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DRONESHIELD

@DroneShield
www.droneshield.com
ABN 26 608 915 859

Appendix 4E
For the year ended 31 December 2017

DroneShield Limited
ABN 26 608 915 859

1. Reporting period

The financial information contained in the attached consolidated financial report is for the year ended 31 December 2017. The previous corresponding period was the year ended 31 December 2016.

Results for announcement to the market				
	Up/ Down	% Movement		2017 $
Revenue from continuing activities	Up	268%	to	310,724
Loss from continuing activities after tax attributable to members	Up	11%	to	(5,476,613)
Net loss attributable to members	Up	11%	to	(5,476,613)
Dividends: No dividends are being proposed or have been paid	Nil	Nil		Nil

Additional information:

2. Commentary related to the above results

Refer to Directors Report in the attached Annual Report.

3. Net Tangible Assets/(Liabilities) per share:

31 December 2017: $0.02; 31 December 2016: $0.03

4. There was no change of control during the year

5. There were no payments of dividends during the year

6. There is no dividend reinvestment plan in operation

7. There are no associates or joint venture entities

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

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

DRONESHIELD

Annual Report

For the Year Ended
31 December 2017

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Image: DroneShield's DroneGun Tactical Product

DroneShield Limited (ASX:DRO)
ASX Release
ABN 26 608 915 859

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Corporate Information

Directors & Management

Peter James Independent Non-Executive Chairman
Oleg Vornik CEO and Managing Director
Robert Clisdell Non-Executive Director
Bradley Buswell Independent Non-Executive Director

Registered Office

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Australia

Telephone: +61 2 9995 7280

Email: info@droneshield.com
Website: www.droneshield.com

Auditors

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Level 19, 207 Kent Street
Sydney, NSW 2000
Australia

Bankers

Commonwealth Bank of Australia
Level 21, 201 Sussex Street
Sydney, NSW 2000
Australia

PNC Bank
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Solicitors

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267 St Georges Terrace
Perth WA 6000
Australia

Enquiries (within Australia): 1300 288 664
Enquiries (outside Australia): +61 8 9324 2099

Stock Exchange Listing

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

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Chairman's Review

Dear Fellow Shareholders,

The 2017 financial year continued the strong momentum for DroneShield Limited ("DroneShield" or "the Company"), following its listing on the ASX in June 2016.



Peter James, Independent Non-Executive Chairman

The Company continued to build out its world leading suite of cutting-edge counter-drone products. In response to end-user requirements, in the second half of the year, DroneShield launched DroneGun MKII and, subsequent to year end, DroneGun Tactical. Both are innovative portable rifle-shape jammers, covering a broad range of tactical environments and uses. The Company also launched DroneSentinel and DroneSentry in the second half of the year. DroneSentinel is a unique modular drone detection system incorporating radar, radiofrequency, and thermal and optical camera sensors, as well as the patented acoustic detection technology that is at the genesis of DroneShield. All of the detection components of DroneSentinel are also available as standalone products. DroneSentry is a detect-and-defeat product, which incorporates all of these detection capabilities and pairs them up with a jamming capability.

DroneShield also made significant sale and marketing progress during the year. Its sales, installations and test deployments during, or shortly after the end of, the year included those to/with the Boston Marathon (for a third straight year), the Hawaii IRONMAN, the World Economic Forum, NATO militaries, and a competitive Paraguay government tender. DroneShield has a significant sales pipeline. It is participating in a number of trials and procurement processes across military, law enforcement and critical infrastructure customers in the United States, Australia, NATO countries and elsewhere. Its pipeline includes active engagement with dozens of potential end-users, with the size of each potential order ranging between hundreds of thousands of dollars and tens of millions of dollars[1]. Most recently, the Company announced its participation in the 2018 Urban 5th Generation Marine Exploration and Experimentation Exercise ('U5G') and the U.S. Special Operations Command SOFWERX ThunderDrone. During the year, DroneGun was certified by the French military as safe for human use as part of their procurement process, and compliant for human exposure under Australian and New Zealand Communications and Media Authority requirements, as part of an Australian procurement process.



Major General Kathryn Toohey (Head of Land Capability of the Australian Army) with DroneGun MKII

The Company continued its active engagement with the Australian and the United States governments, and recently applied for several high-value R&D grants in both countries. It recently received its first R&D Tax Incentive Grant from the Australian Government. DroneShield was also selected to be a part of Team Defence Australia ('TDA') for the high profile DSEI (London) and AUSA (Washington DC) military exhibitions. TDA is a joint effort with the Australian Department of Defence and Austrade.

The Company continues to work with its third-party partners across its sales partner network in approximately 50 countries, as well as its R&D and manufacturing partners to complement its in-house team, optimising its capital expenditure. The Company successfully completed two rounds of funding during the year, as well receiving additional capital through exercise of its listed options.

DroneShield's developments come against the rapidly increasing backdrop of terrorist organisations increasing the sophistication and frequency of use of consumer and commercial grade drones for nefarious purposes. The military market is expected to continue to be an important market segment for the Company going forward, and the



ISIS propaganda video using a drone

[1]Not all (and there can be no assurance that any) of these sales opportunities will result in sales.

Company is well positioned for the military markets as it is participating in a number of tenders, and its products are undergoing a number of evaluations at present.

DroneShield continues to attract a significant amount of media interest globally, including coverage by Channel 7 and Commsec TV, ABC and 2GB radio in Australia; and CBS, NBC and Fox News in the US.

In October 2017, DroneShield engaged Mesirow Financial, a 600-person U.S. investment bank with a specialty in aerospace and defence, in order to explore strategic options, in response to large defence companies expressing interest in a partnership with the Company. Several parties have now signed confidentiality agreements and proceeded into subsequent rounds of discussions.

On behalf of the Board I would like to thank our Executive team for their significant contributions this year.

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



Peter James

Independent Non-Executive Chairman

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About DroneShield

Based in Sydney, Australia and Virginia, United States of America, DroneShield is a leader in drone security technology. The company has developed drone security solutions that protect people, organisations and critical infrastructure from the intrusion of drones. Its team includes professionals with world-class expertise in engineering and physics, combined with substantial experience in government, defence and intelligence.

History of DroneShield

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

DroneShield Limited listed on the ASX on 22 June 2016, raising $7m through the issue of 35 million shares at $0.20 per share in an oversubscribed initial public offer ('IPO'). It subsequently raised $1.25m through a placement and Share Placement Plan ('SPP') in June 2017 and a further $2.32m in a placement in October 2017. Further funding was raised in early 2017 through exercise of some of the listed DROO options, which were issued as part of the IPO.

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

Business Model

Affordable consumer-grade drones have become popular around the world, but they present unique and frequent threats to privacy, physical security and public safety in a wide variety of environments. DroneShield's distribution channels focus on third party distributors, as well as direct relationships with various key customers, such as the various branches of the United States military. With offices in Australia and the United States, DroneShield has an experienced salesforce with approximately 60 distribution partners across 50 countries. The ultimate end-users and potential end-users of DroneShield's products come from a diverse array of global sectors, including the following:

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

DroneShield offers a comprehensive solution to drone threats with a suite of detection and countermeasure products. DroneShield's products are readily available and it offers one of the few commercially available and affordable solutions to the worldwide threat caused by consumer grade drones.

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

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Detection

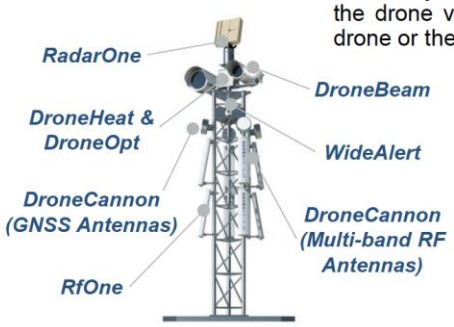
- ✓ Detects drones using an advanced, highly effective multi-sensor detection system (Radar, RF, Acoustic and Optical / Thermal)
- ✓ High detection rates versus other methods and is available in a low-profile system
- ✓ Provides real-time alerts and offers digital evidence collection
- ✓ Easy integration into existing security systems / platforms

Countermeasures

- ✓ DroneShield offers effective, tactical drone countermeasure capabilities
- ✓ Portable solution – DroneGun – can be carried by a single person
- ✓ Long-range accuracy and effectiveness – can be used against drones with an effective range over 2km (the most powerful ratios of a portable product on the market)
- ✓ Offers safe, "soft-kill" countermeasure capabilities that can safely return a drone to its starting point or descend the drone vertically on the spot without damaging the drone or the surrounding environment



DroneSentinel
Integrated Drone Detection



DroneSentry
Automatic Detection & Countermeasure



DroneGun
Countermeasure

Environment

The overall global demand for drone detection and mitigation products continued to increase through 2017 and into 2018, against the backdrop of a nearly daily barrage of news about drone threats.

Dozens of high profile incidents and concerns took place during the year and subsequent to its end. One can read about some of these at https://www.droneshield.com/press-coverage and https://twitter.com/DroneShield.

The urgency of the "drone issue" became particularly evident following the September 26, 2017 testimony by the FBI Director Christopher Ray and the Director of the National Counterterrorism Center ('NCC') Nicholas Rasmussen to the US Senate Committee on Homeland Security and Governmental Affairs, in which the FBI Director stated that terrorist drones were *"…coming here imminently"* and the NCC Director stated that *"two years ago this wasn't a problem, one year ago it was an emerging problem, and now it's a real problem."*



Image: FBI director Christopher Wray and Nicholas Rasmussen, Director of the NCC testify on drone threats before the U.S. Senate Committee on Homeland Security & Governmental Affairs in Washington on September 26, 2017

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Examples of recent relevant incidents and concerns, public statements by officials, and media coverage about relevant issues include the following:

- In May 2017 General Raymond Thomas, head of U.S. Special Operations Command, said small ISIS drones were the "most daunting threat" his troops faced in Iraq and Syria in 2016. He recalled once during the battle for Mosul when the coalition forces' "effort nearly came to a screeching halt" because the sky was filled with buzzing robotic aircraft. "At one point there were 12 killer bees, if you will, right overhead… and our only available response was small arms fire."

- In July 2017, a South Carolina inmate broke out of a maximum-security prison using wire cutters that were apparently flown in by drone, officials said Friday, "describing a new and devilishly hard-to-stop means of escape".

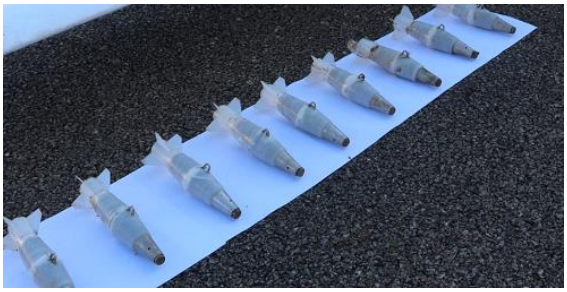
- The Washington Examiner reported a former Secret Service agent stating drone "swarm attacks" posing "grave threat" to President Trump. Terrorists have considered drones "for a long time," and "the real threat comes from the more spectacular swarm attacks."

- In September 2017, Australian Financial Review reported Australian Senator Barry O'Sullivan, a former air crash investigator, saying that a collision between an aircraft and a drone is a "catastrophe waiting to happen" and that "we must get out in front of this so we can restore, as best we can, air safety."

- The same month, a drone hit a U.S. Army helicopter over New York. "As that drone came apart, a piece of it was right at the bottom of the main rotor system… which is very distressing that something would be able to get in there. And that has always been the thing that we worry about constantly."

- In late 2017, a swarm of 13 homemade, presumably ISIS, drones simultaneously attacked two Russian military installations in Syria - an air base and a naval installation.





Images: homemade drones that attacked the Russian Air Force base in Syria in early January, including apparent 3D printed explosive payloads

- In October 2017, footage uploaded to YouTube reportedly showed an armed ISIS drone destroying an arms depot in northern Syria.

- In November 2017, the U.S. Department of Homeland Security issued a terror bulletin focusing on the threat of weaponized drones.

- Earlier in 2017, the United States Federal Aviation Administration (the FAA) banned drone flights over 133 domestic U.S. military facilities. Nevertheless, unauthorized drone flyovers over domestic U.S. military installations continue to be reported.

- Turkish security forces have seized Kurdish militants' bomb-laden drone.

- The FAA barred drone flights over seven major U.S. nuclear sites, including the Los Alamos National Laboratory in New Mexico. The new restrictions include the Hanford Site in Washington State, Idaho National Laboratory, Savannah River National Laboratory in South Carolina, Pantex Site in Texas and the Y-12 National Security Site and Oak Ridge National Laboratory in Tennessee.

- A high number of near misses whereby drones narrowly avoided colliding with aircraft continue to be reported globally, with experts warning of deadly consequences in a collision. Recently, these included:
    - A drone struck a passenger Boeing plane descending over theme park in Argentina.
    - A drone hit a commercial aircraft in Canada.
    - A drone and an airliner collided in Canada.
    - The Ben Gurion Airport in Israel halted traffic as a drone was spotted shortly after the United States Vice President Mike Pence disembarked from Air Force Two at the airport during a state visit.
    - A man in New Zealand was charged over the use of a drone which grounded eight helicopters involved in fighting an out-of-control fire.
    - A plane missed a drone by "three seconds" over Glasgow.
    - Multiple near misses between planes and drones at Edinburgh airport.

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  - The Sao Paolo Congonhas airport was shut down for two hours due to a drone scare.
  - Close encounters between planes and drones were reported at an Alabama airport.
  - Drones were reported to have impeded California firefighting efforts.
  - A drone prompted a diversion of an Arkansas wildfire surveillance plane.

- A man was arrested for flying drones to drop leaflets over NFL games.

- Ongoing multiple reports of drones delivering contraband into prisons continue, around the world, including reports from Lithgow Correctional Centre (NSW), Arizona, Georgia, Northern California and South Carolina (U.S.) and British Columbia (Canada).

- The United States Deputy Attorney General Rod J. Rosenstein told the American Correctional Association's conference in Orlando in early January 2018, "In the old days, cell phones and other contraband items entered our facilities through the doors, or the loading docks, in some cases, they were thrown over the fence. Today, we face another technological threat: drones that can fly contraband into jail and prison yards."[2]

- The U.S. border protection agents were reported to have spotted 13 drones suspected of carrying drugs across one section of the U.S.-Mexico border in just one four-day period in November 2017.

Market Position

DroneShield is a leader in the drone security market for the following reasons.

- Most of the purported anti-drone products remain "vapourware" – products that have not progressed beyond an idea or a prototype. DroneShield is shipping products and has made early sales.

- DroneShield has a substantial marketing and distribution network lead in the industry.

- The Company is addressing what is believed to be a US$12 billion+ addressable market, with hundreds of thousands of potential user installations.

- DroneShield is one of the very few providers of both detection and countermeasures. DroneShield is believed to be the only provider of both detection and rifle-shaped "soft kill" countermeasures, which appeal to the military and the law enforcement markets. Most competing or purportedly competing products, prototypes and ideas provide detection or countermeasures but not both. The effectiveness of detection is limited without countermeasures, and countermeasures cannot be deployed in most circumstances without drones having first been detected.

- DroneShield's customers and potential customers favour the effectiveness of DroneShield's products. Its products are not time of day or season-dependent, do not rely on line of sight or visibility, are passive to the surrounding environment, and cover most major commercial drone models (including frequency hoppers).

- As DroneShield is an Australian company with meaningful U.S. operations, its origin is a positive factor in the decision-making process by allied country users, especially government users.

- DroneShield is prominently positioned as an Australian defence contractor, having been part of Team Defence Australia at the DSEI and AUSA pre-eminent military conferences in 2017, and having engaged in active dialogue with Austrade and Centre for Defence Industry Capability (CDIC).



Image: The Honourable Christopher Pyne, Australian Minister for Defence Industry with DroneGun MKI

- DroneShield's products are materially cheaper than most competing detection products that are being marketed (particularly, systems being marketed by larger defence contractors) and are in fact capable of being delivered.

- DroneShield is participating in a number of tenders, and its products are undergoing a number of evaluations at present. While some of these are undertaken by governments on accelerated procurement timelines, because of the urgency of the drone problem, these nonetheless take time, and DroneShield has now completed a significant part of the tender procurement processes in number of the processes in its pipeline.

- Safety certifications further underpin the Company's position through the Government tenders.

[2] https://www.washingtonpost.com/world/national-security/justice-dept-scrambles-to-jam-prison-cellphones-stop-drone-deliveries-to-inmates/2018/01/08/42492896-f4a0-11e7-b34a-b85626af34ef_story.html?utm_term=.9c50dc0820d2

Board of Directors and Executives



Peter James; Independent Non-Executive Chairman

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

Mr. James has recently completed 12 years as a Non-Executive Director for ASX-listed iiNet; Australia's second largest DSL Internet Services Provider, chairing iiNet's Strategy and Innovation Committee. iiNet was recently acquired by TPG Telecom for $1,560,000,000.

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



Oleg Vornik; CEO and Managing Director

Mr. Vornik is an experienced senior executive with investment banking and treasury experience at the Royal Bank of Canada, Leighton Contractors, Brookfield, Deutsche Bank and ABN AMRO.

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

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



Bradley Buswell; Independent Non-Executive Director

Mr. Buswell has extensive experience leading businesses and U.S. government agencies in the defence and homeland security domains. He was president of the North Americas division of Rapiscan Systems, Inc., and Chief Executive Officer of Morpho Detection, Inc., both world leaders in state of the art security screening products, services and solutions.

Mr. Buswell also served at the U.S. Department of Homeland Security as the first Deputy Under Secretary for Science and Technology where he led the development of technologies in support of DHS operating components. He was the acting Undersecretary during the first year of the Obama administration. He also served over 20 years as a nuclear submarine officer in the U.S. Navy in a variety of assignments at sea and ashore.

Mr. Buswell graduated from the U.S. Naval Academy with a Bachelor of Science in Systems Engineering, and the George Washington University with a Master of Business Administration. Mr. Buswell does not hold any other public company directorships.

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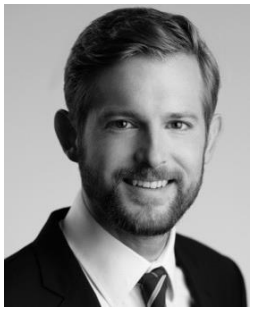
Robert Clisdell; Non-Executive Director

Mr. Clisdell is based in Sydney and is the Vice-President at Bergen Capital (Australia) Ltd, an affiliate of the Company's largest shareholder. Prior to Bergen, Mr. Clisdell worked in the middle market corporate advisory practice for Credit Suisse's Private Bank in Melbourne. Prior to Credit Suisse, Mr. Clisdell was an M&A banker with Caliburn Partnership (now Greenhill & Co.) in Sydney, and worked in Equity Capital Markets at Ord Minnett Corporate Finance.

Mr. Clisdell began his career with Arthur Anderson and qualified as a Chartered Accountant in 2005. He holds a Bachelor of Commerce from the University of Sydney and a Graduate Diploma in Applied Finance from FINSIA. Mr. Clisdell joined the Board of DroneShield on 24 January 2017. Mr. Clisdell does not hold any other public company directorships.



John Franklin; Chief Scientist

Mr. Franklin is one of DroneShield's co-founders. Mr. Franklin holds an MSc in Applied and Computational Math from John Hopkins University.

Previously, Mr. Franklin was a member of the research staff at the Air and Missile Defense Sector at Johns Hopkins University Applied Physics Laboratory, and Adjunct Research Associate (Science and Technology Division) at the Institute for Defense Analyses.



Simon Woodward; Chief Technology Officer

Mr. Woodward previously held a number of high profile technical and engineering roles in communications and banking industries in Australia and Europe. He was also the founder of several businesses including Wholesale Communications Group, which rapidly become the largest non-retail telecommunications provider in Australia before being acquired by ASX-listed M2 Group Limited (ASX:MTU).

Mr. Woodward's previous projects include leading the architecture and implementation of a nation-wide telecommunication network across the challenging landscape of the Solomon Islands, and development and support of large scale transactional processing engines handling billions of records a day. Mr. Woodward has studied Material Engineering, Physics, IT and Computer Science at the University of Wollongong and is certified in PRINCE2 project management.



Claire Newey; Chief Financial Officer

An experienced Chartered Accountant, Ms. Newey has 12 years of international financial reporting, management and advisory experience, across public and private companies spanning various industries.

Ms. Newey is a Member of the Institute of Chartered Accountants of England and Wales and holds a BSc (Hons) from the University of Edinburgh and an MSc from LSHTM.

Ms. Newey was appointed Chief Financial Officer at DroneShield on 24 January 2017, following a role as the Group's Financial Controller.



Alistair McKeough; Company Secretary

Mr. McKeough is a Solicitor and is Managing Director of Whittens & McKeough, a Sydney based law firm specialising in corporate and commercial law. Mr. McKeough is an experienced company secretary, having served in that role for numerous public companies. Mr. McKeough was appointed Company Secretary of DroneShield on 28 November 2017.

Mr. McKeough holds a BA (English and History) from the University of Sydney and an LLB and LLM from the University of New South Wales.

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Corporate Governance Statement

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

To the extent relevant and practical, the Company has adopted a corporate governance framework that is consistent with *The Corporate Governance Principles and Recommendations (3rd Edition)* as published by ASX Corporate Governance Council ("**Recommendations**").

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

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

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

The Company is pleased to report that its practices are largely consistent with the Recommendations of the ASX Corporate Governance Council and sets out below its compliance and departures from the Recommendations for the year ended 31 December 2017.

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

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

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PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
Recommendation 1.2 A listed entity should: (a) undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a Director; and (b) provide security holders with all material information relevant to a decision on whether or not to elect or re-elect a Director.	YES	(a) The Company's Corporate Governance Plan requires the Board to undertake appropriate checks as to the character, experience, education, criminal record and bankruptcy history of the candidate before appointing a person, or putting forward to security holders a candidate for election, as a Director. During the 2017 Financial Year the Company undertook the appropriate checks prior to the appointments of the Directors of the Company. (b) All material information relevant to a decision on whether to elect or re-elect a Director will be provided to security holders in any notice of meeting pursuant to which the resolution to elect or re-elect such Director will be voted on.
Recommendation 1.3 A listed entity should have a written agreement with each Director and senior executive setting out the terms of their appointment.	YES	Each Director and senior executive of the Company is party to a written agreement with the Company which sets out the terms and conditions of that Director's or senior executive's appointment.
Recommendation 1.4 The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.	YES	The Board Charter outlines the role, responsibility and accountability of the Company Secretary. The Company Secretary is accountable directly to the Board, through the Chair, on all matters relating to the proper functioning of the Board. The Chairman and the Company Secretary co-ordinate the Board agenda.
Recommendation 1.5 A listed entity should: (a) have a diversity policy which includes requirements for the board or a relevant committee of the board: (i) to set measurable objectives for achieving gender diversity; and (ii) to assess annually both the objectives and the entity's progress in achieving them; (b) disclose that policy or a summary or it; and (c) disclose as at the end of each reporting period: (i) 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 (ii) either: (A) the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined "senior executive" for these purposes); or (B) if the entity is a "relevant employer" under the Workplace Gender Equality Act, the entity's most recent "Gender Equality Indicators", as defined in the Workplace Gender Equality Act 2012.	YES YES NO	(a) The Company has adopted a Diversity Policy which identifies gender diversity as a key area of focus for the Company. However, given the current size of the Company, the Board has determined that the benefits of the initiatives recommended by the ASX Corporate Governance Council in this regard are disproportionate to the costs involved in the implementation of such strategies. Accordingly, the Board has elected to adopt a tiered approach to the implementation of its Diversity Policy which is relative to the size of the Company and its workforce, such that: - Where the Company employs 20 or more employees, the Board will adopt practices in line with the Recommendations. - While the Company's workforce remains below this threshold, the Board will continue to drive the Company's diversity strategies on an informal basis and will apply the initiatives contained in the Diversity Policy to the extent that the Board considers relevant and necessary. (b) A copy of the Company's Diversity Policy is contained in its Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors (c) (i) As the Company did not employ 20 or more employees during the 2017 Financial Year, the Company did not formally define a set of measurable gender diversity objectives; (ii) During the reporting period (i.e. the year ended 31 December 2017), the respective proportions of men and

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<table>
<tr><th>PRINCIPLES AND RECOMMENDATIONS</th><th>COMPLY (YES/NO)</th><th>EXPLANATION</th></tr>
<tr><td></td><td></td><td>women in the following roles were as follows:<table><tr><td></td><td>Men</td><td>Women</td></tr><tr><td>Board</td><td>75%</td><td>25%</td></tr><tr><td>Senior executives</td><td>85%</td><td>15%</td></tr><tr><td>Across the whole organisation</td><td>85%</td><td>15%</td></tr></table></td></tr>
<tr><td>Recommendation 1.6
A listed entity should:
(a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual Directors; and
(b) disclose in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.</td><td>YES

YES</td><td>(a) The performance of the Board as a group and of individual Directors will be assessed each year for all future years. The Remuneration Committee (the function of which is currently performed by the full Board) is responsible for evaluating the performance of the Board and individual Directors on an annual basis. The process for this is set out in the Company's Performance Evaluation Procedures policy which is contained in its Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.
(b) The Board undertook an evaluation of Board performance in early 2017.</td></tr>
<tr><td>Recommendation 1.7
A listed entity should:
(a) have and disclose a process for periodically evaluating the performance of its senior executives; and
(b) disclose in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.</td><td>YES

YES</td><td>(a) The Remuneration Committee (the function of which is currently performed by the full Board) is responsible for evaluating the performance of senior executives on an annual basis. The process for this is set out in the Company's Performance Evaluation Procedures policy which is contained in its Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.
(b) A formal performance evaluation of senior executives was undertaken during the 2017 financial year.</td></tr>
<tr><td colspan="3">Principle 2: Structure the board to add value</td></tr>
<tr><td>Recommendation 2.1
The board of a listed entity should:
have a nomination committee which:
(i) has at least three members, a majority of whom are independent Directors; and
(ii) is chaired by an independent Director,
and disclose:
(iii) the charter of the committee;
(iv) the members of the committee; and
(v) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or</td><td>NO

NO

NO
NO

N/A</td><td>Due to its size, the Board has determined that the function of the Nomination Committee is most efficiently carried out with full Board participation and accordingly, the Board has elected not to establish a separate Nomination Committee at this stage.
As a result, the duties that would ordinarily be assigned to the Nomination Committee under the Nomination Committee Charter are carried out by the full Board.
A copy of the Nomination Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.
The Board devotes time at Board meetings on at least an annual basis to discuss Board succession issues. Where appropriate, all members of the Board are involved in the Company's nomination process,</td></tr>
</table>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, experience, independence and knowledge of the entity to enable it to discharge its duties and responsibilities effectively.	YES	to the maximum extent permitted under the Corporations Act and ASX Listing Rules. The Board also conducts an annual review of the Company's Board Skills Matrix (in accordance with Recommendation 2.2) to ensure the Board maintains an appropriate balance of skills, experience, independence and knowledge to discharge its duties and responsibilities effectively.
Recommendation 2.2 A listed entity should have and disclose a board skill matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.	YES	The Board of the Company is comprised of Directors with a broad range of technical, commercial, financial and other skills, experience and knowledge relevant to overseeing the business of a drone security company. The Company had developed a Board Skills Matrix which is used as a tool to assess the appropriate and ideal balance of skills, experience, independence and diversity necessary for the Board to discharge its duties and responsibilities effectively. A summary of the collective skills, experience, independence and diversity of the Board is set in Annexure C of the Company's Corporate Governance Plan which is available on the Company's website: https://www.droneshield.com/investors.
Recommendation 2.3 A listed entity should disclose: (a) the names of the Directors considered by the board to be independent Directors; (b) if a Director has an interest, position, association or relationship of the type described in Box 2.1 of the ASX Corporate Governance Principles and Recommendation (3rd Edition), but the board is of the opinion that it does not compromise the independence of the Director, the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion; and (c) the length of service of each Director	YES	(a) During the 2017 financial year, the Independent Directors of the Company were: - Mr. Peter James (Non-Executive Chairman); - Mr. Winton Willesee (Non-Executive Director); - Dr. Samantha Ravich (Non-Executive Director); - Mr. Bradley Buswell (Non-Executive Director) Mr. Oleg Vornik, the Managing Director, was not considered to be independent during his tenure due to his executive role as Managing Director of the Company. It should also be noted that Mr. Peter James assumed the role of Interim Executive Chairman from 2 December 2016 – 24 January 2017, following the resignation of Mr. James Walker. During this time period, he was not considered to be an Independent Director of the Company. (b) The Board has determined the independence of each of the Company's Directors in line with the guidance set out by the ASX's Corporate Governance Council and have not formed an opinion contrary to those guidelines. (c) The Directors who held office during and after the 2017 financial year have served continuously since their respective dates of appointment unless otherwise noted below: - Mr. Peter James: appointed 1 April 2016; - Mr. Oleg Vornik: appointed 24 January 2017 - Mr. Winton Willesee: appointed 4 November 2015, resigned 24 January 2017; - Mr. Robert Clisdell: appointed 24 January 2017;

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PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
		- Dr. Samantha Ravich: appointed 1 April 2016, resigned 29 December 2017 - Mr. Bradley Buswell; appointed 29 December 2017
Recommendation 2.4 A majority of the board of a listed entity should be Independent Directors.	YES	The Board Charter requires that where practical the majority of the Board will be independent. During the 2017 financial year, the following three of the Company's four Directors were considered to be Independent Directors: - Mr. Peter James (Non-Executive Chairman); - Mr. Winton Willesee (Non-Executive Director) - Dr. Samantha Ravich (Non-Executive Director); - Mr. Bradley Buswell (Non-Executive Director) As noted above, Mr. Peter James assumed the role of Interim Executive Chairman from 2 December 2016 – 24 January 2017, following the resignation of Mr. James Walker. During this time period, he was not considered to be an Independent Director of the Company.
Recommendation 2.5 The chair of the board of a listed entity should be an Independent Director and, in particular, should not be the same person as the CEO of the entity.	YES	The Chairman, Mr. Peter James is an Independent Non-Executive Director and is not the same person as the Managing Director of the Company. As noted above, Mr. Peter James assumed the role of Interim Executive Chairman from 2 December 2016 – 24 January 2017, following the resignation of Mr. James Walker. During this time period, he was not considered to be an Independent Director of the Company.
Recommendation 2.6 A listed entity should have a program for inducting new Directors and providing appropriate professional development opportunities for continuing Directors to develop and maintain the skills and knowledge needed to perform their role as a Director effectively.	YES	The Company's program for the induction of new Directors is tailored for each new Director (depending on their personal requirements, background skills, qualifications and experience) and includes the provision of a formal letter of appointment and an induction package containing sufficient information to allow the new Director to gain an understanding of the business of the Company, and the roles, duties and responsibilities of Directors and the Executive team. All Directors are encouraged to undergo continual professional development and, subject to prior approval by the Chairman, all Directors may have access to various resources and professional development training to address any skills gaps.
Principle 3: Act ethically and responsibly		
Recommendation 3.1 A listed entity should: (a) have a code of conduct for its Directors, senior executives and employees; and disclose that code or a summary of it.	YES	(a) The Company has adopted a Corporate Code of Conduct which applies to Directors, employees and contractors of the Company. The Corporate Code of Conduct is contained in the Company's Corporate Governance Plan which is available on the Company's website at: https://www.droneshield.com/investors.

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
Principle 4: Safeguard integrity in corporate reporting		
Recommendation 4.1 The board of a listed entity should: have an audit committee which: (i) has at least three members, all of whom are Non-Executive Directors and a majority of whom are Independent Directors; and (ii) is chaired by an Independent Director, who is not the chair of the board, and disclose: (iii) the charter of the committee; (iv) the relevant qualifications and experience of the members of the committee; and (v) in relation to each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or if it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its financial reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.	NO NO NO YES N/A N/A YES	Due to the current size of the Company, the Board has determined that the function of the Audit and Risk Committee is most efficiently carried out with full Board participation and accordingly, the Company has elected not to establish a separate Audit and Risk Committee at this stage. As a result, the duties that would ordinarily be assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter are carried out by the full board. The Audit and Risk Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors. The Board devotes time on at least an annual basis to consider the robustness of the various internal control systems it has in place to safeguard the integrity of the Company's financial reporting. In addition, following the completion of each half year review and annual audit review, the Company's external auditors confer with the Board on any matters identified during the course of the audit that have the potential to increase the Company's exposure to risks of material misstatements in its financial reports. The full Board also assumes responsibility for recommendations to security holders on the appointment and removal of the external auditor. Audit partner rotations will be enforced in accordance with the relevant guidelines.
Recommendation 4.2 The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively.	YES	Prior to the execution of the financial statements of the Company, the Company's Managing Director and Chief Financial Officer provide the Board with written assurances that the financial records of the Company have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the Company and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively in all material aspects.
Recommendation 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.	YES	An external auditor will be present at the Company's Annual General Meeting ("AGM") and be available to answer questions from security holders relevant to the audit.

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PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
Principle 5: Make timely and balanced disclosure		
Recommendation 5.1 A listed entity should: - have a written policy for complying with its continuous disclosure obligations under the Listing Rules; and - disclose that policy or a summary of it.	YES	- The Company has adopted a Continuous Disclosure Policy which details the processes and procedures which have been adopted by the Company to ensure that it complies with its continuous disclosure obligations as required under the ASX Listing Rules and other relevant legislation. - The Company's Continuous Disclosure Policy is contained within the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.
Principle 6: *Respect the rights of security holders*		
Recommendation 6.1 A listed entity should provide information about itself and its governance to investors via its website.	YES	Shareholders can access information about the Company and its governance (including its constitution and adopted corporate governance policies) from the Company's website https://www.droneshield.com/investors. The Company will regularly update the website and contents therein as deemed necessary.
Recommendation 6.2 A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors.	YES	The Company has adopted a Shareholder Communications Strategy which aims to promote and facilitate effective two-way communication with investors. The Strategy outlines a range of ways in which information is communicated to Shareholders, including via its website, through announcements released to the ASX, its annual report and general meetings. Shareholders are also welcome to contact the Company or its registrar, Automic Registry Services, via email or telephone. The Company's Shareholder Communications Strategy is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.
Recommendation 6.3 A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.	YES	As noted above, the Company's Shareholder Communications Strategy is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors. Shareholders will be encouraged to participate at all general meetings of the Company by written statement contained in every Notice of Meeting sent to shareholders prior to each meeting. The Company intends to accommodate shareholders who are unable to attend general meetings in person by accepting votes by proxy. Further, any material presented to shareholders at the meeting will be released to the ASX immediately prior to the commencement of the meeting for the benefit of those shareholders who are unable to attend in person. The Company will also announce to the ASX the outcome of each meeting immediately following its conclusion. At each general meeting, shareholders will be given an opportunity to ask questions in relation to the

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PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
		resolutions put to shareholders at that meeting, and in respect of the Company's business and operations generally. At each AGM, shareholders will also be invited by the Chairman to ask questions of the Company's external auditor and the Board in relation to the annual financial report of the Company and the conduct of the audit.
Recommendation 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.	YES	Shareholders have the option of electing to receive all shareholder communications by e-mail and can update their communication preferences with the Company's registrar, Automic Registry Services, at any time. Security holders can also register with the Company at info@droneshield.com to receive email notifications following the release of a material announcement to ASX.
Principle 7: Recognise and manage risk		
Recommendation 7.1 The board of a listed entity should: have a committee or committees to oversee risk, each of which: (i) has at least three members, a majority of whom are Independent Directors; and (ii) is chaired by an Independent Director, and disclose: (iii) the charter of the committee; (iv) the members of the committee; and (v) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the process it employs for overseeing the entity's risk management framework.	NO NO NO YES N/A N/A YES	Due to its size, the Board has determined that the function of the Audit and Risk Committee is most efficiently carried out with full Board participation and accordingly, the Company has elected not to establish a separate Audit and Risk Committee at this stage. As a result, the duties that would ordinarily be assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter are carried out by the full Board. The Audit and Risk Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors. The Board devotes time on at least an annual basis to fulfil the roles and responsibilities associated with overseeing risk and maintaining the Company's risk management framework and associated internal compliance and control procedures.
Recommendation 7.2 The board or a committee of the board should: review the entity's risk management framework with management at least annually to satisfy itself that it continues to be sound, to determine whether there have been any changes in the material business risks the entity faces and to ensure that they remain within the risk appetite set by the board; and disclose in relation to each reporting period, whether such a review has taken place.	YES	During the 2017 financial year, the Board, in carrying out the duties typically assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter, undertook a formal review the Company's risk management framework in line with its Risk Management Policy.
Recommendation 7.3 A listed entity should disclose: if it has an internal audit function, how the function is structured and what role it performs; or if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.	NO YES	Due to the current size of the Company and the manageable scale of its operations, the Board, in carrying out the duties typically assigned to the Audit & Risk Committee under the Audit & Risk Committee Charter, have determined that the Company's existing risk management processes and internal controls are sufficiently robust and as such, no internal audit committee is required at this stage.

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PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
Recommendation 7.4 A listed entity should disclose whether, and if so how, it has regard to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.	YES	The Company's Risk Management Policy details the Company's risk management systems which assist in identifying and managing potential or apparent business, economic, environmental and social sustainability risks (where appropriate). During the 2017 financial year, the Company undertook a formal review of the Company's risk management framework, which included an assessment of the Company's exposure to economic, environmental and social sustainability risks. The Board was satisfied with the effectiveness of the Company's risk management framework and associated internal compliance and control procedures that are in place to eliminate, mitigate or otherwise manage the Company's exposure to such risks. All material risks are announced to the market, in accordance with the requirements of the ASX listing rules and otherwise.
Principle 8: Remunerate fairly and responsibly		
Recommendation 8.1 The board of a listed entity should: have a remuneration committee which: (i) has at least three members, a majority of whom are Independent Directors; and (ii) is chaired by an Independent Director, and disclose: (iii) the charter of the committee; (iv) the members of the committee; and (v) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or if it does not have a remuneration committee, disclose that fact and the processes it employs for setting the level and composition of remuneration for Directors and senior executives and ensuring that such remuneration is appropriate and not excessive.	NO NO NO YES N/A N/A YES	Due to the size of the Board and the scale of the Company's operations, the Board have determined that the function of the Remuneration Committee is most efficiently carried out with full Board participation (to the extent permitted under the Corporations Act and ASX Listing Rules), and accordingly has elected not to establish a separate Remuneration Committee at this stage. As a result, the duties that would ordinarily be assigned to the Remuneration Committee under the Remuneration Committee Charter are carried out by the full Board. The Remuneration Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors. The Board devotes time on at least an annual basis to fulfil the roles and responsibilities associated with setting the level and composition of remuneration for Directors and senior executives and ensuring that such remuneration is appropriate and not excessive.
Recommendation 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 and ensure that the different roles and responsibilities of Non-Executive Directors compared to Executive Directors and other Senior Executives are reflected in the level and composition of their remuneration.	YES	The Company's general policies and practices regarding the remuneration of Non-Executive and Executive Directors and other senior employees are set out in the Remuneration Policy which is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors. Further information regarding the remuneration practices of the Company is contained in the Remuneration Report section of the Company's 2016 Annual Report.
Recommendation 8.3 A listed entity which has an equity-based remuneration scheme should: (i) have a policy on whether participants are permitted to enter into transactions	YES	The Company's Remuneration Committee (the function of which is currently performed by the full Board) is responsible for the review and approval of any equity-based remuneration schemes offered to Directors and Employees of the Company. Further, in accordance with the Remuneration Committee

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
(whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme; and (ii) disclose that policy or a summary of it.		Charter, the Remuneration Committee (the function of which is currently performed by the full Board) is also responsible for granting permission, on a case by case basis, for scheme participants to enter transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme. During the 2017 financial year, the Board of the Company authorised the issue of securities to Directors and employees under its shareholder approved Incentive Option Plan. To date, no participant to the Incentive Option Plan has sought (or been granted) approval to enter in to transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme. The Company's policy in this regard is set out the Company's Remuneration Committee Charter, a copy of which is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors. The Company also has a Securities Trading Policy that prohibits Directors, Officers and employees from entering into transactions or arrangements which limits the economic risk of participating in unvested entitlements under any equity based remuneration scheme. A copy of the Securities Trading Policy is contained in the Company's Corporate Governance Plan which is available on the Company's website https://www.droneshield.com/investors.

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Directors' Report

Your Directors present their report for DroneShield Limited (the "Company") and its controlled entities ("the Group") for the year ended 31 December 2017.

Directors

The names of the Company's Directors in office during the year and until the date of this report are set out below. Directors were in office for this entire period unless otherwise stated. Details of the current members of the Board, including their experience, qualifications, special responsibilities and term of office are included on page 9 of the Annual Report.

Name	Position	Effective date
Directors		
Peter James	Independent Non-Executive Chairman	Executive Chairman until 24 January 2017 Returned to Independent Non-Executive Chairman 24 January 2017
Oleg Vornik	Executive Director and former CFO CEO and Managing Director	Appointed as CEO and Managing Director 24 January 2017
Robert Clisdell	Non-Executive Director	Appointed 24 January 2017
Bradley Buswell	Independent Non-Executive Director	Appointed 29 December 2017
Dr. Samantha Ravich[3]	Independent Non-Executive Director	Resigned as Director 29 December 2017
Winton Willesee[4]	Independent Non-Executive Director	Resigned as Director 24 January 2017

[3] Dr. Samantha Ravich is a defence and intelligence policy and tech entrepreneur. She was the Republican Co-Chair of the Congressionally-mandated National Commission for Review of Research and Development Programs in the United States Intelligence Community and the former Deputy National Security Advisor for Vice President Cheney. She served in the White House for 5½ years where she was the Vice President's representative on Asian and Middle East Affairs as well as on Counter-Terrorism and Counter-Proliferation. She is now an advisor on cyber and geo-political threats and trends to numerous technology, manufacturing, and services companies as well as the Principal Investigator on the Cyber-Enabled Economic Warfare project housed at FDD's Center for Sanctions and Illicit Finance. Dr. Ravich is currently a partner at West Meadow, LLC and A2P, LLC. Ravich received her Ph.D. in Policy Analysis from the RAND Graduate School and her MCP/BSE from the University of Pennsylvania/Wharton School. Dr. Ravich is a member of the Council on Foreign Relations and advises the US Intelligence Community and the Department of Defense. Dr. Ravich does not hold any other public company directorships.

[4] Mr. Willesee is an experienced company Director with a broad range of skills and experience in strategy, company development, corporate governance, company public listings, merger and acquisition transactions and corporate finance. Mr Willesee holds a Master of Commerce, a Post-Graduate Diploma in Business (Economics and Finance), a Graduate Diploma in Applied Finance and Investment, a Graduate Diploma in Applied Corporate Governance, a Graduate Diploma in Education and a Bachelor of Business. He is a Fellow of the Financial Services Institute of Australasia, a Graduate of the Australian Institute of Company Directors, a Member of CPA Australia and a Fellow of the Governance Institute of Australia and the Institute of Chartered Secretaries and Administrators/Chartered Secretary. Over the past three years Mr. Willesee has held Directorships with the following public companies: Birimian Limited, Metallum Limited (now Kopore Metals Limited), Ding Sheng Xin Finance Co Limited, Nanollose Limited, xTV Networks Limited, MMJ PhytoTech Limited, Cove Resources Limited (now BidEnergy Limited), Basper Limited and Coretrack Limited (now LWP Technologies Limited).

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Directors' Report *continued*

Meetings of Directors

Name	Meetings eligible to attend	Meetings attended
Directors		
Peter James	11	11
Winton Willesee	1	1
Dr. Samantha Ravich	10	10
Robert Clisdell	11	11
Bradley Buswell	1	1
Oleg Vornik	11	11

Review of Operations and Financial Results

The net loss after tax for the year was $5,476,613 (2016: loss of $4,939,819). The Company listed on the ASX on 22 June 2016, raising $7m which has funded increased investment in sales and marketing, R&D, product development, intellectual property protection, legal and administration costs and working capital. DroneShield subsequently undertook a $1.25m Placement and SPP in June 2017, and a $2.32m Placement in November 2017. The Company has also received proceeds on exercise of some of its DROO listed options in early 2017.

In January 2017, the Board appointed Oleg Vornik, who had been the Chief Financial Officer of the Company for over a year, as the CEO and Managing Director. Additionally, Robert Clisdell and Anand Sundaraj joined DroneShield as Non-Independent Non-Executive Director and Company Secretary respectively, following the resignations of Winton Willesee (Non-Executive Director) and Erlyn Dale (Company Secretary) in January 2017. Anand Sundaraj of Whittens & McKeough was replaced as company secretary by Alistair McKeough, a partner of Whittens & McKeough, in November 2017. In late December 2017, Bradley Buswell joined the Board of the Company, replacing Dr Samantha Ravich, who transitioned to the Company's Advisory Board.

Following release of DroneGun MKI in November 2016, in response to end-user requirements, in mid-2017, the Company launched DroneGun MKII. DroneGun Tactical was subsequently released in late January 2018. Both DroneGun MKII and DroneGun Tactical are innovative portable rifle-shape jammers, covering a broad range of tactical environments and uses. DroneGun Tactical represents a break-through in the product segment for tactical forward deployments, as it contains no backpack (which is required for DroneGun MKI and DroneGun MKII). DroneGun Tactical does not replace DroneGun MKII. Rather, it is designed for users whose requirements differ from those of DroneGun MKII's users.

The Company also launched DroneSentinel and DroneSentry in the second half of the year. DroneSentinel is a unique modular drone detection system incorporating radar, radiofrequency, and thermal and optical camera sensors, as well as the patented acoustic detection technology that is at the genesis of DroneShield. All of the detection components of DroneSentinel are also available as standalone products. DroneSentry is a detect-and-defeat product, which incorporates all of these detection capabilities and pairs them up with a jamming capability. These products are effective against both individual drones, and swarms.



Image: Korean military officials review DroneGun in Q4 2017

DroneShield also made significant sale and marketing progress during the year. Its sales, installations and test deployments during, or shortly after the end of, the year included those to/with the Boston Marathon (for a third straight year), the Hawaii IRONMAN, the World Economic Forum, NATO militaries, and a competitive Paraguay government tender. The sale for use by the Paraguay government required an approval by the relevant U.S. regulator, and DroneShield obtained such approval.

DroneShield has a significant sales pipeline. It is participating in a number of trials and procurement processes across military, law enforcement and critical infrastructure customers in the United States, Australia, NATO countries and elsewhere. Its pipeline includes active engagement with dozens of potential end-users, with the size of each potential order ranging between hundreds of thousands of dollars and tens of

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Directors' Report *continued*

Review of Operations and Financial Results *continued*

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millions of dollars[5]. By way of example, the sales pipeline includes U.S. federal government opportunities (multiple agencies and multiple branches of the military) and opportunities with a wide range of Spanish, French and South Korean governmental users.

In connection with these processes, the Company has obtained Certification of DroneGun MKII as compliant for human exposure - EMC Technologies, a specialist SAR (Specific Absorption Rate) measurement NATA (National Association of Testing Authorities) approved laboratory for global certifications, certified DroneShield's DroneGun MKII as compliant with the ARPANSA EN 62311 and EN 62209-1 (Australian and New Zealand Communications and Media Authority requirements for human exposure to radio frequencies) within the specific frequency bands of operation which cross references to the international ICNIRP standard. Similarly, in France, DroneGun product has been certified as compliant under the French military's Dangers des Rayonnements Electromagnétiques sur les Personnels ("DREP") test, which measures electromagnetic emission levels on human users.

The Company has announced its participation in the 2018 Urban 5th Generation Marine Exploration and Experimentation Exercise (U5G) and the U.S. Special Operations Command SOFWERX ThunderDrone RPEII event. U5G is organised by the United States Marine Corps Deputy Commandant for Combat Development & Integration ("CD&I") and the Deputy Assistant Secretary of the Navy for Research, Development, Test and Evaluation ("NR&DE"). The U5G 18 event takes place at Marine Corps Base Camp Pendleton, San Diego, California, between March 15, 2018 and March 25, 2018. The U5G 18 event focuses on evaluating new technologies by the United States Marines, for subsequent acquisition and deployment considerations. SOFWERX is a Tampa, Florida based experimental lab created under a Partnership Intermediary Agreement between Doolittle Institute and the United States Special Operations Command (USSOCOM). ThunderDrone RPEII is the SOFWERX exercise focused on counterdrone systems and designed to expose new and emerging counterdrone technologies to the Strategic Capabilities Office (SCO) and USSOCOM. DroneShield was one of a limited number of counter-drone providers invited to participate in the event.



Image: Commsec Securities interview with DroneShield chairman Peter James

The Company continued its active engagement with the Australian and the United States governments, and recently applied for several high-value R&D grants in both countries. It recently received its first R&D Tax Incentive Grant from the Australian Government. DroneShield was also selected to be a part of Team Defence Australia (TDA) for the high profile DSEI (London) and AUSA (Washington DC) military exhibitions. TDA is a joint effort with the Australian Department of Defence and Austrade.

The Company continues to work with its third-party partners across its sales partner network in approximately 50 countries, as well as its R&D and manufacturing partners to complement its in-house team, optimising its capital expenditure.

DroneShield continues to attract a significant amount of media interest globally, including coverage by Channel 7 and Commsec TV, ABC and 2GB radio in Australia; and CBS, NBC and Fox News in the US.

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[5] This refers to DroneShield's sales pipeline and specific sales opportunities. However, not all (and there can be no assurance that any) of these sales opportunities will result in sales.

Directors' Report *continued*

Review of Operations and Financial Results *continued*

During the year, DroneShield presented at the 38th Annual Cowen Aerospace/Defense & Industrials Conference in New York City. Cowen & Company is a leading US investment bank in the aerospace and defence sector. Now in its 38th year, the conference is a premier invitation-only global investor event for leading companies in the aerospace and defence sectors. In addition to DroneShield's CEO Oleg Vornik, this year's speakers include the CEOs or CFOs of Raytheon, Lockheed Martin, Boeing and Northrop Grumman, as well as the Executive Director of the United States Missile Defence Agency.

In October 2017, DroneShield engaged Mesirow Financial, a 600-person U.S. investment bank with a specialty in aerospace and defence, in order to explore strategic options, in response to large defence companies expressing interest in a partnership with the Company. Several parties have now signed confidentiality agreements and proceeded into subsequent rounds of discussions.



Image: DroneShield CEO Oleg Vornik on Fox News in New York

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Directors' Report *continued*

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Principal Activities

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

Significant Changes in the State of Affairs

Other than discussed in the Review of Operations above, there have been no significant changes in the state of affairs of the Company during the year ended 31 December 2017.

Significant Events after the Balance Date

The following employee share options have been awarded and issued subsequent to the year end:

- Class F options — 450,000 options issued on 19 January 2018.
  Exercise price of $0.30, vesting on 22 June 2018 and expiring on 22 June 2021
- Class J options — 125,000 options issued on 25 January 2018.
  Exercise price of $0.50, vesting on 22 June 2018 and expiring on 22 June 2021
- Class K options — 125,000 options issued on 25 January 2018.
  Exercise price of $0.50, vesting on 22 June 2019 and expiring on 22 June 2022

No other matter or circumstance has arisen since 31 December 2017 which has significantly affected or may significantly affect:

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

Likely developments and expected results of operations

Refer to the Chairman's Review to shareholders, on pages 3 to 4, for further information on likely developments and expected results of the Group.

Environmental regulation

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

Dividends

No dividends were declared or paid to shareholders during the financial year (2016: $nil)

Directors' Report *continued*

Insurance of officers

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

Proceedings on behalf of the Company

No person has applied to the Court under section 237 of the *Corporations Act 2001* for leave to bring proceedings on behalf of the Group, or to intervene in any proceedings to which the Group is party, for the purpose of taking responsibility on behalf of the Group for all or part of those proceedings.

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

Non-audit services

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

Details of the amounts paid or payable to the auditor (HLB Mann Judd Assurance (NSW) Pty Ltd) for audit and non-audit services provided during the year are outlined in note 24 to the financial statements.

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

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

Auditor's Independence Declaration

A copy of the auditor's independence declaration as required under the Section 307C of the *Corporations Act 2001* is set out on page 35.

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Directors' Report- Remuneration Report (audited)

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Executive remuneration governance

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

Remuneration committee

Due to the size and nature of the existing Board and the magnitude of the Company's operations, the Company does not currently have a Remuneration Committee. Pursuant to clause 5.1 of the Company's Board Charter https://www.droneshield.com/investors, the full Board currently carries out the duties that would ordinarily be assigned to the Remuneration Committee under the written terms of reference for that committee.

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

Directors' remuneration

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

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

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

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

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

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

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

Executive remuneration and other terms of employment are reviewed annually by the Board having regard to performance, relevant comparative information and, where necessary, expert advice.

Executive remuneration framework

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

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

Directors' Report- Remuneration Report *continued*

Executive remuneration framework *continued*

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

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

KMP remuneration disclosures in detail

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

Name	Position	Effective date
Non-Executive Directors		
Peter James	Independent Non-Executive Chairman	Executive Chairman until 24 January 2017 Returned to Non-Executive Chairman 24 January 2017
Winton Willesee	Independent Non-Executive Director	Resigned as Director 24 January 2017
Dr. Samantha Ravich	Independent Non-Executive Director	Resigned as Director 29 December 2017
Robert Clisdell	Non-Executive Director	Appointed 24 January 2017
Bradley Buswell	Independent Non-Executive Director	Appointed 29 December 2017
Executive Directors		
Oleg Vornik	Executive Director and former CFO Managing Director and CEO	Appointed as Managing Director and CEO 24 January 2017

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Directors' Report- Remuneration Report *continued*

Shareholdings of KMP

The number of shares in the Company and subsidiary held during the financial year by each Director of DroneShield and other KMP, including their personally related entities, are set out in the following table:

31 December 2017	Opening balance (Number)	Received during the year on exercise of options (Number)	Other changes during the year (Number)	Balance at 31 December 2017 (Number)
Non-Executive Directors				
Peter James	250,000	-	63,292	313,292
Winton Willesee	10,000	-	-	-[6]
Dr. Samantha Ravich	1,350,000	-	10,549	-[7]
Robert Clisdell	-	-	100,792[8]	100,792
Bradley Buswell	-	-	-	-
Executive Directors				
Oleg Vornik	50,000	-	63,292	113,292
Total	**1,660,000**	**-**	**237,925**	**527,376**

31 December 2016	Opening balance (Number)	Received during the year on exercise of options (Number)	Received on listing of DroneShield (Number)	Other changes during the year (Number)	Balance at 31 December 2016 (Number)
Non-Executive Directors					
Peter James	-	-	-	250,000	250,000
Winton Willesee	-	-	-	10,000	10,000
Dr. Samantha Ravich	-	-	1,350,000	-	1,350,000
Robert Clisdell	-	-	-	-	-
Executive Directors					
James D Walker	-	-	-	270,170	-[9]
Simon Crowther	-	-	-	-	-
Oleg Vornik	-	-	-	50,000	50,000
Total	**-**	**-**	**1,350,000**	**580,170**	**1,660,000**

[6] Winton Willesee ceased to be a KMP on 24 January 2017
[7] Dr. Samantha Ravich ceased to be a KMP on 29 December 2017
[8] Robert Clisdell was appointed as a KMP on 24 January 2017.
[9] James Walker ceased to be a KMP on 2 December 2016.

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Directors' Report- Remuneration Report *continued*

Performance shares held by KMP

Holdings by KMP are listed below.

31 December 2017	Plan	Opening balance (Number)	Granted as compensation (Number)	Performance shares converted (Number)	Performance shares lapsed (Number)	Balance at 31 December 2017 (Number)
Non-Executive Directors						
Peter James		-	-	-	-	-
Winton Willesee		-	-	-	-	-
Dr Samantha Ravich[10]	A	202,500	-	-	-	-
	B	202,500	-	-	-	-
	C	202,500	-	-	-	-
Robert Clisdell		-	-	-	-	-
Bradley Buswell		-	-	-	-	-
Executive Directors						
Oleg Vornik		-	-	-	-	-
Total		**607,500**	**-**	**-**	**-**	**-**

31 December 2016	Plan	Opening balance (Number)	Granted as compensation (Number)	Received on listing of DroneShield (Number)	Performance shares converted (Number)	Performance shares lapsed (Number)	Balance at 31 December 2016 (Number)
Non-Executive Directors							
Peter James		-	-	-	-	-	-
Winton Willesee		-	-	-	-	-	-
Dr Samantha Ravich	A	-	-	202,500	-	-	202,500
	B	-	-	202,500	-	-	202,500
	C	-	-	202,500	-	-	202,500
Robert Clisdell		-	-	-	-	-	-
Executive Directors							
James D Walker		-	-	-	-	-	-
Simon Crowther		-	-	-	-	-	-
Oleg Vornik		-	-	-	-	-	-
Total	**-**	**-**	**-**	**607,500**	**-**	**-**	**607,500**

[10] Dr. Samantha Ravich ceased to be a KMP on 29 December 2017.

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Directors' Report- Remuneration Report *continued*

Share options held by KMP

31 December 2017	Opening balance Number	Granted as compensation Number	Other option acquisitions Number	Options lapsed Number	Balance at 31 December 2017 Number
Non-Executive Directors					
Peter James	4,750,000	-	-	-	4,750,000
Winton Willesee	1,010,000	-	-	-	-[11]
Dr. Samantha Ravich	1,000,000	-	-	-	-[12]
Robert Clisdell	-	500,000	37,500	-	537,500
Bradley Buswell	-	-	-	-	-
Executive Directors					
Oleg Vornik	3,250,000	1,300,000	-	-	4,550,000
Total	**10,010,000**	**1,800,000**	**37,500**	**-**	**9,837,500**

31 December 2016	Opening balance Number	Granted as compensation Number	Other option acquisitions Number	Options lapsed Number	Balance at 31 December 2016 Number
Non-Executive Directors					
Peter James	-	4,500,000	250,000	-	4,750,000
Winton Willesee	-	1,000,000	10,000	-	1,010,000
Dr. Samantha Ravich	-	1,000,000	-	-	1,000,000
Erlyn Dale	-	-	-	-	-
Executive Directors					
James D Walker	-	10,000,000	250,000	(6,500,000)	-[13]
Simon Crowther	-	-	-	-	-
Oleg Vornik	-	3,200,000	50,000	-	3,250,000
Total	**-**	**19,700,000**	**560,000**	**(6,500,000)**	**10,010,000**

[11] Winton Willesee ceased to be a KMP on 24 January 2017.
[12] Dr. Samantha Ravich ceased to be a KMP on 29 December 2017.
[13] James Walker ceased to be a KMP on 2 December 2016.

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Directors' Report- Remuneration Report *continued*

Remuneration details of KMP

31 December 2017	Salary and fees $	Cash bonus $	Post-employment benefits $	Termination payment $	Share based payments (options) $	Total $
Non-Executive Directors						
Peter James	100,000	-	-	-	-	100,000
Winton Willesee	5,000[14]	-	-	-	-	5,000
Dr Samantha Ravich	30,000	-	-		-	30,000
Robert Clisdell	28,387	-	-	-	85,041	113,428
Bradley Buswell	-	-	-	-	-	-
Executive Directors						
Oleg Vornik	221,535	-	1,980	-	221,106	444,621
Total	**384,922**	**-**	**1,980**	**-**	**306,147**	**693,049**

31 December 2016	Salary and fees $	Cash bonus $	Post-employment benefits $	Termination payment $	Share based payments (options) $	Total $
Non-Executive Directors						
Peter James	45,000	-	-	-	334,085	379,085
Winton Willesee	50,500	-	-	-	94,225	144,725
Dr Samantha Ravich	22,500	-	-	-	94,225	116,725
Erlyn Dale	20,680	-	-	-	-	20,680
Executive Directors						
James D Walker	192,889	-	16,848	138,389	342,352	690,478
Simon Crowther	70,736	-	5,815	-	-	76,551
Oleg Vornik	279,223	100,000	24,408	-	166,915	570,546
Total	**681,528**	**100,000**	**47,071**	**138,389**	**1,031,802**	**1,998,790**

[14] Azalea Consulting Pty Ltd, an entity associated with Mr. Winton Willesee, received payments totalling $44,000 (2016: $114,300) in relation to Director services, administration and Company Secretarial services provided to the Group. No balance was outstanding at year end (2016: $10,000).

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Directors' Report- Remuneration Report *continued*

Remuneration details of KMP continued

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

	Fixed		Performance	
	2016	**2017**	**2016**	**2017**
Non-Executive Directors				
Peter James	12%	100%	88%	0%
Winton Willesee	35%	100%	65%	0%
Dr Samantha Ravich	19%	100%	81%	0%
Robert Clisdell	n/a	25%	n/a	75%
Erlyn Dale	100%	n/a	0%	n/a
Bradley Buswell	n/a	n/a	n/a	n/a
Executive Directors				
Oleg Vornik	53%	50%	47%	50%
James D Walker	50%	n/a	50%	n/a
Simon Crowther	100%	n/a	0%	n/a

The performance component of remuneration received by Directors relates to share options (with the exception of Executive Director, Oleg Vornik, who received a cash bonus in 2016). The issue of share options to Directors is subject to shareholder approval. Remuneration in the form of DroneShield share options is used as a tool to align KMP remuneration with shareholder interests.

Employment agreements of Executive Directors during the year included the following key terms:

Name	**Positions held during the year**	**Key terms of employment agreement**
Oleg Vornik	CEO and Managing Director	- Base remuneration of US$147,200 p.a. (translated to $188,416 p.a. at the year-end exchange rate) - Eligible to participate in short term incentive program - Eligible to participate in long term incentive program - A notice period of 3 months, except in defined circumstances - No fixed term
Peter James	Non-Executive Chairman[15]	- All contractual terms relating to Mr. James's appointment as a Director are in accordance with DroneShield's Constitution. - No additional terms were applied and Mr. James received no additional remuneration or benefits during his tenure as Executive Chairman.

[15] Mr. James served as Executive Chairman from 2 December 2016 until 24 January 2017.

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Directors' Report- Remuneration Report *continued*

Advisory Board remuneration

During the year, the Advisory Board has included five individuals[16] who were remunerated as follows:

31 December 2017 **$**	**Salary and Fees**	**Share based payments (options)**	**Total**
Carol Haave	6,531	-	6,531
Hon. Jay M Cohen	12,734	-	12,734
Lieutenant General Robin Brims CB CBE DSO	6,485	-	6,485
Robert Hill	6,522	-	6,522
Joanna Riley	6,522	-	6,522
Total	**38,794**	**-**	**38,794**

31 December 2016 **$**	**Salary and Fees**	**Share based payments (options)**	**Total**
Carol Haave	6,531	32,979	39,510
Hon. Jay M Cohen	6,531	32,979	39,510
Lieutenant General Robin Brims CB CBE DSO	6,485	32,979	39,464
Robert Hill	6,522	32,979	39,501
Joanna Riley	6,522	32,979	39,501
Total	**32,591**	**164,895**	**197,486**

End of Remuneration Report.

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



Peter James
Independent Non-Executive Chairman

Sydney, NSW
22 February 2018

[16] Following her resignation from the Board on 29 December 2017, Dr. Samantha Ravich transitioned to the DroneShield Advisory Board. Dr. Ravich was not remunerated for her Advisory Board post in 2017. As at 31 December 2017, the Advisory Board included only Dr. Samantha Ravich and Hon. Jay M Cohen.

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HLB Mann Judd Assurance

Quality Audit Services

DRONESHIELD LIMITED

ABN 26 608 915 859

AUDITOR'S INDEPENDENCE DECLARATION

As lead auditor for the audit of the consolidated financial report of DroneShield Limited for the year ended 31 December 2017, I declare that, to the best of my knowledge and belief, there have been no contraventions of:

(a) the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and

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

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



Sydney, NSW
22 February 2018

A G Smith
Director

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Consolidated Statement of Profit or Loss and Other Comprehensive Income

	Note	31 December 2017 $	31 December 2016 $
Revenue	**4**	**310,724**	**84,398**
Other revenue and income	**5**	69,583	47,998
Cost of sales		(230,198)	(67,051)
Product development expense		(1,926,420)	(643,827)
Sales and customer service expense		(1,046,604)	(418,434)
Corporate and support expense	**6**	(1,764,602)	(2,278,436)
Corporate governance expense	**7**	(475,973)	(447,531)
Share based payment expense	**3**	(647,743)	(1,216,936)
Loss before income tax		**(5,711,233)**	**(4,939,819)**
Income tax benefit	**8**	234,620	-
Loss after income tax		**(5,476,613)**	**(4,939,819)**
Other comprehensive income:			
Items that may be reclassified to profit or loss			
Adjustments on translation of foreign controlled entity		(25,404)	53,265
Total comprehensive loss for the period		**(5,502,017)**	**(4,886,554)**
Basic loss per share	**22**	(0.04)	(0.07)
Diluted loss per share	**22**	(0.04)	(0.07)

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

	Note	31 December 2017 $	31 December 2016 $
ASSETS			
Current assets			
Cash and cash equivalents	**9**	2,362,894	3,497,077
Trade and other receivables	**10**	207,851	266,627
Inventories	**11**	499,194	238,273
Total current assets		**3,069,939**	**4,001,977**
Non-current assets			
Plant, equipment and intangible assets	**12**	387,770	59,155
Total non-current assets		**387,770**	**59,155**
Total assets		**3,457,709**	**4,061,132**
LIABILITIES			
Current liabilities			
Trade payables		164,672	34,757
Provisions	**14**	120,214	48,079
Other liabilities	**15**	254,170	588,545
Total current liabilities		**539,056**	**671,381**
Total liabilities		**539,056**	**671,381**
Net assets (deficiency)		**2,918,653**	**3,389,751**
EQUITY			
Share capital	**16**	7,533,586	3,400,993
Reserves		5,957,655	5,478,166
Accumulated losses		(10,572,588)	(5,489,408)
Total equity (deficiency)		**2,918,653**	**3,389,751**

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

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Consolidated Statement of Changes in Equity

	Contributed equity $	Options reserve $	Foreign currency translation reserve $	Accumulated losses $	Total equity $
Balance at 1 January 2016	**28,320**	**-**	**(11,785)**	**(549,589)**	**(533,054)**
Transactions with owners in their capacity as owners:					
Conversion of convertible notes and warrants into contributed equity	1,203,174	-	-	-	1,203,174
Options issued	-	5,436,686	-	-	5,436,686
Contributions of equity, net of transaction costs	2,169,499	-	-	-	2,169,499
	3,400,993	5,436,686	(11,785)	(549,589)	8,276,305
Exchange difference on translation of foreign operations	-	-	53,265	-	53,265
Loss for the period	-	-	-	(4,939,819)	(4,939,819)
Total comprehensive loss for the period	**-**	**-**	53,265	(4,939,819)	(4,886,554)
Balance at 31 December 2016	**3,400,993**	**5,436,686**	**41,480**	**(5,489,408)**	**3,389,751**
Balance at 1 January 2017	**3,400,993**	**5,436,686**	**41,480**	**(5,489,408)**	**3,389,751**
Transfer from option reserve to accumulated losses	-	(393,433)	-	393,433	-
Transactions with owners in their capacity as owners:					
Options exercised	966,020	-	-	-	966,020
Options issued	-	898,326	-	-	898,326
Contributions of equity, net of transaction costs	3,166,573	-	-	-	3,166,573
	4,132,593	898,326	-	-	5,030,919
Exchange difference on translation of foreign operations	-	-	(25,404)	-	(25,404)
Loss for the period	-	-	-	(5,476,613)	(5,476,613)
Total comprehensive loss for the period	-	-	(25,404)	(5,476,613)	(5,502,017)
Balance at 31 December 2017	**7,533,586**	**5,941,579**	**16,076**	**(10,572,588)**	**2,918,653**

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

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Consolidated Statement of Cash Flows

	Note	31 December 2017 $	31 December 2016 $
Cash flows from operating activities			
Receipts from customers		340,367	191,917
Payments to suppliers and employees		(5,706,781)	(3,757,170)
Research and Development Tax Incentive received		234,620	-
Net cash flows from (used in) operating activities	**26**	**(5,131,794)**	**(3,565,253)**
Cash flows from investing activities			
Purchase of plant and equipment		(428,384)	(51,577)
Net cash flows from (used in) investing activities		**(428,384)**	**(51,577)**
Cash flows from financing activities			
Interest income on cash deposits		46,252	46,699
Repayment of borrowings	**13**	-	(180,155)
Proceeds from option exercise		966,020	-
Proceeds from share and option issues		3,600,590	7,545,145
Share issue transaction costs		(181,958)	(658,408)
Net cash flows from (used in) financing activities		**4,430,904**	**6,753,281**
Cash and cash equivalents at beginning of period		**3,497,077**	**378,448**
Net increase (decrease) in cash and cash equivalents		(1,129,274)	3,136,451
Exchange rate adjustments to balances held in foreign currencies		(4,909)	(17,822)
Cash and cash equivalents at the end of the year	**9**	**2,362,894**	**3,497,077**

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

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Notes to the Financial Statements

Corporate Information

The consolidated financial report of DroneShield Limited ("the Company") and its controlled entities ("DroneShield" or "the Group") for the year ended 31 December 2017 was authorised for issue in accordance with a resolution of the Directors on 22 February 2018.

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

The principal activity of the Group during the period was the development and commercialisation of hardware and software acoustic technology for drone detection and security.

Statement of compliance

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

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

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

1. Summary of Significant Accounting Policies

(a) Basis of preparation

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

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

Going Concern

During the year ended 31 December 2017, the Group incurred losses of $5,476,613 and net cash outflows from operating activities of $5,131,794, with cash on hand at 31 December 2017 of $2,362,894.

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

The Group's ability to continue as a going concern beyond this period is dependent on generating additional revenues from operations, raising further capital and / or reducing costs, thus resulting in a material uncertainty that may cast doubt on the Group's ability to continue as a going concern and, therefore, it may be unable to realise its assets and discharge its liabilities in the normal course of business.

The Directors believe that there are reasonable grounds to believe that the Group will continue as a going concern post the 12 month period to February 2019, after consideration of the following factors:

- the Group expects to generate increased revenues from the sale of DroneGun, DroneSentry and DroneSentinel products within the next 12 months and beyond;
- the Company has the ability to issue additional shares to raise further working capital and has been successful in doing this previously, as evidenced by the successful capital raising completed during financial year ended 31 December 2016 and more recently in June and October 2017;
- R&D and product development constitute a substantial part of the Company's costs. The Company has applied for, and may apply for further, non-dilutive governmental grants. If such grants are awarded, the Company's R&D and product development costs may be funded, in whole or in part, using such non-dilutive grants;
- As previously disclosed, the Company, together with its advisers Mesirow Financial, is undertaking a review of its strategic options. Such review may result in a range of transactions, including, without limitation, a partnership with a larger industry participant with more substantial financial resources, a fund-raising, and/or an M&A transaction;
- with the share price trading above 22c, the Directors expect option holders to exercise their options resulting in further capital inflows – with 4,390,999 already exercised as at 31 December 2017 with proceeds received by the Group of $966,020, and 34,478,988 remaining outstanding listed options with exercise value of $7,585,377;
- the Group also has the ability to scale down its operations in order to curtail expenditure in the event insufficient cash is available to meet projected expenditure.

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Notes to the Financial Statements (continued)

(b) Principles of consolidation

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

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

(c) Foreign currency translation

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

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

(d) Revenue recognition

Revenue arises from the sale of goods and the rendering of services. It is measured by reference to the fair value of consideration received or receivable, excluding sales taxes, rebates, and trade discounts.

The Group enters into sales transactions involving either an outright sale to the client or on a subscription basis. The Group applies the revenue recognition criteria set out below to each separately identifiable component of the sales transaction in order to reflect the substance of the transaction.

Outright sale of goods

Outright sale of goods is recognised when the Group has transferred to the buyer the significant risks and rewards of ownership, generally when the customer has taken undisputed delivery of the goods.

Subscription sales

The Group generates revenues from subscription sales which also includes transferring ownership of goods to the customer. The revenue from such transactions is recognised on a monthly basis, with equal amounts for each month recognised over the life of the subscription agreement.

Interest income

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

(e) Income tax

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

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

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

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

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

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

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Notes to the Financial Statements *continued*

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(e) Income tax *continued*

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

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

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

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

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

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

(g) Cash and cash equivalents

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

(h) Trade and other receivables

Trade and other receivables are stated at their cost less an allowance for impairment of receivables. These receivables are unsecured and generally due for settlement prior to the shipment of goods.

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

(i) Trade and other payables

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

(j) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost includes all expenses directly attributable to the manufacturing process as well as related production overheads. Costs of ordinarily interchangeable items are assigned using the average cost method. Net realisable value is the estimated selling price in the ordinary course of business less any applicable selling expenses.

(k) Leases

Leases where the lessor retains substantially all of the risks and rewards of ownership of the asset are classified as operating leases. Payments made under operating leases are recognised as an expense on a straight-line basis over the period of the lease. Associated costs, such as maintenance and insurance, are expensed as incurred.

(l) Employee benefits

Wages, salaries and annual leave

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

Notes to the Financial Statements *continued*

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(l) Employee benefits *continued*

Long service leave

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

Post-employment benefits

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

(m) Provisions, contingent liabilities and contingent assets

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

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

(n) Contributed equity

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

(o) Plant and equipment

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

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

Office equipment	2 - 5 years
Demonstration equipment	3 - 5 years
R&D equipment	2 - 5 years

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

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

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

(p) Intangible assets

Intangible assets relate to computer software. Amortisation is recognised on a straight-line basis over an estimated useful economic life of 3 to 7 years. The estimated useful economic life is reviewed at the end of each reporting period with the effect of any changes in estimate being accounted for on a prospective basis.

(q) Earnings per share

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

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

Notes to the Financial Statements *continued*

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(r) Research and development

Research is the original and planned investigation undertaken with the prospect of gaining new knowledge and understanding. Development is the application of research findings to a plan or design for the production of new or substantially improved processes or products prior to the commencement of commercial production. Research costs are expensed as they are incurred. All development costs incurred did not meet the criteria for recognition as an intangible asset and have been expensed.

(s) Share-based payments

Share based compensation benefits are provided to employees via an Employee Option Plan. Information in relation to this plan is set out in note 3.

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

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

(t) Impairment of assets

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

(u) Segment reporting

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

Notes to the Financial Statements *continued*

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(v) New accounting standards and interpretations

DroneShield has adopted all of the new, revised or amended Accounting Standards and interpretations issued by the Australian Accounting Standards Board (AASB) that are mandatory for the current reporting period.

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2017 reporting periods and have not been early adopted by the Group. The Group's assessment of the impact of these new standards and interpretations is set out below.

Title of standard	Nature of change	Impact to group	Application date of standard	Application date for group
AASB 9 Financial Instruments	AASB 9 is a new standard that replaces AASB 139. The new standard includes a model for classification and measurement, a single, forward-looking 'expected loss' impairment model and introduces a reformed approach to hedge accounting. The standard is available for early adoption.	The new standard is not expected to have a significant impact on the financial statements.	1 January 2018	1 January 2018
AASB 15 Revenue from contracts with customers	The AASB has issued a new standard for the recognition of revenue. This will replace AASB 118 which covers contracts for goods and services and AASB 111 which covers construction contracts. The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer- so the notion of control replaces the existing notion of risks and rewards. The standard is available for early adoption.	The new standard will impact the manner in which subscription sales are currently accounted for, potentially advancing a portion of revenue streams relating to hardware when compared with the treatment currently applied which spreads the total revenue over the life of the subscription. The impact will not be material for DroneShield.	1 January 2018	1 January 2018
AASB 16 Leases	AASB 16 is a new standard that replaces AASB 117. The new standard removes the distinction between operating and finance leases, recognising all lease assets and liabilities on the balance sheet, with limited exceptions for short term leases and leases of low value assets.	The new standard changes how the group accounts for its current operating leases, which primarily relate to its premises. All such leases will be brought onto the Statement of Financial Position by the recognition of a 'right to use' asset, together with a liability for the present value of lease payments for the life of the lease. The future recognition of lease expenses will change with more expenses recognised in the early periods of a lease. The impact will not be material for DroneShield as the Group does not have any significant leases.	1 January 2019	1 January 2019

No other standards or interpretations are expected to have a material impact on the Group.

Notes to the Financial Statements *continued*

2. Critical accounting judgements, estimates and assumptions

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

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

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

Licence and patent expenses

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

Share based payments

The Group measures the cost of equity settled transactions by reference to the fair value of the equity instruments at the date they are granted. The accounting estimates and assumptions relating to equity-settled share-based payments would have no impact on the carrying amounts of assets and liability within the next annual reporting period but may impact profit or loss and equity. Details of the key assumptions used are set out in note 3.

Inventories

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

Demonstration Units

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

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Notes to the Financial Statements *continued*

3. Options issued

During the year ended 31 December 2017, a number of options were issued to Directors, management and other employees of the Group as well as to the Group's corporate advisors and investors who subscribed for shares under the Share Placement that occurred in October 2017. Using the Black Scholes Model, the fair value of each option is as set out below and based on the following criteria/assumptions. The options below were issued at various dates between 19 May and 1 November 2017.

Options Issued 31 December 2017	Class A Options[17]	Class D Options	Class J Options	Class K Options	Listed Options[18]	Other Options[19]	Total option expense for the year
No of new options	2,000,000	1,800,000	625,000	625,000	3,869,987		
Expiry (years)[20]	1.6	3	4	5	0.5		
Exercise price ($)	0.22	0.30	0.50	0.50	0.22		
Vesting period (days)	Immediately	Immediately	263 to 407	628 to 772	Immediately		
Underlying volatility	87.7%	87.7%	87.7%	87.7%	-		
Risk free interest rate	1.73%	1.92%	1.85% to 2.28%	1.85% to 2.28%	-		
Calculated fair value of each option ($)	0.0866	0.1701	0.0895	0.1062	0.02		
Total expense recorded for the period ended 31 December 2017 ($)	-	306,147	49,219	33,744	-	258,633	647,743

[17] Class A options were issued to brokers as part of the capital raises during the year and included as part of share transaction costs and treated as a deduction from equity (of $173,190, see note 16).
[18] Listed DROO Options were issued to shareholders who subscribed for shares under the October share placement for $nil consideration. Accordingly, the value of these options ($77,400) has been assigned to the option reserve, instead of contributed equity.
[19] An expense of $258,633 was incurred in relation to option expense relating to the vesting of options within classes D, F and H issued in 2016. Refer to prior year comparative below for further details of these options.
[20] Class J and K options carry the escrow restrictions of continuous employment to 22 June 2018 and 22 June 2019 respectively.

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Notes to the Financial Statements *continued*

3. Options issued *continued*

During the year ended 31 December 2016, a number of options were issued to Directors, management and other employees of the Group, as well as to the Group's corporate advisors and investors who subscribed to shares under DroneShield's IPO. Using the Black Scholes Model, the fair value of each option is as set out below and based on the following criteria/assumptions. Note that the issue date for all options, with the exception of those in Class I, was 14 June 2016. Class I Options were issued on 20 December 2016.

Options Issued 31 December 2016	Class A[21] Options	Class B Options	Class C[22] Options	Class D[23] Options	Class E Options	Class F Options	Class G Options	Class H Options	Class I Options	Other[24] Options	Total option expense for the year
No of options	10,000,000	9,050,000	1,000,000	3,300,000	0	800,000	0	800,000	200,000	35,000,000	
Expiry (years)	3	3	3.75	4	4.75	5	5.75	6	3	2	
Exercise price ($)	0.22	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.22	
Vesting period (days)	Immediately	Immediately	163	365	645	730	1,010	1,095	Immediately	Immediately	
Underlying volatility	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	
Risk free interest rate	1.62%	1.58%	1.58%	1.72%	1.72%	1.72%	1.72%	1.72%	2.02%	1.62%	
Calculated fair value of each option ($)	0.1084	0.0942	0.1068	0.1107	0.1208	0.1238	0.1321	0.1346	0.1312	0.0896	
Total expense recorded for the period ended 31 December 2016 ($)	-	852,733	106,790	186,241	-	26,056	-	18,877	26,239	*	1,216,936

[21] Class A options were issued to the brokers as part of the IPO and included as part of share transaction costs and treated as a deduction from equity (of $1,083,897, see note 16) rather than being expensed.

[22] On 22 June 2016, 2,500,000 Class C, 2,500,000 Class E and 2,500,000 Class G options were issued to James Walker, the then-CEO of the Group. On James Walker's resignation on 2 December 2016, the following options lapsed: 1,500,000 Class C options, all Class E options and all Class G options. The remaining 1,000,000 Class C options vested on 2 December 2016.

[23] Class D, F and H options carry the escrow restrictions of continuous employment to 22 June 2017; 22 June 2018 and 22 June 2019 respectively.

[24] Other Options were issued to all shareholders who subscribed for shares under the IPO for $nil consideration. Accordingly, the value of these options ($3,135,853) has been assigned to the option reserve, with a corresponding decrease in contributed equity.

Notes to the Financial Statements *continued*

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	31 December 2017 $	31 December 2016 $
4. Revenue		
Subscription sales	135,777	19,168
Hardware sales	154,378	57,648
Shipping income	20,569	7,582
Total revenue	**310,724**	**84,398**
5. Other revenue and income		
Interest revenue	46,809	43,023
Other revenue	26,052	3,676
Net foreign exchange gains (losses)	(3,278)	1,299
Total other revenue and income	**69,583**	**47,998**
6. Corporate and support expense		
Office costs and communication	323,398	144,373
Payroll	526,475	908,643
Legal	571,886	708,985
Travel and entertainment	76,766	204,011
Marketing and advertising	78,392	96,086
Professional expenses	176,316	205,728
Other	11,369	10,610
Total corporate and support expense	**1,764,602**	**2,278,436**
7. Corporate governance expense		
Audit	56,812	75,096
Board and Advisory Board expenses	196,219	203,184
Professional expenses	109,772	12,410
Insurance	47,930	38,917
ASX fees	41,139	102,959
Other	24,101	14,965
Total corporate governance expense	**475,973**	**447,531**

Notes to the Financial Statements *continued*

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	31 December 2017 $	31 December 2016 $
8. Income taxes relating to continuing operations		
The components of tax recognised in profit or loss include:		
Current tax	-	-
Deferred tax	-	-
Research and Development Tax Incentive[25]	(234,620)	-
Total tax expense/(credit)	**(234,620)**	**-**
The income tax for the year can be reconciled to the accounting profit as follows:		
Income tax expense/ (credit) calculated at 27.5% (2016: 30%)	(1,570,589)	(1,481,946)
Tax effect of amounts which are not deductible (taxable)	191,540	365,081
Research and Development Tax Incentive	(234,620)	-
Effect of unused tax losses not recognised as deferred tax assets	1,379,049	1,116,865
Income tax expense/ (credit) recognised in profit or loss (relating to continuing operations)	**(234,620)**	**-**

The tax rate used for the 2017 and 2016 reconciliations above is the corporate tax rate of 27.5% (2016: 30%) payable by Australian corporate entities on taxable profits under Australian tax law.

The Company has unused tax losses of $3,047,147 (2016: $1,668,098). The benefit of these losses will only be recognised where it is probable that future taxable profit will be available against which the benefit of the deferred tax asset can be utilised.

9. Cash and cash equivalents		
Cash at bank and in hand	312,894	997,077
Short-term deposits	2,050,000	2,500,000
Total cash and cash equivalents	**2,362,894**	**3,497,077**
10. Trade and other receivables		
Trade receivables	114,128	87,110
Prepayments	93,723	179,517
Total trade and other receivables	**207,851**	**266,627**
11. Inventories		
Finished goods inventory	**499,194**	**238,273**

[25] A tax credit of $234,620 was received in the current year in relation to expenses incurred in the 31 December 2016 financial year.

Notes to the Financial Statements *continued*

12. Plant, equipment and intangible assets

	R&D equipment $	Demonstration equipment $	Office equipment $	Intangible Assets (software) $	Total $
Balance at 1 January 2016	**12,501**	**1,141**	**-**	**-**	**13,642**
Additions	-	11,527	30,676	9,424	51,627
Disposals	-	-	-	-	-
Depreciation/Amortisation	(2,384)	(674)	(2,640)	(345)	(6,043)
Exchange differences	(32)	-	(39)	-	(71)
Balance at 31 December 2016	**10,085**	**11,994**	**27,997**	**9,079**	**59,155**
Additions	21,298	310,226	49,026	3,000	383,550
Disposals	(1,708)	-	(2,376)	-	(4,084)
Depreciation/Amortisation	-	(31,088)	(11,347)	(2,517)	(44,952)
Exchange differences	(319)	(4,207)	(1,373)	-	(5,899)
Balance at 31 December 2017	**29,356**	**286,925**	**61,927**	**9,562**	**387,770**

13. Borrowings

Convertible notes, warrants and borrowings

DroneShield Limited held no debt during the year ended 31 December 2017.

During the year ended 31 December 2016, a number of convertible notes were converted into preferred units in the issued capital of DroneShield LLC. Other borrowings of $125,856 at 1 January 2016, relating to loans in the form of interest-free Promissory Notes, were repaid in full in July 2016.

	31 December 2017 $	31 December 2016 $
14. Provisions		
Onerous contract	48,765	-
Employee entitlements	71,449	48,079
Total provisions	**120,214**	**48,079**
15. Other liabilities		
Accrued expenses	112,975	402,434
Revenue received in advance	141,195	186,111
Total other liabilities	**254,170**	**588,545**

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Notes to the Financial Statements *continued*

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16. Contributed equity

	No. of shares	$
Balance at beginning of period (1 January 2017)	**135,000,001**	**3,400,993**
Shares issued following option exercise during period (note a)	4,390,999	966,020
Shares issued under Share Purchase Plan and top-up placement (note b)	5,394,893	1,278,590
Transaction costs in relation to Share Purchase Plan and top-up placement	-	(97,177)
Shares issued from Share Placement (note c)	11,610,000	2,244,600
Transaction costs in relation to the Share Placement (note d)	-	(259,440)
Balance at end of period (31 December 2017)	**156,395,893**	**7,533,586**

Note (a): During the first half of 2017, 4,390,999 listed options were exercised, resulting in the issue of one new share in DroneShield Limited for each option. With an exercise price of $0.22 per option, the total cash received from the exercise of options during the period was $966,020.

Note (b): In June 2017, the Company issued 5,394,893 shares in a Share Purchase Plan ('SPP') and top-up placement, raising $1,278,590. The SPP offered eligible shareholders the opportunity to apply for new, fully-paid ordinary shares ('Shares') in the Company. The issue price of $0.237 per share was based on a 20% discount to the volume weighted average price of Shares traded on the ASX during the five days immediately prior to the issue date of Shares under the SPP.

Note (c): In October 2017, the Company issued 11,610,000 shares, (with one free option stapled to every three shares issued under the Share Placement), raising $2,322,000. A value of $77,400 was assigned to the options and this has been assigned to the options reserve. The assumptions used in valuing these options are set out in Note 3.

Note (d): Included within the transaction costs are the value of options issued to brokers of $173,190. The assumptions used in valuing these options are set out in Note 3.

Notes to the Financial Statements *continued*

17. Shares and options

	Number of Shares	Number of Unlisted Options	Number of Listed DROO options	Number of Performance Shares
Opening balances at 1 January 2017	135,000,001	25,150,000	35,000,000	45,000,000
SPP and top-up shares issued	5,394,893	-	-	-
Share Placement	11,610,000	2,000,000	3,869,987	-
Options exercised during the period	4,390,999	-	(4,390,999)	-
Options issued to Directors and Management	-	3,050,000	-	-
Closing balance at 31 December 2017	**156,395,893**	**30,200,000**	**34,478,988**	**45,000,000**

Unlisted Options:

4,150,000 Unlisted Options were issued to Directors and Management during the year to 31 December 2017. These Options are subject to various escrow and vesting conditions relating to length of employment with the Company. 1,100,000 of these Options lapsed due to staff leaving the Company. See note 3 for further details.

In addition, 2,000,000 Class A Options were issued to Patersons Securities Limited as part of their compensation for acting as Lead Manager for the Share Placement that occurred in October 2017. These options expire on 14 June 2019 with an exercise price of $0.22.

Listed DROO Options:

During the year ended 31 December 2017, 4,390,999 listed options were exercised, generating $966,020 in cash. An additional 3,869,987 options were issued attached to the Share Placement that occurred in October 2017. As at 31 December 2017, 34,478,988 listed options remain, these are exercisable at 22 cents on or before 22 Jun 2018.

Performance shares:

As part of the acquisition of DroneShield LLC by DroneShield Limited in 2016, 45,000,000 Performance Shares were issued to DroneShield LLC's existing shareholders. The performance shares carry the following vesting conditions, relating to the achievement of various performance milestones (with Revenue and EBIT targets in relation to the acoustic drone detection system).

Shareholders	Vesting date	Performance Shares[1]	Number in issue
Class A Performance Shares	22-Jun-18	30 day Volume weighted average price ("VWAP") >$0.30 + 20 paid system installations within 24 months of listing date	15,000,000
Class B Performance Shares	22-Jun-18	Revenue: $2,500,000 in any 12 month period or $7,000,000 cumulative within 36 months of listing date	15,000,000
Class C Performance Shares	22-Jun-18	EBIT: $1,000,000 annual (financial year) or $3,000,000 cumulative within 36 months of listing date	15,000,000

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Notes to the Financial Statements *continued*

18. Commitments

(a) Lease commitments

The cash flows in the table below relate to the minimum payments for non-cancellable operating leases. In addition to the cash flows below, at 31 December 2017 a bank guarantee for $133,035 exists in relation to the office leasing agreement.

	Minimum lease payments due		
	Within 1 year $	1-5 years $	After 5 years $
31 December 2016	124,219	186,902	-
31 December 2017	125,232	87,087	-

(b) Sub lease arrangement

The Company entered into a sublease arrangement for the Sydney office effective 13 November 2017. The cash flows in the table below relate to the minimum receipts for non-cancellable operating lease income.

	Minimum lease receivables due		
	Within 1 year $	1-5 years $	After 5 years $
31 December 2016	-	-	-
31 December 2017	86,906	59,071	-

(c) Other commitments

At 31 December 2017, a contractual agreement existed to pay a supplier $51,760 (US$40,015) for the completion of an order (2016: $105,534).

19. Key Management Personnel disclosures and related party transactions

(a) KMP Compensation

	31 December 2017 $	31 December 2016 $
Short-term employee benefits	384,922	781,528
Post-employment benefits	1,980	47,071
Termination payments	-	138,389
Share-based payments	306,147	1,031,802
Total KMP compensation	**693,049**	**1,998,790**

Detailed remuneration disclosures are provided in the Remuneration Report on pages 27- 34.

(b) Other transactions with related parties

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

- Azalea Consulting Pty Ltd, an entity associated with Mr. Winton Willesee, received payments totalling $44,000 (2016: $114,300) in relation to Director services, administration and Company Secretarial services provided to the Group. No balance was outstanding at year end (2016: $10,000).

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Notes to the Financial Statements *continued*

20. Parent entity financial information

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

	31 December 2017 $	31 December 2016 $
Statement of financial Position		
Current assets	126,643	278,331
Total assets	442,131	292,809
Current liabilities	1,593,407	148,295
Total liabilities	1,593,407	148,295
Net assets	(1,151,275)	144,514
Share Capital	1,322,547	1,322,547
Reserves	16,076	41,480
Accumulated losses	(2,489,898)	(1,219,513)
Total Equity	(1,151,275)	144,514
Loss for the year	**(1,270,385)**	**(738,399)**
Other comprehensive loss	**(25,404)**	**-**
Total comprehensive loss	**(1,295,789)**	**(738,399)**

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Notes to the Financial Statements *continued*

21. Financial risk management

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

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

Credit risk

There is limited credit risk from Trade Receivables within the Group as it currently requests payment in full before an item is shipped. Accordingly, the Trade Receivable balance at 31 December 2017 relates to invoices raised in respect of deposits for the sale of goods.

With respect to credit risk arising from other financial assets, which comprise cash and cash equivalents and prepayments, the Company's exposure to credit risk arises in the form of default of the counter party, with a maximum exposure equal to the carrying amount of these instruments. Management has considered impairment, with none noted at 31 December 2017.

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

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

	31 December 2017 $	31 December 2016 $
Cash and cash equivalents	2,362,894	3,497,077
Trade and other receivables	207,851	266,627

Liquidity risk

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

Foreign exchange risk

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

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

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

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

	31 December 2017 $	31 December 2016 $
Cash	24,398	129,902
Trade and other receivables	93,082	-
Total Financial assets	**117,480**	**129,902**
Trade and other payables	(134,710)	(41,998)
Provisions	(47,363)	(7,845)
Borrowings	-	-
Total Financial liabilities	**(182,073)**	**(49,843)**

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Notes to the Financial Statements *continued*

21. Financial risk management continued

Foreign exchange risk continued

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

	31 December 2017 $	31 December 2016 $
+ 10%	(130,216)	(8,042)
- 10%	101,427	8,042

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

Financial instrument composition and maturity analysis

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

Contractual maturities of financial liabilities	Less than 6 months $	6-12 Months $	Between 1 and 2 years $	Between 2 and 5 years $	Over 5 years $	Total contractual cash flows $	Carrying amount (assets)/ liabilities $
As at 31 December 2016							
Trade and other payables	34,757	-	-	-	-	34,757	34,757
Other financial liabilities	402,434	-	-	-	-	402,434	402,434
Total	**437,191**	**-**	**-**	**-**	**-**	**437,191**	**437,191**
As at 31 December 2017							
Trade and other payables	164,672	-	-	-	-	164,672	164,672
Other financial liabilities	112,975	-	-	-	-	112,975	112,975
Total	**277,647**	**-**	**-**	**-**	**-**	**277,647**	**277,647**

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Notes to the Financial Statements *continued*

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	31 December 2017 $	31 December 2016 $
22. Earnings (loss) per share		
(a) Basic earnings (loss) per share		
Total basic earnings (loss) per share attributable to the ordinary equity holders of the company	(0.04)	(0.07)
(b) Dilutive earnings per share		
Dilutive earnings (loss) per share attributable to the ordinary equity holders of the company	(0.04)	(0.07)
(c) Weighted average number of shares used as the denominator		
Weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share	143,593,584	71,013,699

Options and Performance Shares

Options on issue (Class A to Class K Options as set out in note 3) and Performance Shares set out in note 17 are not included in the calculation of diluted earnings per share because they are considered to be antidilutive for the period ended 31 December 2017. These options and shares could potentially dilute basic earnings per share in future periods.

23. Contingent liabilities

As at 31 December 2017 a contingent liability exists in relation to a termination payment made to a former employee of between $nil and $99,660 depending on certain contractual milestones.

24. Remuneration of auditor

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

	31 December 2017 $	31 December 2016 $
Audit and assurance services	57,000	63,796
Other services (investigating accountants report for DroneShield's IPO)	-	7,975
Taxation services	10,979	12,773
Total Auditor's remuneration	**67,979**	**84,544**

Notes to the Financial Statements *continued*

25. Segment information

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

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

The following tables present certain information regarding geographical segments for the years ended 31 December 2017 and 31 December 2016.

Segment performance 31 December 2017	**USA $**	**Australia $**	**Elimination $**	**Total $**
External sales	11,108	299,616	-	**310,724**
Total segment revenue	11,108	299,616	-	**310,724**
Interest income	-	46,809	-	**46,809**
Depreciation	(33,075)	(11,877)	-	**(44,952)**
Finance costs	-	-	-	**-**
Income tax credit/ (expense)	-	234,620	-	**234,620**
Loss after income tax expense	(1,270,385)	(4,206,228)	-	**(5,476,613)**
Assets and liabilities				
Segment assets	442,131	4,491,307	(1,475,729)	**3,457,709**
Segment liabilities	(1,593,407)	(421,378)	1,475,729	**(539,056)**

Segment performance 31 December 2016	**USA $**	**Australia $**	**Elimination $**	**Total $**
External sales	43,751	40,647	-	**84,398**
Total segment revenue	43,751	40,647	-	**84,398**
Interest income	-	43,023	-	**43,023**
Depreciation	(3,805)	(2,238)	-	**(6,043)**
Finance costs	-	-	-	**-**
Income tax expense	-	-	-	**-**
Loss after income tax expense	(738,399)	(4,201,420)	-	**(4,939,819)**
Assets and liabilities				
Segment assets	292,809	3,866,775	(98,452)	**4,061,132**
Segment liabilities	(148,295)	(621,538)	98,452	**(671,381)**

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Notes to the Financial Statements *continued*

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

	31 December 2017 $	31 December 2016 $
Operating loss for the year after tax	**(5,476,613)**	**(4,939,819)**
Add/ (deduct) non-cash items- income and expenses		
Depreciation	44,952	6,043
Provisions	72,135	47,108
Share option expense	647,743	1,216,936
Effects of foreign currency translation	(17,489)	71,089
Loss on disposal of fixed asset	4,083	-
Change in operating assets and liabilities		
Decrease/(Increase) in trade and other receivables	58,776	(260,342)
(Increase) in inventory	(260,921)	(221,534)
(Decrease)/increase in trade and other payables	(204,460)	515,266
Net cash flows from (used in) operating activities	**(5,131,794)**	**(3,565,253)**

27. Events after the reporting date

The following employee share options have been awarded and issued subsequent to the year end:

- Class F options — 450,000 options issued on 19 January 2018.
  Exercise price of $0.30, vesting on 22 June 2018 and expiring on 22 June 2021
- Class J options — 125,000 options issued on 25 January 2018.
  Exercise price of $0.50, vesting on 22 June 2018 and expiring on 22 June 2021
- Class K options — 125,000 options issued on 25 January 2018.
  Exercise price of $0.50, vesting on 22 June 2019 and expiring on 22 June 2022

No other matter or circumstance has arisen since 31 December 2017 which has significantly affected or may significantly affect:

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

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Directors' Declaration

1. In the opinion of the Directors:

   (a) the consolidated financial statements and notes set out on pages 36 to 60 are in accordance with the *Corporations Act 2001*, including:

      (i) giving a true and fair view of the Group's financial position as at 31 December 2017 and of its performance for the financial year ended on that date; and

      (ii) complying with Australian Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

   (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

2. The notes to the consolidated financial statements include a statement of compliance with International Financial Reporting Standards.

3. The Directors have been given the declarations by the Chief Executive Officer and the Chief Financial Officer for the year ended 31 December 2017 required by section 295A of the *Corporations Act 2011*.

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



Peter James
Independent Non-Executive Chairman

Sydney, NSW
22 February 2018

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Quality Audit Services

DRONESHIELD LIMITED

ABN 26 608 915 859

INDEPENDENT AUDITOR'S REPORT

To the Members of DroneShield Limited

REPORT ON THE AUDIT OF THE FINANCIAL REPORT

Opinion

We have audited the financial report of DroneShield Limited ("the Company") and its controlled entities ("the Group"), which comprises the consolidated statement of financial position as at 31 December 2017, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

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

(a) giving a true and fair view of the Group's financial position as at 31 December 2017 and of its financial performance for the year then ended; and
(b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

Basis for Opinion

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

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

Material Uncertainty Related to Going Concern

We draw attention to Note 1(a) in the financial report, which indicates that, the Group incurred a net loss of $5,476,613 and incurred cash outflows from operating activities of $5,131,794 for the year ended 31 December 2017, and had net asset of $2,918,653 at 31 December 2017. As stated in Note 1(a), these events or conditions, along with other matters as set forth in Note 1(a), indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

HLB Mann Judd Assurance

DRONESHIELD LIMITED

ABN 26 608 915 859

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

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. In addition to the matter described in the *Material Uncertainty Related to Going Concern* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Key Audit Matter	How our audit addressed the key audit matter
Valuation of Share Options (Note 3)	
The Company issued a number of share options to directors, management, employees, advisors to and investors in DroneShield Limited. The fair value of the options at grant date was determined by management, and used to account for the options. The key assumptions used in determining the fair value of the options are set out in Note 3 to the financial statements. We focused on this area as a key audit matter due to the judgement involved in assessing the fair value of the options.	We reviewed the valuation of the options, and the methodology used. We also reviewed the key assumptions in the valuation. We assessed whether the Group's disclosures met the requirements of accounting standards.
Valuation of Inventories (note 11)	
At 31 December 2017, the Group held inventories with a carrying value of $499,194. During the year, the Group generated sales of $290,155 (excluding shipping income). The valuation of inventory is a significant area of judgement by management as detailed in note 2, and includes judgements about the future, including sales forecasts. We focussed on this area as a key audit matter as the carrying value of inventory at 31 December 2017 is a significant asset, and due to the judgement used by management in estimating the net realisable value of the inventory.	We reviewed the cost of these items by agreeing a sample to purchase invoices. We discussed with management its plans to sell inventory, and obtained sales forecasts prepared to assess if forecasts were above the value of inventory at year end. Where possible for a product line, we reviewed sales made during the year, and any deposits received for potential future sales, to assess if sales prices being charged or proposed are above carrying value. We enquired of management whether there was any indication that newer inventory models would mean any obsolescence of older inventory models

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DRONESHIELD LIMITED

ABN 26 608 915 859

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Key Audit Matter	How our audit addressed the key audit matter
Valuation of Demonstration Equipment (note 12)	
At 31 December 2017, the Group held demonstration equipment with a carrying value of $286,925. The carrying value of demonstration equipment is a significant area of judgement by management as detailed in note 2 including judgements about the future, including preparing sales forecasts. We focussed on this area as a key audit matter as the carrying value of capitalised demonstration equipment at 31 December 2017 is a significant asset, and due to the judgement used by management in preparing its assessment of impairment.	We reviewed the cost of these items by agreeing a sample to purchase invoices. We assessed whether the policy to capitalise was in accordance with accounting standards. We discussed with management its plans to generate sales, and obtained sales forecasts prepared to identify if any impairment indicators existed. Where possible, we reviewed sales made during the year, and any deposits received for potential future sales, to assess if any impairment indicators existed. We reviewed the useful life of these assets. We enquired of management whether there was any indication that the technological advances would indicate that the items capitalised were obsolete.

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

The directors are responsible for the other information. The other information comprises the information included in the Group's annual report for the year ended 31 December 2017, but does not include the financial report and our auditor's report thereon.

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

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

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

Responsibilities of the Directors for the Financial Report

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

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

HLB Mann Judd Assurance

DRONESHIELD LIMITED

ABN 26 608 915 859

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Auditor's Responsibilities for the Audit of the Financial Report

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

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

- Identify and assess the risks of material misstatement of the financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial report or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

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HLB Mann Judd Assurance

DRONESHIELD LIMITED

ABN 26 608 915 859

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

REPORT ON THE REMUNERATION REPORT

Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 27 to 34 of the directors' report for the year ended 31 December 2017.

In our opinion, the Remuneration Report of DroneShield Limited for the year ended 31 December 2017 complies with section 300A of the *Corporations Act 2001*.

Responsibilities

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

HLB Mann Judd Assurance (NSW) Pty Ltd
Chartered Accountants

A G Smith
Director

Sydney, NSW
22 February 2018

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Shareholder Information

Holdings distribution at 15 February 2018

Holding Ranges	Holders	Total Shares	% Issued Share Capital
1 - 1,000	43	8,204	0.01%
1,001 - 5,000	407	1,215,754	0.78%
5,001 - 10,000	191	1,571,835	1.01%
10,001 - 100,000	358	12,655,802	8.09%
100,001 - over	63	140,944,298	90.12%
Total	**1,062**	**156,395,893**	**100.00%**

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

Twenty largest shareholders at 15 February 2018

Position	Holder Name	Shares Held	% Issued Share Capital
1	LONG HILL CAPITAL LLC	55,000,001	35.17%
2	BRIAN HEARING	17,550,000	11.22%
3	JOHN FRANKLIN	14,850,000	9.50%
4	EAGLE'S VIEW MULTI-STRATEGY LLC	7,287,201	4.66%
5	BNP PARIBAS NOMS PTY LTD <DRP>	6,319,224	4.04%
6	EAGLE'S VIEW CAPITAL PARTNERS L P	5,294,496	3.39%
7	ROBERT DINKEL & KATHLEEN DINKEL	4,500,000	2.88%
7	LAURENCE ROSENFELD	4,500,000	2.88%
8	EAGLE'S VIEW DIVERSIFIED OPP FUND L P	4,134,622	2.64%
9	AZOTH LLC	2,250,000	1.44%
10	EAGLE'S VIEW SPECIAL OPP FUND L P	2,083,449	1.33%
11	EAGLE'S VIEW PARTNERS LTD	2,056,494	1.31%
12	EAGLE'S VIEW OFFSHORE FUND LTD CLASS B	1,708,583	1.09%
13	WEST MEADOW LLC	1,360,549	0.87%
13	Eagle's View	1,360,549	0.87%
15	HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED	1,241,818	0.79%
16	EAGLE'S VIEW OFFSHORE FUND LTD CLASS E	1,001,454	0.64%
17	CITICORP NOMINEES PTY LIMITED	652,318	0.42%
18	BNP PARIBAS NOMS PTY LTD <UOB KAY HIAN PRIV LTD DRP>	445,146	0.28%
19	JNW SFUND PTY LTD <JNW SUPER FUND A/C>	365,093	0.23%
20	MR TERRENCE PETER WILLIAMSON & MS JONINE MAREE JANCEY <THE WILJAN SUPER FUND A/C>	341,948	0.22%
Total		**134,284,374**	**85.87%**
Balance of register		22,111,519	14.13%
Total issued capital		**156,395,893**	**100.00%**

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