<ul style="list-style-type: none"> • Integrated detect-and-defeat system • Best-in-breed detection and defeat range • Includes radiofrequency direction finders, radars and cameras in a modular manner, with an integrated DroneCannon™ drone disruptor • Utilises DroneShield's proprietary DroneSentry-C2™ counterdrone software engine • Successfully deployed in multiple locations globally
 <p>DroneSentry-X™</p>	<ul style="list-style-type: none"> • Integrated detect-and-defeat counterdrone solution • Best-in-breed detection and defeat range • Deployable on a vehicle or fixed site platforms • Customer trials commenced in late 2020, as first production of the product started
 <p>DroneNode™</p>	<ul style="list-style-type: none"> • Covert portable drone disruptor • Best-in-breed effective range • Suitable for counterdrone protection at public gatherings and other similar situations • Deployed at South East Asian (SEA) Games in late 2019, reportedly, to intercept drones in the path of a helicopter carrying the President of the Philippines and Sultan of Brunei
 <p>DroneCannon RW™</p>	<ul style="list-style-type: none"> • Drone disruptor module for a remote weapon station • Best-in-breed effective range • Allows for a layered response to a drone threat, starting with soft defeat / UAS target freeze via DroneCannon, followed by utilisation of the primary kinetic weapon if required • Can be utilised with a range of Remote Weapon Stations (RWSs) • Marketed to numerous high profile customers globally through 2020

Underpinning all DroneShield's detection products is the Company's proprietary software engine, DroneSentry-C2™. The engine is an intuitive interface with a comprehensive reporting suite, which can combine a number of customer sites deploying both DroneShield's and third-party sensor hardware. The software engine comes either included with DroneShield hardware purchases (with a subscription charge), or on a standalone basis as a subscription-based product.

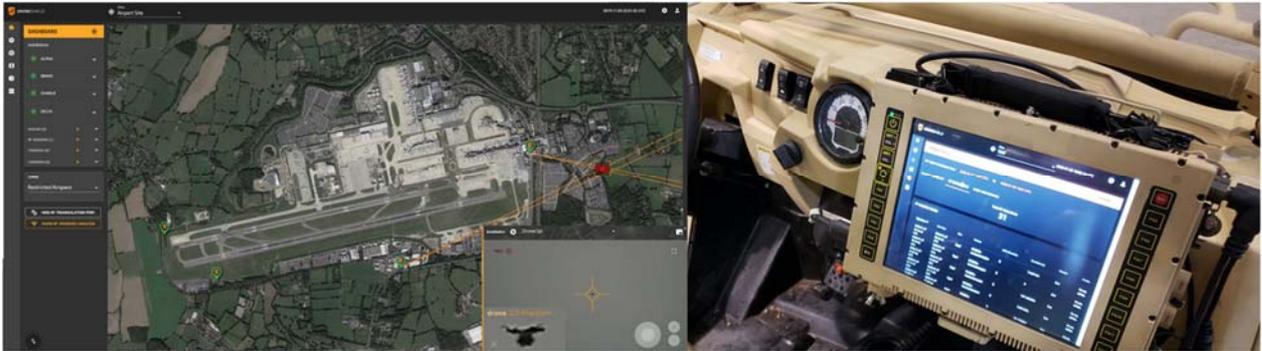


Image: DroneSentry-C2™

Revenue Model and Recurring Cashflows

Importantly, both vehicle/fixed site (DroneSentry™, DroneSentry-X™, RfZero™) and body-worn (RfPatrol™) UAS detection products have a recurring revenue element in that the Company charges its customers for updates to the drone libraries of the products. Over time, DroneShield expects to build a robust recurring revenue line as more products requiring library updates are sold.

Additionally, DroneShield offers lease options of its product range to its in-country partners and end customers (where possession and use of a particular product is lawful for that customer according to local laws). The lease periods vary from weekly, to multi-year. Leasing may be suitable for event-based requirements, product evaluations without a commitment to purchase, or for customers who have a preference to lease vs outright purchase.

The Company does not believe that leasing would cannibalise its sales, as leasing appeals to a different set of customers and utilises different deployment opportunities. Further, the Company believes that leasing is complementary to its sales efforts as it will promote customer awareness of DroneShield's products and their applications.

Finally, defence and Government agency markets are naturally of a recurring nature, with repeat contracts following initial successful deployments. DroneShield has received repeat customer orders globally on that basis.

Environment

The end of 2020 saw the U.S. military place emphasis on the development and deployment of C-UAS equipment in 2021, with plans to spend approximately U.S.\$500 million on the counterdrone sector, as outlined by the Congressional Research Service. On 7 January 2021, the Pentagon released a new strategy to counter increasingly complex small drone threats, that focuses on establishing a common threat picture, architecture and protocol across the services.

The new strategy also sets up stronger coordination between other federal agencies in the homeland as well as with allies and partners abroad.

At the same time, the U.S. Government has added DJI, a Chinese drone manufacturer that is one of the largest drone sellers in the world, to the U.S. Department of Commerce's Entity List, designating DJI as a national security concern and banning US-based companies from exporting technology to the company, in a similar mechanism to the U.S. Government's ongoing ban on the Huawei products.

The use of small UAS is no longer limited to non-government actors, with militaries such as Iran developing low-cost, payload carrying and surveillance aircraft. The Iranian kamikaze UAS, which are more compact than traditional military UAS, were recently used in a two-day exercise as bombers, interceptors and reconnaissance missions, as tensions in the region increase.

Iran and the regional forces it backs have increasingly relied in recent years on drones in Yemen, Syria, Iraq and the Strait of Hormuz at the mouth of the Gulf.



Image: Iranian drones capable of carrying out swarm kamikaze attacks on display at an Iranian military exercise

As military-grade drones become more common, so do publicly accessible drones. Smaller state groups can quickly support their cause with widely available commercial-off-the-shelf (COTS) and modified (MOTS) drones. The Pakistan/India border experienced several incidents where rebel groups delivered supporting equipment, such as ammunition, arms and communication equipment to frontline fighters, with the Punjab Police making two arrests associated with drone smuggling.



Image: One of the drones confiscated by the Punjab Police during the smuggler arrests

The BBC published a report by Conflict Armament Research (CAR) in December 2020 showing ISIS seeking to develop high-speed drones powered by pulse jet engines like those used in V-1 bombs dropped on the UK during World War II.

The report mentioned a "fully constructed pulse jet engine" measuring more than two metres in length was found at a hospital in west Mosul, Iraq in September 2017. Namir Shabibi, the CAR's head of operations in Iraq, was reported stating "remaining cells in Iraq and Syria have become increasingly active in the past year".



Image: The pulse jet engine (pictured left, with air intake unit at right) was found at a hospital in Mosul, Iraq in September 2017

The Taliban were suspected of using a drone to kill at least four security officers in Afghanistan in November, marking a potentially dangerous upgrade to the insurgents' arsenal, as violence continues throughout the country while peace talks with the government remain stalled. The attack on a government compound in the northern province of Kunduz earlier in January was thought to have been the first use of a weaponised drone by the Islamist group during the 19-year war. One Taliban fighter told *The Times* (UK newspaper) that the group had a "fun new weapon" at its disposal.

Meanwhile, the Kuwaiti military has issued a statement threatening legal action to anyone flying drones without permits from the Directorate General of Civil Aviation (DGCA), and in September 2020, Oman also announced new rules regulating drone usage, requiring users to get permits.

Small UAS continued to cause incidents with commercial aircraft. The reported incidents during the quarter have included:

- A student training aircraft in South Africa was forced to make an emergency landing after striking a small UAS and sustaining wing damage.
- In November in Canada, law enforcement was unable to locate the drone that was interfering with air traffic in the North Bay area. Transport Minister Marc Garneau stated: "Interfering with air traffic near airports with a drone, as was the case in North Bay this weekend, can cause a serious incident. When you fly your drone, you're sharing the skies, remember to always stay away from people, airports, and other aircraft."
- A medical helicopter landing at a Michigan hospital came within meters of colliding with a drone that was flown illegally over the helipad. While the drone was recovered after the incident, the pilot could not be located or prosecuted in the absence of drone detection equipment.
- Authorities arrested a man for crashing a drone into an LAPD helicopter.



Image: A small UAS that was involved in a near miss with a landing Aero Med helicopter at Butterworth Hospital in Michigan

Residents of Coral Gates, a small community in San Ysidro, California have been reporting increasing drone flights from across the border (the location is close to Tijuana, Mexico), which reportedly were carrying drugs.

In January 2021, Cyprus Police reportedly seized a drone carrying 60g of cannabis in Ayios Dhometios, Nicosia.

Prison drug drops have continued to be reported, including a man charged over a drone smuggling operation of phones and cocaine at Ireland's maximum security Portlaoise Prison.

Commercial venues have proven to be particularly vulnerable to small UAS, which can discretely circumvent security measures. Even small UAS are capable of causing significant damage in both intentional and negligent scenarios. Allegiant stadium in Las Vegas suffered damage after a UAS was crashed into panels approximately 100 feet above the ground. Whilst the offending drone was captured, its lack of registration meant the pilot could not be found or prosecuted.

The impact of COVID-19 on sporting fixtures resulted in many matches taking place without spectators, causing a spike in UAS incidents as pilots sought to gain exclusive imagery of the games. In all the incidents listed below, authorities were unable to identify or prosecute the pilot.

- Championship match between Rotherham United and Sheffield Wednesday was halted after a UAS was flown into the stadium and hovered above the pitch.
- A Chicago MLB game had to evacuate players and umpires after a drone with filming equipment landed in the outfield.
- An MLB game in New York was delayed after a UAS incursion shortly after the match started.
- A Minneapolis MLB game was halted when an unauthorised UAS flew over the field.



Image: Small UAS that interrupted a Minneapolis Major League Baseball game

Please see <https://www.droneshield.com/press-coverage> and <https://twitter.com/DroneShield> for more information.

Market Position

The Company is addressing what is believed to be a multibillion-dollar addressable market, with hundreds of thousands of potential user installations.

As the counterdrone space continues to rapidly grow, new entrants attempt to enter the market. Broadly, they can be classified into three groups:

- “Garage” businesses, which have limited product or a concept, and are not being considered by the end users due to the immaturity of their offering and their inability to support customers. This group is not considered a competitive threat.
- Large defence and security integrators. Those companies are potential partners for DroneShield, with the potential for them to add the Company’s products into their overall offering. Due to the rapidly evolving nature of the counterdrone industry and competitive pricing, the integrators generally choose to partner with smaller agile providers such as DroneShield. DroneShield has established partnerships with several such companies, including Thales, Bosch and BT, as previously disclosed to the market. Additionally, DroneShield’s products are materially cheaper than most competing detection products that are being marketed (particularly, systems being marketed by larger defence contractors) and are in fact capable of being delivered.
- Mid-sized companies. There are several such companies globally, however DroneShield continues typically to outperform its peers due to:
 - Track record of sales/customer references in the sector.
 - Mature, highly innovative and well performing products – the Company has been successful in a number of competitive processes.
 - The number of high-profile customer and integrator partner credentials, highlighting the quality of the DroneShield brand.
 - A full suite of counterdrone products, meaning that the Company has the ability to sell to the need of every counterdrone customer – as opposed to being a single product company.
 - A global network in over 100 countries, as opposed to being more geographically narrow.
 - Safety certifications further underpin the Company’s position in government tenders.

DroneShield is an Australian company with meaningful U.S. operations, its origin is a positive factor in the decision-making process by allied country users, especially government users. It is prominently positioned as an Australian defence contractor, having been part of Team Defence Australia key global defence events, and having engaged in active dialogue with Austrade and Centre for Defence Industry Capability (CDIC).

Board of Directors and Executives



Peter James; Independent Non-Executive Chairman

Mr. James has over 30 years' experience in the Technology, Telecommunications and Media Industries, and has extensive experience as Chair, Non-Executive Director and Chief Executive Officer across a range of publicly listed and private companies. He is currently Chair of ASX-listed companies Macquarie Telecom, Ansarada, Nearmap Limited and Keytone Dairy Corporation Ltd.

Mr. James joined the Board of DroneShield on 1 April 2016, serving as Executive Chairman from 2 December 2016 to 24 January 2017. Mr. James is an experienced business leader with significant strategic and operational expertise. He is a Fellow of the Australian Institute of Company Directors, a Fellow of the Australian Computer Society and holds a BA degree with Majors in Computer Science and Business.



Oleg Vornik; CEO and Managing Director

Mr. Vornik is an experienced senior executive with previous roles at the Royal Bank of Canada, Brookfield, Deutsche Bank and ABN AMRO.

Prior to becoming the CEO of DroneShield, Mr. Vornik was its Chief Financial Officer. His previous experience includes the Sydney office of the Royal Bank of Canada as well as with Brookfield Asset Management, Deutsche Bank and ABN AMRO in Australia and New Zealand. Mr. Vornik holds a BSc (Mathematics) and BCom (Hons) from the University of Canterbury, New Zealand and has completed a business program with Columbia University in New York.

After co-leading the Company in the role of the Chief Financial Officer for over a year, Mr. Vornik was appointed as the CEO and Managing Director of DroneShield on 24 January 2017. Mr. Vornik does not hold any other public company directorships.



Jethro Marks; Independent Non-Executive Director

Mr. Marks is a Sydney-based CEO and co-founder of the Mercury Retail Group, an eCommerce retail, services, logistics and outsourcing business. Over 17 years Mr. Marks has led, and continuously grown, the business at the forefront of digital commerce, marketing and international logistics, while competing with the largest retailers globally. Mr. Marks brings to the Board extensive commercial experience in successfully scaling a multinational business.

Mercury Retail Group's global supply chain and award-winning logistics capability has extended to most consumer goods categories in multiple countries, and today carries 32 million products. This capability has extended to provisioning international logistics support to multinational brands and technology companies.

Mr. Marks graduated from the University of Auckland, with a Bachelor of Commerce (Honours).

Mr. Marks joined the Board on 16 January 2020. Mr. Marks does not hold any other public company directorships.



Angus Bean; Chief Technology Officer

With a background in Industrial Design and Mechanical Engineering, Angus Bean brings a wealth of knowledge in product development through to production management. Mr. Bean merges the various fields of mechanical hardware, electronics, software, digital interface and technology.

Mr. Bean joined DroneShield early in 2016, since then has been a driving force in DroneShield's technology team, working to build the team and the technology to deliver on key projects and milestones. Previous to DroneShield, Mr. Bean was the Development Lead for Australia's largest and most prominent industrial design and engineering consultancy.

Over his career, Mr. Bean has adopted both a collaborative and leadership role on a number of projects which have attracted multiple Australian and International Awards in Innovation, Consumer Electronics, Defence and Cyber Security. Mr. Bean holds a BDesign in Industrial Design (First Class Hon) from the University of Technology, Sydney.



Carla Balanco; CFO and Company Secretary

Ms. Balanco joined DroneShield in mid-2018, since then she has been instrumental in scaling the Company's financial management systems and controls as DroneShield continues to grow. She has the responsibility of overseeing the Company's Financial Reporting, Financial Planning, Compliance, Human Resources, Administration, and Treasury functions.

Prior to DroneShield, Ms. Balanco gained experience working in Chartered, Commercial and Business Development roles. Ms. Balanco gained an in-depth knowledge of the International Financial Reporting Standards (IFRS) whilst working as a Senior Auditor for mid-tier Chartered firms Crowe Horwath and HLB Mann Judd, auditing both private and public companies.

Ms. Balanco is a member of the South African Institute of Chartered Accountants and holds an Honours in Accounting from the University of Johannesburg and an Honours in Accounting Science from the University of South Africa.

Corporate Governance Statement

The board of the Company ("**Board**") recognises the importance of establishing a comprehensive system of control and accountability as the basis for the administration of corporate governance.

To the extent relevant and practical, the Company has adopted a corporate governance framework that is consistent with *The Corporate Governance Principles and Recommendations (4th Edition)* as published by ASX Corporate Governance Council ("**Recommendations**").

The Board has adopted the following suite of corporate governance policies and procedures which are contained with the Company's **Corporate Governance Plan**, a copy of which is available on the Company's website at <https://www.droneshield.com/investors>.

- Board Charter
- Corporate Code of Conduct
- Public Sector Code of Conduct
- Audit and Risk Committee Charter
- Remuneration Committee Charter
- Nomination Committee Charter
- Continuous Disclosure Policy
- Risk Management Policy
- Remuneration Policy
- Trading Policy
- Diversity Policy
- Whistleblower Policy
- Anti-bribery & Corruption Policy
- Shareholder Communications Strategy
- Performance Evaluation Procedures
- Skills Matrix

The Board is committed to administering the policies and procedures with openness and integrity, pursuing the true spirit of corporate governance commensurate with the Company's needs.

The Company is pleased to report that its practices are largely consistent with the Recommendations of the ASX Corporate Governance Council and sets out below its compliance and departures from the Recommendations for the year ended 31 December 2020.

In the context of the Company's nature, scale and operations, the Board considers that the current corporate governance regime is an efficient, practical and cost-effective method of directing and managing the Company. As the Company's activities develop in size, nature and scope, the implementation of additional corporate governance policies and structures will be reviewed and considered.

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
<i>Principle 1: Lay solid foundations for management and oversight</i>		
Recommendation 1.1 A listed entity should have and disclose a board charter setting out: (a) the respective roles and responsibilities of its board and management; and (b) those matters expressly reserved to the board and those delegated to management.	YES	The Board is responsible for the corporate governance of the Company. The Company has adopted a Board Charter which sets out, amongst other things, the specific responsibilities of the Board, the roles and responsibilities of the Chairman, Board and management, as well as the matters expressly reserved for the decision of the Board and those delegated to management. A copy of the Company's Board Charter is contained in its Corporate Governance Plan which is available on the Company's website: https://www.droneshield.com/investors . The Company is committed to the circulation of relevant materials to Directors in a timely manner to facilitate Directors' participation in Board discussions on a fully informed basis. The Company intends to regularly review the balance of responsibilities between the Board and

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION												
		management to ensure that the division of functions remains appropriate to the needs of the Company.												
<p>Recommendation 1.2 A listed entity should:</p> <p>(a) undertake appropriate checks before appointing a director or senior executive, or putting someone forward for election, as a Director; and</p> <p>(b) provide security holders with all material information relevant to a decision on whether or not to elect or re-elect a Director.</p>	YES	<p>(a) The Company’s Corporate Governance Plan requires the Board to undertake appropriate checks as to the character, experience, education, criminal record and bankruptcy history of the candidate before appointing a person or putting forward to security holders a candidate for election, as a Director.</p> <p>(b) All material information relevant to a decision on whether to elect or re-elect a Director will be provided to security holders in any notice of meeting pursuant to which the resolution to elect or re-elect such Director will be voted on.</p>												
<p>Recommendation 1.3 A listed entity should have a written agreement with each Director and senior executive setting out the terms of their appointment.</p>	YES	Each Director and senior executive of the Company is party to a written agreement with the Company which sets out the terms and conditions of that Director’s or senior executive’s appointment.												
<p>Recommendation 1.4 The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.</p>	YES	The Board Charter outlines the role, responsibility and accountability of the Company Secretary. The Company Secretary is accountable directly to the Board, through the Chair, on all matters relating to the proper functioning of the Board. The Chairman and the Company Secretary co-ordinate the Board agenda.												
<p>Recommendation 1.5 A listed entity should:</p> <p>(a) have and disclose a diversity policy;</p> <p>(b) through its board or a committee of the board set measurable objectives for achieving gender diversity in the composition of its board, senior executives and workforce generally; and</p> <p>(c) disclose in relation to each reporting period:</p> <p>a. the measurable objectives set for that period to achieve gender diversity;</p> <p>b. the entity’s progress towards achieving those objectives; and</p> <p>c. either:</p> <p>A. the respective proportions of men and women on the board, in senior executive positions and across the whole workforce (including how the entity has defined “senior executive” for these purposes); or</p> <p>B. (if the entity is a “relevant employer” under the Workplace Gender Equality Act, the entity’s most recent “Gender Equality Indicators”, as defined in and published under that Act.</p> <p>If the entity was in the S&P / ASX 300 Index at the commencement of the reporting period, the measurable objective for achieving gender diversity in the composition of its board should be to have not less than 30% of its directors of each gender within a specified period.</p>	<p>YES</p> <p>YES</p> <p>NO</p>	<p>(a) The Company has adopted a Diversity Policy which identifies gender diversity as a key area of focus for the Company. However, given the current size of the Company, the Board has determined that the benefits of the initiatives recommended by the ASX Corporate Governance Council in this regard are disproportionate to the costs involved in the implementation of such strategies.</p> <p>Accordingly, the Board has elected to adopt a tiered approach to the implementation of its Diversity Policy which is relative to the size of the Company and its workforce, such that:</p> <ul style="list-style-type: none"> - Where the Company employs 20 or more employees, the Board will adopt practices in line with the Recommendations. <p>(b) A copy of the Company’s Diversity Policy is contained in its Corporate Governance Plan which is available on the Company’s website https://www.droneshield.com/investors.</p> <p>(c)</p> <p>(i) As the Company did not employ 20 or more employees for the majority of the 2020 Financial Year, the Company did not formally define a set of measurable gender diversity objectives.</p> <p>(ii) During the reporting period (i.e. the year ended 31 December 2020), the respective proportions of men and women in the following roles were as follows:</p> <table border="1" data-bbox="938 1917 1422 2105"> <thead> <tr> <th></th> <th>Men</th> <th>Women</th> </tr> </thead> <tbody> <tr> <td>Board</td> <td>100 %</td> <td>0%</td> </tr> <tr> <td>Senior executives</td> <td>50%</td> <td>50%</td> </tr> <tr> <td>Across the whole organisation</td> <td>89%</td> <td>11%</td> </tr> </tbody> </table>		Men	Women	Board	100 %	0%	Senior executives	50%	50%	Across the whole organisation	89%	11%
	Men	Women												
Board	100 %	0%												
Senior executives	50%	50%												
Across the whole organisation	89%	11%												

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
<p>Recommendation 1.6 A listed entity should:</p> <p>(a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual Directors; and</p> <p>(b) disclose for each reporting period, whether a performance evaluation has been undertaken in the reporting period in accordance with that process during or in respect of that period.</p>	<p>YES</p> <p>YES</p>	<p>(a) The performance of the Board as a group and of individual Directors will be assessed each year for all future years. The Remuneration Committee (the function of which is currently performed by the full Board) is responsible for evaluating the performance of the Board and individual Directors on an annual basis. The process for this is set out in the Company's Performance Evaluation Procedures policy which is contained in its Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>(b) The Board undertook an evaluation of Board performance in 2021.</p>
<p>Recommendation 1.7 A listed entity should:</p> <p>(a) have and disclose a process for periodically evaluating the performance of its senior executives at least once every reporting period; and</p> <p>(b) disclose in relation to each reporting period, whether a performance evaluation has been undertaken in the reporting period in accordance with that process during or in respect of that period.</p>	<p>YES</p> <p>YES</p>	<p>(a) The Managing Director of the Company is responsible for evaluating the performance of senior executives on an annual basis. The process for this is set out in the Company's Performance Evaluation Procedures policy which is contained in its Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>(b) A formal performance evaluation of senior executives was undertaken during the 2020 financial year.</p>
<p>Principle 2: Structure the board to be effective and add value</p>		
<p>Recommendation 2.1 The board of a listed entity should: have a nomination committee which:</p> <p>(a) has at least three members, a majority of whom are independent Directors; and</p> <p>(b) is chaired by an independent Director, and disclose:</p> <p>(c) the charter of the committee;</p> <p>(d) the members of the committee; and</p> <p>(e) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or</p> <p>if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, experience, independence and knowledge of the entity to enable it to discharge its duties and responsibilities effectively.</p>	<p>NO</p> <p>NO</p> <p>NO</p> <p>NO</p> <p>N/A</p> <p>YES</p>	<p>Due to its size, the Board has determined that the function of the Nomination Committee is most efficiently carried out with full Board participation and accordingly, the Board has elected not to establish a separate Nomination Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Nomination Committee under the Nomination Committee Charter are carried out by the full Board.</p> <p>A copy of the Nomination Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>The Board devotes time at Board meetings on at least an annual basis to discuss Board succession issues. Where appropriate, all members of the Board are involved in the Company's nomination process, to the maximum extent permitted under the Corporations Act and ASX Listing Rules.</p> <p>The Board also conducts an annual review of the Company's Board Skills Matrix (in accordance with Recommendation 2.2) to ensure the Board maintains an appropriate balance of skills, experience, independence and knowledge to discharge its duties and responsibilities effectively.</p>
<p>Recommendation 2.2 A listed entity should have and disclose a board skill matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.</p>	<p>YES</p>	<p>The Board of the Company is comprised of Directors with a broad range of technical, commercial, financial and other skills, experience and knowledge relevant to overseeing the business of a drone security company.</p> <p>The Company had developed a Board Skills Matrix which is used as a tool to assess the appropriate and</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
		<p>ideal balance of skills, experience, independence and diversity necessary for the Board to discharge its duties and responsibilities effectively.</p> <p>A summary of the collective skills, experience, independence and diversity of the Board is set in Annexure C of the Company's Corporate Governance Plan which is available on the Company's website: https://www.droneshield.com/investors.</p>
<p>Recommendation 2.3 A listed entity should disclose:</p> <p>(a) the names of the Directors considered by the board to be independent Directors;</p> <p>(b) if a Director has an interest, position, association or relationship of the type described in Box 2.3 of the ASX Corporate Governance Principles and Recommendation (3rd Edition), but the board is of the opinion that it does not compromise the independence of the Director, the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion; and</p> <p>(c) the length of service of each Director.</p>	YES	<p>(a) During the 2020 financial year, the Independent Directors of the Company were:</p> <ul style="list-style-type: none"> - Mr. Peter James (Non-Executive Chairman); and - Mr. Jethro Marks (Non-Executive Director). <p>Mr. Oleg Vornik, the Managing Director, was not considered to be independent during his tenure due to his executive role as Managing Director of the Company.</p> <p>(b) The Board has determined the independence of each of the Company's Directors in line with the guidance set out by the ASX's Corporate Governance Council and have not formed an opinion contrary to those guidelines.</p> <p>(c) The Directors who held office during and after the 2020 financial year have served continuously since their respective dates of appointment unless otherwise noted below:</p> <ul style="list-style-type: none"> - Mr. Peter James: appointed 1 April 2016; - Mr. Oleg Vornik: appointed 24 January 2017; - Mr. Jethro Marks: appointed 16 January 2020; - Mr. Robert Clisdell: appointed 24 January 2017, resigned 16 January 2020.
<p>Recommendation 2.4 A majority of the board of a listed entity should be Independent Directors.</p>	YES	<p>The Board Charter requires that where practical the majority of the Board will be independent.</p> <p>During the 2020 financial year, the following two of the Company's four Directors were considered to be Independent Directors:</p> <ul style="list-style-type: none"> - Mr. Peter James (Non-Executive Chairman); and - Mr. Jethro Marks (Non-Executive Director).
<p>Recommendation 2.5 The chair of the board of a listed entity should be an Independent Director and, in particular, should not be the same person as the CEO of the entity.</p>	YES	<p>The Chairman, Mr. Peter James is an Independent Non-Executive Director and is not the same person as the Managing Director of the Company.</p>
<p>Recommendation 2.6 A listed entity should have a program for inducting new Directors and for periodically reviewing whether there is a need for existing directors to undertake professional development to maintain the skills and knowledge needed to perform their role as a Director effectively.</p>	YES	<p>The Company's program for the induction of new Directors is tailored for each new Director (depending on their personal requirements, background skills, qualifications and experience) and includes the provision of a formal letter of appointment and an induction package containing sufficient information to allow the new Director to gain an understanding of the business of the Company, and the roles, duties and responsibilities of Directors and the Executive team.</p> <p>All Directors are encouraged to undergo continual professional development and, subject to prior approval by the Chairman, all Directors may have access to various resources and professional development training to address any skills gaps.</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
Principle 3: Instil a Culture of acting Lawfully, Ethically and Responsibly		
Recommendation 3.1 A listed entity should articulate and disclose its values.	YES	The Company's values are: <ul style="list-style-type: none"> • Maintain high performance, nimble team culture; • Communicate with transparency and inclusion; • Think critically, independently and take pride of ownership in your role; and • Act ethically and in the best interests of the customers, shareholders and other stakeholders. The Company values are available in the Corporate Code of Conduct.
Recommendation 3.2 A listed entity should: <ol style="list-style-type: none"> (a) have and disclose a code of conduct for its Directors, senior executives and employees; and (b) ensure that the board or a committee of the board is informed of any material breaches of that code. 	YES	<ol style="list-style-type: none"> (a) The Company has adopted a Corporate Code of Conduct which applies to Directors, employees and contractors of the Company. The Corporate Code of Conduct is contained in the Company's Corporate Governance Plan which is available on the Company's website at: https://www.droneshield.com/investors. (b) The Board is informed of any material breaches of the Corporate Code of Conduct.
Recommendation 3.3 A listed entity should: <ol style="list-style-type: none"> (a) have and disclose a whistleblower policy; and (b) ensure that the board or a committee of the board is informed of any material incidents reported under that policy. 	YES	The Company has adopted a Whistleblower Policy which is available on the Company's website https://www.droneshield.com/investors . Clause 7 of the Whistleblower Policy provides that the board is informed of any material incidents reported
Recommendation 3.4 A listed entity should: <ol style="list-style-type: none"> (a) have and disclose an anti-bribery and corruption policy; and (b) ensure that the board or committee of the board is informed of any material breaches of that policy. 	YES	The Company has adopted an anti-bribery and corruption (ABC) policy which applies to all officers, employees, and contractors who represent the Company. The ABC policy is available on the Company's website https://www.droneshield.com/investors . Clause 8.2 of the ABC Policy provides that all material breaches of the ABC Policy must be reported immediately to the Board.

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
Principle 4: Safeguard the integrity of corporate reports		
<p>Recommendation 4.1</p> <p>The board of a listed entity should: have an audit committee which:</p> <ul style="list-style-type: none"> (i) has at least three members, all of whom are Non-Executive Directors and a majority of whom are Independent Directors; and (ii) is chaired by an Independent Director, who is not the chair of the board, <p>and disclose:</p> <ul style="list-style-type: none"> (iii) the charter of the committee; (iv) the relevant qualifications and experience of the members of the committee; and (v) in relation to each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or <p>if it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its financial reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.</p>	<p>NO</p> <p>NO</p> <p>YES</p> <p>YES</p> <p>N/A</p> <p>N/A</p> <p>YES</p>	<p>Due to the current size of the Company, the Board has determined that the function of the Audit and Risk Committee is most efficiently carried out with full Board participation and accordingly, the Company has elected not to establish a separate Audit and Risk Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter are carried out by the full board.</p> <p>The Audit and Risk Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>The Board devotes time on at least an annual basis to consider the robustness of the various internal control systems it has in place to safeguard the integrity of the Company's financial reporting.</p> <p>In addition, following the completion of each half year review and annual audit review, the Company's external auditors confer with the Board on any matters identified during the course of the audit that have the potential to increase the Company's exposure to risks of material misstatements in its financial reports.</p> <p>The full Board also assumes responsibility for recommendations to security holders on the appointment and removal of the external auditor. Audit partner rotations will be enforced in accordance with the relevant guidelines.</p>
<p>Recommendation 4.2</p> <p>The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.</p>	<p>YES</p>	<p>Prior to the execution of the financial statements of the Company, the Company's Managing Director and Chief Financial Officer provide the Board with written assurances that the financial records of the Company have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the Company and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively in all material aspects.</p>
<p>Recommendation 4.3</p> <p>A listed entity should disclose its process to verify the integrity of any periodic corporate report it releases to the market that is not audited or reviewed by an external auditor.</p>	<p>YES</p>	<p>The Board ensures that any periodic corporate report the Company releases to the market that has not been subject to audit or review by an external auditor discloses the process taken to verify the integrity of its content.</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
Principle 5: Make timely and balanced disclosure		
Recommendation 5.1 A listed entity should have and disclose a written policy for complying with its continuous disclosure obligations under listing rule 3.1.	YES	The Company has adopted a Continuous Disclosure Policy which details the processes and procedures which have been adopted by the Company to ensure that it complies with its continuous disclosure obligations as required under the ASX Listing Rules and other relevant legislation. The Company's Continuous Disclosure Policy is contained within the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors .
Recommendation 5.2 A listed entity should ensure that its board receives copies of all material market announcements promptly after they have been made.	YES	The Company Secretary ensures the Board is provided with copies of all material market announcements promptly after they have been made.
Recommendation 5.3 A listed entity that gives a new and substantive investor or analyst presentation should release a copy of the presentation materials on the ASX Market Announcements Platform ahead of the presentation.	YES	Pursuant to the Company's Continuous Disclosure Policy ahead of any new and substantive investor or analyst presentation, a copy of the presentation materials must be released to the ASX (even if the information in the presentation would not otherwise require market disclosure).
Principle 6: Respect the rights of security holders		
Recommendation 6.1 A listed entity should provide information about itself and its governance to investors via its website.	YES	Shareholders can access information about the Company and its governance (including its constitution and adopted corporate governance policies) from the Company's website https://www.droneshield.com/investors . The Company will regularly update the website and contents therein as deemed necessary.
Recommendation 6.2 A listed entity should have an investor relations program that facilitates effective two-way communication with investors.	YES	The Company has adopted a Shareholder Communications Strategy which aims to promote and facilitate effective two-way communication with investors. The Strategy outlines a range of ways in which information is communicated to Shareholders, including via its website, through announcements released to the ASX, its annual report and general meetings. Shareholders are also welcome to contact the Company or its registrar, Automatic Registry Services, via email or telephone. The Company's Shareholder Communications Strategy is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors .
Recommendation 6.3 A listed entity should disclose how it facilitates and encourages participation at meetings of security holders.	YES	As noted above, the Company's Shareholder Communications Strategy is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors . Shareholders will be encouraged to participate at all general meetings of the Company by written

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
		<p>statement contained in every Notice of Meeting sent to shareholders prior to each meeting.</p> <p>The Company intends to accommodate shareholders who are unable to attend general meetings in person by accepting votes by proxy.</p> <p>Further, any material presented to shareholders at the meeting will be released to the ASX immediately prior to the commencement of the meeting for the benefit of those shareholders who are unable to attend in person. The Company will also announce to the ASX the outcome of each meeting immediately following its conclusion.</p> <p>At each general meeting, shareholders will be given an opportunity to ask questions in relation to the resolutions put to shareholders at that meeting, and in respect of the Company's business and operations generally.</p> <p>At each AGM, shareholders will also be invited by the Chairman to ask questions of the Company's external auditor and the Board in relation to the annual financial report of the Company and the conduct of the audit.</p>
<p>Recommendation 6.4</p> <p>A listed entity should ensure that all substantive resolutions at a meeting of security holders are decided by a poll rather than by a show of hands.</p>	YES	<p>The Company's Shareholder Communications Strategy provides that all substantive resolutions at a meeting of security holders will be decided by a poll rather than a show of hands.</p>
<p>Recommendation 6.5</p> <p>A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.</p>	YES	<p>Shareholders have the option of electing to receive all shareholder communications by e-mail and can update their communication preferences with the Company's registrar, Automic Registry Services, at any time.</p> <p>Security holders can also register with the Company at info@droneshield.com to receive email notifications following the release of a material announcement to the ASX.</p>
<p>Principle 7: Recognise and manage risk</p>		
<p>Recommendation 7.1</p> <p>The board of a listed entity should:</p> <p>have a committee or committees to oversee risk, each of which:</p> <ul style="list-style-type: none"> (a) has at least three members, a majority of whom are Independent Directors; and (b) is chaired by an Independent Director, <p>and disclose:</p> <ul style="list-style-type: none"> (c) the charter of the committee; (d) the members of the committee; and (e) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or <p>if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the process it employs for overseeing the entity's risk management framework.</p>	<p>NO</p> <p>NO</p> <p>YES</p> <p>YES</p> <p>N/A</p> <p>N/A</p> <p>YES</p>	<p>Due to its size, the Board has determined that the function of the Audit and Risk Committee is most efficiently carried out with full Board participation and accordingly, the Company has elected not to establish a separate Audit and Risk Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter are carried out by the full Board.</p> <p>The Audit and Risk Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>The Board devotes time on at least an annual basis to fulfil the roles and responsibilities associated with overseeing risk and maintaining the Company's risk management framework and associated internal compliance and control procedures.</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
<p>Recommendation 7.2</p> <p>The board or a committee of the board should:</p> <ul style="list-style-type: none"> (a) review the entity's risk management framework at least annually to satisfy itself that it continues to be sound and that the entity is operating with due regard to the risk appetite set by the board; and (b) disclose in relation to each reporting period, whether such a review has taken place. 	YES	<p>During the 2020 financial year, the Board, in carrying out the duties typically assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter, undertook a review of the Company's risk management framework in line with its Risk Management Policy.</p>
<p>Recommendation 7.3</p> <p>A listed entity should disclose:</p> <ul style="list-style-type: none"> (a) if it has an internal audit function, how the function is structured and what role it performs; or (b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its governance, risk management and internal control processes. 	<p>NO</p> <p>YES</p>	<p>Due to the current size of the Company and the manageable scale of its operations, the Board, in carrying out the duties typically assigned to the Audit & Risk Committee under the Audit & Risk Committee Charter, have determined that the Company's existing risk management processes and internal controls are sufficiently robust and as such, no internal audit committee is required at this stage.</p>
<p>Recommendation 7.4</p> <p>A listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks.</p>	YES	<p>The Company's Risk Management Policy details the Company's risk management systems which assist in identifying and managing potential or apparent business, economic, environmental and social sustainability risks (where appropriate).</p> <p>During the 2020 financial year, the Company undertook a review of the Company's risk management framework in line with its Risk Management Policy.</p> <p>All material risks are announced to the market, in accordance with the requirements of the ASX listing rules and otherwise.</p>
Principle 8: Remunerate fairly and responsibly		
<p>Recommendation 8.1</p> <p>The board of a listed entity should: have a remuneration committee which:</p> <ul style="list-style-type: none"> (a) has at least three members, a majority of whom are Independent Directors; and (b) is chaired by an Independent Director, and disclose: (c) the charter of the committee; (d) the members of the committee; and (e) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or <p>if it does not have a remuneration committee, disclose that fact and the processes it employs for setting the level and composition of remuneration for Directors and senior executives and ensuring that such remuneration is appropriate and not excessive.</p>	<p>NO</p> <p>NO</p> <p>YES</p> <p>YES</p> <p>N/A</p> <p>N/A</p> <p>YES</p>	<p>Due to the size of the Board and the scale of the Company's operations, the Board have determined that the function of the Remuneration Committee is most efficiently carried out with full Board participation (to the extent permitted under the Corporations Act and ASX Listing Rules), and accordingly has elected not to establish a separate Remuneration Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Remuneration Committee under the Remuneration Committee Charter are carried out by the full Board.</p> <p>The Remuneration Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>The Board devotes time on at least an annual basis to fulfil the roles and responsibilities associated with setting the level and composition of remuneration for Directors and senior executives and ensuring that such remuneration is appropriate and not excessive.</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
<p>Recommendation 8.2</p> <p>A listed entity should separately disclose its policies and practices regarding the remuneration of Non-Executive Directors and the remuneration of Executive Directors and other Senior Executives.</p>	YES	<p>The Company's general policies and practices regarding the remuneration of Non-Executive and Executive Directors and other senior employees are set out in the Remuneration Policy which is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>Further information regarding the remuneration practices of the Company is contained in the Remuneration Report section of the Company's 2020 Annual Report.</p>
<p>Recommendation 8.3</p> <p>A listed entity which has an equity-based remuneration scheme should:</p> <ul style="list-style-type: none"> (a) have a policy on whether participants are permitted to enter into transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme; and (b) disclose that policy or a summary of it. 	YES	<p>The Company's Remuneration Committee (the function of which is currently performed by the full Board) is responsible for the review and approval of any equity-based remuneration schemes offered to Directors and Employees of the Company. Further, in accordance with the Remuneration Committee Charter, the Remuneration Committee (the function of which is currently performed by the full Board) is also responsible for granting permission, on a case by case basis, for scheme participants to enter transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme.</p> <p>During the 2020 financial year, the Board of the Company authorised the issue of securities to Directors and employees under its shareholder approved Incentive Option Plan. To date, no participant to the Incentive Option Plan has sought (or been granted) approval to enter into transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme.</p> <p>The Company's policy in this regard is set out the Company's Remuneration Committee Charter, a copy of which is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p> <p>The Company also has a Securities Trading Policy that prohibits Directors, Officers and employees from entering into transactions or arrangements which limits the economic risk of participating in unvested entitlements under any equity-based remuneration scheme. A copy of the Securities Trading Policy is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.</p>

Directors' Report

Your Directors present their report for DroneShield Limited (the "Company") and its controlled entities ("the Group") for the year ended 31 December 2020.

Directors

The names of the Company's Directors in office during the year and until the date of this report are set out below. Directors were in office for this entire period unless otherwise stated. Details of the current members of the Board, including their experience, qualifications, special responsibilities and term of office are included on page 11 of the Annual Report.

Name	Position	Effective date
Directors		
Peter James	Independent Non-Executive Chairman	Appointed as Independent Non-Executive Chairman 1 April 2016. Served as Executive Chairman from 2 December 2016. Returned to Independent Non-Executive Chairman 24 January 2017.
Oleg Vornik	Executive Director, CEO and Managing Director	Appointed as CEO and Managing Director 24 January 2017.
Jethro Marks	Independent Non-Executive Director	Appointed 16 January 2020.
Robert Clisdell	Non-Executive Director	Appointed 24 January 2017. Resigned 16 January 2020.

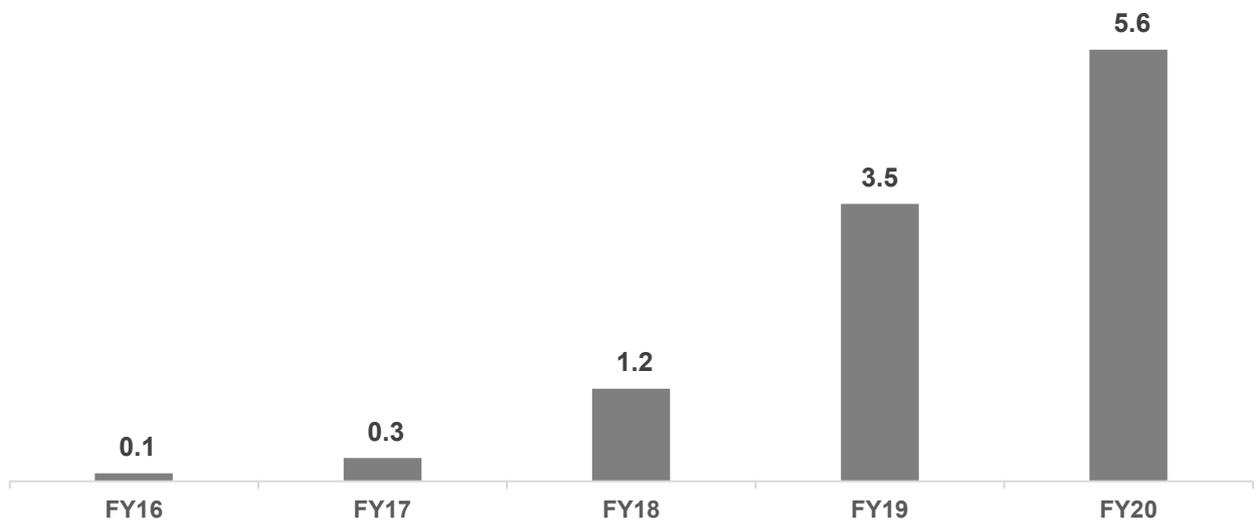
Meetings of Directors

Name	Meetings eligible to attend	Meetings attended
Directors		
Peter James	12	12
Oleg Vornik	12	12
Jethro Marks	12	12
Robert Clisdell	-	-

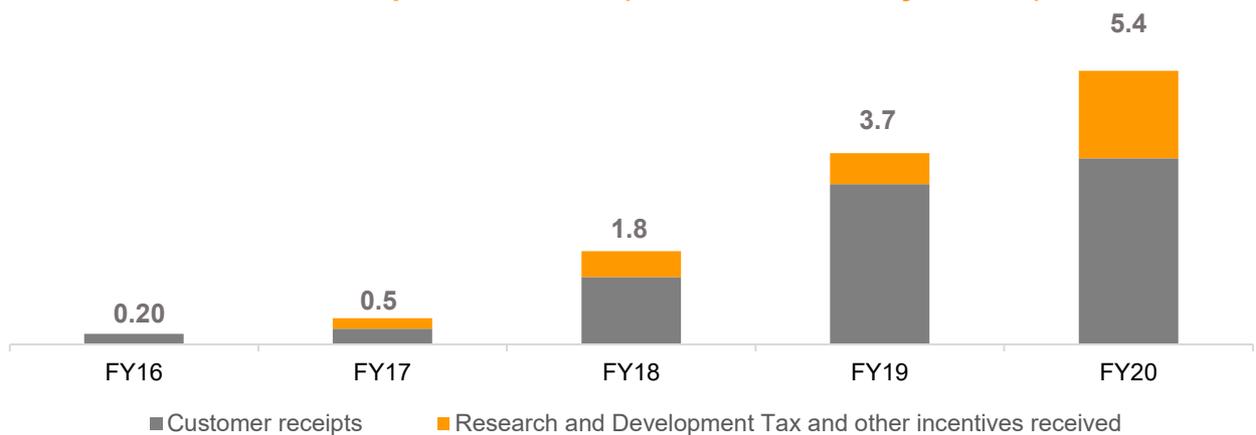
Review of Operations and Financial Results

- **All-time record high revenue of \$5.6 million in 2020 due to sales to high quality, blue chip customers, along with \$1.7 million in grants and government incentives² received, compared to revenue of \$3.5 million in 2019**
- **Rapidly growing C-UAS and greyzone warfare markets, estimated to be worth A\$5.9b by 2026**
- **Strong sales pipeline with \$100 million³ in active contract discussions and total sales opportunities of \$200 million³**
- **Strong cash position, following \$17 million raised in late 2020, with minimal debt**

Revenue since 2016 (A\$m – December year end)



Cash Receipts since 2016 (A\$m – December year end)



² Including R&D Tax Incentive of \$883,592

The net loss after tax for the year was \$5.9 million, a decrease of 24% relative to the 2019 loss of \$7.7 million. Through 2020, DroneShield has continued to substantially scale up its research and development (R&D) and sales and marketing activities, secure initial and repeating orders for its products, generating revenues which were over 50% higher than those in the previous year, while reducing its net loss for the year. Importantly, \$2.5 million of the loss related to non-cash share-based payments.

During 2020, the Company undertook a \$17 million substantially oversubscribed Placement and Share Purchase Plan in August and September. Related transaction costs amounted to \$867k. The Company carries no meaningful financial debt, other than lease liabilities. The capital raise has put the Company's balance sheet in a strong position, with a \$16 million bank balance as at 31 December 2020. The Company's steady-state fixed cost base (including its R&D team) is approximately \$850k/month, before any cash receipts from sales or grants.

In January 2020, Robert Clisdell stepped down from his position as a Non-Executive Director and Jethro Marks joined the Board as an Independent Non-Executive Director. DroneShield's Board currently comprises of Peter James (Independent Non-Executive Chairman), Oleg Vornik (CEO and Managing Director) and Jethro Marks (Independent Non-Executive Director).

The Company's high conviction pipeline is estimated at approximately \$100 million³. In addition to the high conviction pipeline, there are a number of further tenders and other processes in the \$200 million³ *full project pipeline* that DroneShield is participating in, which are not referred to in the *high conviction pipeline*, due to the Company having lesser visibility of the probability of winning the project.

Key Sales Themes

At the macro level, international tensions and greyzone warfare (which C-UAS, EW and related areas are a key part of) continue to rise, driving increases in security and national defence budgets. During the quarter, DroneShield continued to expand the range of its customers and its sales pipeline. The Company currently offers its products in over 100 countries and the diversity of its pipeline is one of its key strengths. Importantly, with a wide distribution network and a history of orders from a variety of customers, DroneShield is not dependent on any one customer or any one existing or potential contract for its success.

The update below does not seek to cover each of the Company's sales opportunities or even each type of Company's sales opportunities, which are numerous. Rather, it highlights a limited number of near-term themes that are some of the main sales drivers for the Company.

Five Eyes Community

As an Australian defence manufacturer with an on the ground presence in the U.S. and the UK, DroneShield is closely aligned with the Five Eyes (a signals intelligence alliance between the U.S., Canada, Australia, UK and New Zealand). During the quarter, the Company completed delivery of a \$900,000 order for its DroneGun Tactical™ hand-held counter-drone product from a major intelligence Government agency of a Five Eyes country, with a follow up \$400,000 order received during the same quarter, on 29 December 2020. This follow up order is expected to be delivered in 1Q21, with payments received across 1Q21 and 2Q21⁴.

The United States Department of Defense and other U.S. government agencies

The United States government, through a wide variety of its agencies and departments, is the largest counterdrone customer globally.

During the quarter, DroneShield continued to expand its U.S. operations, moving into a larger U.S. premises (consisting of an office, demonstration facility and an inventory warehouse) within the same Warrenton precinct in Virginia as its previous office. The precinct has a long defence heritage with a substantial amount of defence facilities and military contractors within its vicinity. The Company has also continued to expand its U.S. team, including hiring of a dedicated Sales Director to service Corrections, Ports and Maritime and Commercial markets within the U.S.

³ Necessarily, not all, and there can be no assurance that any, of the Company's sales opportunities will result in sales

⁴ All quarters refer to calendar quarters, as DroneShield's financial year end is December



Image: DroneShield U.S. Government agency demonstration

To further accelerate its work in the U.S. market, the Company continues to work with Cassidy & Associates, Inc. (“Cassidy”), a pre-eminent Washington, DC government relations firm, whereby Cassidy advises the Company on contracting with U.S. government agencies, contracts in connection with U.S. federal government budgetary allocations, and other U.S. federal government relations matters.

During the quarter DroneShield continued to undertake product demonstrations and meetings with the U.S. Department of Defense and other Government agencies, including supporting the recent U.S. Army Defense in Depth Exercise (DiDEX 20) with several of its C-UAS solutions for dismounted, mounted, and fixed-site drone detection.

During DiDEX, DroneShield successfully demonstrated its DroneSentry™, DroneSentry-X™, RfPatrol™, and DroneGun™ solutions to support multiple operational scenarios within a densely populated urban environment. DroneGun™ and RfPatrol™ were used to support dismounted operations, providing situational awareness and an intuitive response capability at the tactical edge by an individual operator. DroneSentry-X™, while mounted to a commercial vehicle, provided real-time alerts, stationary and on-the-move through the city, proving a highly effective, portable, and flexible C-UAS solution for mobile operations.



Images: DroneShield’s fixed-site DroneSentry™ system being installed in support of Defense in Depth Exercise (DiDEX) and DroneShield’s vehicle mounted DroneSentry-X™ operating near the Superdome in New Orleans, LA

DroneSentry™ demonstrated its extended range of Radio Frequency (“RF”) detection and triangulation throughout the urban airspace with its RfOne™ sensors. In addition to long-range detections, DroneSentry demonstrated interoperability with the U.S. Army’s Forward Area Air Defense Command and Control (“FAAD C2”) software. FAAD C2 was selected and approved by the Department of Defense Joint Counter Small-Unmanned Aircraft Systems Office (“JCO”) earlier this year. This is a key step towards a more seamless integration between the DroneSentry™ multi-sensor system and FAAD C2.

One of DroneShield's key demonstrated advantages during the evaluation was offering a family of adaptable and interoperable solutions to effectively detect and mitigate the threat, and protect the Warfighter, as opposed to a single "one size fits all" solution. This enables individuals and units to effectively address their C-UAS requirements, leverage existing mission components, and reduce overall cognitive burden. DroneSentry™ and DroneSentry-C2™'s open architecture allows for interoperability of DroneShield solutions across the ecosystem of JCO approved C-UAS systems and solutions including FAAD C2 and others.

DiDEX is facilitated by the U.S. Army's C5ISR Center Unique Mission Cell (UMC), part of the Combat Capabilities Development Command (CCDC). Following DroneShield's participation in DiDEX last month, the Company announced MIL-STD-2525 compliance of its DroneSentry-C2™, further demonstrating its commitment to and support of U.S. DoD end users.

Additionally, the Company is currently awaiting on finalisation of internal DoD spectrum approvals to complete the installation of its DroneSentry™ system at a DoD base. This is currently expected to be complete this March 2021 quarter, with installation and payment shortly following.

In addition to the defence work, DroneShield has been selected as a shortlisted tenderer for a major state-wide prison rollout tender in the U.S., with an expected total value of about \$15 million (upfront and ongoing), with DroneShield bidding to act as the primary contractor for the commissioning, deployment and operations of the system.



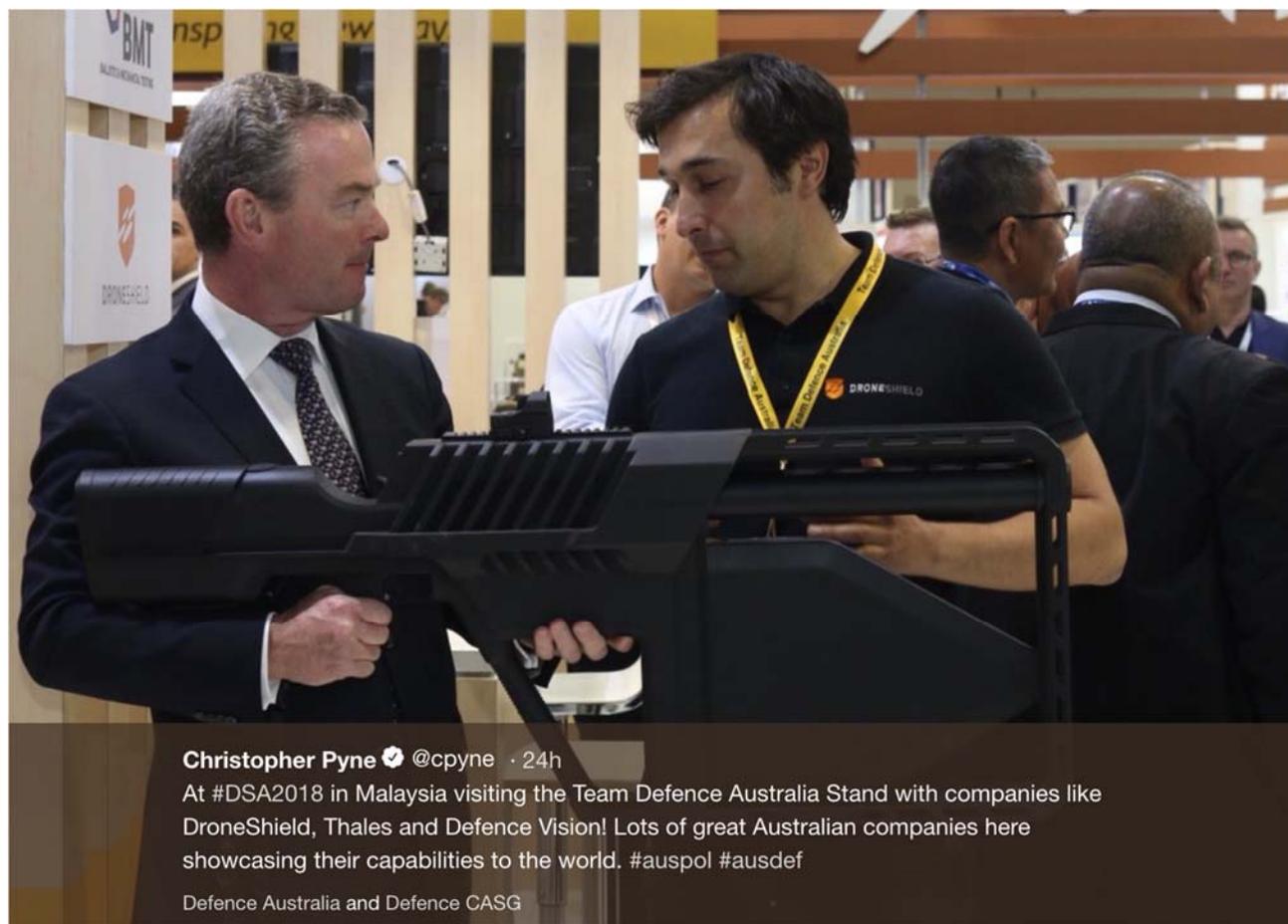
Image: U.S. Government agency DroneGun™ demonstration

Australian and New Zealand Departments of Defence and other government agencies

Following several orders from the Australian Department of Defence ("DoD") in the recent 12 months, DroneShield continues to actively engage with the DoD and other Australian Government agencies, both directly and as a subcontractor for large defence prime contractors.

The Company won a \$630,000 contract with the DoD in November 2020. Further, it is the preferred bidder on a high-profile defence project in Australia as a subcontractor to a major defence prime, and expects to finalise and announce this contract in the current quarter. DroneShield is also working with several other primes, who are including the Company's products and capabilities into their submissions to the Australian DoD as part of the Australian Industrial Capability (AIC) requirement for the primes to do business with the DoD.

In February 2021, DroneShield appointed Pyne & Partners to assist in its rapid growth within the Australian defence and government agency market. Pyne & Partners is led by Christopher Pyne who served as the 54th Australian Defence Minister, and was responsible for delivering the \$200 billion build-up of Australia's military capability, the largest in Australia's peacetime history. Pyne & Partners will support DroneShield's executive team, identifying business development and strategic growth opportunities, and assist the Company's aspirations to achieve Australian sovereign defence prime status.



Christopher Pyne 🇦🇺 @cpyne · 24h

At #DSA2018 in Malaysia visiting the Team Defence Australia Stand with companies like DroneShield, Thales and Defence Vision! Lots of great Australian companies here showcasing their capabilities to the world. #auspol #ausdef

Defence Australia and Defence CASG

Image: Hon Christopher Pyne, as the Australian Defence Minister, at a defence exhibition with DroneShield's CEO Oleg Vornik

As previously reported in October 2020, DroneShield received a Capability Improvement Grant from the Australian Department of Defence via the Centre for Defence Industry Capability ("CDIC"), towards meeting the standards for secret clearance levels required for the Company as the overall business, to engage in more classified work. As DroneShield is in the business of understanding, and minimising defence and Government customer vulnerabilities, secret clearances are important for closer and more productive customer engagements as the Company scales its business. The Company anticipates completing its Defence Industry Security Program ("DISP") process and becoming eligible for a defence clearance, this 2021 calendar year.

The Middle East

DroneShield is awaiting a payment of approximately \$2.3 million (in addition to the funds previously received by DroneShield under this order) for a shipment of the remaining DroneGun Tactical™ units under a prior Middle Eastern Ministry of Defence order, with the customer confirming successful receipt of the goods and all obligations met on DroneShield's part. The delays resulted from COVID-19-related disruptions and a recent transfer of the counter-UAS responsibility between the departments within the Ministry of Defence, however an active engagement to process the payment continues and the payment is currently expected in the present quarter.

DroneShield also continues to pursue the \$58 million to \$71 million⁵ potential order, with a fully completed form of contract awaiting execution by the sovereign customer. During the quarter, DroneShield's in-country partner held multiple discussions with the customer and work continues to arrange near term execution of the contract.⁶

Europe

During 4Q20, DroneShield delivered and received full payment for a DroneSentry™ system from a European Ministry of Defence. The system will be used for evaluation deployments by the customer, with a view to potential near-term purchases of additional units following the successful deployment.

Further, DroneShield is presently in the process of delivering several large orders to Europe across its product range, including portables, vehicle and fixed site solutions.

⁵ Corresponding to U.S.\$45-55 million. Movement from previously reported amount due to AUD/USD FX fluctuations

⁶ Originally announced on 10 July 2018. Necessarily, there can be no assurance that any of the Company's sales opportunities will result in sales. There is no assurance that the bid referenced in this paragraph will result in a sale

Also during 4Q20, the Company announced deployment of a DroneSentry™ system at the Altenrhein Airport in Switzerland. The provided system was entirely passive (no emissions) with no interference to other equipment, making it well suited for the airport environment.



Image: DroneSentry-C2™ screen at air traffic control tower of Altenrhein Airport

While the system has been deployed on a no revenue basis, an ability to have a working airport with a DroneShield system that can be referenced and visited by prospective airport and other customers, around Europe and globally, is expected to result in paid deployments, as a number of airports in Europe and globally have indicated upcoming deployments of C-UAS systems in 2021.

The Company also continues to progress discussions with the European Union police forces, where it has won the framework agreement, under which DroneGun Tactical™ is expected to be rolled out across a range of police units across the European Union. The first order under the EU police framework agreement was received on 18 January 2021.

The United Kingdom – Partnership with BT

DroneShield continues its partnership with BT on its counterdrone pipeline. UK Ministry of Defence (“UK MOD”) is presently the prime focus for the partnership, given the COVID-19 slowdown affecting other customers in the UK, particularly in light of the recent lockdowns. DroneShield and BT have made substantial inroads within the UK MOD in the last nine months, including DroneShield products having been successfully deployed by the UK MOD in actual combat conditions, with highly positive reviews. The DroneShield/BT team is progressing several opportunities ranging from hundreds of thousands to millions of pounds in value, expecting to close some of these opportunities in the 2021 calendar year, with the timing being substantially dependent on the UK COVID-19 situation⁷. Additionally, BT has demonstrated its confidence in its partnership with the Company and continued to support the partnership in the short term by purchasing DroneShield equipment for demonstration purposes, including taking sensor deliveries from DroneShield under purchase orders this March quarter.

As part of its joint marketing, BT and DroneShield conducted multiple defence and commercial customer webinars, which were both well attended by key prospective stakeholders of the UK C-UAS industry.

⁷ Necessarily, not all, and there can be no assurance that any, of the Company’s sales opportunities will result in sales



Image: BT DroneShield C-UAS webinar

Importantly, in addition to the C-UAS strategy, BT has been actively growing its civilian Unmanned Traffic Management ("UTM") strategy, including its Future Flight consortium with Altitude Angel (a UK based UTM provider) selected by the UK Research & Innovation to deliver the UK's first commercial drone corridor in open and unrestricted airspace, located south of Reading, Berkshire. DroneShield RfOne™ sensors, are ideally suited for the sensor hardware element of the UTM systems, being long range passive sensors not requiring the tracked drones to carry any specialised transponders or cooperate with the sensors in any way.

Team and Operations

Following the transformative \$17 million capital raise in 3Q20, DroneShield expanded the team, including additions to its engineering and operations staff in its Australian office, and sales and engineering field support staff in the U.S. office. The team is currently approximately 40 full time staff across Australia, U.S. and UK.

In order to assist scale up in operations and increase efficiency, DroneShield is continuing to onboard an experienced defence manufacturing contractor in Australia (a fully Australian owned and operated medium size specialised electronics manufacturer), for some of its product lines. DroneShield continues to do its own manufacturing for products which continue to be further developed. The outsourced manufacturer works on a per unit cost basis, meaning DroneShield does not take volume associated risks, and orders for manufacture are placed to align with customer and demonstration requirements.



Image: DroneShield's Australian manufacturing partner operations



Image: RfOne MKII™ units completing manufacturing process

Marketing

While most trade shows continued to be postponed or held virtually due to COVID-19 during the quarter, DroneShield is planning to participate in events which are still going ahead in 2021, directly or via local partners, starting with the International Defence Exhibition and Conference (“IDEX”) in Abu Dhabi in February 2021.



Image: DroneGun Tactical™ at a South Korean Army Training and Doctrine Command conference, held during 4Q20

DroneShield continues to be recognised at premier Australian defence awards.



Image: DroneShield’s CEO Oleg Vornik, CFO Carla Balanco and Vice President of Design Lawrence Marychurch at the DefenceConnect Australian Defence Industry Awards, where DroneShield was selected as the Finalist in several categories, held December 2020

DroneShield’s Guillaume Jounel was selected as the winner of the Australian Industry and Defence Network (AIDN) NSW Young Achiever of the Year Award, going on to the AIDN National Awards along with winners from the other States, held in Canberra on 3rd February 2021. This continues DroneShield’s tradition of winning the AIDN NSW Young Achiever Award, with the previous year winners being its CTO Angus Bean and Vice President of Design Lawrence Marychurch.



Image: Guillaume Jounel, DroneShield Optical AI Lead, receiving the AIDN NSW Young Achiever Award, with DroneShield CEO Oleg Vornik

In November 2020, DroneShield held a launch event together with the University of Technology Sydney (UTS), with whom it has collaborated on the optical Artificial Intelligence technology for UAS detection, under the Australian Government's Defence Innovation Network scheme. Collaboration between defence industry and universities forms an important part of product development in defence. The event was held at the Sydney Science Park in Western Sydney and attended by the UTS Vice Chancellor Professor Attila Brungs and Hon Stuart Ayers, NSW Minister for Jobs, Investment, Tourism and Western Sydney.



Image: DroneShield/UTS showcase event at the Sydney Science Park

Product Development

DroneShield continues to position itself at the cutting edge of solutions for detection and response to a wide variety of asymmetric multi-domain threats, as the greyzone conflict continues to rapidly rise, at both non-State actor level and State-on-State warfare.

This presents several current priorities for 2021 being:

- rapid software advancements including Artificial Intelligence/Machine Learning, at Field-Programmable Gate Array (“FPGA”) circuit level up – making sense of a wide amount of received multi-domain information
- Printed Circuit Board (“PCB”) design technologies – making our circuits smarter and faster
- waveform technologies – receiving and emitting RF signals better
- ecosystem integration, both as third-party products into DroneShield’s ecosystem, and offering the Company’s sensors into ecosystems of defence primes and similar integrators. This dual approach maximises the sales opportunities available to the Company. During 4Q20, DroneShield completed integration of several third party sensors into its C2, with further detail available at <https://www.dronesshield.com/partner-technologies>
- continuous refinement of supply chain, enhancement of build manuals and other required work to maximise scalability and short delivery time for complex products, exceeding defence and security customer expectations in the industry known for excessive delivery timeframes and scope creep. DroneShield positions itself as an industry disruptor not only in the nature of its products, but in transforming customer expectations on responsiveness and order delivery timing.

DroneSentry-C2™

During the December quarter, the Company released a U.S. DoD MIL-STD-2525 compliant version of its DroneSentry-C2™ command-and-control system, as part of its continued work with the U.S. Department of Defense.

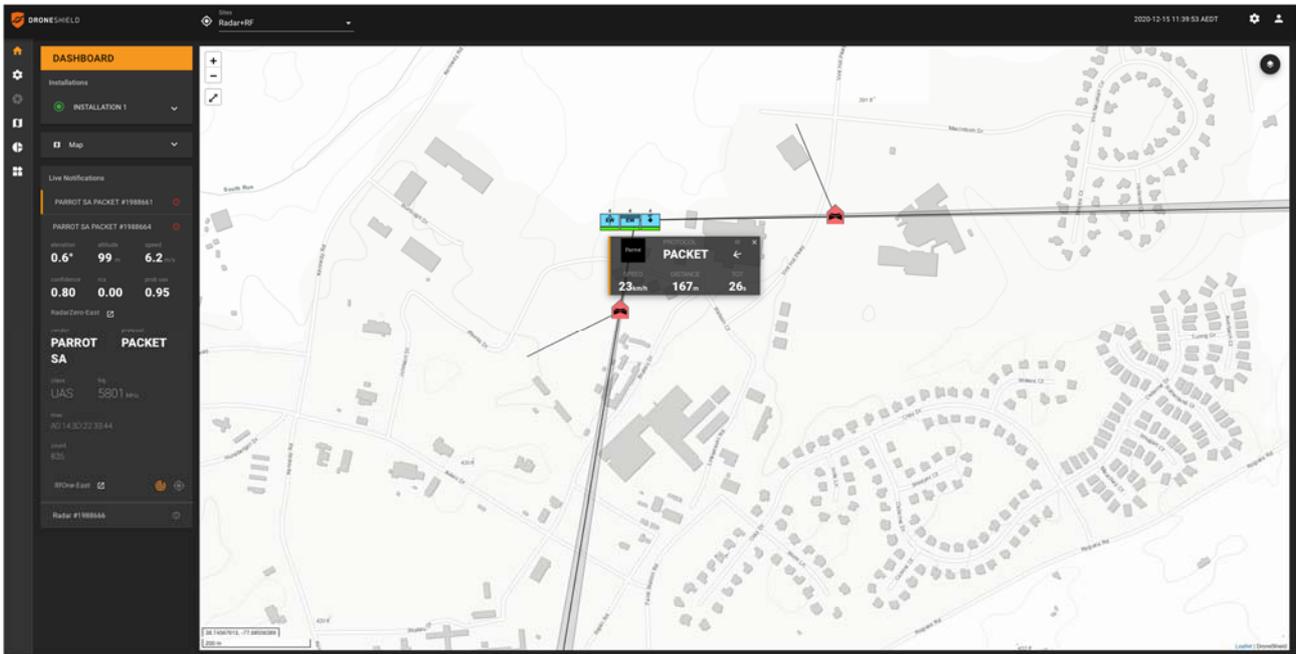


Image: DroneShield’s DroneSentry-C2™ system in the MIL-STD-2525 compliant mode

MIL-STD-2525 refers to a standard structured set of symbology for the display of information in command-and-control (C2) systems and applications, used by the U.S. Department of Defense, and non-DOD entities such as other Federal agencies and NATO partners. DroneSentry-C2™ now provides users with industry leading enterprise features and MIL-STD-2525 compliance.

DroneSentry-C2™ is a common operating picture for the Counter-UxS mission. DroneSentry-C2™ enables its users to visualise their operational space, integrate with existing perimeter security and C2 systems, and leverage multi-sensor fusion capabilities unique to DroneSentry-C2™. As a sensor agnostic, open architecture platform, DroneSentry-C2™ brings advanced interoperability and flexibility to users.

Intellectual Property

DroneShield holds several current counterdrone patents and is progressing the registration process in relation to several additional patents globally.

The Company does not file patents for all of its inventions, due to the requirement to publish the “secret sauce” as part of a patent filing.

Press Coverage

DroneShield continued to be reported as being at the cutting edge of the counterdrone industry in the media. Recent coverage of DroneShield included the following:

- Pyne signs up third defence client⁸
- DroneShield received \$900K order from major Govt. Agency⁹
- Why the DroneShield (ASX:DRO) share price is climbing higher¹⁰
- Trakka Systems and DroneShield announce strategic partnership¹¹
- DroneShield partners with M2K Technologies for the Indian market¹²
- Future of warfare: New tech helps better detect drones¹³
- DroneShield, UTS develop technology to better detect and track drone threats¹⁴
- DroneShield highlights DroneOptID's AI-driven UAS identification capabilities¹⁵
- DroneShield boosts AI capabilities for C-UAS and beyond¹⁶
- Common ways counter-drone technology detects drones¹⁷
- How counter-drone systems defeat and destroy rogue drones¹⁸
- DroneShield and Squarehead partner in the C-UAS space¹⁹
- DroneShield releases U.S. Military compliant counter drone system, DroneSentry-C2²⁰
- DroneShield hits record sales, rolls out demonstration airport system²¹
- DroneShield deploys C-UAS DroneSentry at Swiss airport²²
- DroneShield receives follow-up order from a Five Eyes government agency²³
- A Five Eyes country has upped its recent order for DroneShield's DroneGun²⁴
- Counter-Drone Technology Supports U.S. Army Exercise²⁵
- DroneShield receives first order under EU Police contract²⁶
- DroneShield 'aggressively' investing in growth²⁷

DroneShield appeared on Channel 7 news late last year:



Video: DroneShield on Channel 7 News

⁸ <https://www.afr.com/rear-window/pyne-signs-up-third-defence-client-20210131-p56y5n>

⁹ <https://themarketherald.com.au/dronesshield-asxdro-receives-900k-order-from-major-govt-agency-2020-10-01/>

¹⁰ <https://www.fool.com.au/2021/02/08/why-the-dronesshield-asxdro-share-price-is-climbing-higher/>

¹¹ <http://www.australiandefence.com.au/news/trakka-systems-and-dronesshield-announce-strategic-partnership>

¹² <https://www.suasnews.com/2021/02/dronesshield-partners-with-m2k-technologies-for-the-indian-market/>

¹³ <https://www.miragenews.com/future-of-warfare-new-tech-helps-better-detect-drones/>

¹⁴ <https://www.thedefensepost.com/2020/11/11/dronesshield-uts-drone-threats/>

¹⁵ <https://www.janes.com/defence-news/news-detail/dronesshield-highlights-droneoptids-ai-driven-uas-identification-capabilities>

¹⁶ <https://asianmilitaryreview.com/2020/11/dronesshield-boosts-ai-capabilities-for-c-uas-and-beyond/>

¹⁷ <https://dronedj.com/2020/12/01/common-ways-counter-drone-technology-detects-drones/>

¹⁸ <https://dronedj.com/2020/12/03/how-counter-drone-systems-defeat-and-destroy-rogue-drones/>

¹⁹ <https://www.suasnews.com/2020/12/dronesshield-and-squarehead-partner-in-the-c-uas-space/>

²⁰ <https://www.unmannedairspace.info/counter-uas-systems-and-policies/dronesshield-releases-us-military-compliant-counter-drone-system-dronesentry-c2/>

²¹ <https://themarketherald.com.au/dronesshield-asxdro-hits-record-sales-rolls-out-demo-airport-system-2020-12-15/>

²² <https://uasweekly.com/2020/12/17/dronesshield-deploys-c-uas-dronesentry-at-swiss-airport/>

²³ <https://dronedj.com/2020/12/29/dronesshield-receives-follow-up-order-from-a-five-eyes-government/>

²⁴ <https://stockhead.com.au/tech/a-five-eyes-country-has-upped-its-recent-order-for-dronesshields-dronegun/>

²⁵ <https://www.unmannedsystemstechnology.com/2020/12/counter-drone-technology-supports-u-s-army-exercise>

²⁶ <https://www.defenceconnect.com.au/key-enablers/7502-dronesshield-receives-first-order-under-eu-police-contract>

²⁷ <https://www.eurekareport.com.au/investment-news/dronesshield-aggressively-investing-in-growth/149238>

Principal Activities

The principal activity of the Company is the development, commercialisation and sales of hardware and software technology for drone detection and security.

Significant Changes in the State of Affairs

Other than discussed in the Review of Operations above, there have been no significant changes in the state of affairs of the Company during the year ended 31 December 2020.

Significant Events after the Balance Date

No matter or circumstance has arisen since 31 December 2020 which has significantly affected or may significantly affect:

- The Group's operations in future financial years; or
- The results of those operations in future financial years; or
- The Group's state of affairs in future financial years.

Likely developments and expected results of operations

Refer to the Chairman's Review to shareholders, on page 3, for further information on likely developments and expected results of the Group.

Environmental regulation

The Group's operations are not subject to any significant environmental regulation under either Commonwealth or State legislation. The Board considers that adequate systems are in place to manage the Group's obligations and is not aware of any breach of environmental requirements as they relate to the Group.

Dividends

No dividends were declared or paid to shareholders during the financial year (2019: \$nil).

Insurance of officers

During or since the end of the financial year the Company has paid, or agreed to pay, premiums to insure persons who are, or have been, an officer of the Company, or any past, present or future Director or officer of the Company. The contracts prohibit disclosure of the amount of the premium paid. The liabilities insured include costs and expenses that may be incurred in defending civil or criminal proceedings that may be brought against the officers in their capacity as officers of entities of the Group.

Proceedings on behalf of the Company

No proceedings have been brought or intervened in on behalf of the Group with leave of the Court under section 237 of the *Corporations Act 2001*.

Non-audit services

The Company may decide to employ the auditor on assignments additional to their statutory audit duties where the auditor's expertise and experience with the Company and/or the Group are important.

Details of the amounts paid or payable to the auditor (HLB Mann Judd Assurance (NSW) Pty Ltd) for audit and non-audit services provided during the year are outlined in Note 27 to the financial statements.

The Board of Directors has considered the position and is satisfied that the provision of non-audit services is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*. The Directors are satisfied that the provision of non-audit services provided by the auditor did not compromise the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services have been reviewed by the Board to ensure they do not impact the objectives and impartiality of the auditor;
- none of the services undermine the general principles relating to auditor independence as set out in APES 110 *Code of Ethics for Professional Accountants*, including review or auditing the auditor's own work, acting in a management or decision-making capacity for the Group, acting as advocate for the Group or jointly sharing economic risks and rewards.

Auditor's Independence Declaration

A copy of the auditor's independence declaration as required under the Section 307C of the *Corporations Act 2001* is set out on page 44.

Directors' Report- Remuneration Report (audited)

Executive remuneration governance

The Board reviews and approves the remuneration policy to enable the Company to attract and retain executives and Directors who will create value for shareholders having consideration to the amount deemed to be commensurate for a company of its size and level of activity as well as the relevant Directors' time, commitment and responsibility. The Board is also responsible for reviewing any employee incentive and equity-based plans including the appropriateness of performance hurdles and total payments proposed.

Remuneration committee

Due to the size and nature of the existing Board and the magnitude of the Company's operations, the Company does not currently have a Remuneration Committee. In accordance with the Company's Corporate Governance Plan, which is available on the Company's website <https://www.droneshield.com/investors>, the full Board currently carries out the duties that would ordinarily be assigned to the Remuneration Committee under the written terms of reference for that committee.

The Board will devote time on an annual basis to fulfil the roles and responsibilities associated with setting the level and composition of remuneration for Directors and senior executives and ensuring that such remuneration is appropriate and not excessive. The Managing Director of the Company is responsible for evaluating the performance of senior executives on an annual basis. The Board of Directors is responsible for overseeing the Managing Director's performance evaluations. This evaluation is based on specific criteria, including the business performance of the Company, whether strategic objectives are being achieved and the development of management and personnel.

Directors' remuneration

The remuneration of an Executive Director is decided by the Board, without the affected Executive Director participating in that decision-making process.

In accordance with the Constitution, the total maximum remuneration of Non-Executive Directors is initially set by the Board and subsequent variation is by ordinary resolution of shareholders in general meeting in accordance with the Constitution, the *Corporations Act 2001* and the ASX Listing Rules, as applicable.

The determination of Non-Executive Directors' remuneration within that maximum will be made by the Board having regard to the inputs and value to the Company of the respective contributions by each Non-Executive Director. The current amount has been set at an amount not to exceed \$500,000 per annum.

In addition, a Director may be paid fees or other amounts (i.e. subject to any necessary shareholder approval, non-cash performance incentives such as options) as the Directors determine where a Director performs special duties or otherwise performs services outside the scope of the ordinary duties of a Director.

Directors are also entitled to be paid reasonable travelling, hotel and other expenses incurred by them respectively in or about the performance of their duties as Directors.

The Group's remuneration policy for Executive Directors (including the Managing Director) and senior management is designed to promote superior performance and long-term commitment to the Group. Executives receive a base remuneration which is market related and may also be entitled to performance-based remuneration at the ultimate discretion of the Board.

Overall remuneration policies are subject to the discretion of the Board and can be changed to reflect competitive market and business conditions where it is in the interests of the Group and the Company's shareholders to do so.

Executive remuneration framework

The Group's reward policy reflects the benefits of aligning executive remuneration with shareholders' interests and to retain appropriately qualified executive talent for the benefit of the Group. The main principles of the policy are:

- (a) remuneration is reasonable and fair, taking into account the Group's obligations at law, the competitive market in which the Group operates and the relative size and scale of the Group's business;
- (b) individual reward should be linked to clearly specified performance targets which should be aligned to the Group's short term and long-term performance objectives; and
- (c) executives should be rewarded for both financial and non-financial performance.

Directors' Report- Remuneration Report *continued*

Executive remuneration framework *continued*

The total remuneration of Executive Directors (including the Managing Director) and other senior managers consist of the following:

- (a) Salary - Executive Directors and senior managers may receive a fixed sum payable monthly in cash;
- (b) Short term incentive - Executive Directors and nominated senior managers are eligible to participate in a profit participation plan if deemed appropriate. The Board may at its discretion award bonuses for exceptional performance in relation to each person's pre-agreed Key Performance Indicators;
- (c) Post-employment benefits – this refers to superannuation schemes; and
- (d) Long term incentives - Executive Directors may participate in share option schemes with the prior approval of shareholders. Executives may also participate in employee share option schemes, with any option issues generally being made in accordance with thresholds set in plans approved by shareholders. The Board, however, considers it appropriate to retain the flexibility to issue options to executives outside of approved Employee Option Plans in exceptional circumstances.

KMP remuneration disclosures in detail

The Directors and other Key Management Personnel ("KMP") of the Company during or since the end of the financial year were:

Name	Position	Effective date
Non-Executive Directors		
Peter James	Independent Non-Executive Chairman	Appointed as Independent Non-Executive Chairman 1 April 2016. Served as Executive Chairman from 2 December 2016. Returned to Independent Non-Executive Chairman 24 January 2017.
Jethro Marks	Independent Non-Executive Director	Appointed 16 January 2020.
Robert Clisdell	Non-Executive Director	Appointed 24 January 2017. Resigned 16 January 2020.
Executive Director		
Oleg Vornik	Executive Director, Managing Director and CEO	Appointed as CEO and Managing Director 24 January 2017.

Directors' Report- Remuneration Report *continued*

Shareholdings of KMP

The number of shares in the Company and subsidiary held during the financial year by each Director of DroneShield and other KMP (of which there are none), including their personally related entities, are set out in the following table:

31 December 2020	Opening balance (Number)	(a) Received during the year on exercise of options (Number)	(c) Other changes during the year (Number)	Balance at 31 December 2020 (Number)
Non-Executive Directors				
Peter James	3,170,435	132,500	149,587	3,452,522
Jethro Marks	-	83,333	-	83,333
Robert Clisdell	745,435	-	-	(b)
Executive Director				
Oleg Vornik	3,970,435	250,000	149,587	4,370,022
Total	7,886,305	465,833	299,174	7,905,877

Notes

- (a) The options exercised during the year were exercised using limited recourse loans provided by the Company. The loans are interest free and due for repayment by December 2025. The loans are non-recourse except against the shares issued on exercise of the options and are held by the Director to which the loan relates.
- (b) Robert Clisdell resigned as a director on 16 January 2020 and therefore his share holdings are no longer shown in the table above as he no longer is a member of key management personnel.
- (c) Shares issued due to participation in Share Purchase Plan.

31 December 2019	Opening balance (Number)	Received during the year on exercise of options (Number)	Other changes during the year (Number)	Balance at 31 December 2019 (Number)
Non-Executive Directors				
Peter James	670,435	2,500,000	-	3,170,435
Robert Clisdell	245,435	500,000	-	745,435
Executive Director				
Oleg Vornik	270,435	3,700,000	-	3,970,435
Total	1,186,305	6,700,000	-	7,886,305

Directors' Report- Remuneration Report *continued*

Share options held by KMP

31 December 2020	Opening balance (Number)	Granted as compensation (Number)	Options lapsed (Number)	(a)(b) Options exercised (Number)	Balance at 31 December 2020 (Number)	Vested Options December 2020 (Number)	Unvested Options December 2020 (Number)
Non-Executive Directors							
Peter James	7,395,000	-	-	(132,500)	7,262,500	-	7,262,500
Jethro Marks	-	250,000	-	(83,333)	166,667	-	166,667
Robert Clisdell	1,795,000	-	-	-	-	-	(c)
Executive Director							
Oleg Vornik	13,900,000	-	-	(250,000)	13,650,000	-	13,650,000
Total	23,090,000	250,000	-	(465,833)	21,079,167	-	21,079,167

Notes

- The options exercised during the year were exercised using limited recourse loans provided by the Company. The loans are interest free and due for repayment by December 2025. The loans are non-recourse except against the shares issued on exercise of the options and are held by the Director to which the loan relates.
- The options exercised during the year by Directors were exercised at \$0.65 per share.
- Robert Clisdell resigned as a director on 16 January 2020 and therefore his share options holdings are no longer shown in the table above as he no longer is a member of key management personnel.

31 December 2019	Opening balance (Number)	Granted as compensation (Number)	Options lapsed (Number)	Options exercised (Number)	Balance at 31 December 2019 (Number)	Vested Options December 2019 (Number)	Unvested Options December 2019 (Number)
Non-Executive Directors							
Peter James	11,100,000	795,000	(2,000,000)	(2,500,000)	7,395,000	-	7,395,000
Robert Clisdell	2,100,000	195,000	-	(500,000)	1,795,000	-	1,795,000
Executive Director							
Oleg Vornik	16,900,000	1,500,000	(800,000)	(3,700,000)	13,900,000	-	13,900,000
Total	30,100,000	2,490,000	(2,800,000)	(6,700,000)	23,090,000	-	23,090,000

Directors' Report- Remuneration Report *continued*

Performance based remuneration granted and exercised during the year

	31 December 2020		31 December 2019	
	(a)	(b)	(a)	(b)
	Value granted \$	Value exercised \$	Value granted \$	Value exercised \$
Non-Executive Directors				
Peter James	-	86,125	141,906	750,000
Jethro Marks	7,287	54,166	-	-
Robert Clisdell	-	-	36,349	150,000
Executive Directors				
Oleg Vornik	-	162,500	267,747	1,110,000
Total	7,287	302,791	446,002	2,010,000

Notes

- (a) The value at grant date is calculated using the Black Scholes Model.
 (b) The value of the options exercised is calculated using the exercise price.

Terms and conditions of the share-based payment arrangements

The terms and conditions of each grant of options affecting remuneration in the current or a future reporting period are as follows:

Class of Options issued during 2020	Number of Options	Grant date	Vesting date	Expiry date	Exercise Price	Value per option at grant date \$	Performance achieved	% Vested during 2020
Q	83,333	28-Aug-20	30-Nov-20	30-Jun-23	0.65	0.0291	Yes to be determined to be	100%
Q	83,333	28-Aug-20	30-Nov-21	30-Jun-23	0.65	0.0291	determined to be	n/a
Q	83,333	28-Aug-20	30-Nov-22	30-Jun-23	0.65	0.0291	determined	n/a

Class of Options issued during 2019	Number of Options	Grant date	Vesting date	Expiry date	Exercise Price	Value per option at grant date \$	Performance achieved	% Vested during 2019
ZEPO	1,147,500	12-Dec-19	(a)	30-Nov-22	-	0.2550	to be determined to be	n/a
ZEPO	97,500	17-Dec-19	(a)	30-Nov-22	-	0.2650	determined to be	n/a
Q	382,500	12-Dec-19	30-Nov-20	30-Jun-23	0.65	0.1020	determined to be	n/a
Q	32,500	17-Dec-19	30-Nov-20	30-Jun-23	0.65	0.1078	determined to be	n/a
Q	382,500	12-Dec-19	30-Nov-21	30-Jun-23	0.65	0.1020	determined to be	n/a
Q	32,500	17-Dec-19	30-Nov-21	30-Jun-23	0.65	0.1078	determined to be	n/a
Q	382,500	12-Dec-19	30-Nov-22	30-Jun-23	0.65	0.1020	determined to be	n/a
Q	32,500	17-Dec-19	30-Nov-22	30-Jun-23	0.65	0.1078	determined	n/a

Directors' Report- Remuneration Report *continued*

Notes

- (a) Zero Price ("Zepo") options are subject to the following vesting conditions being satisfied: DroneShield achieving \$20 million revenue or customer cash receipts (excluding any revenue or customer cash receipts which are applied towards satisfaction of the vesting condition attaching to the Tranche 1 Zepos) in any 12-month period within 36 months of the date of issue of the Options; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months.

Remuneration details of KMP

31 December 2020	Salary and fees \$	Cash bonus \$	Post-employment benefits \$	Termination payment \$	Share based payments (options) \$	Total \$
Non-Executive Directors						
Peter James	94,996	-	-	-	431,681	526,677
Jethro Marks	44,651	-	-	-	3,459	48,110
Robert Clisdell (a)	1,290	-	-	-	207,821	209,111
Executive Director						
Oleg Vornik	317,482	-	21,348	-	849,193	1,188,023
Total	458,419	-	21,348	-	1,492,154	1,971,921

Notes

- (a) Robert Clisdell resigned as a director on 16 January 2020.

31 December 2019	Salary and fees \$	Cash bonus \$	Post-employment benefits \$	Termination payment \$	Share based payments (options) \$	Total \$
Non-Executive Directors						
Peter James	100,000	-	-	-	380,773	480,773
Robert Clisdell	30,000	-	-	-	108,010	138,010
Bradley Buswell (a)	-	-	-	-	83,984	83,984
Executive Director						
Oleg Vornik	303,135	-	27,484	-	770,674	1,101,293
Total	433,135	-	27,484	-	1,343,441	1,804,060

Notes

- (b) Bradley Buswell resigned as a director on 3 October 2019.

Directors' Report- Remuneration Report *continued*

The relative proportions of remuneration that are linked to performance and those that are fixed are as follows:

	Fixed		Performance	
	2019	2020	2019	2020
Non-Executive Directors				
Peter James	21%	18%	79%	82%
Robert Clisdell	22%	1%	78%	99%
Jethro Marks	n/a	n/a	100%	n/a
Executive Director				
Oleg Vornik	31%	29%	69%	71%

The performance component of remuneration received by Directors relates to share options. The issue of share options to Directors is subject to shareholder approval. Remuneration in the form of DroneShield share options is used as a tool to align KMP remuneration with shareholder interests.

The employment agreement of the Executive Director during the year included the following key terms:

Name	Positions held during the year	Key terms of employment agreement
Oleg Vornik	CEO and Managing Director	<ul style="list-style-type: none"> - Base remuneration of \$330,000 p.a. - Eligible to participate in short term incentive program - Eligible to participate in long term incentive program - A notice period of 3 months, except in defined circumstances - No fixed term

Advisory Board remuneration

During the year, the Advisory Board included one individual who was remunerated as follows:

	Salary and Fees \$	Share based payments (options) \$	Total \$
31 December 2020			
Hon. Jay M Cohen	-	-	-
Total	-	-	-

	Salary and Fees \$	Share based payments (options) \$	Total \$
31 December 2019			
Hon. Jay M Cohen	-	60,646	60,646
Total	-	60,646	60,646

End of Remuneration Report.

This Directors' Report is made in accordance with a resolution of Directors.



Peter James
Independent Non-Executive Chairman
Sydney, NSW
25 February 2021



Auditor's Independence Declaration

To the directors of DroneShield Limited:

As lead auditor for the audit of the consolidated financial report of DroneShield Limited for the year ended 31 December 2020, I declare that, to the best of my knowledge and belief, there have been no contraventions of:

- (a) the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and
- (b) any applicable code of professional conduct in relation to the audit.

This declaration is in relation to DroneShield Limited and the entities it controlled during the year.

A handwritten signature in black ink, appearing to read 'A G Smith'.

Sydney, NSW
25 February 2021

A G Smith
Director

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HLB Mann Judd is a member of HLB International, the global advisory and accounting network.

Consolidated Statement of Profit or Loss and Other Comprehensive Income

	Note	31 December 2020 \$	31 December 2019 \$
Revenue	3	5,557,736	3,520,615
Other income (losses)	4	325,836	93,969
Cost of sales		(1,826,864)	(1,610,636)
Product development expense		(3,287,028)	(3,177,227)
Sales and customer service expense		(1,778,252)	(1,896,707)
Corporate and support expense	5	(2,626,681)	(2,862,926)
Corporate governance expense	6	(590,627)	(495,342)
Share based payment expense	8	(2,524,702)	(1,752,177)
Loss before income tax		(6,750,582)	(8,180,431)
Income tax benefit	7	883,592	485,351
Loss after income tax		(5,866,990)	(7,695,080)
Other comprehensive income:			
<i>Items that may be reclassified to profit or loss</i>			
Adjustments on translation of foreign controlled entity		9,922	(21,800)
Total comprehensive loss for the period		(5,857,068)	(7,716,880)
Basic loss per share	21	(0.02)	(0.04)
Diluted loss per share	21	(0.02)	(0.04)

The above Consolidated Statement of Profit or Loss and Other Comprehensive Income should be read in conjunction with the accompanying notes.

Consolidated Statement of Financial Position

	Note	31 December 2020 \$	31 December 2019 \$
ASSETS			
Current assets			
Cash and cash equivalents	9	7,858,738	5,485,000
Trade and other receivables	10	3,710,494	1,581,432
Inventories	11	2,018,279	725,920
Other investments	12	8,430,034	-
Total current assets		22,017,545	7,792,352
Non-current assets			
Plant, equipment and intangible assets	13	874,115	1,158,642
Right-of-use assets	14	236,973	427,579
Total non-current assets		1,111,088	1,586,221
Total assets		23,128,633	9,378,573
LIABILITIES			
Current liabilities			
Trade payables		884,363	397,993
Provisions	15	184,007	182,583
Other liabilities	16	1,994,265	1,666,940
Lease Liabilities	17	135,461	118,528
Borrowings	18	107,043	32,707
Total current liabilities		3,305,139	2,398,751
Non-current liabilities			
Lease Liabilities	17	191,108	328,709
Borrowings	18	42,953	-
Total non-current liabilities		234,061	328,709
Total liabilities		3,539,200	2,727,460
Net assets		19,589,433	6,651,113
EQUITY			
Share capital	19	37,283,293	21,012,607
Reserves		7,765,812	6,135,277
Accumulated losses		(25,459,672)	(20,496,771)
Total equity		19,589,433	6,651,113

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

Consolidated Statement of Changes in Equity

	Contributed equity \$	Options reserve \$	Foreign currency translation reserve \$	Accumulated losses \$	Total equity \$
Balance at 1 January 2019	11,628,172	7,343,147	(290)	(16,908,688)	2,062,341
Transfer from option reserve to accumulated losses	-	(4,106,997)	-	4,106,997	-
<i>Transactions with owners in their capacity as owners:</i>					
Options exercised	417,159	-	-	-	417,159
Options issued	-	1,752,177	-	-	1,752,177
Contributions of equity, net of transaction costs	8,967,276	1,169,040	-	-	10,136,316
	<u>9,384,435</u>	<u>2,921,217</u>	<u>-</u>	<u>-</u>	<u>12,305,652</u>
Exchange difference on translation of foreign operations	-	-	(21,800)	-	(21,800)
Loss for the period	-	-	-	(7,695,080)	(7,695,080)
Total comprehensive loss for the period	<u>-</u>	<u>-</u>	<u>(21,800)</u>	<u>(7,695,080)</u>	<u>(7,716,880)</u>
Balance at 31 December 2019	<u>21,012,607</u>	<u>6,157,367</u>	<u>(22,090)</u>	<u>(20,496,771)</u>	<u>6,651,113</u>
Balance at 1 January 2020	21,012,607	6,157,367	(22,090)	(20,496,771)	6,651,113
Transfer from option reserve to accumulated losses	-	(904,089)	-	904,089	-
<i>Transactions with owners in their capacity as owners:</i>					
Options issued	-	2,524,702	-	-	2,524,702
Contributions of equity, net of transaction costs	16,099,895	-	-	-	16,099,895
Repayment of management/ employee option exercise loan	170,791	-	-	-	170,791
	<u>16,270,686</u>	<u>2,524,702</u>	<u>-</u>	<u>-</u>	<u>18,795,388</u>
Exchange difference on translation of foreign operations	-	-	9,922	-	9,922
Loss for the period	-	-	-	(5,866,990)	(5,866,990)
Total comprehensive loss for the period	<u>-</u>	<u>-</u>	<u>9,922</u>	<u>(5,866,990)</u>	<u>(5,857,068)</u>
Balance at 31 December 2020	<u>37,283,293</u>	<u>7,777,980</u>	<u>(12,168)</u>	<u>(25,459,672)</u>	<u>19,589,433</u>

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

Consolidated Statement of Cash Flows

	Note	31 December 2020 \$	31 December 2019 \$
Cash flows from operating activities			
Receipts from customers		3,660,494	3,162,838
Payments to suppliers and employees		(10,026,619)	(8,744,543)
Research and Development Tax and other incentives received		1,706,555	582,224
Net cash flows used in operating activities	29	(4,659,570)	(4,999,481)
Cash flows from investing activities			
Purchase of plant and equipment		(772,158)	(1,044,592)
Net cash flows used in investing activities		(772,158)	(1,044,592)
Cash flows from financing activities			
Interest income on cash deposits		23,657	35,702
Proceeds from option exercise		-	417,159
Proceeds from share and option issue		16,967,000	10,849,696
Proceeds from borrowings		750,368	500,000
Repayment of borrowings		(600,000)	(500,000)
Borrowings transaction costs		(12,000)	(155,580)
Payments for lease liabilities		(114,277)	(94,592)
Share issue transaction costs		(876,344)	(719,230)
Repayment of employee loans		170,791	-
Net cash flows from financing activities		16,309,195	10,333,155
Cash and cash equivalents at beginning of period		5,485,000	1,229,499
Net increase in cash and cash equivalents		10,877,467	4,289,082
Exchange rate adjustments to balances held in foreign currencies		(73,695)	(33,581)
Cash and cash equivalents at the end of the year	9 & 12	16,288,772	5,485,000

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

Notes to the Financial Statements

Corporate Information

The consolidated financial report of DroneShield Limited (“the Company”) and its controlled entities (“DroneShield” or “the Group”) for the year ended 31 December 2020 was authorised for issue in accordance with a resolution of the Directors on 25 February 2021.

DroneShield Limited is a company incorporated in Australia, limited by shares which are publicly traded on the ASX.

The principal activity of the Company is the development, commercialisation and sales of hardware and software technology for drone detection and security.

Statement of compliance

These consolidated financial statements are general purpose financial statements which have been prepared in accordance with the *Corporations Act 2001*, Accounting Standards and Interpretations, and comply with other requirements of the law.

Accounting Standards are Australian Accounting Standards (“AAS”). Compliance with AAS ensures that the financial statements and notes of the Group comply with International Financial Reporting Standards (“IFRS”).

The financial statements comprise the consolidated financial statements of the Group. For the purposes of preparing the consolidated financial statements, the Group is a for-profit entity.

1. Summary of Significant Accounting Policies

(a) Basis of preparation

The consolidated financial statements have been prepared on the basis of historical cost as explained in the accounting policies below.

The consolidated financial statements are presented in Australian dollars (“AUD”), unless otherwise noted, which is also the functional currency of the Company. The principal accounting policies are set out below.

Going Concern

This consolidated financial report has been prepared on the basis that the Group will continue to meet its commitments and can therefore continue normal business activities and realise assets and settle liabilities in the ordinary course of business.

For the year ended 31 December 2020, the Group incurred a loss after income tax of \$5,866,990 and net cash outflows from operating activities of \$4,659,570, with cash on hand and term deposits at 31 December 2020 of \$16,288,772. At 31 December 2020, the Group had net assets of \$19,589,433 and an excess of current assets over current liabilities of \$18,712,406.

During the year, the Company issued 60,000,000 shares in a Share Placement and 75,735,467 shares in a Share Purchase Plan. The issue price per share was \$0.125 and the total cash received was \$16,967,000 (before transaction costs).

A cash flow forecast for the next 12 months prepared by management has indicated that the Group will have sufficient cash assets and term deposits to be able to meet its debts as and when they are due, and therefore the financial statements have been prepared on a going concern basis.

(b) Principles of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (i.e. subsidiaries). Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity.

Intercompany transactions, balances and unrealised gains on transactions between Group companies (if any) are eliminated. Accounting policies of all companies in the Group are consistent.

Notes to the Financial Statements *continued*

(c) Foreign currency translation

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-measurement of monetary items at year end exchange rates are recognised in profit or loss.

On consolidation, assets and liabilities have been translated into AUD at the closing rate at the reporting date. Income and expenses have been translated into AUD at the average rate over the reporting period. Exchange differences on consolidation are charged or credited to other comprehensive income and recognised in the foreign currency translation reserve in equity.

(d) Revenue recognition

The Group recognises revenue from the following major sources:

- Sale of hardware
- Subscription services
- Services

Revenue is measured based on the consideration specified in a contract with a customer. The Group recognises revenue when it transfers control of a product or service to a customer.

Sale of hardware

The Group sells hardware to distributors and directly to customers. Sales-related warranties associated with hardware cannot be purchased separately and they serve as an assurance that the products sold comply with agreed-upon specifications. Accordingly, the Group accounts for warranties in accordance with AASB 137 Provisions, Contingent Liabilities and Contingent Assets.

For sales of hardware to distributors, revenue is recognised when control of the hardware has transferred, being when the hardware has been shipped to the distributor's specified location (delivery) and collected from Customs by the distributor. Following delivery, the distributor has full discretion over the manner of distribution and price to sell the hardware, has the primary responsibility when on-selling the goods and where there is a risk of obsolescence and loss in relation to the goods. A receivable is recognised by the Group when the hardware is delivered to the distributor as this represents the point in time at which the right to consideration becomes unconditional, as only the passage of time is required before payment is due.

Contracts with customers have a variable sales element, dependent on volume sold. Currently, revenue from sales is fixed with no variable consideration. Contracts do not include financing components.

For sales directly to customers, revenue is recognised when control of the hardware has transferred to the customer, being at the point the hardware is delivered to the customer. Delivery occurs when the goods have been shipped to the customer's specified location. A receivable is recognised by the Group when the hardware is delivered to the customer as this represents the point in time at which the right to consideration becomes unconditional, as only the passage of time is required before payment is due.

As shipping income is directly related to the sale of hardware, it is not seen as a separate performance obligation and is recognised as and when the related hardware sale is recognised.

When the customer or distributor initially places the order, the customer or distributor is invoiced and the transaction price of the invoice at that point is recognised by the Group as deferred revenue, until control of the hardware has transferred to the customer or distributor and revenue is recognised.

Outside of warranties, customers do not have the right to return hardware sold therefore no "right to returned goods asset" is recognised.

Subscription services

The Group provides a subscription service for software updates. Such services are recognised as a performance obligation satisfied over time.

The transaction price allocated to these services is recognised as deferred revenue at the time of the initial sales transaction and is released on a straight-line basis over the period of service

Notes to the Financial Statements *continued*

Services

The Group provides services for research and training. Such services are recognised as a performance obligation satisfied over time.

The transaction price allocated to these services is recognised as deferred revenue at the time of the initial sales transaction and is released on a straight-line basis over the period of service.

Interest income

Interest income and expenses are reported on an accrual basis using the effective interest method.

Government grant income

Income from government grants is recognised at their fair value in profit and loss when there is reasonable assurance that the grant will be received, and the Group will comply with attached conditions.

(e) Income tax

The income tax expense/ (income) for the year comprises current income tax expense/ (income) and deferred tax expense/ (income).

Current tax and deferred tax are recognised as an expense/ (income) except to the extent that they relate to a business combination or are recognised directly in equity or other comprehensive income. Current tax liabilities/ (assets) are therefore measured at the amounts expected to be paid to/ (received from) the relevant taxation authority.

Deferred income tax expense reflects movements in deferred tax assets and deferred tax liability balances during the year as well as unused tax losses.

Current and deferred income tax expense/ (income) is recognised in equity instead of profit or loss when the tax relates to items that are credited or charged directly to equity.

Except for business combinations, no deferred income tax is recognised from the initial recognition of an asset or liability where there is no effect on accounting or taxable profit or loss.

Deferred tax liabilities/ (assets) are calculated at the tax rates that are expected to apply to the period when the liability is settled (asset is realised), and their measurement also reflects the manner in which management expects to settle the carrying amount of the related liability/ (recover the assets).

Deferred tax assets relating to temporary differences and unused tax losses are recognised only to the extent that it is probable that future taxable profit will be available against which the benefits of the deferred tax asset can be utilised.

Deferred tax assets and liabilities are offset only when the Group has a right and intention to set off current tax assets and liabilities from the same taxation authority.

The research and development tax incentive claim is recognised as income tax revenue in the period in which it is received.

(f) Goods and services and other value-added taxes ("GST")

Revenue, expenses and assets are recognised net of the amount of associated GST, except where the amount of GST incurred is not recoverable from the taxation authority, in which case it is recognised as part of the acquisition cost of an asset or as part of the expense.

Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net amount of GST recoverable from, or payable to, the taxation authority is included as part of other receivables or payables in the statement of financial position.

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.

Notes to the Financial Statements *continued*

(g) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and demand deposits with terms of less than three months, together with other short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.

(h) Trade and other receivables

Trade and other receivables are stated at their cost less an allowance for impairment of receivables. These receivables are unsecured.

Payment for hardware sales and subscription services are due from the customer on the date the invoice is issued. Contracts do not include financing components.

Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default.

The Group applies the AASB 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables. To measure the expected credit losses, trade receivables have been grouped based on shared credit risk characteristics and the days past due. The expected loss rates are based on the payment profiles of sales over a period of 36 months before 31 December 2020 or 1 January 2020 respectively and the corresponding historical credit losses experienced within this period.

(i) Trade and other payables

Trade and other payables are liabilities for goods and services provided to the Group prior to the end of the financial period which are unpaid. These amounts are unsecured and generally payable within 30 days of recognition.

(j) Inventories

Inventories are stated at the lower of cost and net realisable value. Costs of ordinarily interchangeable items are assigned using the average cost method. Net realisable value is the estimated selling price in the ordinary course of business less any applicable selling expenses.

(k) Leases

The Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, and subsequently at cost less accumulated depreciation and impairment losses and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by the lease payment made. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

The Group has applied judgement to determine the lease term for some lease contracts in which it is a lessee that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognised.

For short-term leases (lease term of 12 months or less) and leases of low-value assets the Group will recognise a lease expense on a straight-line basis.

(l) Employee benefits

Wages, salaries and annual leave

Liabilities for wages and salaries, including non-monetary benefits expected to be settled within 12 months, are recognised in other payables. Annual leave is recognised in provisions and is measured using the remuneration rate expected to apply at the time of settlement.

Notes to the Financial Statements *continued*

Long service leave

The liability for long service leave is measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using interest rates on national government bonds with terms to maturity that match, as closely as possible, the estimated future cash outflows.

Post-employment benefits

The Group makes fixed percentage contributions for all Australian resident employees to complying third party superannuation funds and recognises the expense as they become payable.

(m) Provisions, contingent liabilities and contingent assets

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

No liability is recognised if an outflow of economic resources as a result of present obligations is not probable. Such situations are disclosed as contingent liabilities, unless the outflow of resources is remote, in which case no liability is disclosed.

(n) Contributed equity

Costs directly attributable to the issue of new shares are shown as a deduction from the equity proceeds net of any income tax benefit.

(o) Plant and equipment

Plant and equipment (including fittings and furniture) are initially recognised at acquisition cost.

Depreciation is recognised on a straight-line basis to write down the cost less estimated residual value of plant and equipment. The following useful lives are applied:

Office equipment	2 – 5 years
Plant & Equipment	2 – 5 years
Demonstration equipment	2 years
Vehicles and Trailers	8 years

Depreciation will commence for self-constructed assets once the asset is available for use.

Material residual value estimates and estimates of useful life are updated as required, but at least annually.

Gains or losses arising on the disposal of property, plant and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognised in profit or loss within other income or other expenses.

(p) Intangible assets

Intangible assets relate to purchased computer software. Amortisation is recognised on a straight-line basis over an estimated useful economic life of 5 years. The estimated useful economic life is reviewed at the end of each reporting period with the effect of any changes in estimate being accounted for on a prospective basis.

(q) Earnings per share

Basic earnings per share is computed by dividing net earnings by the weighted average number of ordinary shares outstanding during each period.

Dilutive earnings per share is computed by dividing net earnings by the dilutive weighted average number of ordinary shares assuming the conversion of all dilutive potential ordinary shares.

Notes to the Financial Statements *continued*

(r) Research and development

Research is the original and planned investigation undertaken with the prospect of gaining new knowledge and understanding. Development is the application of research findings to a plan or design for the production of new or substantially improved processes or products prior to the commencement of commercial production. Research costs are expensed as they are incurred.

(s) Share-based payments

Share based compensation benefits are provided to employees via an Employee Option Plan. Information in relation to this plan is set out in Note 8.

The fair value of options granted is recognised as an employee benefits expense with a corresponding increase in equity. The total amount to be expensed is determined by reference to the fair value of the options granted, which includes any market performance conditions and the impact of any non-vesting conditions but excludes the impact of any service and non-market performance vesting conditions.

Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the end of each period, the entity revises its estimates of the number of options that are expected to vest based on the non-market vesting conditions. It recognises the impact of the revision or original estimates, if any, in profit or loss, with a corresponding adjustment to equity.

(t) Impairment of assets

Assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely dependent of the cash inflows from other assets or other groups of assets (cash generating units).

(u) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, is the CEO.

(v) Comparative disclosures

Where appropriate, comparative disclosures have been reclassified/amended to be consistent with the current year's presentation.

(w) New accounting standards and interpretations

DroneShield has adopted all of the new, revised or amended Accounting Standards and interpretations issued by the Australian Accounting Standards Board (AASB) that are mandatory for the current reporting period. There has been no material impact on the Group on the adoption of these new standards.

There are no new Accounting Standards or interpretations that have been published, but not yet mandatory, that are expected to have a material impact on the Group.

Notes to the Financial Statements *continued*

2. Critical accounting judgements, estimates and assumptions

In the application of the Group's accounting policies, which are described in Note 1, the Directors are required to make judgements, estimates and assumptions in the preparation of the financial statements about matters that are not readily available from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis.

The judgements, estimates and assumptions that have a significant risk of causing a material adjustment to items (refer to the respective notes) within the next financial year are discussed below.

Licence and patent expenses

There is a degree of judgement required in respect of the capitalisation of patent costs and the future commercial application thereof. The Directors have adopted a prudent approach and all patent costs incurred have been expensed.

Share based payments

The Group measures the cost of equity settled transactions by reference to the fair value of the equity instruments at the date they are granted. The accounting estimates and assumptions relating to equity-settled share-based payments would have no impact on the carrying amounts of assets and liability within the next annual reporting period but may impact profit or loss and equity. Details of the key assumptions used are set out in Note 8.

Inventories

Management estimates the net realisable values of inventories, taking into account the most reliable evidence available at each reporting date. The future realisation of these inventories may be affected by future technology or other market-driven changes that may reduce future selling prices.

Demonstration Units

Management reviews its estimate of the useful lives of demonstration assets at each reporting date, based on the expected utility of these assets. Uncertainties in these estimates relate to technical obsolescence that may change the utility of certain items.

Leases

Management estimates the Group's incremental borrowing rate which is used as the discount rate to calculate the present value of the lease payments that are not paid at the commencement date.

Judgement is also applied by management to determine the lease term for some lease contracts, in which it is a lessee, that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognised.

Notes to the Financial Statements *continued*

	31 December 2020 \$	31 December 2019 \$
3. Revenue		
Demonstration revenue	16,455	72,689
Hardware sales	4,710,275	3,131,124
Services revenue	134,084	-
Shipping revenue	148,281	83,973
Subscription services	16,782	1,699
Total revenue from sales	5,025,877	3,289,485
The Group derives its revenue from the transfer of goods and services over time and at a point in time. This is consistent with the revenue information that is disclosed for each reportable segment (see Note 28).		
Timing of revenue recognition		
At a point in time		
Hardware sales including shipping income		
- <i>direct sales</i>	928,138	1,455,441
- <i>distributors</i>	3,930,418	1,759,655
Demonstration revenue		
- <i>direct sales</i>	-	27,889
- <i>distributors</i>	16,455	44,801
Over time		
Subscription services		
- <i>direct sales</i>	15,000	-
- <i>distributors</i>	1,782	1,699
Services revenue		
- <i>direct sales</i>	134,084	-
Total revenue from sales	5,025,877	3,289,485
Other revenue		
Interest revenue	23,660	35,702
Revenue for achieving customer performance targets	383,148	-
Other revenue	125,051	128,888
Sublease revenue	-	66,540
Total other revenue	531,859	231,130
Total revenue	5,557,736	3,520,615
4. Other income (losses)		
Awards and incentives revenue (Note a)	823,348	96,873
Net foreign exchange losses	(497,512)	(2,904)
Total other gains (losses)	325,836	93,969
Note a: Awards and incentives income comprises of government and industry assistance including the JobKeeper scheme, payroll tax relief and ATO cashflow boost.		
5. Corporate and support expense		
Legal	151,411	200,897
Office costs and communication	443,885	401,390
Other	420,912	481,297
Payroll	985,527	1,060,964
Professional expenses	610,298	628,337
Travel and entertainment	14,648	90,041
Total corporate and support expense	2,626,681	2,862,926

Notes to the Financial Statements *continued*

	31 December 2020 \$	31 December 2019 \$
6. Corporate governance expense		
ASX fees	105,771	126,674
Audit	71,879	62,106
Board and Advisory Board expenses	141,909	129,993
Insurance	133,718	91,117
Other	81,941	46,472
Professional expenses	55,409	38,980
Total corporate governance expense	590,627	495,342
7. Income taxes relating to continuing operations		
The components of tax recognised in profit or loss include:		
Current tax	-	-
Deferred tax	-	-
Research and Development Tax Incentive ²⁸	(883,592)	(485,351)
Total tax benefit	(883,592)	(485,351)
The income tax for the year can be reconciled to the accounting profit as follows:		
Income tax benefit calculated at 27.5%	(1,856,410)	(2,249,619)
Tax effect of amounts which are not deductible	694,293	481,849
Research and Development Tax Incentive	(883,592)	(485,351)
Effect of unused tax losses not recognised as deferred tax assets	1,162,117	1,767,770
Income tax benefit recognised in profit or loss (relating to continuing operations)	(883,592)	(485,351)

The tax rate used for the 2020 and 2019 reconciliations above is the corporate tax rate of 27.5% payable by DroneShield Limited on taxable profits under Australian tax law.

The Company has unused tax losses of \$15,066,071 (2019: \$10,840,191). The benefit of these losses will only be recognised where it is probable that future taxable profit will be available against which the benefit of the deferred tax asset can be utilised. The deferred tax asset not recognised in relation to these tax losses is \$4,143,170 (2019: \$2,981,053).

²⁸ A tax credit of \$883,592 was received in the current year in relation to expenses incurred in the 31 December 2019 financial year.

Notes to the Financial Statements *continued*

8. Options issued

During the year ended 31 December 2020, a number of options were issued to Directors, management and other employees of the Group. Using the Black Scholes Model, the fair value of each option is as set out below and based on the following criteria/assumptions. The options below were issued at various dates between January and December 2020.

Options Issued 31 December 2020	Class F Options	Class Q Options	Class S Options	Zero Price Options ¹	Other Options ²	Total option expense for the year ³
No of new options	1,150,000	750,000	2,200,000	500,000		
Expiry (years)	0.79	3.45	3.01	2.87		
Exercise price (\$)	0.30	0.65	0.25	0		
Average vesting period (years)	0	1.87	0.00	2.87		
Underlying volatility	87.7%	87.7%	87.7%	n/a		
Average risk-free interest rate	0.21%	0.76%	0.11%	n/a		
Average calculated fair value of each option (\$)	0.0241	0.0876	0.0794	0.2350		
Total expense recorded for the period ended 31 December 2020 (\$)	27,626	30,344	174,597	38,979	2,253,156	2,524,702

¹ Zero Price ("Zepo") options are subject to the following vesting conditions being satisfied: DroneShield achieving \$20,000,000 of revenue or customer cash receipts (excluding any revenue or customer cash receipts which are applied towards satisfaction of the vesting condition attaching to the Tranche 1 Zepos) or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months.

² \$2,253,156 relates to the vesting expense from options issued in prior periods, comprising option expense for Tranche 2 Zepos, Classes N, P and Q (issued in 2019), Tranche 1 Zepos (issued in 2018). Refer to 2018 and 2019 Annual Report for details of options issued in prior periods.

³ During the year, limited-recourse loans were issued to certain employees and directors, where the company provided interest free loans for conversion of options previously issued by the company. In total, 1,682,500 options were converted into ordinary shares, at various exercise prices. The loans are due for repayment by December 2025. The loans are non-recourse except against the shares issued on exercise of the options and are held by the participant to which the loan relates. Non-recourse loans issued are treated as a modification of the option under the Accounting Standards. No additional expense has been recognised in relation to these modifications.

Notes to the Financial Statements *continued*

Options issued (*continued*)

During the year ended 31 December 2019, a number of options were issued to Directors, management and other employees of the Group as well as to brokers participating in the Share Placements that occurred in February and August 2019. Using the Black Scholes Model, the fair value of each option is as set out below and based on the following criteria/assumptions. The options below were issued at various dates between January and December 2019.

Options Issued 31 December 2019	Class G Options	Class K Options	Class M Options	Class N Options	Class O Options ¹	Class P Options	Class Q Options	Class R Options ²	Zero Price Options ³	Other Options ⁴	Total option expense for the year ⁵
No of new options	200,000	450,000	175,000	175,000	2,825,425	1,050,000	5,200,000	10,000,000	5,200,000		
Expiry (years)	3	2.75	2.93	3.93	2	2.82	3.54	2.63	3		
Exercise price (\$)	0.3	0.50	0.20	0.20	0.22	0.40	0.65	0.40	0		
Average vesting period (years)	-	-	-	0.69	-	0.47	1.96	-	3		
Underlying volatility	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	n/a		
Average risk-free interest rate	1.53%	0.78%	0.81%	0.83%	1.72%	0.78%	0.83%	1.72%	n/a		
Average calculated fair value of each option (\$)	0.0344	0.1659	0.1297	0.1434	0.0352	0.1467	0.1091	0.1118	0.2671		
Total expense recorded for the period ended 31 December 2019 (\$)	6,881	76,496	17,436	15,302	-	100,400	15,761	-	20,704	1,499,197	1,752,177

¹ Class O options were issued to brokers as part of the February 2019 capital raise and included as part of share transaction costs and treated as a deduction from equity (of \$99,344 see Note 19).

² Class R options were issued to brokers as part of the August 2019 capital raise and included as part of share transaction costs and treated as a deduction from equity (of \$1,118,195 see Note 19).

³ Zero Price ("Zepo") options are subject to the following vesting conditions being satisfied: DroneShield achieving \$20,000,000 of revenue or customer cash receipts (excluding any revenue or customer cash receipts which are applied towards satisfaction of the vesting condition attaching to the Tranche 1 Zepos; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months.

⁴ \$1,499,197 relates to the vesting expense from options issued in prior periods, comprising option expense for Tranche 1 Zepos, Classes G, H, M and N (issued in 2018), and H (issued in 2016). Refer to 2018 Annual Report for details of options issued in prior periods.

⁵ During the year, limited-recourse loans were issued to certain employees and directors, where the company provided interest free loans for conversion of options previously issued by the company. In total, 9,575,000 options were converted into ordinary shares, at an exercise price of \$0.30. The loans are due for repayment by September 2024. The loans are non-recourse except against the shares issued on exercise of the options and are held by the participant to which the loan relates. Non-recourse loans issued are treated as a modification of the option under the Accounting Standards. No additional expense has been recognised in relation to these modifications.

Notes to the Financial Statements *continued*

	31 December 2020 \$	31 December 2019 \$
9. Cash and cash equivalents		
Cash at bank and in hand	4,158,819	1,906,555
Short-term deposits	<u>3,699,919</u>	<u>3,578,445</u>
Total cash and cash equivalents	<u>7,858,738</u>	<u>5,485,000</u>

The cash and cash equivalents at the end of the year in the Consolidated Statement of Cash Flows include term deposits of \$8,430,034 (Note 12).

10. Trade and other receivables		
Trade receivables	2,669,714	602,942
Deferred sales proceeds (see Note 16)	816,438	732,095
Prepayments	<u>224,342</u>	<u>246,395</u>
Total trade and other receivables	<u>3,710,494</u>	<u>1,581,432</u>

Trade receivables disclosed above include amounts (see below for aged analysis) that are past due at the end of the reporting period for which the Group has not recognised a provision for expected credit loss because there has not been a significant change in credit quality and the amounts are still considered recoverable.

Age of receivables that are past due but not impaired.

60 – 90 days	-	-
>120 days	2,363,746	601,753

Payment for hardware sales and subscription services are due from the customer as per the terms specified in the contract.

11. Inventories		
Finished goods inventory at cost	1,282,041	441,023
Work in Progress	<u>736,238</u>	<u>284,897</u>
Total Inventory	<u>2,018,279</u>	<u>725,920</u>

12. Other investments		
Term Deposits	<u>8,430,034</u>	-
Total Other investments	<u>8,430,034</u>	<u>-</u>

Term deposits have interest rates of 0.30% to 0.70% and mature in less than 12 months.

Notes to the Financial Statements *continued*

13. Plant, equipment and intangible assets

	Development equipment \$	Demonstration equipment \$	Office equipment \$	Plant & equipment \$	Vehicles and Trailers \$	Intangible Assets (software) \$	Total \$
Balance at 1 Jan 19	109,939	512,643	39,900	127,597	-	16,172	806,251
Additions	407,048	231,082	122,188	258,000	-	29,086	1,047,404
Disposals	-	(43,857)	(3,244)	-	-	-	(47,101)
Transfers from (to) other fixed asset categories	(288,447)	278,672	9,775	-	-	-	-
Transfer from (to) inventory	(10,903)	(128,409)	6,566	-	-	-	(132,746)
Depreciation/amortisation	-	(424,347)	(52,358)	(33,697)	-	(7,626)	(518,028)
Exchange differences	-	2,580	282	-	-	-	2,862
Balance at 31 Dec 19	217,637	428,364	123,109	351,900	-	37,632	1,158,642
Additions	225,749	42,325	80,302	4,531	153,656	13,392	519,955
Disposals	-	(23,780)	(6,943)	-	-	-	(30,723)
Transfers from (to) other fixed asset categories	(128,426)	128,426	-	-	-	-	-
Transfer from (to) inventory	(185,246)	(76,028)	-	-	-	-	(261,274)
Depreciation/amortisation	-	(317,994)	(80,355)	(81,775)	(3,239)	(10,818)	(494,181)
Exchange differences	-	(6,066)	(810)	-	(11,428)	-	(18,304)
Balance at 31 Dec 20	129,714	175,247	115,303	274,656	138,989	40,206	874,115

	Cost \$	Accumulated Depreciation \$	Carrying Value \$
Development equipment	129,714	-	129,714
Demonstration equipment	762,499	587,252	175,247
Office equipment	272,707	157,404	115,303
Plant & Equipment	399,612	124,956	274,656
Vehicles and Trailers	141,952	2,963	138,989
Intangible Assets (software)	63,344	23,138	40,206
Balance at 31 December 2020	1,769,828	895,713	874,115
Development equipment	217,637	-	217,637
Demonstration equipment	1,003,180	574,816	428,364
Office equipment	212,275	89,166	123,109
Plant & Equipment	395,081	43,181	351,900
Intangible Assets (software)	49,952	12,320	37,632
Balance at 31 December 2019	1,878,125	719,483	1,158,642

Notes to the Financial Statements *continued*

	31 December 2020 \$	31 December 2019 \$
14. Right-of-use asset		
Balance at 1 January 2020	427,579	-
Additions	-	541,829
Depreciation	(135,140)	(114,250)
Impairment	(55,466)	-
Balance at 31 December 2020	236,973	427,579

The Group leases various assets including offices and storage units. The contractual lease terms range from 1 to 3 years.

The total cash outflow for leases, including short-term leases was \$278,725.

The maturity analysis of lease liabilities is presented in Note 17.

Amounts recognised in profit and loss

Depreciation expense on right-of-use assets	135,140	114,250
Expense relating to short-term leases	147,989	86,328
Impairment expense on right-of-use assets	55,466	-
Interest expense on lease liabilities	35,324	39,030

15. Provisions

Employee entitlements	184,007	164,761
Other	-	17,822
Total provisions	184,007	182,583

16. Other liabilities

Accrued expenses	132,299	413,148
Deferred Revenue		
- Hardware sales	1,646,614	1,126,173
- Subscription services	212,851	2,567
- Other revenue	2,501	125,052
Total other liabilities	1,994,265	1,666,940

17. Lease liabilities

Amounts due for settlement within 12 months	135,461	118,528
Amounts due for settlement after 12 months	191,108	328,709
Total lease liabilities	326,569	447,237

These liabilities were measured at the present value of the remaining lease payments, discounted using the weighted average incremental borrowing rate of 9%.

Notes to the Financial Statements *continued*

	31 December 2020 \$	31 December 2019 \$
18. Borrowings		
Unsecured borrowing at amortised cost		
Insurance Premium Finance	21,136	32,707
Paycheck Protection Program Term Note	128,860	-
Total borrowings	149,996	32,707
Amount due for settlement within 12 months	107,043	32,707
Amount due for settlement after 12 months	42,953	-

19. Contributed equity

	No. of shares (Note a)	\$
Balance at beginning of period (1 January 2020)	252,462,135	21,012,607
Shares issued following options exercised during period (Note b)	1,682,500	-
Shares issued from Share Placement (Note c)	60,000,000	7,500,000
Shares issued from Share Purchase Plan (Note d)	75,735,467	9,466,933
Transaction costs in relation to Shares issued from Share Placement (Note e)	-	(867,038)
Repayment of limited recourse loan (Note f)	-	170,791
Balance at end of period (31 December 2020)	389,880,102	37,283,293

Note a: The number of shares disclosed is the number of shares in DroneShield Limited.

Note b: During 2020, 1,682,500 unlisted options were exercised by Directors and employees using the limited recourse loan provided by the Company.

Note c: In August 2020, the Company issued 60,000,000 shares in a Share Placement. The issue price was \$0.125 per share and the total cash received from the placement of shares was \$7,500,000.

Note d: In September 2020, the Company issued 75,735,467 shares in a Share Purchase Plan. The issue price was \$0.125 per share, and the total cash received from the placement of shares was \$9,466,933.

Note e: Included in transaction costs is \$867,038 management, selling and success fees paid to brokers in relation to the August 2020 Share Placement and September 2020 Share Purchase Plan.

Note f: During the 2019 year, limited-recourse loans were issued to certain employees and directors, where the company provided interest free loans for conversion of options previously issued by the company into shares. The loans are due for repayment by September 2024. The loans are non-recourse except against the shares issued on exercise of the options and are held by the participant to which the loan relates. During 2020, \$170,791 of this loan amount was repaid.

Notes to the Financial Statements *continued*

20. Shares and options

	Number of Shares	Number of Unlisted Options
Opening balances at 1 January 2020	252,462,135	48,751,450
August Share Placement	60,000,000	-
September Share Purchase Plan	75,735,467	-
Options exercised during the period	1,682,500	(1,682,500)
Options cancelled prior to vesting	-	(2,160,000)
Options cancelled after vesting	-	(275,000)
Options lapsed during the period	-	(621,000)
Options issued to Directors, Management and Employees	-	4,700,000
Closing balance at 31 December 2020	389,880,102	48,712,950

Unlisted Options

4,700,000 Unlisted Options were issued to Directors, Management and employees during the year to 31 December 2020. These Options are subject to various escrow and vesting conditions relating to length of employment with the Company and performance of the Company. See Note 8 for further details.

	31 December 2020 \$	31 December 2019 \$
21. Earnings (loss) per share		
(a) Basic earnings (loss) per share		
Total basic earnings (loss) per share attributable to the ordinary equity holders of the company	(0.02)	(0.04)
(b) Dilutive earnings per share		
Dilutive earnings (loss) per share attributable to the ordinary equity holders of the company	(0.02)	(0.04)
(c) Weighted average number of shares used as the denominator		
Weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share	299,102,204	214,031,563

Options

Unlisted Options on issue (refer to Note 20) are not included in the calculation of diluted earnings per share because they are considered to be antidilutive for the period ended 31 December 2020. These options and shares could potentially dilute basic earnings per share in future periods.

Notes to the Financial Statements *continued*

22. Key Management Personnel disclosures and related party transactions

	31 December 2020 \$	31 December 2019 \$
(a) KMP Compensation		
Post-employment benefits	21,348	27,484
Salaries and fees	458,419	433,135
Share-based payments	1,492,154	1,343,441
Total KMP compensation	1,971,921	1,804,060

Detailed remuneration disclosures are provided in the Remuneration Report on pages 37- 43.

(b) Other transactions with related parties

During the financial year, the Group engaged the services of the following related parties on normal commercial terms and conditions no more favourable than those available to other parties:

Sort Hub Pty Ltd, of which Jethro Marks is a Director, received payments totalling \$168,048. Sort Hub Pty Ltd invoiced the Company \$310,563 for shipping of inventory globally during the year. At year end, \$142,515 was owed to Sort Hub Pty Ltd.

The Company also entered into a short-term lease with Sort Hub Pty Ltd for a manufacturing facility. The lease ended prior to 31 December 2020, as the Company moved into its current larger combined office, R&D and manufacturing facility in central Sydney. The Group paid \$22,685 to lease the premises of which \$12,992 was paid during the year. At year-end \$9,693 was owed to Sort Hub Pty Ltd.

23. Parent entity financial information

The individual financial statements for the accounting parent entity, DroneShield Limited, show the following aggregate amounts:

Statement of financial Position

Current assets	23,593,483	11,530,659
Non-current Assets	958,614	1,492,904
Total assets	<u>24,552,097</u>	<u>13,023,563</u>
Current liabilities	2,061,681	1,908,507
Non-Current Liabilities	191,108	328,709
Total liabilities	<u>2,252,789</u>	<u>2,237,216</u>
Net assets	22,299,308	10,786,347
Share Capital	35,960,746	19,690,060
Reserves	7,777,980	6,157,367
Accumulated losses	(21,439,418)	(15,061,080)
Total Equity	<u>22,299,308</u>	<u>10,786,347</u>
Loss for the year	<u>(7,282,426)</u>	<u>(6,921,043)</u>
Other comprehensive loss	<u>-</u>	<u>-</u>
Total comprehensive loss	<u>(7,282,426)</u>	<u>(6,921,043)</u>

DroneShield LLC, DroneShield Corporation Pty Ltd and DroneShield UK Limited are all legal subsidiaries of DroneShield Limited and are 100% owned by DroneShield Limited.

Notes to the Financial Statements *continued*

24. Financial risk management

The Group's financial instruments consist mainly of deposits with banks, accounts receivable and payable and inter-entity loans.

The Directors' overall risk management strategy seeks to assist the Group in meeting its financial targets whilst minimising potential adverse effects on financial performance.

Credit risk

With respect to credit risk arising from other financial assets, which comprise cash and cash equivalents, trade and other receivables and other investments, the Company's exposure to credit risk arises in the form of default of the counter party, with a maximum exposure equal to the carrying amount of these instruments. Management has considered impairment, with none noted at 31 December 2020.

Since the Company trades only with recognised parties, there is no requirement for collateral security.

The maximum exposure to credit risk at the balance date is as follows:

	31 December 2020 \$	31 December 2019 \$
Cash and cash equivalents	7,858,738	5,485,000
Other investments	8,430,034	-
Trade and other receivables	3,486,152	1,335,037

Liquidity risk

The Company's policy is to maintain a comfortable level of liquidity through the continual monitoring of actual and forecast cash flows and the maturity profile of term deposits, and the raising of additional capital as required.

Foreign exchange risk

The Company operates from Australia, UK and the U.S., and accordingly transactions currently occur in a mix of AUD, GBP and USD. Cash and cash equivalents used to fund working capital are held in USD and AUD bank accounts.

Transactional currency exposures arise from sales or purchases in currencies other than the Company's functional currency. For example, the Company is exposed to transactional exposure in respect of non-functional currencies on foreign currency denominated sales contracts entered into by DroneShield Limited in Australia.

Additionally, the Company is exposed to foreign currency exchange risk when capital is raised in AUD and transferred to the U.S. entity. The Company closely monitors foreign currency movements at such times but does not use hedging instruments to manage such risk.

Foreign currency denominated financial assets and liabilities which expose the Company to currency risk are disclosed below. The amounts shown are translated into AUD at the closing rate.

	31 December 2020 \$	31 December 2019 \$
Cash	904,325	19,370
Trade and other receivables	2,389,702	1,020,740
Total Financial assets	3,294,027	1,040,110
Borrowings	(128,860)	-
Other liabilities	(6,895)	(277,063)
Provisions	(16,162)	(64,009)
Trade and other payables	(450,146)	(197,770)
Total Financial liabilities	(602,063)	(538,842)

Notes to the Financial Statements *continued*

Foreign exchange risk

The following table, expressed in AUD, indicates DroneShield's sensitivity to movements in exchange rates on the profit or loss, based on the AUD strengthening/ weakening against the USD by 10%:

	31 December 2020 \$	31 December 2019 \$
+ 10%	(244,596)	143,103
- 10%	299,264	(762,258)

Exposure to foreign currency varies during the year depending on the volume of transactions. Nonetheless, the analysis above is considered to be representative of the Group's exposure to currency risk.

Financial instrument composition and maturity analysis

The table below reflects the undiscounted contractual settlement terms for financial liabilities.

Contractual maturities of financial liabilities	Less than 6 months \$	6-12 Months \$	Between 1 and 2 years \$	Between 2 and 5 years \$	Total contractual cash flows \$	Carrying amount (assets)/ liabilities \$
As at 31 December 2019						
Trade and other payables	397,993	-	-	-	397,993	397,993
Borrowings	27,017	5,690	-	-	32,707	32,707
Lease Liabilities	56,947	61,582	135,260	193,448	447,237	447,237
Accrued Expenses	413,148	-	-	-	413,148	413,148
Total	895,105	67,272	135,260	193,448	1,291,085	1,291,085
As at 31 December 2020						
Trade and other payables	884,363	-	-	-	884,363	884,363
Borrowings	59,900	47,143	42,953	-	149,996	149,996
Lease Liabilities	65,643	69,818	152,985	38,123	326,569	326,569
Accrued Expenses	132,299	-	-	-	132,299	132,299
Total	1,142,205	116,961	195,938	38,123	1,493,227	1,493,227

25. Contingent liabilities

A former supplier of the Group ("the plaintiff") has filed a civil lawsuit against the Group for alleged breaches of contract and misappropriation of trade secrets. As the plaintiff has not provided all evidence to court, it is not practical to provide an estimate of the financial effect of this matter. However, based on legal advice received, the directors consider that:

- the plaintiff does not have a case; and
- there is a low likelihood that the Group will incur any material adverse financial effect.

26. Commitments

At 31 December 2020, contractual agreements existed to pay suppliers \$1,577,947 for the manufacturing of inventory to deliver on orders received. (2019: \$873,482).

Notes to the Financial Statements *continued*

27. Remuneration of auditor

During the year, the following fees were paid or payable for services provided by the auditor, HLB Mann Judd Assurance (NSW) Pty Limited and its related practices:

	31 December 2020 \$	31 December 2019 \$
Audit and assurance services	71,879	62,106
Taxation services	10,624	12,168
Total Auditor's remuneration	82,503	74,274

28. Segment information

The Group operates in one operating segment, being the development and commercialisation of hardware and software technology for drone detection and security.

This operating segment is monitored by the Group's chief operating decision maker and strategic decisions are made on the basis of adjusted segment operating results. The chief operating decision maker of the Group is the CEO.

The following tables present certain information regarding geographical segments for the years ended 31 December 2020 and 31 December 2019.

Segment performance 31 December 2020	USA \$	UK \$	Australia \$	Elimination \$	Total \$
Hardware sales including shipping income					
- <i>direct sales</i>	538,950	-	389,188	-	928,138
- <i>distributors</i>	-	-	3,930,418	-	3,930,418
Subscription services					
- <i>direct sales</i>	-	-	15,000	-	15,000
- <i>distributors</i>	1,782	-	-	-	1,782
Services Revenue					
- <i>direct sales</i>	19,204	-	114,880	-	134,084
- <i>distributors</i>	-	-	16,455	-	16,455
Total revenue from sales	559,936	-	4,465,941	-	5,025,877
Other revenue	21,891	-	509,968	-	531,859
Total revenue	581,827	-	4,975,909	-	5,557,736
Depreciation	(75,282)	(1,447)	(546,079)	-	(622,808)
Loss after income tax expense	(1,058,304)	(173,784)	(4,634,902)	-	(5,866,990)
Assets and liabilities					
Segment assets	316,363	4,753	30,652,468	(7,844,951)	23,128,633
Segment liabilities	(6,287,972)	(309,516)	(4,786,663)	7,844,951	(3,539,200)

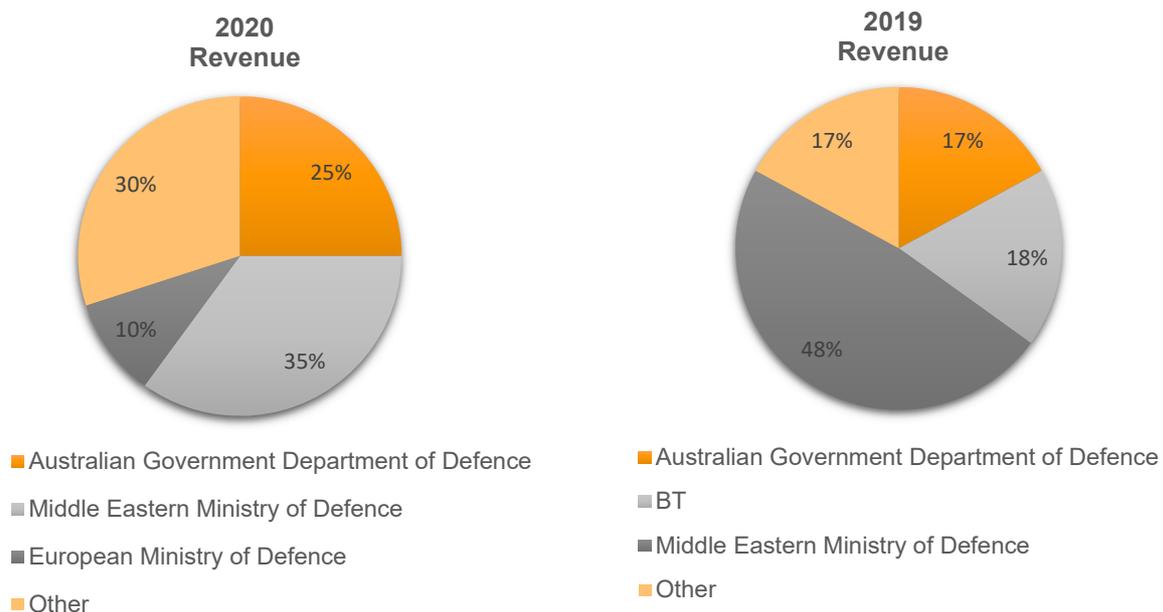
Notes to the Financial Statements *continued*

28. Segment information *continued*

Segment performance 31 December 2019	USA \$	UK \$	Australia \$	Elimination \$	Total \$
Hardware sales including shipping income					
- <i>direct sales</i>	-	-	1,455,441	-	1,455,441
- <i>distributors</i>	-	-	1,759,655	-	1,759,655
Subscription services					
- <i>distributors</i>	1,699	-	-	-	1,699
Services Revenue					
- <i>direct sales</i>	-	-	27,889	-	27,889
- <i>distributors</i>	-	-	44,801	-	44,801
Total revenue from sales	1,699	-	3,287,786	-	3,289,485
Other revenue	421,878	271,060	230,654	(692,462)	231,130
Total revenue	423,577	271,060	3,518,440	(692,462)	3,520,615
Depreciation	(185,843)	(929)	(445,506)	-	(632,278)
Loss after income tax expense	(1,532,336)	(136,365)	(6,026,379)	-	(7,695,080)
Assets and liabilities					
Segment assets	119,754	7,230	14,319,225	(5,067,636)	9,378,573
Segment liabilities	(5,028,165)	(150,227)	(2,616,704)	5,067,636	(2,727,460)

Information about major customers

The following chart presents certain information regarding customers/distributors who contributed 10 per cent or more to the Group's revenue for the years ended 31 December 2020 and 31 December 2019.



Notes to the Financial Statements *continued*

29. Reconciliation from loss after income tax to net cash outflow from operating activities

	31 December 2020 \$	31 December 2019 \$
Operating loss for the year after tax	(5,866,990)	(7,695,080)
Bad debts	-	35,516
Depreciation	622,808	632,278
Effects of foreign currency translation	509,168	73,872
Interest income on cash deposits	(23,657)	(35,702)
Inventory impairment expense	20,606	40,000
Loss on disposal of fixed asset	30,723	41,262
Provisions	1,424	88,516
Right-of-use asset impairment	55,466	-
Share option expense	2,524,702	1,752,177
Transaction costs related to loans and borrowings	12,000	155,580
<i>Change in operating assets and liabilities</i>		
Decrease/(Increase) in trade and other receivables	(2,066,772)	(291,742)
(Increase) in inventory	(1,292,359)	(83,417)
(Decrease)/increase in trade and other payables	486,371	213,677
(Decrease)/increase in other liabilities	326,940	73,582
Net cash flows from (used in) operating activities	(4,659,570)	(4,999,481)

30. Impact of COVID-19

During March 2020, COVID-19 was declared a pandemic by the World Health Organisation and has had a significant impact on domestic and global markets and economies. The impact of the COVID-19 pandemic, which continues to evolve on a daily basis, has significantly affected market volatility, exchange rates, supply chains, consumer demand, liquidity and credit conditions and unemployment rates and in a bid to curtail the spread of COVID-19, travel, trade and social restrictive measures have been imposed by the Australian Government.

The majority of the Group's customers are Military and Government agencies which have remained substantially unaffected by COVID-19, thereby reducing the project pipeline exposure of DroneShield. Whilst there were delays in some customer procurement processes, there were no cancellations of any customer orders for DroneShield's products, nor did any potential customer decline to purchase the Company's products.

While there were some delays in the supply chain process, these delays were substantially resolved, resulting in no material impact on the manufacturing process.

In response to the COVID-19 pandemic, the Group had initially decreased its operating expenditure including employee payroll, and requested and received a partial deferral, for 6 months, of the Sydney office rental expense. The Group also applied for and received government assistance including the JobKeeper scheme, payroll tax relief and ATO cashflow boost in Australia and Paycheck Protection Program in the USA. Following the \$7.5 million capital raise via a Share Placement, and \$9.47 million capital raise via a Share Purchase Plan, the Company commenced growing the business and increasing operating expenditure again, to pursue emerging customer opportunities.

The Directors are managing and monitoring the Group's operations closely in response to COVID-19 which continues to evolve on a daily basis. The extent of the impact COVID-19 may have on the Group's future financial performance and position is currently not known given the degree of uncertainty in the current climate.

Notes to the Financial Statements *continued*

31. Events after the reporting date

No matter or circumstance has arisen since 31 December 2020 which has significantly affected or may significantly affect:

- The Group's operations in future financial years; or
- The results of those operations in future financial years; or
- The Group's state of affairs in future financial years.

Directors' Declaration

1. In the opinion of the Directors:
 - (a) the consolidated financial statements and notes set out on pages 45 to 71 are in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the Group's financial position as at 31 December 2020 and of its performance for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and
 - (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.
2. The notes to the consolidated financial statements include a statement of compliance with International Financial Reporting Standards.
3. The Directors have been given the declarations by the Chief Executive Officer and the Chief Financial Officer for the year ended 31 December 2020 required by section 295A of the *Corporations Act 2001*.

This declaration is made in accordance with a resolution of the Directors.



Peter James
Independent Non-Executive Chairman

Sydney, NSW
25 February 2021



Independent Auditor's Report to the Members of DroneShield Limited

REPORT ON THE AUDIT OF THE FINANCIAL REPORT

Opinion

We have audited the financial report of DroneShield Limited ("the Company") and its controlled entities ("the Group"), which comprises the consolidated statement of financial position as at 31 December 2020, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

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

- (a) giving a true and fair view of the Group's financial position as at 31 December 2020 and of its financial performance for the year then ended; and
- (b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

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

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

Key Audit Matters

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

Key Audit Matter	How our audit addressed the key audit matter
Revenue recognition (Note 3)	
The Group recognised total revenue from sales of \$5,025,877 during the year ended 31 December 2020 (2019: \$3,289,485).	We reviewed management's revenue recognition accounting policy to assess whether it complied with AASB 15.
We focussed on this area as a key audit matter due to the judgements involved in applying AASB 15 <i>Revenue from Contracts with Customers</i> .	We reviewed a sample of revenue items recorded during the year and reviewed contracts and other documentation in relation to these to assess whether revenue recognised was in accordance with the requirements of AASB 15.

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Key Audit Matter	How our audit addressed the key audit matter
	We also reviewed disclosures in the financial statements to assess whether these were in accordance with AASB 15.
Capitalised demonstration equipment (Note 13)	
At 31 December 2020, the Group held demonstration equipment with a carrying value of \$175,247 (2019: \$428,364).	We reviewed the cost of these items by agreeing a sample to purchase invoices.
We focussed on this area as a key audit matter due to the judgement used by management in preparing its assessment of impairment.	We assessed whether the policy to capitalise the equipment was in accordance with accounting standards.
	We discussed with management its plans to generate sales, and obtained sales forecasts prepared to identify if any impairment indicators existed.
	We reviewed sales made during the year to assess if any impairment indicators existed.
	We reviewed the useful life of these assets.
	We enquired of management whether there was any indication that the technological advances would indicate that the items capitalised were obsolete.
Valuation of share options (Note 8)	
The Company issued a number of share options to directors and management.	We reviewed the valuation of the options, and the methodology used. We also reviewed the key assumptions in the valuation.
The fair value of the options at grant date was determined by management, and used to account for the options.	We assessed whether the Group's disclosures met the requirements of accounting standards.
The key assumptions used in determining the fair value of the options are set out in Note 8 to the financial statements.	
We focused on this area as a key audit matter due to the judgement involved in assessing the fair value of the options.	

Information Other than the Financial Report and Auditor's Report Thereon

The directors are responsible for the other information. The other information comprises the information included in the Group's annual report for the year ended 31 December 2020, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly 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, 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.



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 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.

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 37 to 43 of the directors' report for the year ended 31 December 2020.

In our opinion, the Remuneration Report of DroneShield Limited for the year ended 31 December 2020 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.

HLB Mann Judd Assurance (NSW) Pty Ltd
Chartered Accountants

Sydney, NSW
25 February 2021

A G Smith
Director

Shareholder Information

Holdings distribution at 24 February 2021

Holding Ranges	Holders	Total Shares	% Issued Share Capital
1 - 1,000	123	22,549	0.01%
1,001 - 5,000	2,238	7,619,283	1.95%
5,001 - 10,000	1,596	12,648,491	3.24%
10,001 - 100,000	3,303	115,342,546	29.58%
100,001 - over	584	254,247,233	65.21%
Total	7,844	389,880,102	100.00%

The shareholders are entitled to one vote for each share held.

Twenty largest shareholders at 24 February 2021

Position	Holder Name	Shares Held	% Issued Share Capital
1	BNP PARIBAS NOMINEES PTY LTD <IB AU NOMS RETAILCLIENT DRP>	32,165,384	8.25%
2	BETA GAMMA PTY LTD	21,500,000	5.51%
3	CITICORP NOMINEES PTY LIMITED	12,635,134	3.24%
4	J P MORGAN NOMINEES AUSTRALIA PTY LIMITED	10,311,250	2.64%
5	S R BENNETT PTY LTD <D&S BENNETT PTY LTD SF A/C>	5,717,538	1.47%
6	CS THIRD NOMINEES PTY LIMITED <HSBC CUST NOM AU LTD 13 A/C>	5,424,989	1.39%
7	Oleg Vornik	4,370,022	1.12%
8	Peter James	3,452,522	0.89%
9	MR RICHARD GUY DARLING	2,294,729	0.59%
10	AZOTH LLC	2,250,000	0.58%
11	MR HEIN VICTOR GRAAFHUIS	1,700,000	0.44%
12	MR VOLODYMYR YATSYNA	1,500,000	0.38%
13	SOIRHU PTY LTD <THE BRAGG MCDONALD A/C>	1,282,362	0.33%
14	WRITEMAN PTY LIMITED <P L H A INVESTMENT A/C>	1,249,587	0.32%
15	BRISPOPT NOMINEES PTY LTD <HOUSE HEAD NOMINEE A/C>	1,236,549	0.32%
16	UBS NOMINEES PTY LTD	1,166,823	0.30%
17	BLACKWOOD CONSULTING PTY LTD <ROGER CAMPBELL FAMILY A/C>	1,139,240	0.29%
18	DR DONALD LIU & MRS WENDY YAO <LIU-YAO FAMILY S/F A/C>	1,046,000	0.27%
19	MR ADAM O'DONNELL FERRIS	1,000,000	0.26%
19	MR DAVID PHILLIP RICKARDS & MRS KERRY ANNE RICKARDS	1,000,000	0.26%
19	ROSSBEL PTY LIMITED <THE ROSSBEL A/C>	1,000,000	0.26%
19	MR WARWICK VERNON BOYD	1,000,000	0.26%
20	MIGHTYBOY PTY LTD	999,587	0.26%
Total		115,441,716	29.61%
Balance of register		274,438,386	70.39%
Total issued capital		389,880,102	100.00%

The number of unquoted equity securities on issue as at 31 December 2020 was 48,712,950, held by 33 holders.

1012 holders held less than a marketable parcel of DRO securities, based on the closing market price as at 31 December 2020 of \$0.17.