

SECURITY MATTERS LIMITED

ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

SECURITY MATTERS LIMITED

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The amounts are stated in U.S dollars

CORPORATE DIRECTORY

Corporate Directory

Directors of the Company

Everardus (Ed) Hofland (Executive Chairman)

Jovanka Naumoska (Non-Executive Director)

Dr Gregory J Clark AC (Non-Executive Director)

David Rosenblatt (Executive Director)

Amir Bader (Non-Executive Director)

Haggai Alon (Chief Executive Officer and Executive Director)

Company Secretary

c/- Mertons Corporate Services Pty Ltd

Mark Licciardo

Level 7, 330 Collins Street

Melbourne VIC 3000

Australia

Ph: + 61 3 8689 9997

Registered Office

c/- Holding Redlich

Level 8, 555 Bourke St

Melbourne VIC 3000 Australia

Company Contact Details

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Auditors

BDO East Coast Partnership

Collins Square, Tower Four

Level 18, 727 Collins Street

Melbourne VIC 3008 Australia

Legal Advisor

Holding Redlich

Level 8, 555 Bourke St

Melbourne VIC 3000 Australia

Israel Legal Advisor

Afik & Co

103 Ha'Hashmona'im St. ·

P.O.B 20144

Tel-Aviv Israel 6120101

SECURITY MATTERS LIMITED, ABN 78626192998

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CORPORATE DIRECTORY



Share Registry

Boardroom Pty Limited ABN 14 003 209 836

Level 12, 225 George Street

Sydney NSW 2000

Stock exchange listing

Security Matters Limited shares are listed on the Australian Securities
Exchange (ASX code: SMX)

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DIRECTORS REPORT

Directors' Report

Security Matters Limited ACN 626 192 998

The directors present their report, together with the financial statements, of the consolidated entity (referred to as the 'consolidated entity' or the 'Group') consisting of Security Matters Limited (referred to as the 'Company') and the entities it controlled during the year ended 31 December 2018.

Directors

The name of the directors in office of the Company at any time during or since the end of the financial year, update to the date of this report, are:

Name	Role	Appointed	Resigned
Mr. Everardus (Ed) Hofland	Executive Chairman	24 July 2018	
Ms. Jovanka Naumouska	Non-Executive Director	24 July 2018	
Dr. Gregory Clark	Non-Executive Director	24 July 2018	
Mr. David Rosenblatt	Executive Director	24 July 2018	
Mr. Amir Bader	Non-Executive Director	24 July 2018	
Mr. Haggai Alon	Chief Executive Officer & Executive Director	24 July 2018	
Mr. Doron Afik	Non-Executive Director	16 May 2018	24 July 2018
Mr. Harry Kingsley	Non-Executive Director	16 May 2018	24 July 2018
Mr. Mark Licciardo	Non-Executive Director	16 May 2018	24 July 2018

Principal Activities

The principal continuing activities of the Group during the year was the development and commercialisation of track and trace technology for a wide variety of industries.

The Group owns and has commenced commercialising the technology (Licensed from the Israeli Atomic Agency) to permanently and irrevocably "mark" any object either solid, liquid or gas, allowing identification, proof of authenticity, tracking supply chain movements & quality assurance for countless products in virtually every industry.

Security Matters' vision is to become the global record for physical goods through its unique technology for asset tracking and its ability to create a "Physical to Digital Twin".

Security Matters' technology comprises a chemical-based hidden "barcode" system, alongside a unique "reader" to identify these codes, and a blockchain record to store and protect ownership data. Security Matters offers a B2B, "white-label" solution that serves market leaders' needs for authentication, supply chain integrity and quality assurance.

The Company has generated initial sales in 2018 and is expecting to advance commercialisation of the technology in 2019. Main sectors of activity for 2019 are: plastics, electronics, precious stones and minerals and agriculture.

Significant changes in state of affairs

Security Matters Limited was admitted to the official list of the ASX on October 11, 2018, and official quotation and trading of its shares commenced on October 15, 2018.

Security Matters Limited raised AU\$6,000,000 (US\$4,280,871) pursuant to the Offer under its replacement prospectus dated 7 August 2018 and its supplementary prospectus dated 10 August 2018 by issue of 30,000,000 fully paid ordinary shares at AU\$0.20 per share.

Prior to commencement of trading, Security Matters Limited completed the acquisition of 100% of the issued capital in Security Matters Ltd (Israel).

The accompanying consolidated financial statements represent a continuation of Security Matters' (Israel) financial statements. The consolidated results reflect the full year of Security Matters Ltd. (Israel) plus Security Matters Limited (Australia) from the date of incorporation (May 16 2018). The comparative period results reflect Security Matters Ltd. (Israel) only.

As part of the transaction the following securities were issued:

- **55,500,041** Shares to the Security Matters Ltd. (Israel) Shareholders and their nominees, in consideration for their shares in Security Matters Ltd. (Israel).

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DIRECTORS REPORT

- **30,000,000** Shares to investors were issued with respect to the Offer at an issue price of AU\$0.20 per Share;
- **5,515,293** options to the Lead Manager (or their nominee/s) in consideration for the capital raised under the Offer;
- **11,999,959** Shares on conversion of convertible notes at AU\$0.14 per share;
- **8,805,864** options to certain Directors and employees (including to certain nominees) under the Company's employee share option plan (**ESOP**);
- **4,000,000** options to Security Matters Ltd. (Israel) Shareholders exercisable at AU\$0.20 expiring 5 years from the date of issue;
- **15,000,000** performance options to the Executive Directors (including to certain nominees) exercisable at AU\$0.20 expiring 5 years from the date of issue

Further information on the capital reorganisation is detailed in Note 4 of the financial statements.

Dividend paid or recommended

No dividends were paid or declared during the financial period.

Review of operations

Loss for the period totaled \$4,032,794 compared to a loss of \$3,053,046 in 2017.

The increase in expenses during the current period is mainly due to increase in General and Administrative costs and Legal and consultants' expense as a result of listing on the ASX during the year and starting operations in Australia. In addition, share based compensation costs increased, as well as Research and Development costs.

These results are expected for a young technology company that requires intensive R&D. The Company targets leading brands and manufacturers (instead of targeting direct consumers) in order to create a new market standard for brand authentication and supply chain integrity.

The Company has two main features of its business model:

- (i) The Company as a business to business company; and
- (ii) The Company as offering a 'white label' solution.

Likely Developments and Expected Results of Operations

The Company's principal continuing activity is the development and commercialisation of track and trace technology. The Company's future developments, prospects and business strategies are to continue to develop and commercialise this technology. The Company is primarily focused on the following industries: Plastics, Electronics, Agriculture and Ethical mining & conflict minerals. The short-term goal for the Company is to focus on supplying services to worldwide market leaders in these industries, based mainly on the engagements already in place. The long term strategy of the Company is to utilise market leader adoption to become the industry standard for track and trace solutions, and later also to promote regulatory adoption.

The Company targets leading brands and manufacturers in order to create a new market standard for brand authentication and supply chain integrity. The Company has two main features of its business model are: (1) The Company as a Business to Business company; and (2) The Company as a 'white label' solution.

Projects with industry leaders usually consist of three phases: (a) Initial consultations to determine the needs of the customer and tailor a solution to its requirements; (b) Marker implementation as part of the production process, including software; (c) Ongoing Marking, identification and support services.

Information on likely developments in the operations of the consolidated entity and the expected results of operations have not been included in this report because the directors believe it would be likely to result in unreasonable prejudice to the consolidated entity.

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DIRECTORS REPORT

Operating result

The revenues and profit of the Company for the period amounted to:

	12 months ended Current Period US\$	12 months ended Previous Period US\$	Increase/ (decrease) %	Amount change US\$
Revenues from ordinary activities	40,382	6,114	560%	34,267
Loss from ordinary activities after tax attributable to members	(4,032,794)	(3,053,046)	32%	(979,748)
Net loss for the year attributable to members	(4,032,794)	(3,053,046)	32%	(979,748)

Indemnity and insurance of officers

The Company has indemnified the Directors and Executives of the Company for costs incurred, in their capacity as a Director or Executive, for which they may be held personally liable, except where there is a lack of good faith.

During the financial year, the Company paid a premium in respect of a contract to insure the Directors and Executives of the Company against a liability to the extent permitted by the Corporations Act 2001. The contract of insurance prohibits disclosure of the nature of the liability and the amount of the premium.

Indemnity and insurance of auditor

The Company has not, during or since the end of the financial year, indemnified or agreed to indemnify the auditor of the Company or any related entity against a liability incurred by the auditor.

During the financial year, the Company has not paid a premium in respect of a contract to insure the auditor of the Company or any related entity.

Proceedings on behalf of the Company

No person has applied for leave of court to bring proceedings on behalf of the Company or intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or any part of those proceedings.

The Company was not a party to any such proceedings during the year.

Non-Audit Services

The Board of Directors is satisfied that the provision of non-audit services during the period is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The directors are satisfied that the services disclosed below did not compromise the external auditor's independence for the following reasons:

- all non-audit services are reviewed and approved by the Board prior to commencement to ensure they do not adversely affect the integrity and objectivity of the auditor; and
- the nature of the services provided does not compromise the general principles relating to auditor independence in accordance with APES 110: *Code of Ethics for Professional Accountants* set by the Accounting Professional and Ethical Standards Board.

The following fees were paid or payable to BDO for non-audit services provided during the year ended 31 December 2018:

	2018 US\$	2017 US\$
Investigating Accountant's Report (BDO East Coast Partnership) – Australia	28,988	--
International and local tax support (BDO Ziv Haft) – Israel	24,000	--
Total	52,988	--

Auditor's independence declaration

The Auditor's independence declaration for the period ended 31 December 2018 has been received and can be found on page 17 of the financial report.

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DIRECTORS REPORT

Environmental regulation

The consolidated entity is not subject to any significant environmental regulation under Australian Commonwealth or State law. Security Matters Ltd. (Israel) is subject to some environmental regulations. The Company holds a permit for the use of X-ray devices from the Israeli Ministry of environmental protection. The permit is required for the work conducted with the Reader. The permit must be renewed annually or whenever a new X-ray based reader is purchased and must include an annexure of all of the devices in use by the Company. The permit was last renewed in May 2018 and is valid until May 2019. The Company is in compliance with the requirements of the ISO 9001:2015 standard for quality management and quality assurance. The ISO organisation promotes worldwide proprietary, industrial and commercial standards. The Company is examined annually to verify that it complies with the ISO standards of excellence, safety, quality, process management and risks management.

Key management personnel interest in securities

The key management personnel's interest in the consolidated entity's securities as at 31 December 2018 are as follows:

are as follows.

	Shares		Options		
Name	Number of shares	Number of Options	Exercise price	Vesting date	Expiry date
<i>Executive Directors</i>					
Mr. Everardus (Ed) Hofland	11,339,770	5,000,000	A\$0.2 (US\$ 0.14)	14/10/2022 ⁱ	14/10/2023
Mr. Haggai Alon	5,135,949	5,000,000	A\$0.2 (US\$ 0.14)	14/10/2022 ⁱ	14/10/2023
Mr. David Rosenblatt	9,675,149	5,000,000	A\$0.2 (US\$ 0.14)	14/10/2022 ⁱ	14/10/2023
<i>Non-Executive Directors</i>					
Dr. Gregory Clark	--	755,035	A\$0.2 (US\$ 0.14)	50% 14/10/2019, 50% 14/10/20	14/10/2023
Mr. Amir Bader	10,544,617	1,382,322	A\$0.2 (US\$ 0.14)	Vested	14/10/2023

ⁱ Vesting depends on achieving the milestones described in the remuneration report (page 12) and can be at an earlier date.

Directors' Meetings

The number of meetings of the company's directors held during the year ended 31 December 2018, and the number of meetings attended by each director were:

Director	Number of meetings held while a director	Number of meetings attended
Everardus Hofland	2	2
Haggai Alon	2	2
Amir Bader	2	2
Gregory John Clark	2	2
Jovanka Naumoska	2	2
David Rosenblatt	2	1
Mark Licciardo	0	0
Doron Afik	0	0
Harry Kingsley	0	0

ANNUAL REPORT 31 DECEMBER 2018**DIRECTORS REPORT****Share-Options outstanding**

Unissued ordinary shares of Security Matters Limited as at the date of this report are as follows:

Date granted	Expiry Date	Exercise Price	Number of shares under option
04/04/2017	01/09/2023	A\$0.2	2,490,813
18/06/2017	01/09/2023	A\$0.2	829,507
11/01/2018	01/09/2023	A\$0.2	772,794
15/03/2018	01/09/2023	A\$0.2	1,138,851
08/10/2018	14/10/2023	A\$0.2	7,573,899
08/10/2018	14/10/2021	A\$0.3	5,515,293
08/10/2018	14/10/2023	A\$0.2	15,000,000

Events after the reporting period

Since the reporting date the following significant events have occurred:

- 15/1/2019 – Hire of 3 new personnel to strengthen R&D capabilities
- 22/1/2019 – The Company signed an exclusive agreement with CliniCann to create a global quality standard for the medicinal cannabis industry
- 4/2/2019 – The Company successfully completes seed solution testing
- 21/2/2019 - The Company introduced its new global standard for technology components, systems and devices industry. The Company presented the technology in the 4YFN conference in Barcelona
- 4/3/2019 - The Company signed a collaboration agreement with Performance Chemical division of BASF
- 22/3/19 – The Company signed a development agreement with The Perth Mint for the development of a track & trace solution for the gold value chain
- On 25 March 2019, the Company announced that it was in the process of finalising a proposed capital raising. The Company's securities were suspended from quotation on 27 March 2019 at the Company's request, pending an announcement to be made by the Company in connection with the capital raising. Further details of the capital raising will be provided in this announcement, which is expected to be made by the Company shortly. At this point in time the amount of the Capital raising is uncertain.

Information on directors:

Name of Director	Period as Director	Qualifications and experience
Everardus (Ed) Hofland Executive Chairman	Appointed 24 July 2018 Director of Security Matters Israel since 1/1/2015	Ed Hofland is a co-founder of Security Matters Israel and a business leader that has brought in multi-million dollar investments to the Arava Desert region of Israel. Ed Hofland is the chairman of leading industry, technology and agriculture companies in Israel, such as: i. Chairman of Arava Power Company, Israel's leading solar power company; ii. Chairman of Algatech, micro-algae producer that markets its products worldwide, including Japan, India, New Zealand and Europe; and iii. Chairman and CEO of Ardag Fish Farm that grows fish and caviar.
Haggai Alon Executive Director	Appointed 24 July 2018. Director of Security Matters Israel since 1/1/2015	Haggai Alon is a co-founder of Security Matters Israel and has over 17 years of experience in commercializing technology. Haggai Alon has commercialised technology out of the Ministry of Defence in Israel as well as private sector technology.

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DIRECTORS REPORT

		<p>Haggai Alon has a master's degree out of Tel Aviv and Haifa Universities in international relations and political science and will soon complete his Ph.D.</p> <p>Haggai Alon was previously the chief coordinator of the Israeli military industry body at the Ministry of Défense and was the CEO of an economic consulting firm to the Kibbutz industries.</p>
David Rosenblatt Executive Director	<p>Appointed 24 July 2018</p> <p>Director of Security Matters Israel since 1/1/2015</p>	<p>David Rosenblatt is a co-founder of Security Matters Israel and has developed and scaled businesses in Silicon Valley, Wall Street and Israel. David Rosenblatt's experience spans the healthcare, technology, finance and energy industries.</p> <p>David Rosenblatt has experience both building established businesses and start-ups, including serving as Managing Director at BlackRock and co-founding Quicken Loans at Intuit. Earlier in his career, David Rosenblatt practiced corporate and international law with United States law firm Weil, Goshala & Manges.</p> <p>David Rosenblatt holds a MBA with distinction from Harvard Business School, a Juris Doctor from Northwestern University Law School, and a Bachelor of Science with honours from Pennsylvania State University.</p>
Jovanka Naumoska Australian based Non-Executive Director and Independent Director	<p>Appointed 24 July 2018</p>	<p>Jovanka Naumoska is a corporate lawyer with ASX board-level experience, currently sitting on one other ASX listed company. Jovanka Naumoska serves as non-executive director and company secretary for Imagination Biosystems Ltd (ASX: IBX), a medical device company that develops detection methods for several types of cancer.</p> <p>Jovanka Naumoska has served as senior corporate lawyer specialising in intellectual property for 15 years, and currently manages a business excellence function and is a policy advisor for an Australian government research agency, and currently holds the position of Manager, Business Excellence at such agency.</p> <p>Jovanka Naumoska holds Bachelor of Science and Bachelor of Law degrees and a Graduate Diploma of Legal Practice from the University of Wollongong. Jovanka Naumoska also holds a Graduate Diploma in Applied Corporate Governance from the Governance Institute of Australia.</p>
Dr Gregory J Clark AC Australian based Non-Executive and Independent Director	<p>Appointed 24 July 2018</p>	<p>Dr Gregory Clark is a world-renowned scientist, technologist and businessman. Dr Gregory Clark is currently the Chairman of KaComm Communications.</p> <p>Dr Gregory Clark spent 15 years as a Research Staff Member and Group Leader in the IBM Research Division in New York. Subsequently, Dr Gregory Clark became the President and subsequent Director of News Technology Group. Dr Gregory Clark was also the President and Chief Operating Officer of Loral Space and Communications, the world's largest commercial satellite manufacturer and, at that time, the world's second largest satellite operator.</p> <p>Dr Gregory Clark is currently a Director of NextDC (ASX: NXT), the largest Australian data centre company. He is Chairman of the Australian National University Advisory Board on Science and Engineering, Chairman of CUDOS, a research centre of excellence across several universities, a Questacon Board Member and a Royal Institution Australia Board Member. Recently, Dr Gregory Clark retired as a Director of the ANZ Banking Group (ASX: ANZ). In the past he has chaired a number of companies in the Americas and Europe.</p>

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DIRECTORS REPORT

Amir Bader Non-Executive Director	Appointed 24 July 2018 Director of Security Matters Israel since 26/2/2015	<p>Amir Bader has been a Security Matters board member since 2015 and he brings to the Company extensive experience in the management of agriculture businesses.</p> <p>Amir Bader is currently the manager of one of Israel's largest dairy farms and has more than 20 years of experience at managerial positions in dairy farms and other agricultural projects in Israel and Europe.</p> <p>Amir Bader also served as Kibbutz Dgani A's (a seed shareholder in Security Matters Israel) business manager for five years, during that period he served as the board member of several subsidiaries and companies related to the Kibbutz.</p>
Doron Afik	16 May 2018 – 24 July 2018	<p>Doron's practice focuses primarily on international transactions, including mergers and acquisitions, dispute resolution and issues of public law.</p> <p>During the last years Doron served as a director in many companies, including a director at Eurotrade Bank Ltd. SweetIM Technologies Ltd., Optibase Technologies Ltd., Chairman of the Board of Directors of Biofid Ecological Pest Control Ltd. and an observer on the board of directors of Israel Canada Ltd.</p>
Harry Kingsley	16 May 2018 – 24 July 2018	<p>LLM in Corporate Law, LLB and B. Com (Economics) from Monash University. Harry is a senior corporate and commercial lawyer acting as partner in Holding Redlich law firm, specialising in strategic advice and negotiated transactions. He has extensive legal industry experience working in private practice and organisations in the transport and financial services industries as well as working as an investment banking professional. He is a trusted advisor to private and ASX listed corporations, their directors and management throughout Australasia.</p> <p>Harry is highly regarded for his general commercial expertise as well as specialist knowledge around private equity, private and public M&A, IPOs and equity and debt capital markets.</p>
Mark Licciardo	16 May 2018 – 24 July 2018	<p>B.Bus (Acc), Grad.Dip CSP, FGIA, FCIS, FAICD. Mark is the founder and Managing Director of Merton's Corporate Services which provides company secretarial and corporate governance consulting services to ASX listed and unlisted public and private companies.</p>

Information on Company Secretary

Mark Licciardo, (B Bus(Acc), GradDip CSP, FGIA, FCIS, FAICD)

Mark is the founder and Managing Director of Merton's Corporate Services which provides company secretarial and corporate governance consulting services to ASX listed and unlisted public and private companies.

As a former company secretary of Top 50 ASX listed companies Transurban Group and Australian Foundation Investment Company Limited, his expertise includes working with boards of directors in the areas of corporate governance, business management, administration, consulting and company secretarial matters. Mark is also the former Chairman of the Governance Institute of Australia Victoria division and Melbourne Fringe Festival. Mark is also a director of a number of public and private companies. Current ASX listed company directorships are Mobilicom Limited, Ensogo Limited and Frontier Digital Ventures Limited.

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DIRECTORS REPORT

REMUNERATION REPORT (AUDITED)

This report outlines the remuneration arrangements in place for key management personnel of the consolidated entity for the year ended 31 December 2018. The information contained in this report has been audited as required by section 308(3C) of the Corporations Act 2001.

Key management personnel (KMP) are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including all directors.

The key management personnel of the consolidated entity, at any time during, or since the end of the reporting period, are:

Name	Role	Appointed	Resigned
Mr. Everardus (Ed) Hofland	Executive Chairman	24 July 2018	
Mr. Haggai Alon	Chief Executive Officer and Executive Director	24 July 2018	
Mr. David Rosenblatt	Executive Director	24 July 2018	
Dr. Gregory Clark	Non-Executive Director	24 July 2018	
Ms. Jovanka Naumouska	Non-Executive Director	24 July 2018	
Mr. Amir Bader	Non-Executive Director	24 July 2018	
Mr. Yonatan Musnikow	Chief Financial Officer	24 July 2018	
Mr. Doron Afik	Non-Executive director	16 May 2018	24 July 2018
Mr. Harry Kingsley	Non-Executive director	16 May 2018	24 July 2018
Mr. Mark Licciardo	Non-Executive director	16 May 2018	24 July 2018

Principles used to determine the nature and amount of remuneration

The remuneration report is set out under the following main headings:

- Principles used to determine the nature and amount of remuneration
- Service agreements
- Details of remuneration
- Share-based compensation
- Additional disclosures relating to key management personnel

The Directors believe the Company is not currently of a size nor are its affairs of such complexity as to warrant the establishment of a separate remuneration committee. Accordingly, all matters are considered by the full Board of Directors, in accordance with a remuneration committee charter.

During the financial year, the Company did not engage any remuneration consultants.

The objective of the Company's remuneration policy is to attract and retain high calibre management personnel and directors to run and manage the Group. The policy aligns executive reward with the achievement of strategic objectives.

In accordance with best practice corporate governance, the structure of non-executive director and any executive remuneration is separate and distinct.

Performance Conditions Linked to Remuneration

Short-term incentives (i.e. bonuses) are designed to align the targets of the executives with Company performance. Bonus payments are granted to executives based on satisfaction of the Board at pre-determined time.

The Group has established and maintains Employee Share Option Plan (Plan) to provide an incentive to retain, in the employment or service or directorship of the Company persons of training, experience and provide the ability to attract new employees, directors or consultants whose services are considered valuable. The persons eligible to participate in the Share Option Plan ('Eligible Participants') include any employees, directors and consultants of the Company or any subsidiary of the Company.

ANNUAL REPORT 31 DECEMBER 2018**DIRECTORS REPORT**

The purpose of the Plan is to assist in the reward and motivation of Eligible Participants and link the reward of Eligible Participants to performance and the creation of Shareholder value. It is designed to align the interest of Eligible Participants more closely to the interests of Shareholders by providing an opportunity for Eligible Participants to receive shares. It provides the Eligible Participants with the opportunity to share in any future growth in value of the Company and provides greater incentives for Eligible Participants to focus on the Company's longer-term goals.

Due to the Company's current commercial stage, the Company believes that historical financial data is not relevant for setting the goals of future executive remuneration. The Group's financial performance for the current year is summarised below:

	2018 US\$
Revenue	40,382
Earnings before interest, tax, depreciation and amortisation and fair value movements (EBITDA)	(3,591,345)
Loss after income tax	(4,032,794)
Basic loss per share	(0.06)
Share price at year end	0.29

Three Executive Directors were granted Performance Options, so that their remuneration will be dependent on the Company satisfying commercial and technological milestones. These milestones are viewed by the Board of Directors as key commercial and technological milestones for the long term success of the company as they include a combination of commercial and technological achievements. The milestones are:

Tranche	No of shares	Revenue milestone	Tech milestones	No of shares allocated to each recipient
1	5,000,000	AU\$1 million (US\$ 0.71M at year end) revenues per half year for 2 consecutive half years	<ul style="list-style-type: none"> Completion of bank of 25,000 markers for plastics industry Completion of PDR (Preliminary Design Review) for Reader development 	Haggai Alon – 1,666,667 Ed Hofland - 1,666,667 David Rosenblatt - 1,666,666
2	5,000,000	AU\$2 million (US\$ 1.41M at year end) revenues per half year for 2 consecutive half years	<ul style="list-style-type: none"> Completion of bank of 25,000 markers for Electronics industry Completion of CDR (Critical Design Review) for Reader development Completion of blockchain software adaptation to the reader software 	Haggai Alon – 1,666,667 Ed Hofland - 1,666,666 David Rosenblatt - 1,666,667
3	5,000,000	AU\$4 million (US\$ 2.82M at year end) revenues per half year for 2 consecutive half years	<ul style="list-style-type: none"> Design and construction of automatic Marker production machine Completion of development of new proprietary Reader at cost per reader of less than US\$7,500 	Haggai Alon – 1,666,666 Ed Hofland - 1,666,667 David Rosenblatt - 1,666,667

Non-Executive Director Remuneration

The Board policy is to remunerate non-executive Directors at market rates for comparable companies for time, commitment and responsibilities. The Board determines payments to the Non-Executive Directors and reviews their remuneration annually, based on market practice, duties and accountability.

The maximum aggregate amount of annual fees that can be paid to Non-Executive Directors is presently limited to an aggregate of AU\$300,000 (US\$ 211,740 as at year end), and is subject to approval by shareholders at the Annual General Meeting.

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DIRECTORS REPORT

All Non-Executive Directors enter into a service agreement with the Company in the form of a letter of appointment. The letter summarises the Board policies and terms, including remuneration, relevant to the office of director.

Executive Remuneration

The compensation structures are designed to attract suitably qualified candidates, reward the achievement of strategic objectives, and achieve the broader outcome of creation of value for shareholders. Executive remuneration and reward packages has three components:

- Base salary and non-monetary benefits
- Short-term performance incentives
- Share-based payments

Refer to the Performance Conditions Linked to Remuneration section of this report for details on short-term incentives and long-term incentives.

The Company's three founders and executive directors have received performance options that will vest only upon achieving strategic commercial and development milestones that are material for the Company's success. In such way the Company encourages the executive directors to achieve key development and revenue goals. The main terms of the performance options are described at the end of the remuneration report.

Service Agreements

Remuneration and other terms of employment for key management personnel are formalised in service agreements. Details of these agreements are as follows:

Executive Name	Services Agreement Summary
Mr. Haggai Alon	<ul style="list-style-type: none"> • Executive salary of ILS 35,000 (approximately US\$9,700) gross per month, plus expenses and entitlements (such as sick leave and holidays); • Pension payments according to Israeli law, including advanced education fund up to the tax-exempt amount; • Prior to October 2018, Haggai Alon's salary was ILS 25,000 (approximately US\$6,950) per month, with no additional contributions to pension or sick leave; • The contract is governed by Israeli law; • Haggai Alon was issued 5,000,000 Performance Options. • Upon completion of IPO, Haggai Alon was entitled to a cash bonus of US\$41,726 (ILS 150,000). The bonus was granted during 2018. • Upon 12 months of the IPO, Haggai Alon will be entitled to monetary bonus of ILS 120,000 (approximately US\$33,000), subject to the approval of a committee of the Board of Directors. Minimum bonus is nil and maximum bonus is US\$33,000. • 90 days' notice period
Mr. Yonatan Musnikow	<ul style="list-style-type: none"> • Executive salary of ILS 18,000 (approximately US\$5,000) gross per month, plus expenses which are not expressed to include social benefits (such as sick leave and holidays); • Executive salary for October 2017-January 2018 was ILS 16,000 (approximately US\$4,450) • Pension payments according to Israeli law; • The contract is governed by Israeli law; • 60 days notice period;
Mr. Ed Hofland	<ul style="list-style-type: none"> • Ed Holfand does not receive a salary; • Ed Holfand shall be paid for covering expenses to do with his role, which are not expressed to include social benefits (such as sick leave, holidays or pension payments); • The contract is governed by Israeli law; and • Ed Holfand was issued 5,000,000 Performance Options.
Mr. David Rosenblatt	<ul style="list-style-type: none"> • David Rosenblatt does not receive a salary; • David Rosenblatt shall be paid for covering expenses to do with his role, which are not expressed to include social benefits (such as sick leave, holidays or pension payments); • The contract is governed by Israeli law; and • David Rosenblatt was issued 5,000,000 Performance Options.

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DIRECTORS REPORT

Details of Remuneration

Details of the remuneration of key management personnel of the consolidated entity are set out in the following tables:

2018

	Short term benefits			Post-Employment Retirement Benefits	Share-based payments	Total
	Short Term Salary	Bonuses	Nonmonetary benefits		Equity settled	
	US\$		US\$	US\$	US\$	US\$
<i>Executive Directors</i>						
Mr. Everardus (Ed) Hofland	--	--	--	--	32,970	32,970
Mr. Haggai Alon	89,015	41,726	12,155	3,543	32,970	179,409
Mr. David Rosenblatt	--	--	--	--	32,970	32,970
<i>Non-Executive Directors</i>						
Dr. Gregory Clark	10,283	--	--	--	8,744	19,027
Ms. Jovanka Naumouska	10,283	--	--	--	--	10,283
<i>Executives</i>						
Mr. Yonatan Musnikow	60,085	--	--	8911	--	68,996
Total	169,666	41,726	12,155	12,454	107,654	343,655

2017

	Short term benefits			Post-Employment Retirement Benefits	Share-based payments	Total
	Short Term Salary	Bonuses	Nonmonetary benefits		Equity settled	
	US\$		US\$	US\$	US\$	US\$
<i>Executive Directors</i>						
Mr. Everardus (Ed) Hofland	--	--	--	--	--	--
Mr. Haggai Alon	83,338	--	12,311	--	--	95,649
Mr. David Rosenblatt	--	--	--	--	--	--
<i>Executives</i>						
Mr. Yonatan Musnikow	13,334	--	--	1,977	--	15,311
Total	96,672	--	12,311	1,977	--	110,960

Details of the remuneration of key management personnel of the consolidated entity are set out in the following tables:

	Fixed Remuneration		At- risk- Short-term incentives		At- risk- Long-term incentives	
	2018	2017	2018	2017	2018	2017
<i>Executive Directors</i>						
Mr. Everardus (Ed) Hofland	--	--	--	--	100%	--
Mr. Haggai Alon	58%	100%	23%	--	18%	--
Mr. David Rosenblatt	--	--	--	--	100%	--
<i>Non-Executive Directors</i>						
Dr. Gregory Clark	54%	--	--	--	46%	--
Ms. Jovanka Naumouska	100%	--	--	--	--	--
<i>Executives</i>						
Mr. Yonatan Musnikow	100%	100%	--	--	--	--

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DIRECTORS REPORT

Bonuses

Name	Grant date	Nature of compensation granted	Service and performance criteria used to determine amount of the compensation	% of bonus or grant for financial year that was paid or vested in the financial year	The financial years, after the current financial year, for which the bonus will be payable if the service & performance criteria for the bonus or grant are met
Mr. Haggai Alon	15/10/2018	Cash bonus of US\$41,726 (ILS 150,000)	Completion of IPO as CEO	100%	N/A
Mr. Haggai Alon	15/10/2018	Cash bonus of US\$32,085 (ILS 120,000)	Satisfaction of Board of Directors, according to Board committee, 12 months after IPO	0%	2019

Share-based compensation

The terms and conditions of each grant of options over ordinary shares affecting remuneration of directors and other key management personnel in this financial year or future reporting years are as follows:

Name	Number of Options	Grant date	Vesting and exercisable date	Expiry date	Nature of compensation granted	Service and performance conditions	Exercise price	Value per Option at grant date	\$ value of SBP expense	% Vested
<i>Executive Directors</i>										
Mr. Everardus (Ed) Hofland	5,000,000	08/10/18	Within 4 years, subject to milestones	14/10/23	Performance Options	Described above	A\$0.2 (US\$ 0.14)	A\$0.1 (US\$ 0.07)	US\$ 355,400	0%
Mr. Haggai Alon	5,000,000	08/10/18	Within 4 years, subject to milestones	14/10/23	Performance Options	Described above	A\$0.2 (US\$ 0.14)	A\$0.1 (US\$ 0.07)	US\$ 355,400	0%
Mr. David Rosenblatt	5,000,000	08/10/18	Within 4 years, subject to milestones	14/10/23	Performance Options	Described above	A\$0.2 (US\$ 0.14)	A\$0.1 (US\$ 0.07)	US\$ 355,400	0%
<i>Non-Executive Directors</i>										
Dr. Gregory Clark	755,035	08/10/18	50% 14/10/19, 50% 14/10/20	14/10/23	Options	Continued service as director	A\$0.2 (US\$ 0.14)	A\$0.1 (US\$ 0.07)	US \$53,668	0%

Additional disclosures relating to key management personnel

Options holdings of key management personnel

The tables below disclose the number of share options granted, vested or lapsed during the year. Share options do not carry any voting or dividend rights, and can only be exercised once the vesting conditions have been met, until their expiry date.

The number of options over ordinary shares in Security Matters Limited held, directly, indirectly or beneficially, by each specified Director and specified executive, including their personally related entities as at balance date, is as follows:

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DIRECTORS REPORT

	Balance at Company incorporation	Options issued during the year as remuneration	Other Options issued during the year	Exercised during the year	Balance at the end of the year	Vested and exercisable	Unvested and unexercisable
Mr. Everardus (Ed) Hofland	--	5,000,000	--	--	5,000,000	--	5,000,000
Mr. Haggai Alon	--	5,000,000	--	--	5,000,000	--	5,000,000
Mr. David Rosenblatt	--	5,000,000	--	--	5,000,000	--	5,000,000
Dr. Gregory Clark	--	755,035	--	--	755,035	--	755,035
Mr. Amir Bader ⁱ	--	--	1,382,322	--	1,382,322	1,382,322	--
Total	--	15,755,035	1,382,322	--	17,137,357	1,382,322	15,755,035

ⁱ Options granted to Degania A Business ACS Ltd for their services to the company. Amir Bader (Director of the Company) is a member of Kibbutz Degania A which owns Degania A Business Agricultural Cooperative Society Ltd;

Share holdings of key management personnel

The number of ordinary shares of Security Matters Limited held, directly, indirectly or beneficially, by each key management personnel, including their personally-related entities as at balance date:

	Balance at Company incorporation	Shares issued during the year- at IPO ⁱ	Other changes during the year	Balance at end of the year
<i>Executive Directors</i>				
Mr. Everardus (Ed) Hofland ⁱⁱ	--	11,339,770	--	11,339,770
Mr. Haggai Alon ⁱⁱⁱ	--	5,135,949	--	5,135,949
Mr. David Rosenblatt ^{iv}	--	9,675,149	--	9,675,149
<i>Non-Executive Directors</i>				
Mr. Amir Bader ^v	--	10,544,617	--	10,544,617
Mr. Doron Afik ^{vi}	1	--	(1)	--
Total	1	36,695,485	(1)	36,695,485

ⁱ Including shares received in consideration for Security Matters Limited (Israel) shares as well as shares acquired at IPO

ⁱⁱ Constitutes shares held by Kibbutz Ketura. Ed Hofland is a member of Kibbutz Ketura. Kibbutz Ketura holds 50% of Energy Ketura Cooperative Agricultural Society Ltd. And holds shares directly as well

ⁱⁱⁱ Haggai Alon's (Director/CEO of the Company) securities are held by Benguy Escrow Company Ltd. (as escrow agent)

^{iv} David Rosenblatt (Director of the Company) controls Security Matters Investment LLC (a private company incorporated in the United States) and holds 50% of Energy Ketura Cooperative Agricultural Society Ltd;

^v Constitutes shares held by Degania A Business ACS. Amir Bader (Director of the Company) is a member of Kibbutz Degania A which owns Degania A Business Agricultural Cooperative Society Ltd;

^{vi} Relates only to shares for period as KMP- up to 23 July 2018

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DIRECTORS' REPORT

Loans from key management personnel and their related parties

Details of loans provided to the Group by key management personnel and their related parties are as follows:

	Balance at the start of the year US\$	Interest paid and payable for the year US\$	Repayments made during the year US\$	Change in US\$ value of liability due to exchange rate differences US\$	Balance at the end of the year US\$
Kibbutz Ketura (Ed Hofland)	274,012	10,425	33,351	20,544	220,117
Kibbutz Degania A (Amir Bader)	274,012	10,425	33,351	20,544	220,117
Total	548,024	20,850	66,702	41,087	440,235

In 2015, the Company signed an agreement to receive a loan of NIS 2 Million (US\$ 512,558 at 2015) from its major shareholders on back-to-back terms from a third party (the Kamea Fund). The loan bears an interest at an annual rate of 4%. The loan is to be repaid in eight quarterly installments commencing November 1 2018. More details of the loan can be found in the note 15 of the financial statements.

Other transactions and balances with key management personnel and their related parties

Transactions with related parties are entered into on terms equivalent to those that prevail in arm's length transactions. The Group had the following transactions with key management personnel and/or their related parties during the year.

Entity / Key management personnel	Nature of transaction	Transaction value US\$	Payable balance US\$
Kibbutz Ketura/ Ed Hofland	Payment for services provided by Kibbutz Ketura: bookkeeping, leased cars, finance services, food, lab rent, phone & internet	45,609	6,962
Total		45,609	6,962

This concludes the remuneration report, which has been audited.

The directors have been given the declarations required by s295A of the corporations act 2001. This Directors' report is signed in accordance with a resolution of the Board of Directors pursuant to section 298(2)(a) of the Corporations Act 2001.



Director: Hagga Alon

Date: March 29 2019

DECLARATION OF INDEPENDENCE BY TIM FAIRCLOUGH TO THE DIRECTORS OF SECURITY MATTERS LIMITED

As lead auditor of Security Matters Limited for the year ended 31 December 2018, I declare that, to the best of my knowledge and belief, there have been:

1. No contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
2. No contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of Security Matters Limited and the entities it controlled during the period.



Tim Fairclough
Partner

BDO East Coast Partnership

Melbourne, 29 March 2019

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

		US\$	US\$
	<u>Note</u>	<u>2018</u>	<u>2017</u>
Revenue		40,382	6,114
Cost of sales		<u>(37,717)</u>	<u>(3,007)</u>
Gross profit		2,665	3,107
Research and development expenses	5	(1,227,357)	(844,580)
Share based compensation	19	(1,060,943)	(719,468)
Selling and marketing expenses		(18,575)	(16,432)
Depreciation and amortization	12,13	(113,137)	(60,945)
General and administrative expenses	6	(823,083)	(327,964)
Legal and consultants expenses	7	(487,222)	(113,004)
Change in fair value of convertible notes	16	(328,312)	(545,306)
Finance expenses	8	(30,005)	(428,609)
Finance income	8	53,174	156
Loss before income tax		<u>(4,032,794)</u>	<u>(3,053,046)</u>
Income tax	9	--	--
Loss after income tax for the year attributable to the owners of Security Matters Limited		<u>(4,032,794)</u>	<u>(3,053,046)</u>
Other comprehensive income, net of tax			
<i>Items that may be reclassified subsequently to profit or loss</i>			
Foreign currency translation reserve	18	<u>(31,925)</u>	--
Total comprehensive Income for the year attributable to the owners of Security Matters Limited		<u><u>(4,064,719)</u></u>	<u><u>(3,053,046)</u></u>
 Loss per share attributable to owners of the Company			
Loss per share attributable to owners of the Company	10	<u><u>(0.06)</u></u>	<u><u>(0.07)</u></u>
Diluted loss per share attributable to owners of the Company	10	<u><u>(0.06)</u></u>	<u><u>(0.07)</u></u>

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

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CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2018

		US\$	US\$
	<u>Note</u>	<u>2018</u>	<u>2017</u>
<u>Current Assets</u>			
Cash at bank		2,350,084	10,665
Other receivables	11	204,668	162,979
Total current assets		2,554,752	173,644
<u>Non-current assets</u>			
Property and equipment	12	309,787	360,499
Intangible assets	13	1,084,601	779,051
Total non-current assets		1,394,388	1,139,550
Total assets		3,949,140	1,313,194
<u>Current Liabilities</u>			
Trade payables		280,120	391,489
Amounts owed to related parties	20	7,065	16,113
Other payables	14,22	275,076	335,571
Borrowings	15	266,809	72,000
Convertible notes	16	--	3,586,428
Total current liabilities		829,071	4,401,601
<u>Non-Current Liabilities</u>			
Long term borrowings	15	173,426	476,024
Other Liabilities	22	93,110	91,690
Provisions	25	4,550	3,269
Total non-current liabilities		271,086	570,983
Total liabilities		1,100,157	4,972,584
Net Assets/(Liabilities)		2,848,983	(3,659,390)
<u>Equity</u>			
Issued capital	17	10,892,560	1,250,000
Share based payment reserve	18	1,780,411	719,468
Prepayment on account of shares	17	--	130,411
Foreign currency translation reserve	18	(31,925)	--
Accumulated losses		(9,792,063)	(5,759,269)
Total Equity		2,848,983	(3,659,390)

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

SECURITY MATTERS LIMITED, ABN 78626192998

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



	US\$	US\$	US\$	US\$	US\$	US\$
	<u>Issued Capital</u>	<u>Share based payment reserve</u>	<u>Prepayments on account of shares</u>	<u>Foreign currency translation reserve</u>	<u>Accumulated losses</u>	<u>Total Equity</u>
Balance at 1 January 2018	1,250,000	719,468	130,411	--	(5,759,270)	(3,659,390)
Comprehensive income						
Loss after income tax for the year	--	--	--	--	(4,032,794)	(4,032,794)
Other comprehensive loss for the year, net of tax	--	--	--	(31,925)	--	(31,925)
Total comprehensive income for the year	--	--	--	(31,925)	(4,032,794)	(4,064,719)
Transactions with owners in their capacity as owners						
Issuance of shares	5,030,871	--	(130,411)	--	--	4,900,460
Capital raising costs	(469,164)	--	--	--	--	(469,164)
Conversion of convertible notes	5,080,854	--	--	--	--	5,080,854
Share-based payments	--	1,060,943	--	--	--	1,060,943
Total transactions with owners in their capacity as owners	9,642,560	1,060,943	(130,411)	--	--	10,573,092
Balance at 31 December 2018	10,892,560	1,780,411	--	(31,925)	(9,792,064)	2,848,983

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

SECURITY MATTERS LIMITED, ABN 78626192998

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



	US\$	US\$	US\$	US\$	US\$	US\$
	<u>Issued Capital</u>	<u>Share based payment reserve</u>	<u>Prepayments on account of shares</u>	<u>Foreign currency translation reserve</u>	<u>Accumulated deficit</u>	<u>Total</u>
Balance at 1 January 2017	500,000	--	--	--	(2,706,224)	(2,206,224)
Comprehensive income						
Loss after income tax for the year	--	--	--	--	(3,053,046)	(3,053,046)
Total comprehensive income for the year	--	--	--	--	(3,053,046)	(3,053,046)
Transactions with owners in their capacity as owners						
Issuance of shares	750,000	--	--	--	--	750,000
Share based compensation	--	719,468	--	--	--	719,468
Prepayments on account of shares	--	--	130,411	--	--	130,411
Total transactions with owners in their capacity as owners	750,000	719,468	130,411	--	--	1,599,879
Balance at 31 December 2017	1,250,000	719,468	130,411	--	(5,759,270)	(3,659,389)

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

**CONSOLIDATED STATEMENT OF CASHFLOWS FOR THE YEAR ENDED 31 DECEMBER
2018**

	<u>Note</u>	US\$ 2018	US\$ 2017
<u>Cash flows from operating activities:</u>			
Loss before tax for the year		(4,032,794)	(3,053,046)
Share based compensation	19	1,060,943	719,468
Change in fair value of convertible notes	16	328,312	545,306
Depreciation and amortization	12,13	112,367	60,945
Increase in other receivables	11	(41,690)	(48,689)
(Decrease)/increase in trade payables		(111,369)	67,151
(Decrease)/increase in amounts owed to related party	15,20	(9,048)	13,020
(Decrease)/increase in other payables	14	(60,495)	237,771
Increase/(decrease) in provision	25	1,281	(615)
Increase in other liabilities	22	1,420	18,300
Cash used in operating activities		(2,751,072)	(1,440,389)
<u>Cash flows from investing activities:</u>			
Purchase of property, plant and equipment	12	(37,395)	(14,625)
Purchase of intangible assets	13	(329,809)	(399,026)
Cash used in investing activities		(367,204)	(413,651)
<u>Cash flows from financing activities:</u>			
Proceeds from issue of convertible notes	16	1,191,329	576,868
Payments of borrowings to related parties	15	(66,702)	(28,843)
Proceeds from prepayments on account of shares	17	--	130,411
Proceeds from issuance of shares prior to IPO, net	17	619,589	750,000
Proceeds from issuance of shares at IPO, net	17	3,811,707	--
Cash provided from financing activities		5,555,923	1,428,436
Increase/(decrease) in cash and cash equivalents		2,437,646	(425,605)
Cash and cash equivalents at beginning of year		10,665	137,299
Exchange rate differences (including translation)		(98,227)	298,971
Cash and cash equivalents at end of year		2,350,084	10,665

The above Consolidated Statement of Cashflows should be read in conjunction with the accompanying notes

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 1 - GENERAL:

The financial statements cover Security Matters Limited as a Group consisting of Security Matters Limited and the entities it controlled at the end of, or during, the financial year. The financial statements are presented in US Dollars, which is Security Matters Limited's presentation currency.

The functional currency of Security Matters Limited (Australia) is Australian Dollars.

Security Matters Limited is a listed public company limited by shares, incorporated and domiciled in Australia.

A description of the nature of the consolidated entity's operations and its principal activities are included in the director's report, which is not part of the financial statements

The Financial Statements were authorized for issue on __ March 2019 by the directors of the company.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES:

The significant accounting policies followed in the preparation of the financial statements, on a consistent basis, are:

Basis of preparation

These general purpose financial statements have been prepared in accordance with the *Corporations Act 2001*, Australian Accounting standards and interpretations of the Australian Accounting Standard Board and in compliance with International Financial Reporting Standards. The Company is a for-profit entity for financial reporting purposes under Australian Accounting Standards. Material accounting policies adopted in the preparation of these financial statements are presented below and have been consistently applied unless stated otherwise.

Except for cash flow information, the financial statements have been prepared on an accrual basis and are based on historical costs, modified, where applicable, by the measurement at fair value of selected financial assets and financial liabilities.

Going concern

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

The Group has incurred an operating loss after tax for the year ended 31 December 2018 of \$4,032,794 (2017: loss \$3,053,046). The loss for the current year includes non-cash costs in respect of convertible notes (\$328,312) and share based expenses (\$1,060,943). Net cash outflows from operating activities for the current year totalled \$2,751,072 (2017: \$1,440,389). This is expected for a young technology company and is part of its ordinary life-cycle.

As of 31 December 2018, the Group had cash on hand of \$2,350,084, other current receivables of \$204,669, net current assets of \$1,725,681 and net assets of \$2,848,983.

Management have prepared a cash flow forecast, based on which the group has sufficient funds available to meet its commitments for at least twelve months from the date of signing this report. In addition, the Board is confident of raising further capital through equity if necessary (refer also to note 28, subsequent events).

Critical Accounting Estimates and Assumptions

The preparation of the financial statements requires management to make estimates and assumptions that have an effect on the application of the accounting policies and on the reported amounts of assets, liabilities and expenses. These estimates and underlying assumptions are reviewed regularly. Changes in accounting estimates are reported in the period of the change in estimate. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 3.

Foreign currency

The financial statements are prepared in US Dollars which is the functional and presentation currency. Security Matters Limited's functional currency is Australian Dollars, while the functional currency of Security Matters Ltd. (Israel) is US Dollars.

Transactions and balances in foreign currencies are converted into US Dollars in accordance with the principles set forth by Australian Accounting Standard (AASB) 21 ("The Effects of Changes in Foreign Exchange Rates"). Accordingly, transactions and balances have been converted as follows:

- Monetary assets and liabilities – at the rate of exchange applicable at the reporting date;
- Exchange gains and losses from the aforementioned conversion are recognized in the statement of comprehensive income.
- Expense items – at exchange rates applicable as of the date of recognition of those items.
- Non-monetary items are converted at the rate of exchange at the time of the transaction. Exchange gains and losses from the aforementioned conversions are recognized in the statement of comprehensive income.

ANNUAL REPORT

NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

- Exchange gains and losses of the parent company are recognized in the statement of other comprehensive income and the Foreign Currency Translation Reserve.

Cash and cash equivalents

Cash equivalents are considered by the Company to be highly-liquid investments, including, inter alia, short-term deposits with banks and the maturity of which do not exceed three months at the time of deposit and which are not restricted.

Revenue recognition

The consolidated entity recognises revenue as follows:

Revenue from contracts with customers

Revenue is recognised at an amount that reflects the consideration to which the consolidated entity is expected to be entitled in exchange for transferring goods or services to a customer. For each contract with a customer, the consolidated entity: identifies the contract with a customer; identifies the performance obligations in the contract; determines the transaction price which takes into account estimates of variable consideration and the time value of money; allocates the transaction price to the separate performance obligations on the basis of the relative stand-alone selling price of each distinct good or service to be delivered; and recognises revenue when or as each performance obligation is satisfied in a manner that depicts the transfer to the customer of the goods or services promised.

Variable consideration within the transaction price, if any, reflects concessions provided to the customer such as discounts, rebates and refunds, any potential bonuses receivable from the customer and any other contingent events. Such estimates are determined using either the 'expected value' or 'most likely amount' method. The measurement of variable consideration is subject to a constraining principle whereby revenue will only be recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. The measurement constraint continues until the uncertainty associated with the variable consideration is subsequently resolved. Amounts received that are subject to the constraining principle are initially recognised as deferred revenue in the form of a separate refund liability.

Sale of goods- sale of Markers, Readers and software license

Revenue from the sale of goods is recognised at the point in time when the customer obtains control of the Markers or Readers, which is generally at the time of delivery. Revenue from software license is not yet generated but is expected to be recognised on a monthly basis.

Royalties

Revenue from royalties from the sale of Markers to a third party is recognised at the point in time when the partner recognizes the sale to the customer, which is generally at the time of delivery of Markers to the customer.

Rendering of services

Revenue from a contract to provide services for track and trace development is recognised over time as the services are rendered based on either a fixed price or an hourly/weekly rate. In cases the service agreement is milestones' based the revenue is recognised once milestones are achieved and approved by the customer.

Interest

Interest revenue is recognised as interest accrues using the effective interest method. This is a method of calculating the amortised cost of a financial asset and allocating the interest income over the relevant period using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the net carrying amount of the financial asset.

Research and development

Research costs are expensed as incurred. Development expenditures on an individual project are recognized as an intangible asset when the Company can demonstrate:

- The product is technically and commercially feasible.
- The Company intend to complete the product so that it will be available for use or sale.
- The Company has the ability to use the product or sell it.
- The Company has the technical, financial and other resources to complete the development and to use or sell the product.
- The Company can demonstrate the probability that the product will generate future economic benefits.
- The Company is able to measure reliability the expenditure attributable to the product during the development.

Capitalized development costs are amortized on a straight line basis over their estimated useful lives once the development is completed and the assets are in use. Subsequent expenditure on capitalized intangible assets is capitalized only where it clearly increases the economic benefits to be derived from the asset to which it relates. All other expenditure, including that incurred in order to maintain an intangible assets current level of performance, is expensed as incurred.

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

Goods and Services Tax ('GST') and other similar taxes

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the tax authority. In this case it is recognised as part of the cost of the acquisition of the 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 tax authority is included in other receivables or other payables in the statement of financial position.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the tax authority, are presented as operating cash flows

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the tax authority

Earnings per share*Basic earnings per share*

Basic earnings per share is calculated by dividing the profit attributable to the owners of Security Matters Limited, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the financial year, adjusted for bonus elements in ordinary shares issued during the financial year.

Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share to take into account the after-income tax effect of interest and other financing costs associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

Governmental liabilities on grants received

The Company measured the fair value of its governmental liabilities on grants received and deferred to subsequent reporting periods, each period, based on discounted cash flows derived from Company's future anticipated revenues.

Fair value measurement

Fair value is the price that would be received when selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- A. In the principal market for the asset or liability; or
- B. In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to the Company.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

Classification of financial instruments by fair value hierarchy

The financial instruments presented in the statements of financial position at fair value are grouped into classes with similar characteristics using the following fair value hierarchy which is determined based on the source of input used in measuring fair value:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable either directly or indirectly.
- Level 3 - Inputs that are not based on observable market data (valuation techniques which use inputs that are not based on observable market data).

Financial assets

The Company classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

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Other receivables: These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise principally through the provision of goods and services, but also incorporate other types of contractual monetary asset. These assets are carried at amortized cost less any provision for impairment.

The Company has no financial assets classified at Fair value through profit or loss.

Financial liabilities

The Company classifies its financial liabilities as follows:

Other financial liabilities: Other financial liabilities include the following items:

- Trade payables, loans from related parties and other accounts payables are initially recognized at fair value less any transaction costs directly attributable to the issue of the instrument. Such interest-bearing liabilities are subsequently measured at amortized cost using the effective interest method, which ensures that any interest expense over the period is at a constant interest rate on the balance of the liability carried in the statement of financial position. Interest expense in this context includes initial transaction costs, as well as any interest or coupon payable while the liability is outstanding.
- Fair value through profit and loss: convertible loan is measured at fair value through profit or loss. Transaction costs are recognized in profit or loss.

Impairment of financial assets

The consolidated entity recognises a loss allowance for expected credit losses on financial assets which are either measured at amortised cost or fair value through other comprehensive income. The measurement of the loss allowance depends upon the consolidated entity's assessment at the end of each reporting period as to whether the financial instrument's credit risk has increased significantly since initial recognition, based on reasonable and supportable information that is available, without undue cost or effort to obtain.

Where there has not been a significant increase in exposure to credit risk since initial recognition, a 12-month expected credit loss allowance is estimated. This represents a portion of the asset's lifetime expected credit losses that is attributable to a default event that is possible within the next 12 months. Where a financial asset has become credit impaired or where it is determined that credit risk has increased significantly, the loss allowance is based on the asset's lifetime expected credit losses. The amount of expected credit loss recognised is measured on the basis of the probability weighted present value of anticipated cash shortfalls over the life of the instrument discounted at the original effective interest rate. the loss allowance is recognised in profit or loss.

Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Recoverable amount is the higher of an asset's fair value less costs of disposal and value-in-use. The value-in-use is the present value of the estimated future cash flows relating to the asset using a pre-tax discount rate specific to the asset or cash-generating unit to which the asset belongs. Assets that do not have independent cash flows are grouped together to form a cash-generating unit.

Property, plant and equipment

Items of property, plant and equipment are initially recognized at cost. Cost includes directly attributable costs and the estimated present value of any future costs of dismantling and removing items. Depreciation is computed by the straight line method, based on the estimated useful lives of the assets, as follows:

	<u>%</u>
Computers	33
Machines and equipment	20
Furniture and office equipment	10
Leasehold improvements	5

Leasehold improvements are depreciated over the term of the expected lease including optional extension, or the estimated useful lives of the improvements, whichever is shorter.

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

Employee benefits

The Company contributes towards the state pension in accordance with local legislation where required. The only obligation of the Company is to make the required contributions. Costs related to such contributions are expensed in the period in which they are incurred.

The Company has several employee benefit plans as to Israeli employees:

1. Short-term employee benefits: Short-term employee benefits include salaries, paid annual leave, paid sick leave, recreation and social security contributions and are recognized as expenses as the services are rendered. A liability in respect of a cash bonus or a profit-sharing plan is recognized when the Company has a legal or constructive obligation to make such payment as a result of past service rendered by an employee and a reliable estimate of the amount can be made.
2. Post-employment benefits: The plans are normally financed by contributions to insurance companies and classified as defined contribution plans or as defined benefit plans. The Company has defined for most of its employees contribution plans pursuant to Section 14 to the Severance Pay Law since 2004 under which the Company pays fixed contributions and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient amounts to pay all employee benefits relating to employee service in the current and prior periods.

Contributions to the defined contribution plan in respect of severance or retirement pay are recognized as an expense simultaneously with receiving the employee's services and no additional provision is required in the financial statements except for the unpaid contribution.

Intangible assets

Intangible assets include capitalized technology development costs as well as costs paid to legal and tech consultants. Intangible assets with a finite useful life are amortized over their estimated useful lives and reviewed for impairment whenever there is an indication that the asset may be impaired. The amortization period and the amortization method for an intangible asset are reviewed at least at each year end.

The carrying amount of these assets is reviewed whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of the asset to the future undiscounted cash flows the asset is expected to generate. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. Expenditure incurred on development activities including the Company's software development is capitalized only where the expenditure will lead to new or substantially improved products, the products are technically and commercially feasible and the Company has sufficient resources to complete the development and reach the Stage for which the product is ready for use.

Capitalized development costs are amortized on a straight line basis over their estimated useful lives once the development is completed and the assets are in use and until such date it is tested for impairment test on a yearly basis. Subsequent expenditure on capitalized intangible assets is capitalized only where it clearly increases the economic benefits to be derived from the asset to which it relates. All other expenditure, including that incurred in order to maintain an intangible assets current level of performance, is expensed as incurred.

The amortization period for the company's intangible assets is as follows:

	<u>Period (years)</u>
Patents	20
Marking and Reading Technology	5
Software and Blockchain	3

Share-based payments

Equity-settled share-based compensation benefits are provided to key management personnel and employees.

Equity-settled transactions are awards of shares, or options over shares, that are provided to employees in exchange for the rendering of services.

The cost of equity-settled transactions are measured at fair value on grant date. Fair value is independently determined using either the Black-Scholes option pricing model that takes into account the exercise price, the term of the option, the impact of dilution, the share price at grant date and expected price volatility of the underlying share, the expected dividend yield and the risk free interest rate for the term of the option, together with non-vesting conditions that do not determine whether the consolidated entity receives the services that entitle the employees to receive payment. No account is taken of any other vesting conditions.

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

The cost of equity-settled transactions are recognised as an expense with a corresponding increase in equity over the vesting period. The cumulative charge to profit or loss is calculated based on the grant date fair value of the award, the best estimate of the number of awards that are likely to vest and the expired portion of the vesting period. The amount recognised in profit or loss for the period is the cumulative amount calculated at each reporting date less amounts already recognised in previous periods.

Market conditions are taken into consideration in determining fair value. Therefore any awards subject to market conditions are considered to vest irrespective of whether or not that market condition has been met, provided all other conditions are satisfied.

If equity-settled awards are modified, as a minimum an expense is recognised as if the modification has not been made. An additional expense is recognised, over the remaining vesting period, for any modification that increases the total fair value of the share-based compensation benefit as at the date of modification.

If the non-vesting condition is within the control of the consolidated entity or employee, the failure to satisfy the condition is treated as a cancellation. If the condition is not within the control of the consolidated entity or employee and is not satisfied during the vesting period, any remaining expense for the award is recognised over the remaining vesting period, unless the award is forfeited.

If equity-settled awards are cancelled, it is treated as if it has vested on the date of cancellation, and any remaining expense is recognised immediately. If a new replacement award is substituted for the cancelled award, the cancelled and new award is treated as if they were a modification.

Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries of Security Matters Limited ('company' or 'parent entity') as at 31 December 2018 and the results of all subsidiaries for the year then ended. Security Matters Limited and its subsidiaries together are referred to in these financial statements as the 'consolidated entity'.

Subsidiaries are all those entities over which the consolidated entity has control. The consolidated entity controls an entity when the consolidated entity 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. Subsidiaries are fully consolidated from the date on which control is transferred to the consolidated entity. They are de-consolidated from the date that control ceases.

Intercompany transactions, balances and unrealised gains on transactions between entities in the consolidated entity are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of the impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the consolidated entity.

New or amended Accounting Standards and interpretations adopted**"AASB 9 Financial Instruments":**

AASB 9 replaced the multiple classification and measurement models in AASB 139 Financial instruments: Recognition and Measurement with a single model that has only two classification categories: amortized cost and fair value.

Classification of debt assets are driven by the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. A debt instrument is measured at amortized cost if: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual cash flows under the instrument solely represent payments of principal and interest.

All other debt and equity instruments, including investments in complex debt instruments and equity investments, must be recognized at fair value.

All fair value movements on financial assets are recognized in profit or loss, except for equity investments that are not held for trading, which may be recorded in other comprehensive income (without subsequent recycling to profit or loss), and certain financial assets that are debt instruments, which may also be recorded in other comprehensive income.

For financial liabilities that are measured under the fair value option entities recognize the part of the fair value change that is due to changes in their own credit risk in other comprehensive income rather than profit or loss. The new standard also introduces expanded disclosure requirements and changes in presentation.

There is also a new expected credit loss (ECL) model which involves a three-stage approach whereby financial assets move through the three stages as their credit quality changes. The stage dictates how an entity measures impairment losses and applies the effective interest rate method. A simplified approach is permitted for financial assets that do not have a significant financing component (e.g. trade receivables). On initial recognition, entities will record a day-1 loss equal to the 12 month ECL (or lifetime ECL for trade receivables), unless the assets are considered credit impaired.

The Directors have assessed AASB 9 and determined that there has been no material impact on the financial statements of the group as a result of adopting AASB 9 from 1 January 2018.

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

"AASB 15 Revenue from Contracts with Customers" (hereafter – AASB 15)

AASB 15 replaced other IFRS provisions relating to revenue recognition.

The core principle of AASB 15 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

AASB 15 sets out a single revenue recognition model, according to which the entity shall recognize revenue in accordance with the said core principle by implementing a five-step model framework:

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

AASB 15 provides guidance about various issues related to the application of the said model, including: recognition of revenue from variable consideration set in the contract, adjustment of the price of transaction set in the contract in order to reflect the effect of the time value of money and costs to obtain or fulfill a contract.

AASB 15 extends the disclosure requirements regarding revenue and requires, among other things, that entities disclose qualitative and quantitative information about significant judgments made by management in determining the amount and timing of the revenue.

The standard has been applied retrospectively to annual reporting periods starting on January 1, 2018. The Directors have assessed AASB 15 and determined that it does not have a material impact on the financial statements.

New Accounting Standards and interpretations not yet mandatory or early adoptedAASB 16 Leases

AASB 16 is effective for annual reporting periods beginning on or after 1 January 2019.

The objective of AASB 16 is to report information that (a) faithfully represents lease transactions and (b) provides a basis for users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. To meet that objective, a lessee should recognise assets and liabilities arising from a lease.

AASB 16 introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

A lessee measures right-of-use assets similarly to other non-financial assets (such as property, plant and equipment) and lease liabilities similarly to other financial liabilities. As a consequence, a lessee recognises depreciation of the right-of-use asset and interest on the lease liability. The depreciation would usually be on a straight-line basis. In the statement of cash flows, a lessee separates the total amount of cash paid into principal (presented within financing activities) and interest (presented within either operating or financing activities) in accordance with AASB 107 Statement of cashflows.

Assets and liabilities arising from a lease are initially measured on a present value basis. The measurement includes non-cancellable lease payments (including inflation-linked payments), and also includes payments to be made in optional periods if the lessee is reasonably certain to exercise an option to extend the lease, or not to exercise an option to terminate the lease. The initial lease asset equals the lease liability in most cases.

The lease asset is the right to use the underlying asset and is presented in the statement of financial position either as part of property, plant and equipment or as its own line item.

AASB 16 substantially carries forward the lessor accounting requirements in AASB 117 Leases. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

AASB 16 replaces AASB 117 Leases effective 1 January 2019, with earlier application permitted. AASB 16 has the following transition provisions:

- Existing finance leases: continue to be treated as finance leases.
- Existing operating leases: option for full or limited retrospective restatement to reflect the requirements of AASB 16

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

As at 31 December 2018, the Company has 1 car lease extending beyond 12 months. The Directors are still in the process of determining whether AASB 16 will have a material impact on the financial statements.

Operating segments

An operating segment is a component of an entity that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance and for which discrete financial information is available. This includes start-up operations which are yet to earn revenues. Management will also consider other factors in determining operating segments such as the existence of a line managers and the level of segment information presented to the Chairman of the board of directors. During the year the Company only operated in one segment, which is to further the development and commercialisation of track and trace technology for a wide variety of industries. All of the Company's non-current assets are located in Israel.

NOTE 3 - CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS:**Amortisation of capitalized development costs and determination of useful life**

Intangible assets are amortized or depreciated over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue, which are periodically reviewed for continued appropriateness. As at December 31 2018 part of the Marking and Reading Technology is amortised, and it is expected that other assets will begin amortization during 2019. Changes to estimates can result in significant variations in the amounts charged to the consolidated statement of comprehensive income in specific periods.

Share based payments

The Company has a share based remuneration scheme for employees. The fair value of share options is estimated by using the a Black & Scholes model, which was derived to model the value of the firm's equity over time. The simulation model was designed to take into account the unique terms and conditions of the performance shares and share options, as well as the capital structure of the firm and the volatility of its assets, on the date of grant based on certain assumptions. Those conditions are described in the share based compensation note and include, among others, the dividend growth rate, expected share price volatility and expected life of the options. The fair value of the equity settled options granted is charged to statement of profit or loss over the vesting period of each tranche and the credit is taken to equity, based on the consolidated entity's estimate of shares that will eventually vest.

Convertible Notes

The Convertible Notes are financial instruments that were designated as a financial liability and presented at fair value with changes on fair value recognized in the statement of profit or loss. The fair value of the Convertible notes was measured at the time of issuance, at every 6 months period end, and at the time of conversion to Capital. The fair value is estimated by an external valuator. The simulation model was designed to take into account the unique terms and conditions of the convertible notes, as well as the capital structure of the consolidated entity, its market based value and the volatility of its assets, on each date of measurement based on certain assumptions. Those assumptions and conditions are described in the Convertible Notes note and include, among others, price per share paid in various transactions, discount granted to noteholders, time of lack of marketability, expected share price volatility and risk-free rates .

NOTE 4 - IPO AND CAPITAL RE-ORGANISATION

Security Matters Limited was admitted to the official list of the ASX on October 11, 2018, and official quotation and trading of its shares commenced on October 15, 2018.

Security Matters Limited raised AU\$6,000,000 (US\$ 4,280,871) pursuant to the Offer under its replacement prospectus dated 7 August 2018 and its supplementary prospectus dated 10 August 2018 by issue of 30,000,000 fully paid ordinary shares at AU\$0.2 per share.

Prior to commencement of trading, Security Matters Limited (Australia) completed the acquisition of 100% of the issued capital in Security Matters Ltd, an Israeli company that owns and has commenced commercialising the technology to permanently and irrevocably "mark" any object either solid, liquid or gas, allowing identification, proof of authenticity, tracking supply chain movements & quality assurance.

The consolidated financial statements represent a continuation of Security Matters' (Israel) financial statements. The consolidated results reflect the full year of Security Matters Ltd. (Israel) plus Security Matters Limited (Australia) from the date of incorporation (May 16 2018). The comparative period results reflect Security Matters Ltd. (Israel) only.

ANNUAL REPORT**NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018**

As part of the transaction the following securities were issued:

- **55,500,041** Shares to the Security Matters Ltd. (Israel) Shareholders and their nominees, in consideration for their shares in Security Matters Ltd. (Israel).
- **30,000,000** Shares to investors were issued with respect to the Offer at an issue price of AU\$0.20 per Share;
- **5,515,293** options to the Lead Manager (or their nominee/s) in consideration for the capital raised under the Offer;
- **11,999,959** Shares on conversion of convertible notes at AU\$0.14 per share;
- **8,805,864** options to certain Directors and employees (including to certain nominees) under the Company's employee share option plan (**ESOP**);
- **4,000,000** options to SMI Shareholders exercisable at AU\$0.20 expiring 5 years from the date of issue;
- **15,000,000** performance options to the Executive Directors (including to certain nominees) exercisable at AU\$0.20 expiring 5 years from the date of issue

NOTE 5 - RESEARCH AND DEVELOPMENT EXPENSES:

	2018	2017
	US\$	US\$
Payroll and related expenses	1,090,229	682,069
Research expenses, net	80,033	83,500
Subcontractors	22,518	45,919
Rent	24,638	25,877
Travel expenses	9,939	7,215
Total	1,227,357	844,580

NOTE 6 - GENERAL AND ADMINISTRATIVE EXPENSES:

	2018	2017
	US\$	US\$
Professional services	249,580	121,037
Management fee, payroll and related expenses	295,865	145,535
Travel expenses	101,858	27,852
Insurance	49,365	8,107
Fees	80,138	--
Others	46,277	25,433
Total	823,083	327,964

NOTE 7 - LEGAL AND CONSULTANTS EXPENSES:

	2018	2017
	US\$	US\$
Legal	379,606	94,752
Consultants	107,616	18,252
Total	487,222	113,004

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 8 – FINANCE EXPENSES AND INCOME

	2018	2017
	US\$	US\$
(a) Finance expenses		
Bank fees	3,352	934
Loan interest	20,850	23,642
Financial interest	434	--
Other financial costs	2,346	1,284
Exchange rate payments	3,023	402,750
Total	30,005	428,609
(b) Finance income		
Exchange rate income	51,546	--
Interest received	1,629	156
Total	53,174	156

NOTE 9 - TAXES ON INCOME:

Taxes on income:

The legal parent is incorporated and domiciled in Australia where the applicable tax rate is 27.5%.

Israeli corporate tax rates are 23% in 2018 and 24% in 2017.

	2018	2017
	US\$	US\$
<i>Reconciliation of income tax at the statutory rate</i>		
Loss before income tax	(4,032,794)	(3,053,046)
Tax at the statutory rate of 27.5% (2017- 24% in Israel)	(1,109,018)	(732,731)
Tax effect amounts which are not deductible/(taxable) in calculating taxable income:		
Non-deductible expenditure	402,362	317,304
Deductible expenditure – Capital raising costs	(25,804)	--
Unrecognised temporary differences and tax losses	732,460	415,427
Income tax (benefit)	--	--

Net operating losses carry forwards:

As at December 31 2018, the Group has estimated carry forward tax losses of approximately US\$5,318,059 (2017: US\$2,654,568) which may be carried forward and offset against taxable income for an indefinite period in the future. The Group did not recognize deferred tax assets relating to carry forward losses in the financial statements because their utilization in the foreseeable future is not probable. The unrecognized temporary differences and tax losses as at December 31 2018 are US\$6,752,406 (2017:3,312,414).

ANNUAL REPORT**NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018****NOTE 10 - EARNINGS PER SHARE**

	2018	2017
	US\$	US\$
<i>Earnings per share for profit</i>		
Loss after income tax attributable to the owners of Security Matters Limited	(4,032,794)	(3,053,046)
Basic loss per share	(0.06)	(0.07)
Diluted loss per share	(0.06)	(0.07)
<i>Weighted average number of ordinary shares</i>		
Weighted average number of ordinary shares used in calculating basic earnings per share	63,047,366	43,881,757
Weighted average number of ordinary shares used in calculating diluted earnings per share	63,047,366	43,881,757

33,321,157 options were not included in the number of weighted average ordinary shares used to calculate diluted earnings per share because their impact would be anti-dilutive

NOTE 11 - OTHER RECEIVABLES:

	2018	2017
	US\$	US\$
Indirect taxes	147,766	56,660
Related party	--	42,715
Prepaid expenses	28,251	3,593
Other	28,651	60,010
Total	204,669	162,979

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 12 - PROPERTY AND EQUIPMENT, NET:

	Leasehold improvements US\$	Machines and Equipment US\$	Furniture and Office Equipment US\$	Computers US\$	Total US\$
Cost					
At January 1 2018	38,133	331,342	29,513	26,215	425,203
Additions	244	32,931	--	4,223	37,397
At December 31 2018	<u>38,377</u>	<u>364,274</u>	<u>29,513</u>	<u>30,437</u>	<u>462,601</u>
Accumulated depreciation					
At January 1 2018	3,417	38,300	7,503	15,486	64,706
Depreciation	2,886	72,313	3,136	9,772	88,108
At December 31 2018	<u>6,303</u>	<u>110,613</u>	<u>10,639</u>	<u>25,257</u>	<u>152,814</u>
Net book value at December 31 2018	<u>32,073</u>	<u>253,660</u>	<u>18,874</u>	<u>5,180</u>	<u>309,787</u>
As at December 31 2018					
Cost	38,377	364,274	29,513	30,437	462,601
Accumulated depreciation	6,303	110,613	10,639	25,257	152,814
Net book value as at December 31 2018	<u>32,073</u>	<u>253,660</u>	<u>18,874</u>	<u>5,180</u>	<u>309,787</u>
	Leasehold improvements US\$	Machines and Equipment US\$	Furniture and Office Equipment US\$	Computers US\$	Total US\$
Cost					
At January 1 2017	34,401	327,482	29,513	19,182	410,578
Additions	3,732	3,860	--	7,033	14,625
At December 31 2017	<u>38,133</u>	<u>331,342</u>	<u>29,513</u>	<u>26,215</u>	<u>425,203</u>
Accumulated depreciation					
At January 1 2017	1,911	2,241	4,369	7,712	16,233
Depreciation	1,506	36,059	3,134	7,774	48,473
At December 31 2017	<u>3,417</u>	<u>38,300</u>	<u>7,503</u>	<u>15,486</u>	<u>64,706</u>
Net book value at December 31 2017	<u>34,716</u>	<u>293,042</u>	<u>22,010</u>	<u>10,729</u>	<u>360,497</u>
As at December 31 2017					
Cost	38,133	331,342	29,513	26,215	425,203
Accumulated depreciation	3,417	38,300	7,503	15,486	64,706
Net book value as at December 31 2017	<u>34,716</u>	<u>293,042</u>	<u>22,010</u>	<u>10,729</u>	<u>360,497</u>

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 13 - INTANGIBLE ASSETS:

	Patents US\$	Marking and Reading Technology US\$	Software and Blockchain US\$	Total US\$
Net book value as at 1 January 2018	406,346	258,094	114,612	779,051
Additions - development costs	172,722	100,536	56,551	329,809
Amortisation	--	(24,259)	--	(24,259)
Net book value as at 31 December 2018	<u>579,068</u>	<u>334,370</u>	<u>171,163</u>	<u>1,084,601</u>

As at 31 December 2018

Cost	579,068	371,102	171,163	1,121,333
Accumulated amortisation	--	(36,732)	--	(36,732)
Net book value as at 31 December 2018	<u>579,068</u>	<u>334,370</u>	<u>171,163</u>	<u>1,084,601</u>

	Patents US\$	Marking and Reading Technology US\$	Software and Blockchain US\$	Total US\$
Net book value as at 1 January 2017	254,479	131,818	6,200	392,497
Additions - development costs	151,866	138,748	108,412	399,026
Accumulated amortisation	--	(12,472)	--	(12,472)
Net book value as at 31 December 2017	<u>406,346</u>	<u>258,094</u>	<u>114,612</u>	<u>779,051</u>

As at 31 December 2017

Cost	406,346	270,566	114,612	791,523
Accumulated amortisation	--	(12,472)	--	(12,472)
Net book value as at 31 December 2017	<u>406,346</u>	<u>258,094</u>	<u>114,612</u>	<u>779,051</u>

The consolidated entity has not yet begun amortisation for its patents as the patent applications have not yet completed their registration process and are not ready for use. The consolidated entity has not yet begun amortisation for its software and blockchain as the development of these is not completed and they are not ready for use.

The recoverable amount of the consolidated entity's intangible assets that are not yet used has been determined by the relief from royalty method, performed by an external valuator based on management's assumptions.

Key assumptions are those to which the recoverable amount of an asset is most sensitive. The following key assumptions were used in the relief from royalty model for the intangible assets not yet in use:

- 22.3% After tax net cash flow discount rate;
- 7.5% Royalty rate;
- 18 years expected life;
- Revenue projection based on management plans for first 5 years, steady for next 5 years (0% growth rate) and decreasing over last 8 years;

The discount rate of 22.3% pre-tax reflects management's estimate of the time value of money and the consolidated entity's weighted average cost of capital adjusted for the risk free rate and the volatility of comparable companies' share price relative to market movements.

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

The royalty rate of 7.5% is based on actual average royalty rates of related technology.

The expected life was determined based on the fact that the technology is revolutionary, and is reasonable based on the Patent life span of 20 years.

NOTE 14 - OTHER ACCOUNTS PAYABLE:

	2018 US\$	2017 US\$
Employees, salaries and related liabilities	218,255	200,314
Accrued expenses	30,482	94,903
Liabilities for grants received	26,340	23,020
Other	--	17,334
Total	275,076	335,571

NOTE 15 - BORROWINGS FROM RELATED PARTIES:

In 2015, the Group signed an agreement to receive a loan of NIS 2 Million (US\$ 512,558 at 2015) from its major shareholders on back-to-back terms from a third party (the Kamea Fund). The loan bears an interest at an annual rate of 4% and was expected to be repaid in eight quarterly equal installments commencing December 31, 2016.

In December 2017, the Group reached an oral binding agreement with its shareholders according to which the loan will be repaid in eight equal quarterly installments commencing November 1, 2018. The amendment was put in writing during January 2018.

	2018 US\$	2017 US\$
Balance at 1 January	548,024	520,156
Payment of borrowings	(66,702)	(28,843)
Exchange rate differences	(41,087)	56,712
Balance at 31 December	440,235	548,024

In consideration for the Kamea Fund providing those loans and taking on the risks associated with providing funding as a seed capitalist (through the back-to-back loans provided by the Lenders), Security Matters Israel agreed to provide, as additional consideration, a bonus payment on the occurrence of an exit or major liquidity event. This bonus payment is customary in early stage funding of start-ups in Israel by the Kamea Fund.

The compensation is capped at ILS 3,000,000 (approximately US\$ 800K) per each Lender (together, the **Bonus Payments**).

The Bonus Payments are intended to operate so that, in the event of:

- (i) dividend distributions paid by the Company; or
- (ii) additional consideration for the sale of shares by a Lender in Security Matters Ltd (either in the event of a takeover or otherwise)

(together, **Liquidity Events**), that Lender would be owed the Bonus Payment, the amounts of which are set out in the following paragraph.

Security Matters Israel is only required to commence paying a Bonus Payment once the Company has made a Cumulative Compensation to a Lender of at least ILS 3,075,000 (approximately US\$ 820K) (**Minimum Threshold**).

'Cumulative Compensation' means the total aggregate compensation provided under Liquidity Events.

Once a Lender has received the Minimum Threshold, the Company is required to commence paying the Bonus Payments from any further Cumulative Compensation. The Company must pay, in fulfilment of the Bonus Payment, 50% of any further Cumulative Compensation over and above the Minimum Threshold.

There is no time limit to pay the Bonus Payments. Once the Company has paid each Bonus Payment in its entirety (i.e. the cap of ILS 3,000,000 has been paid to each Lender), then the Company has fulfilled its obligations. Any further distributions thereafter will be distributed pro rata amongst all shareholders of the Company.

These Bonus Payments are governed under the laws of Israel.

The Bonus Payments were examined by an external valuator and based on management's projections and insights it has estimated that the value of the Lender's Bonus is estimated at zero as of 31 December 2018.

ANNUAL REPORT**NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018****NOTE 16 - CONVERTIBLE LOAN AT FAIR VALUE:****1. Loan from 2016 and 2017**

In June 2016, Security Matters Ltd. (Israel) signed convertible note agreements with a number of investors, according to which Security Matters Ltd. (Israel) borrowed a total amount up to NIS 6 Million (US\$1,555,396). On January 2, 2017, Security Matters Ltd. (Israel) received an additional amount of NIS 2 Million (US\$576,868) from a third party under the same terms. The Convertible Notes do not bear interest.

The Convertible Notes are financial instruments that were designated as a financial liability and presented at fair value with changes on fair value recognized in the statement of profit or loss.

In February 2018, the Convertible Notes were converted to a total of 17,553 shares of Security Matters Ltd. (Israel).

2. Loan received in 2018

In May and June 2018, Security Matters Ltd. (Israel) signed additional convertible note agreements (the "Second Convertible Notes") with a number of different investors, in which Security Matters Ltd. (Israel) borrowed a total amount of AUD 1.68 Million (US\$1,191,329). The Second Convertible Notes do not bear interest.

The Investors must convert the loan amount into capital shares at a PPS, equal to:

- 30% discount of the lowest price per share paid in the IPO.
- In an exit event (as defined in the Convertible Notes agreement), 70% of the price per share based on the Company pre-money valuation, on a fully diluted basis. An exit event means the occurrence of trade sale or the date on which listing approval occurs.

All of the Second Convertible Notes were converted to 11,999,959 shares of the company as part of the completion of the IPO. The Convertible Notes are financial instruments that were presented at fair value with changes on fair value recognized in statement of profit or loss.

	2018	2017
	US \$	US \$
As at 1 January	3,586,428	2,221,995
Issue of convertible notes	1,191,329	576,868
Change in fair value of convertible notes	328,312	545,306
Exchange rate effect on value of convertible notes	(25,215)	242,260
Conversion of convertible notes to equity	(5,080,854)	--
As at 31 December	<u> -- </u>	<u>3,586,428</u>

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 17 – ISSUED CAPITAL:

Movements in ordinary Capital

	Date	Number of shares	Unit Price US\$	Share Capital US\$
Balance as at 1 January 2018 ⁱ	01/01/2018	44,946,400		1,250,000
Issuance of new shares in IL company ⁱ	01/02/2018	1,967,802	0.38	750,000
Conversion of convertible loan from 2016-17 ⁱ	25/02/2018	8,585,839	0.42 ⁱⁱ	3,567,904
Conversion of convertible loan at IPO from June 2018	14/10/2018	11,999,959	0.13 ⁱⁱ	1,512,949
Issuance of shares at IPO	15/10/2018	30,000,000	0.14	4,280,871
Capital raising costs	15/10/2018			(469,164)
Balance as at 31 December 2018		97,500,000		10,892,560

	Date	Number of shares	Unit Price US\$	Share Capital US\$
Balance as at 1 January 2017 ⁱ	01/01/2017	42,946,315		500,000
Issuance of new shares in IL company ⁱ	01/04/2017	32,283	0	0
Issuance of new shares in IL company ⁱ	16/07/2017	1,967,802	0.38	750,000
Balance as at 31 December 2017ⁱ		44,946,400		1,250,000

ⁱ For transactions prior to the IPO, number of shares and unit price are adjusted to the number of shares received in parent entity in consideration for the shares in Security Matters Ltd. (Israel).

ⁱⁱ Unit price for the convertible notes is presented with regards to the fair value and not the actual funds received.

Ordinary shares

Ordinary shares entitle the holder to participate in dividends and the proceeds on the winding up of the company in proportion to the number of and amounts paid on the shares held. The fully paid ordinary shares have no par value and the company does not have a limited amount of authorised capital.

On a show of hands every member present at a meeting in person or by proxy shall have one vote and upon a poll each share shall have one vote.

Capital risk management

The consolidated entity's objectives when managing capital is to safeguard its ability to continue as a going concern, so that it can provide returns for shareholders and benefits for other stakeholders and to maintain an optimum capital structure to reduce the cost of capital.

Capital is regarded as total equity, as recognised in the statement of financial position, plus net debt. Net debt is calculated as total borrowings less cash and cash equivalents.

In order to maintain or adjust the capital structure, the consolidated entity may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The consolidated entity would look to raise capital when an opportunity to invest in a business or company was seen as value adding relative to the current company's share price at the time of the investment. The consolidated entity is not actively pursuing additional investments in the short term as it continues to integrate and grow its existing businesses in order to maximise synergies.

The consolidated entity is subject to certain financing arrangements covenants and meeting these is given priority in all capital risk management decisions. There have been no events of default on the financing arrangements during the financial year.

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 18 – RESERVES:*Share based compensation*

The Company completed the following share-based payment transactions during the year:

Option granted in Security Matters Ltd.

	2018	2017
	US\$	US\$
a) Share Based Payment Reserve		
33,321,157 (31 December 2017: equivalent of 3,320,320)		
options on issue	1,780,411	719,468
b) Movement in Share Based Payment Reserve		
	Number of	US\$
	Options	
Opening balance at 1 January 2017	--	--
Issue of ESOP Options to Employees	5,796	719,468
Closing balance at 31 December 2017	5,796	719,468
Issue of ESOP options (Note 19)	3,337	249,439
Closing balance at Security Matters Ltd. (Israel) at 14/10/18	9,133	968,907
<u>Security Matters Limited Options</u>		
Conversion of Security Matters Ltd. (Israel) Options to Australian parent Options	5,231,965	968,907
Issue of performance options (Note 19)	15,000,000	98,908
Issue of ESOP options (Note 19)	3,573,899	119,947
Issue of Options to lead manager and nominees	5,515,293	239,816
Issue of Options to various shareholders for services rendered	4,000,000	284,320
Cost of ESOP Options from 2017	--	68,513
Closing balance at 31 December 2018	33,321,157	1,780,411

Foreign currency reserve

The reserve is used to recognise exchange differences arising from the translation of the financial statements of operations in Australia to US dollars (the presentation currency).

	2018	2017
	US\$	US\$
Foreign currency translation reserve	(31,925)	--

NOTE 19 – SHARE BASED PAYMENTS

The Option grants from 2018 were issued under the following terms and conditions:

Equivalent of 1,911,645 Options (3,337 Options in IL company) to Employees of the group granted in Security Matters Ltd.(Israel) during H1 2018:

FV per option or right at grant date;	US\$0.89
Exercise price per share or unit;	A\$0.2
Amount, if any, paid or payable by the recipient;	N/A
Expiry date;	1/9/2023
Date or dates when the options or rights may be exercised;	50% on July 2019, 50% on July 2020. Escrow of shares until 15/10/2020
A summary of the service and performance criteria that must be met before the beneficial interest vests in the person.	Must remain an employee or consultant of the Company
Class and number of equity instruments for which options/rights may be exercised	Ordinary Shares

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

3,573,899 Options to Employees and Directors of the group granted on 8 October 2018:

FV per option or right at grant date;	A\$0.10
Exercise price per share or unit;	A\$0.2
Amount, if any, paid or payable by the recipient;	N/A
Expiry date;	1/9/2023 for 1,308,794 Options And 14/10/2023 for 2,265,105 Options 1,308,794 Vested; 31,460 every Quarter for 3 years from grant date;
Date or dates when the options or rights may be exercised;	755,035 vest on 15/10/19; 1,135,552 vest on 15/10/20;
A summary of the service and performance criteria that must be met before the beneficial interest vests in the person.	Must remain an employee or consultant of the Company
Class and number of equity instruments for which options/rights may be exercised	Ordinary Shares

5,515,293 Options to Lead Manager and its nominees

FV per option or right at grant date;	A\$0.06
Exercise price per share or unit;	A\$0.3
Amount, if any, paid or payable by the recipient;	N/A
Expiry date;	14/10/2021
Date or dates when the options or rights may be exercised;	Escrowed until 15/10/2020
A summary of the service and performance criteria that must be met before the beneficial interest vests in the person.	N/A
Class and number of equity instruments for which options/rights may be exercised	Ordinary Shares

4,000,000 Options to shareholders of Company for services rendered

FV per option or right at grant date;	A\$0.1
Exercise price per share or unit;	A\$0.2
Amount, if any, paid or payable by the recipient;	N/A
Expiry date;	14/10/2023
Date or dates when the options or rights may be exercised;	Escrowed until 15/10/2020
A summary of the service and performance criteria that must be met before the beneficial interest vests in the person.	N/A
Class and number of equity instruments for which options/rights may be exercised	Ordinary Shares

15,000,000 Performance Options to Executive Directors

FV per option or right at grant date;	A\$0.1
Exercise price per share or unit;	A\$0.2
Amount, if any, paid or payable by the recipient;	N/A
Expiry date;	14/10/2023
Date or dates when the options or rights may be exercised;	Escrowed until 15/10/2020
A summary of the service and performance criteria that must be met before the beneficial interest vests in the person.	Described in detail in clause 3. Must achieve milestones and remain a Director/Employee/Consultant of Company
Class and number of equity instruments for which options/rights may be exercised	Ordinary Shares

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

Fair Value

The Black Scholes option pricing model was used to determine the fair value of the options issued. The Black Scholes inputs and valuations were as follows:

ESOP granted prior to IPO

Number of options	2,414	968	966	1,448	1,350
Grant date	04/04/2017	04/04/2017	04/04/2017	18/06/2017	11/01/2018
Issue date	04/04/2017	04/04/2017	04/04/2017	18/06/2017	11/01/2018
Exercise price US\$	28.25	28.25	29.25	52.17	186
Expected volatility	96%	96%	96%	94%	88%
Implied option life	6.25	2.01	2.02	1.74	1.18
Expected dividend yield	0%	0%	0%	0%	0%
Risk free rate	1.55%	1.42%	1.50%	1.37%	2.42%
Valuation per option US\$	173	172	172	165	140
Total valuation US\$	417,260	166,496	166,625	238,732	188,393

ESOP granted prior to IPO- continued

Number of options	1,987
Grant date	15/03/2018
Issue date	15/03/2018
Exercise price AU\$	200
Expected volatility	89%
Implied option life	3.48
Expected dividend yield	0%
Risk free rate	2.14%
Valuation per option A\$	62.17
Exchange rate	0.79
Valuation per option US\$	48.97
Total valuation US\$	97,293

Options granted at IPO

Number of options	15,000,000	4,000,000	3,573,899	5,515,293
Grant date	15/10/2018	15/10/2018	15/10/2018	15/10/2018
Issue date	15/10/2018	15/10/2018	15/10/2018	15/10/2018
Exercise price US\$	0.20	0.20	0.20	0.30
Expected volatility	85.0%	85.0%	85.0%	81.9%
Implied option life	5	5	5	3
Expected dividend yield	0%	0%	0%	0%
Risk free rate	2.25%	2.25%	2.25%	2.11%
Valuation per option A\$	0.1	0.1	0.1	0.06
Exchange rate	0.71	0.71	0.71	0.71
Valuation per option US\$	0.07	0.07	0.07	0.04
Total valuation US\$	1,070,218	285,391	254,990	236,103

ANNUAL REPORT**NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018****NOTE 20 - RELATED PARTIES:****Liabilities to related parties at December 31 (excluding remuneration)**

	2018	2017
	US\$	US\$
Kibbutz Ketura	(6,962)	(15,801)
Kibbutz Degania A	(104)	(312)
	(7,065)	(16,113)

Key Management Personnel Compensation

The totals of remuneration paid to KMP during the year are as follows:

	2018	2017
	US\$	US\$
Short-term salary and fees	169,666	96,672
Bonus payment	41,726	--
Non-monetary benefits	12,155	12,311
Post-Employment Retirement Benefits	12,454	1977
Share based payments	107,654	--
	343,655	110,960

Other related party transactions**Entity / Key
management
personnel****Nature of transactions****Transaction value****Payable balance**

		2018	2017	2018	2017
		US\$	US\$	US\$	US\$
Kibbutz Ketura	Interest for shareholder borrowings (note 15)	10,425	11,821	387	2,979
Kibbutz Degania A	Interest for shareholder borrowings (note 15)	10,425	11,821	387	2,979
Kibbutz Ketura (related party of Ed Hofland)	Payment for services: bookkeeping, leased cars, finance services, food, lab rent, phone & internet	45,609	49,721	6,961	15,801
Kibbutz Degania A (related party of Amir Bader)	1,382,322 Options	98,255	--	N/A	--

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 21 – PARENT ENTITY FINANCIAL INFORMATION

The following information of the legal parent Security Matters Limited has been prepared in accordance with Australian Accounting Standards and the accounting policies as outlined in Note 2.

(a) Financial Position of Security Matters Limited

	2018 US\$
<u>Assets</u>	
Current Assets	307,483
Non-Current Assets	318
Total Assets	307,801
<u>Liabilities</u>	
Current Liabilities	34,804
Non-Current Liabilities	0
Total Liabilities	34,804
Net Assets	272,997
<u>Shareholders' Equity</u>	
Issued Capital	10,892,560
Share based payment reserve	1,780,411
Foreign currency translation reserve	(31,925)
Accumulated losses	(12,368,051)
Shareholders' Equity	272,997

(b) Statement of profit or loss and other comprehensive income

Loss for the year	(12,368,051)
Other comprehensive loss	(31,925)
Total comprehensive loss	(12,399,975)

Included within non-current assets is a net intercompany receivable of \$11,378,069 that the directors have impaired in the current year.

(c) Guarantees entered into by Security Matters Limited for the debts of its subsidiary

There are no guarantees entered into by Security Matters Limited.

(d) Contingent liabilities of Security Matters Limited

There were no contingent liabilities as at 31 December 2018.

(e) Commitments for the acquisition of property, plant and equipment by Security Matters Limited

There were no commitments for the acquisition of property, plant and equipment as at 31 December 2018

NOTE 22 – GOVERNMENT GRANTS

The Government of Israel encourages research and development projects oriented towards products for export or projects which will otherwise benefit the Israeli economy. This is conducted via the Office of the Chief Scientist (OCS).

The Company has one approved project with the OCS (project number 55715 approved 23 November, 2015) of a 40% grant out of a project of up to ILS 1,551,825 (~US\$ 400,000 at the time) under which it received ILS 547,596 (~US\$ 142,000 at the time) in 2016 and ILS 62,269 (~US\$ 17,000 at the time) in 2017. The Company passed a final review by the OCS and no additional funding is expected to be received under the project.

The Company is subject to paying 3% of its relevant revenues for the first three years, and 3.5% of the relevant revenues for further years, until repayment of the entire grant, being ILS 609,865 (equivalent to approximately US\$160,000).

The Company measured the fair value of its governmental liabilities on grants received, each period, based

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

on discounted cash flows derived from Company's future anticipated revenues.

	2018 US\$	2017 US\$
Short term Liability at year end	26,340	23,019
Long Term Liability at year end	93,110	91,690
Total	119,450	114,709

NOTE 23 – AUDITOR REMUNERATION

During the year the following fees were paid or payable for services provided by the auditor of the parent entity and its subsidiaries, its related practices and non-related audit firms:

	2018 US\$	2017 US\$
<u>Audit Remuneration</u>		
Auditing and reviewing the financial reports (BDO East Coast Partnership) – Australia	24,277	--
Auditing and reviewing the financial reports (BDO Ziv Haft) – Israel	58,000	68,000
Total	82,277	68,000
<u>Other non-audit remuneration</u>		
Investigating Accountant's Report (BDO East Coast Partnership) – Australia	28,988	--
International and local tax support (BDO Ziv Haft) – Israel	24,000	--
Total	52,988	--

*The fee for BDO Israel for 2017 includes Audit of 2016 and 2015 results as well. The fee includes the audit of statutory financial statements for Security Matters Ltd (Israel) and audit of tax return for Security Matters Ltd (Israel)

NOTE 24 – CONTROLLED ENTITIES

The ultimate legal parent entity of the Group is Security Matters Limited, incorporated and domiciled in Australia. The consolidated financial statements incorporate the assets, liabilities and results of the following subsidiaries in accordance with the accounting policies described in Note 2.

Controlled entity	Country of Incorporation	Percentage Owned 2018	Percentage Owned 2017
Security Matters Ltd	Israel	100%	0%

The proportion of ownership interest is equal to the proportion of voting power held

NOTE 25 – PROVISIONS

	2018 US\$	2017 US\$
Opening net carrying amount	3,269	3,885
Increase (decrease) in provision	1,281	(615)
Closing net carrying amount	4,550	3,269

Provisions relate to long-term employee benefits.

NOTE 26 - COMMITMENTS AND CONTINGENT LIABILITIES:

As part of the Board's ongoing regulatory compliance process, the Board continues to monitor legal and regulatory developments and their potential impact on the Company. Management is not aware of any contingencies that may have a significant impact on the financial position of the Company.

The Company leases its offices and Laboratory under an operating lease agreement, as well as 1 company car.

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

	2018 US\$	2017 US\$
<i>Lease commitments - operating</i>		
<i>Committed at the reporting date but not recognised as liabilities, payable:</i>		
Within one year	33,163	18,000
One to five years	14,030	4,000
More than five years	--	--
	47,193	22,000

As Described in note 15 borrowings from related parties, the Company is committed to pay a bonus payment upon achieving certain goals. The Bonus Payments were examined by an external valuator and based on management's projections and insights it has estimated that the value of the Lender's Bonus is estimated at nil as of 31 December 2018. The Maximum future bonus payment payable by the company is ILS 6,000,000 (US\$1,600,854 as at 31 December 2018 and US\$ 1,730,603 as at 31 December 2017).

NOTE 27 - FINANCIAL INSTRUMENTS AND RISK MANAGEMENT:**Financial risk management objectives**

The consolidated entity's activities expose it to a variety of financial risks: market risk (including foreign currency risk, price risk and interest rate risk), credit risk and liquidity risk. The consolidated entity's overall risk management program focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the consolidated entity. The consolidated entity uses different methods to measure different types of risk to which it is exposed. These methods include sensitivity analysis in the case of interest rate, foreign exchange and other price risks, ageing analysis for credit risk and beta analysis in respect of investment portfolios to determine market risk.

Market risk*Foreign currency risk*

The consolidated entity undertakes certain transactions denominated in foreign currency and is exposed to foreign currency risk through foreign exchange rate fluctuations.

Foreign exchange risk arises from future commercial transactions and recognised financial assets and financial liabilities denominated in a currency that is not the entity's functional currency. The risk is measured using sensitivity analysis and cash flow forecasting.

The Company is exposed to foreign exchange risk arising from various currency exposures primarily with respect to the New Israeli Shekel ("ILS"). The Company's policy is not to enter into any currency hedging transactions.

The carrying amount of the consolidated entity's foreign currency denominated financial assets and financial liabilities at the reporting date were as follows:

	Assets		Liabilities	
	2018 US\$	2017 US\$	2018 US\$	2017 US\$
ILS	2,120,863	130,574	777,357	1,110,430
Euro	34,511	--	--	--
	2,155,374	130,574	777,357	1,110,430

Sensitivity analysis

A 10% strengthening of the United States Dollar against the following currencies would have increased (decreased) equity and the income statement by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. For a 10% weakening of the United States Dollar against the relevant currency, there would be an equal and opposite impact on the profit and other equity. 10% is chosen due to the USD-ILS stability over the last 24 months.

	2018 US\$	2017 US\$
Assets less liabilities held in ILS	1,343,506	(979,856)
	10%	10%
	134,351	(97,986)

ANNUAL REPORT**NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018***Price risk*

The consolidated entity is not exposed to any significant price risk.

Interest rate risk

The consolidated entity is not exposed to any significant interest rate risk.

Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the consolidated entity. The maximum exposure to credit risk at the reporting date to recognised financial assets is the carrying amount, net of any provisions for impairment of those assets, as disclosed in the statement of financial position and notes to the financial statements. The consolidated entity does not hold any collateral. To mitigate the risk of default the consolidated entity deposits its cash with leading banks in Israel and Australia.

Generally, trade receivables are written off when there is no reasonable expectation of recovery. Indicators of this include the failure of a debtor to engage in a repayment plan, no active enforcement activity and a failure to make contractual payments for a period greater than 1 year.

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	2018	2017
	US\$	US\$
Cash and cash equivalents	2,350,084	10,665
Other receivables	204,669	162,979
Total	2,554,752	173,644

Liquidity risk

Vigilant liquidity risk management requires the consolidated entity to maintain sufficient liquid assets (mainly cash and cash equivalents) and available borrowing facilities to be able to pay debts as and when they become due and payable.

The consolidated entity manages liquidity risk by maintaining adequate cash reserves and available borrowing facilities by continuously monitoring actual and forecast cash flows and matching the maturity profiles of financial assets and liabilities.

2018:

	Interest rate %	Less than 6 months US\$	6-12 months US\$	12-18 months US\$	18-24 months US\$	2-5 years US\$	Over 5 years US\$
<i>Financial liabilities at amortised cost</i>							
Trade and other payables	--	535,922	26,340	--	--	--	--
Borrowings	4%	133,404	133,404	133,404	40,021	--	--
Total		669,326	159,744	133,404	40,021	--	--

2017:

	Interest rate %	Less than 6 months US\$	6-12 months US\$	12-18 months US\$	18-24 months US\$	2-5 years US\$	Over 5 years US\$
<i>Financial liabilities at amortised cost</i>							
Trade and other payables	--	724,871	18,302	--	--	--	--
Borrowings	4%	--	72,000	144,000	144,000	188,024	--
Total		724,871	90,302	144,000	144,000	188,024	--

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NOTES TO FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2018

NOTE 28 – SUBSEQUENT EVENTS:

Since the reporting date the following significant events have occurred:

- 15/1/2019 – Hire of 3 new personnel to strengthen R&D capabilities
- 22/1/2019 – The Company signed an exclusive agreement with CliniCann to create a global quality standard for the medicinal cannabis industry
- 4/2/2019 – The Company successfully completes seed solution testing
- 21/2/2019 - The Company introduced its new global standard for technology components, systems and devices industry. The Company presented the technology in the 4YFN conference in Barcelona
- 4/3/2019 - The Company signed a collaboration agreement with Performance Chemical division of BASF
- 22/3/19 – The Company signed a development agreement with The Perth Mint for the development of a track & trace solution for the gold value chain
- On 25 March 2019, the Company announced that it was in the process of finalising a proposed capital raising. The Company's securities were suspended from quotation on 27 March 2019 at the Company's request, pending an announcement to be made by the Company in connection with the capital raising. Further details of the capital raising will be provided in this announcement, which is expected to be made by the Company shortly. At this point in time the amount of the Capital raising is uncertain.

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DIRECTORS' DECLARATION

DIRECTORS' DECLARATION

In accordance with a resolution of the directors of Security Matters Limited, the directors of the company declare that:

1. the financial statements and notes, as set out on pages 18 to 47, are in accordance with the *Corporations Act 2001* and:
 - a. comply with Australian Accounting Standards, which, as stated in accounting policy Note 2 to the financial statements, constitutes compliance with International Financial Reporting Standards; and
 - b. give a true and fair view of the financial position as at 31 December 2018 and of the performance for the period ended on that date of the company;
2. The directors have been given the declarations required by s295A of the corporations act 2001.
3. in the directors' opinion there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable;

Signed in accordance with a resolution of directors made pursuant to section 295(5)(a) of the corporations Act 2001

Director 

Haggai Alon

Dated this29..... day of ...March..... 2019

INDEPENDENT AUDITOR'S REPORT

To the members of Security Matters Limited

Report on the Audit of the Financial Report

Opinion

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

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

- (i) Giving a true and fair view of the Group's financial position as at 31 December 2018 and of its financial performance for the year ended on that date; and
- (ii) Complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for opinion

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

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

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

Key audit matters

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

Accounting for ASX IPO Related Transactions

<i>Key audit matter</i>	<i>How the matter was addressed in our audit</i>
<p><i>Refer to Note 4 of the accompanying financial report.</i></p> <p>On 16 May 2018, Security Matters Limited was incorporated in Australia for the purposes of facilitating a listing on the ASX (Australian Stock Exchange). On 19 July 2018, Security Matters Limited acquired the shares of Security Matters (Israel) Limited, a company incorporated in Israel, through the issue of vendor shares, as consideration for the issued equity interests of Security Matters (Israel) Limited. The Directors concluded that the transaction was a continuation of the Security Matters (Israel) Limited business, in line with Australian Accounting Standards.</p> <p>Prior to the capital reorganisation, the Group issued and subsequently converted a number of Convertible Notes. The converted equity formed part of the consideration for the issued equity interests in Security Matters (Israel) Limited. The valuation of the Convertible Notes, on the date of issue and conversion, involved significant judgement.</p> <p>Given the significance of the acquisition of Security Matters (Israel) Limited, level of judgment involved in valuing the Convertible Notes and time spent by the audit team on this transaction, we determined that this was a key audit matter.</p>	<p>Our audit procedures included, amongst others:</p> <ul style="list-style-type: none"> • Reviewed the Share Swap agreement and vouched the consideration, in the form of issued vendor shares, to issued equity in Security Matters Limited. • Assessed the adequacy of the Group's accounting treatment of the capital reorganisation through consultations with our internal technical experts. • Vouched the fair value of Convertible Notes issued and converted during the year to an External Valuation report. • Reviewed the validity of the Convertible Notes valuation through the use of our internal valuation specialists. • Assessed whether the accounting treatment of Convertible Notes was in line with AASB 9 <i>Financial Instruments</i>. • Vouched capital raising costs to supporting documentation and assessed the nature of capitalised costs. • Reviewed the adequacy of the Group's issued equity and share option disclosures in the remuneration report and financial statements.

Audit Strategy for Overseas Operations

<i>Key audit matter</i>	<i>How the matter was addressed in our audit</i>
<p>The Group's corporate structure comprises significant overseas operations. The existence of such operations increases the importance of engagement with component auditors to mitigate the risk associated with delivering an audit in a location and regulatory environment other than Australia.</p> <p>Given the quantum of the overseas operations, the audit risks associated with balances in the overseas subsidiary and level of interaction between ourselves and the component auditors, we determined that this was a key audit matter.</p>	<p>Our audit procedures included, amongst others:</p> <ul style="list-style-type: none"> • Gained an understanding of the Group, its components and the environment it operates in to identify the risks of material misstatement to the Group's financial report. • Engaged the use of BDO component auditors in Israel. • Confirmed the component auditors' understanding of ethical requirements and their professional competence to ensure they were component and independent. • Maintained regular communication with the component auditors to identify issues that were significant to the Group throughout the audit process. • Assessed the susceptibility of the component's financial information to material misstatement from fraud and error. • Reviewed a sample of component auditor working papers and deliverables, in particular the areas that were key to the Group audit.

Other information

The directors are responsible for the other information. The other information comprises the information in the Group's annual report for the year ended 31 December 2018, but does not include the financial report and the auditor's report thereon.

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

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

If, based on the work we have performed, 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 the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website (<http://www.auasb.gov.au/Home.aspx>) at:

http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf

This description forms part of our auditor's report.



Report on the Remuneration Report

Opinion on the Remuneration Report

We have audited the Remuneration Report included in the directors' report for the year ended 31 December 2018.

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

Responsibilities

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

BDO East Coast Partnership

A handwritten signature in black ink that reads 'Tim Fairclough'. Above the signature, the letters 'BDO' are handwritten in a large, stylized font.

Tim Fairclough
Partner

Melbourne, 29 March 2019

ANNUAL REPORT**CORPORATE GOVERNANCE STATEMENT****Corporate Governance Statement**

The Board of Directors of Security Matters Limited (SMX or **the Company**) is responsible for the corporate governance of the Company and its subsidiaries. The Board guides and monitors the business and affairs of SMX on behalf of the Shareholders by whom they are elected and to whom they are accountable.

The table below summarises the Company's compliance with the ASX Corporate Governance Council's Principles and Recommendations.

PRINCIPLE 1 – LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

	Corporate Governance Council Recommendation	Compliance	Disclosure
1.1	<p>A listed entity should disclose:</p> <ul style="list-style-type: none"> (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. 	Complies	<p>The Board is responsible for the overall corporate governance of the Company's business.</p> <p>The Board is responsible for the overall corporate governance of the Company, including establishing and monitoring key performance goals. The Board monitors the operational and financial position and performance of the Company and oversees its business strategy including, approving the strategic goals of the Company and considering and approving an annual business plan, including a budget.</p> <p>The Board is committed to maximising performance, generating appropriate levels of Shareholder value and financial return, and sustaining the growth and success of the Company. In conducting the Company's business with these objectives, the Board seeks to ensure that the Company is properly managed to protect and enhance Shareholder interests, and that the Company, its Directors, officers and personnel operate in an appropriate environment of corporate governance. Accordingly, the Board has created a framework for managing the Company, including adopting relevant internal controls, risk management processes and corporate governance policies and practices, which it believes, are appropriate for the Company's business and which are designed to promote the responsible management and conduct of the Company.</p> <p>The Board has adopted a Board Charter to outline the manner in which its constitutional powers and responsibilities will be exercised and discharged.</p>

ANNUAL REPORT**CORPORATE GOVERNANCE STATEMENT**

			<p>The CEO is responsible for running the day to day affairs of the Company under delegated authority from the Board and to implement the policies and strategy set by the Board. In carrying out these responsibilities, the CEO must report to the Board in a timely and clear manner and ensure all reports to the Board present a true and fair view of the Company's financial condition and operational results.</p> <p>The role of management is to support the CEO and implement the running of the general operations and financial business of the Company, in accordance with the delegated authority of the Board.</p>
1.2	<p>A listed entity should:</p> <p>(a) undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a director; and</p> <p>(b) provide security holders with all material information in its possession relevant to a decision on whether or not to elect or re-elect a director.</p>	Complies	<p>(a) The Board is responsible for ensuring it is comprised of individuals who are best able to discharge the responsibilities of Directors having regard to the law and the best standards of governance.</p> <p>(b) This will necessarily include undertaking background and other checks before appointing a person or putting them forward to security holders as a candidate for election as a Director, as well as providing all material information relevant to a decision for election as a Director. The qualifications, experience and special responsibilities of the Board Members are set out in the Directors' Report of the Financial Statements for the year ended 31 December 2018.</p>
1.3	A listed entity should have a written agreement with each director and senior executive setting out the terms of their appointment.	Complies	On appointment of a Director or senior executive, the Company issues a letter of appointment setting out the terms and conditions of their appointment to the Board and Company. The Directors and senior executives have received a letter setting out the terms of their appointment.
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.	Complies	The Company Secretary is appointed by the Board and is responsible for developing and maintaining the appropriate governance systems and processes for the Board to fulfil its role and is responsible to the Board for ensuring compliance with Board procedures and governance matters. The Company Secretary is also responsible for overseeing and coordinating disclosure

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			of information to the ASX as well as communicating with the ASX. The Company Secretary is Mark Licciardo.
1.5	<p>A listed entity should:</p> <p>(a) have a diversity policy which includes requirements for the board or a relevant committee of the board to set measurable objectives for achieving gender diversity and to assess annually both the objectives and the entity's progress in achieving them;</p> <p>(b) disclose that policy or a summary of it; and</p> <p>(c) disclose as at the end of each reporting period the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity's diversity policy and its progress towards achieving them and either:</p> <p>(1) the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how</p>	Does not comply	<p>The Company does not have a separate Board approved policy on diversity, until such time as the size of SMX's operations and the Board justifies the establishment of such a policy. The Company recognises that people are its most important asset and is committed to the maintenance and promotion of workplace diversity and equal opportunity. Diversity drives the Company's ability to attract, retain and develop the best talent, create an engaged workforce, deliver the highest quality services to its customers and continue to grow the business. The Company promotes diversity through inclusive practices and behaviours for the benefit of all staff, improved employment and career development opportunities for women, and a work environment that values and utilises the contributions of all employees.</p> <p>As a measurement of gender diversity, the proportion of women employees in the entity as at 31 December 2018 are as follows:</p> <p>Women on the Board: 17%</p> <p>Women in senior executive roles: 33%</p> <p>Women in management position: 50%</p> <p>Women in the organisation: 47%</p> <p>The Company is not a relevant employer under the Workplace Gender Equality Act.</p>

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	<p>the entity has defined “senior executive” for these purposes); or</p> <p>(2) 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>		
1.6	<p>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, in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.</p>	Complies	<p>(a) SMX has adopted a performance evaluation process in relation to the Board and its Committees. The performance of the Board, its Committees and the individual Directors is subject to regular review.</p> <p>(b) Due to the Company listing in October 2018 a performance evaluation was not undertaken during this reporting period. A performance evaluation will be carried out in due course.</p>
1.7	<p>A listed entity should:</p> <p>(a) have and disclose a process for periodically evaluating the performance of its senior executives; and</p> <p>(b) disclose, in relation to each reporting period, whether a performance</p>	Complies	<p>(a) The Company’s senior executives, including the CEO, are evaluated on their performance on a yearly basis in line with the Company’s performance evaluation plan and risk management process. Agreed upon strategic objectives must be met by senior executives as part of their key performance targets. The Chief Executive Officer (CEO) then reviews the performance of the senior executives against those objectives. These reviews occur annually.</p> <p>(b) Due to the Company listing in October 2018 a performance evaluation was undertaken during the reporting period. A performance evaluation will be carried out in due course.</p>

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	evaluation was undertaken in the reporting period in accordance with that process.		
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PRINCIPLE 2 – STRUCTURE THE BOARD TO ADD VALUE

2.1	<p>The board of a listed entity should:</p> <p>(a) have a nomination committee which:</p> <ol style="list-style-type: none"> 1. has at least three members, a majority of whom are independent directors; and 2. is chaired by an independent director, and disclose the charter of the committee, the members of the committee; and 3. 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: <u>OR</u> <p>(b) if it does not have a nomination committee, disclose that fact and the</p>	Does not comply	<p>A Remuneration and Nomination Committee has not been established and the function of the Remuneration and Nomination Committee will be fulfilled by the Board having regard to the policies set in the Remuneration and Nomination Committee Charter until such time as the size of SMX's operations and the Board justifies the establishment of such a Committee. The Company shall review this position periodically.</p> <p>Remuneration levels are competitively set to attract the best qualified and experienced Directors, Key Management Personnel and senior executives appropriate to the size and stage of development of the Company.</p> <p>Details of the amount of remuneration, and all monetary and non-monetary components, for each of the Key Management Personnel during the period is included in the Directors' Report.</p>
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	processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, knowledge, experience, independence and diversity to enable it to discharge its duties and responsibilities effectively.		The Board will, as a group, give due and regular consideration to all relevant remuneration and nomination matters and will address succession issues having regard to the Company's corporate governance policies and charters.
2.2	A listed entity should have and disclose a board skills matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.	Complies in part	The Company supports the appointment of Directors who bring a wide range of business and professional skills and experience. While the Company does not have or disclose a formal skills matrix it does consider Directors' attributes prior to any appointment. The qualifications, skills, experience and expertise relevant to the position of Director held by each Director in office at the date of the Annual Report and their attendance at Board meetings is included in the Directors' Report. The Board has an extensive range of knowledge and skills with relevant experience as detailed in the Annual Report.
2.3	<p>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 Recommendations 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</p>	Complies	<p>The Directors considered by the Board to be independent are set out in the Directors' Report of the Annual Report. The Board has adopted a definition of independence based on that set out in Principle 2 of the ASX Corporate Governance Council Principles and Recommendations.</p> <p>The Board considers Non-Executive Directors, Jovanka Naumoska and Dr Gregory Clark, free from any business or any other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the independent exercise of their judgement and so each is considered an independent Director.</p> <p>The length of service for each Director is detailed in the Director's Report of the Annual Report.</p>

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	and an explanation of why the board is of that opinion; and (c) the length of service of each director.		
2.4	A majority of the board of a listed entity should be independent directors.	Does not comply	Currently only Jovanka Naumoska and Dr Gregory Clark are considered by SMX to be independent Directors. Accordingly, the majority of the Board will not be independent. The Board believes that the composition of its Board is appropriate for SMX having regard to the size and operations and skill set of the Company's Directors both individually and collectively. However the Board will periodically review the size and composition of its Board with a view to making further appointments (which may include further independent Directors) at appropriate times. The Board believes that independent judgment is achieved and maintained in respect of its decision-making processes. Furthermore, all Directors are entitled to seek independent professional advice as and when required. The Directors believe that they are able to objectively analyse the issues before them in the best interests of all shareholders and in accordance with their duties as Directors.
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.	Does not comply	The Chair of SMX is Everardus (Ed) Hofland who is an Executive Director. Given the Company's current size and its operations, SMX is of the view that Ed Hofland is the most appropriate person to lead the Company as Executive Director and Chairman, and will bring appropriate judgement to matters falling both within his scope as Chairman and as an Executive with the benefit of his long standing knowledge of, and experience in, the SMX business.
2.6	A listed entity should have a program for inducting new directors and provide appropriate professional development opportunities for directors to develop and maintain the skills and knowledge needed	Complies	The Company's induction program provides incoming Directors with information that will enable them to carry out their duties in the best interests of the Company. New Directors are encouraged to spend time with the Management team and receive information packages and documentation pertinent to the role. This includes supporting ongoing education of Directors for the benefit of the Company. SMX is committed to procuring appropriate professional development opportunities for Directors so that they may develop and maintain the skill and knowledge needed to perform their roles effectively, whether this be by informal program or otherwise. Members of the Board are able to take independent professional advice at the expense of the Company.

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	to perform their role as directors effectively.		
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PRINCIPLE 3 – ACT ETHICALLY AND RESPONSIBLY

3.1	<p>A listed entity should:</p> <p>(a) have a code of conduct for its directors, senior executives and employees; and</p> <p>(b) disclose that code or a summary of it.</p>	Complies	<p>The Board recognises the need to observe the highest standards of corporate practice and business conduct. Accordingly, the Board has adopted a Code of Conduct to be followed by all employees, contractors and officers. The Code of Conduct outlines the Company's policies on various matters including protection of confidential information, avoiding conflicts of interest, ethical conduct, business and personal conduct, privacy and financial integrity.</p> <p>A copy of the code is available on the Company's website https://www.securitymattersltd.com.</p>
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PRINCIPLE 4 – SAFEGUARD INTEGRITY IN CORPORATE**REPORTING**

4.1	<p>The board of a listed entity should:</p> <p>(a) have an audit committee which:</p> <ol style="list-style-type: none"> has at least three members, all of whom are non-executive directors and a majority of whom are independent directors; and is chaired by an independent director, who is not the chair of the board; <p>and disclose:</p>	Does not comply	<p>An Audit and Risk Committee has not been established and the function of the Committee will be fulfilled by the Board having regard to the policies set in the Audit and Risk Committee Charter until such time as the size of SMX's operations and the Board justifies the establishment of such a Committee. The Company shall review this position periodically.</p> <p>The Board will, as a group, give due and regular consideration to all relevant audit and risk matters and will address any issues having regard to the Company's corporate governance policies and charters.</p>
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	<p>3. the charter of the committee;</p> <p>4. the relevant qualifications and experience of the members of the committee; and</p> <p>(b) 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; <u>OR</u></p> <p>(c) 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 corporate reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.</p>		
4.2	<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, in their opinion, 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</p>	Complies	<p>The Chief Executive Officer and Chief Financial Officer state in writing to the Board that the Company's Financial Reports present a true and fair view, in all material respects, of the Company's financial condition and operational results and are in accordance with relevant accounting standards; and that the statement is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board.</p>

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	that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.		
4.3	A listed entity that has an AGM should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit.	Complies	The external auditors are requested to attend the Annual General Meeting and are available to answer shareholders' questions about the conduct of the audit and preparation of the Auditor's Report.

PRINCIPLE 5 – MAKE TIMELY AND BALANCED DISCLOSURE

5.1	<p>A listed entity should:</p> <p>(a) have a written policy for complying with its continuous disclosure obligations under the Listing Rules; and</p> <p>(b) disclose that policy or a summary of it.</p>	Complies	<p>The Company has adopted a Disclosure and Communication Policy to ensure it complies with the continuous disclosure regime under the ASX Listing Rules and the Corporations Act 2001. The Company's Communication and Disclosure Policy is available on the Company's website https://www.securitymattersltd.com.</p>
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PRINCIPLE 6 – RESPECT THE RIGHTS OF SECURITY HOLDERS

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6.1	A listed entity should provide information about itself and its governance to investors via its website.	Complies	The Company's Disclosure and Communication Policy outlines the shareholder communications protocols which the Company has adopted. The Company uses its website (https://www.securitymattersltd.com), annual report, market disclosures and media announcements to communicate with its shareholders, as well as encourages participation at general meetings.
6.2	A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors.	Complies	<p>The Company is committed to:</p> <ul style="list-style-type: none"> • ensuring that shareholders and the financial markets are provided with full and timely information about the Company's activities in a balanced and understandable way through the annual and half yearly reports, ASX releases, general meetings and the Company's website https://www.securitymattersltd.com; • actively responding to shareholder's direct enquiries; • complying with continuous disclosure obligations contained in the applicable ASX Listing Rules and the Corporations Act in Australia; and • encouraging shareholder participation at general meetings.
6.3	A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.	Complies	The Board encourages full participation of shareholders at the Company's annual general meetings and any general meetings to ensure a high level of accountability and identification with the Company's strategy. The external auditor will also be invited to attend the annual general meeting of shareholders and will be available to answer any questions concerning the conduct, preparation and content of the auditor's report.
6.4	A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.	Complies	The Company's registrar, Boardroom, provides the option for shareholders to receive and send communications electronically.

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PRINCIPLE 7 – RECOGNISE AND MANAGE RISK

7.1	<p>The board of a listed entity should:</p> <p>(a) have a committee or committees to oversee risk, each of which:</p> <p>(1) has at least three members, a majority of whom are independent directors; and</p> <p>(2) is chaired by an independent director, and disclose the charter of the committee; the members of the committee; and</p> <p>(3) 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; <u>OR</u></p> <p>(4) if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the processes it employs for overseeing the entity's risk management framework.</p>	Does not comply	<p>An Audit and Risk Committee has not been established and the function of the Committee will be fulfilled by the Board having regard to the policies set in the Audit and Risk Committee Charter until such time as the size of SMX's operations and the Board justifies the establishment of such a Committee. The Company shall review this position periodically.</p> <p>Ultimate responsibility for risk oversight and risk management rests with the Board. The identification and proper management of the Company's risks are an important priority of the Board. The Board has adopted a Risk Management Policy appropriate for its business, which will ensure appropriate systems are implemented to identify material risks that may impact on the Company's business and delegate appropriate responsibilities to control any identified risk. The Policy will also ensure that any material changes to the Company's risk profile will be disclosed in accordance with the Company's Disclosure and Communication Policy.</p> <p>The Board will be responsible for overseeing and approving the Company's risk management strategy and policies, monitoring risk management, and establishing procedures, which seek to provide assurance that major risks to the business are identified, assessed and appropriately addressed, recognising however that no cost effective internal control system will preclude all errors and irregularities.</p> <p>The Board has also received written assurances from the Chief Executive Officer and Chief Financial Officer that to the best of their knowledge and belief:</p>
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CORPORATE GOVERNANCE STATEMENT

			<ul style="list-style-type: none"> The Company's financial statements present a true and fair view of the Company's financial condition and operational results, and comply with relevant accounting standards; and The risk management and internal compliance and control systems are sound, appropriate and operate effectively, and implement the policies adopted by the Board.
7.2	<p>The board or a committee of the board should:</p> <p>(a) review the entity's risk management framework at least annually to satisfy itself that it continues to be sound; and</p> <p>(b) disclose, in relation to each reporting period, whether such a review has taken place.</p>	Complies	<p>(a) The Board reviews and oversees the operation of systems of risk management to ensure that the significant risks facing the Company are identified, that appropriate control, monitoring and reporting mechanisms are in place and that risk is appropriately dealt with.</p> <p>(b) During the period under review individual components of the risk management framework were reviewed by the Board, which recommended further development by management was required for reassessment during the forthcoming financial year.</p>
7.3	<p>A listed entity should disclose:</p> <p>(a) if it has an internal audit function, how the function is structured and what role it performs; OR</p> <p>(b) if it does not have an internal audit function, that fact and the processes it employs for evaluation and continually improving the effectiveness of its risk management and internal control processes.</p>	Complies in part	The Company does not have an internal audit function. The Board works closely with the Management Team to identify and manage operational, financial and compliance risks which could prevent the Company from achieving its objectives. The Board actively encourages the External Auditor to raise internal control issues, and oversees management's timely remediation thereof.
7.4	A listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability	Complies	<p>The Company has identified key risks within the business. In the ordinary course of business, management monitor and manage these risks.</p> <p>Key operational and financial risks are presented to and reviewed by the Board.</p>

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CORPORATE GOVERNANCE STATEMENT

	risks and, if it does, how it manages or intends to manage those risks.		
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PRINCIPLE 8 – REMUNERATE FAIRLY AND RESPONSIBLY

8.1	<p>The board of a listed entity should:</p> <p>(a) have a remuneration committee which:</p> <p>(1) has at least three members, a majority of whom are independent directors; and</p> <p>(2) is chaired by an independent director, and disclose:</p> <p>(3) the charter of the committee;</p> <p>(4) the members of the committee; and</p> <p>(5) 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; <u>OR</u></p> <p>(b) 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</p>	Does not comply	<p>A Remuneration and Nomination Committee has not been established and the function of the Remuneration and Nomination Committee will be fulfilled by the Board having regard to the policies set in the Remuneration and Nomination Committee Charter until such time as the size of SMX's operations and the Board justifies the establishment of such a Committee. The Company shall review this position periodically.</p> <p>Remuneration levels are competitively set to attract the best qualified and experienced Directors and Key Management Personnel appropriate to the size and stage of development of the Company.</p> <p>Details of the amount of remuneration, and all monetary and non-monetary components, for each of the Key Management Personnel during the period is included in the Directors' Report.</p> <p>The Board will, as a group, give due and regular consideration to all relevant remuneration and nomination matters and will address succession issues having regard to the Company's corporate governance policies and charters.</p>
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	ensuring that such remuneration is appropriate and not excessive.		
8.2	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.	Complies	The details of the remuneration paid to Directors and Officers is included in the Remuneration Report section of the Annual Report.
8.3	<p>A listed entity which has an equity-based remuneration scheme should:</p> <p>(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</p> <p>(b) disclose that policy or a summary of it.</p>	Complies	In accordance with SMX's share trading policy, participants in any equity based incentive scheme are prohibited from entering into any transaction that would have the effect of hedging or otherwise transferring the risk of any fluctuation in the value of any unvested entitlement in SMX's securities to any other person. A copy of the Policy for dealing in securities is available on the Company's website https://www.securitymattersltd.com .

Unless otherwise indicated, SMX's corporate governance practices were in place for the financial year ended 31 December 2018 and to the date of signing the Directors' Report.

Various corporate governance practices are discussed within this statement. For further information on corporate governance policies adopted by the Company, refer to our website <https://www.securitymattersltd.com>.

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Additional information required by the ASX Limited Listing Rules not disclosed elsewhere in this Annual Report is set out below. The shareholder information set out below was applicable as at March 7 2019.

Number of holders of Equity SecuritiesOrdinary shares

97,500,001 Ordinary share are held by 542 individual shareholders.

All ordinary shares carry one vote per share and the right to dividend.

Options to shares

33,321,157 Options to shares are held by 32 individual Option-holders.

Option holders do not have the right to vote.

Distribution schedule

Holdings Ranges	Number of holders of Ordinary Shares	Number of holders of Ordinary Shares ASX Escrowed 12 months	Number of holders of Ordinary Shares ASX Escrowed 24 months	Number of holders of Options over Ordinary Shares
1-1,000	18	0	0	0
1,001-5,000	126	0	0	0
5,001-10,000	134	0	0	0
10,001-100,000	175	16	1	2
100,001-9,999,999,999	71	11	8	30
Totals	524	27	9	32

Holding less than a marketable parcel- 12

Twenty largest shareholders

Fully paid ordinary shares & Fully paid ordinary shares voluntarily escrowed

Name	Balance	%
DEGANIA A BUSINESS AGRICULTURAL COOPERATIVE SOCIETY LTD	5,141,019	9.50%
CAPE BOUVARD EQUITIES PTY LTD	4,000,000	7.39%
KIBBUTZ KEFAR GLIKSON HOLDINGS ACS	2,655,530	4.91%
KIBBUTZ KETURA ACS	2,437,458	4.50%
KIBBUTZ YIZRAEL HOLDINGS 2004 ACS	2,124,815	3.93%
KIBBUTZ MAGEN ACS	2,124,815	3.93%
HAROLD CHARLES MITCHELL	1,500,000	2.77%
KAFRIT INDUSTRIES (1993) LTD	1,311,868	2.42%
ALARA PTY LTD <ALARA INVESTMENTS FUND A/C>	1,250,000	2.31%
FRALARA PTY LTD <FRAID ALARA FAMILY A/C>	1,250,000	2.31%
CERATONE PTY LTD <EXISTANT RETIREMENT S/F A/C>	1,000,000	1.85%
DAVFT PTY LTD <DAVENPORT FAMILY A/C>	1,000,000	1.85%
BENGUY ESCROW COMPANY LIMITED <THE NACRE A/C>	999,865	1.85%
HSBC CUSTODY NOMINEES	979,707	1.81%
MR JEREMY EDOUARD MALAI	826,408	1.53%
SECURITY MATTERS INVESTMENT LLC	772,838	1.43%
DAVFT LIMITED <DAVENPORT FAMILY A/C>	750,000	1.39%
NILCAN FINANCE LTD S.A.R.L	700,000	1.29%
MAHAM FASTENERS LTD	695,034	1.28%
DORON AFIK	672,736	1.24%
Total Securities of Top 20 Holdings	32,192,093	59.48%
Total number of Securities	54,126,645	

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ADDITIONAL ASX INFORMATION

Substantial holders

Substantial Shareholders	Balance as at 07-03-2019	%
Kibbutz Ketura ACS Ltd	20,242,081	20.76%
Degania A Business Agricultural Cooperative Society Ltd	10,544,617	10.78%
Benguy Escrow Company Ltd	6,564,328	6.73%

Restricted Securities

As at March 7 2019 the following securities are subject to escrow:

The number and class of restricted securities or securities subject to voluntary escrow on issue	Number
Fully Paid Ordinary Shares Voluntary Escrow 12 Months from 27 June 2018	2,378,570
Fully Paid Ordinary Shares Voluntary Escrow 24 Months from Quotation	15,726,673
Fully Paid Ordinary Shares ASX Escrowed 12 Months from Issue	3,265,603
Fully Paid Ordinary Shares ASX Escrowed 24 Months from Quotation	40,107,753
Options over Ordinary Shares Expiring 5 Years ASX Escrowed 24 Months from IPO	19,755,035
Options over Ordinary Shares Expiring 1 September 2023 Voluntary Escrow 2 Years from IPO	6,540,759
Options over Ordinary Shares Expiring 5 Years from IPO Date Voluntary Escrow 24 Months	1,510,070
Options over Ordinary Shares Expiring 3 Years from IPO ASX Escrow 2 Years from IPO	5,515,293

Unquoted equity securities

The following holders hold 20% or more of unquoted equity securities

<i>Fully Paid Ordinary Shares ASX Escrowed 24 Months from Quotation</i>	Number
ENERGY KETURA COOPERATIVE AGRICULTURAL SOCIETY LTD	17,804,623
<i>Options Expiring 5 Years ASX Escrowed 24 Months from IPO</i>	
SECURITY MATTERS INVESTMENT LLC	5,000,000
BENGUY ESCROW COMPANY LTD	5,000,000
KIBBUTZ KETURA ACS	5,000,000
<i>Options Expiring 5 Years from IPO Date Voluntary Escrow 24 Months</i>	
LEON KEMPLER	755,035
MR JOHN POYNTON	755,035
<i>Options Expiring 3 Years from IPO ASX Escrow 2 Years from IPO</i>	
GNAT PTY LTD <G & N INVESTMENT A/C>	3,350,000

On market buy back

There is currently no on-market buy-back.

Voting rights

The voting rights attached to ordinary shares are set out below:

On a show of hands every member present at a meeting in person or by attorney, proxy or by representative shall have one vote and upon a poll each share shall have one vote