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Half-Year Report of *Electro Optic Systems Holdings Limited* for the Half-Year Ended 30 June 2019

ACN 092 708 364

This Half-Year Report is provided to the Australian Stock Exchange (ASX) under ASX Listing Rule 4.2A.3.

Current Reporting Period: Half-year ended 30 June 2019

Previous Corresponding Period: Half-year ended 30 June 2018

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Results for Announcement to the Market

Revenue and Net Profit

		Percentage Change %	Amount
Revenue from ordinary activities	Up	62.0	\$57,433,610
Profit from ordinary activities after tax attributable to members	Up	40.8	To \$7,521,411
Profit attributable to members	Up	40.8	To \$7,521,411

Dividends (Distributions)

	Amount per security	Franked amount per security
Final dividend	Nil¢	Nil¢
Interim dividend	Nil¢	Nil¢
Record date for determining entitlements to the dividend:		
• final dividend		N/A
• interim dividend		N/A
Net tangible assets at 30 June 2019		\$104,197,140
Number of ordinary shares outstanding at 30 June 2019		96,103,879
NTA per ordinary share at 30 June 2019		108.42 cents
NTA per ordinary share at 30 June 2018		90.10 cents

Brief Explanation of Revenue, Net Profit and Dividends (Distributions)

Refer to Directors' Report

Review of Operations

1. RESULTS FOR HALF-YEAR ENDED 30 JUNE 2019

The consolidated entity (“EOS”) reported an operating profit after tax of \$7,519,823 for the six month period to 30 June 2019 [30 June 2018: \$5,341,475] after allowing for income tax expenses of \$2,115,680 [30 June 2018: Nil]. This is based on revenues from ordinary activities totalling \$57,433,610 [30 June 2018: \$35,439,848].

The consolidated entity reported net cash used by operations for the six month period totalling \$1,279,750 [30 June 2018: \$7,888,829]. At 30 June 2019, the consolidated entity held cash totalling \$36,234,727 [30 June 2018: \$59,661,721]. Cash of \$102,025 [30 June 2018: \$8,665,599] is restricted as it secures bank guarantees relating to performance on some contracts.

The net profit before income tax of \$9,635,503 represents an EBIT of \$9,360,724 after adjusting for net interest of \$274,779 (refer notes 2(b) and 2(d)). Foreign exchange operations did not make a substantial contribution to this result.

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

2. EOS DEFENCE SYSTEMS

The half year sector profit before income tax of \$10.9 million represents an EBIT of \$10.6 million is an improvement over the corresponding prior period. The improved result was principally due to increased efficiency as plant utilisation moved past 60% of full capacity in the Australian plant at Hume, ACT.

Almost all processes showed performance improvement as output moved closer towards the design capacity of 480 remote weapon systems (“RWS”) per year.

During the period the sector significantly increased outlays in marketing, product development and production capacity, consistent with the needs of an expanding market:

- Marketing efforts increased by over 50% in terms of outlays and deployed staff. This has included an improved web site, and social media and media presence, and the introduction of targeted advertising campaigns.
- Investment in new products, or customer-specified variants of current products, increased significantly. This expansion has included the high cost of design and production management of rapidly-proliferating configurations.
- Capacity expansions were initiated in EOS plants in the USA, Singapore and UAE.

Improved efficiency of execution is allowing EOS to be price-competitive on new tenders and proposals, and the sector has taken an aggressive stance to defend market share in the new markets it is creating.

Review of Operations

3. EOS SPACE SYSTEMS

The half year segment loss of \$1.2 million is consistent with prior expectations.

During this period EOS operated a network of its space sensors to provide space tracking data on an internationally-significant scale. This activity was performed on time and within the allocated budget.

The sector continues to make strong investments in research and development. During this six month period, investments in research through the Commonwealth's Cooperative Research Centre for Space Environment Management exceeded \$2 million. Other significant internal research programs continue to be supported, and EOS researchers believe that they may now be close to breakthroughs of strong commercial significance.

4. OUTLOOK AND FORECAST

Defence

The half year result of \$10.6 million EBIT is consistent with expectations and places the sector on track for the forecast full-year result.

EOS expects a stronger second half result based on further improvements in capacity utilisation. However this improvement will be largely offset by significant investments the company must now allocate from management, engineering and production resources to prepare for the next stage of growth. This should not impact delivery of forecast profits.

From 2016-2019 EOS has implemented a plan to expand annual RWS production capacity of 600% from \$50 million to \$300 million. This plan involved establishing scalable production in Australia as a template for replication globally, and the company has previously reported on key aspects of this expansion process and the associated risk management.

With less than 12 months remaining to execute on this original plan, key metrics and operating results suggest it has been completely successful.

EOS must initiate the next stage of capacity expansion at least 12 months before output begins to saturate at \$300 million of annual production. This next expansion phase will see a capacity increase of 300% over the period 2020-2024, to achieve over \$900 million in annual production capacity. This capacity will be distributed globally, profitably scalable and connected to a resilient supply chain.

Customer offset requirements and skill shortages in Australia require EOS growth offshore to now be much higher than in Australia. Existing EOS plants in the USA, Singapore and UAE are expanding in capacity, and new production ventures are being configured into most major tenders. These developments leverage the scalable production processes developed by EOS over the past 30 months, and are not expected to degrade profitability.

Review of Operations

There are three key aspects of the new expansion:

- A. **New Plants.** In the initial expansion phase, quiescent plants were established in the USA, Singapore and UAE but production was not initiated in any of them. All of these plants will come on line in 2020 with scalable production tailored to local and regional needs.
- B. **New Processes.** To achieve scale, EOS must again upgrade its capabilities, resources and infrastructure in financial systems, cost control, engineering software, configuration management and global IT networks. A new management team is being installed with global briefs for production, engineering, IT and supply chain management.
- C. **Supply Chain.** The management of the supply chain has been a highlight of the initial expansion phase. Global diversification of the supply chain, initiated over the past two years, will now be accelerated with special adaptations to meet the requirements of each EOS plant globally.

The offshore expansion plants have been established already and the additional capital equipment required for each to ramp production can be prudently financed within the normal course of business unless capacity growth must be further accelerated.

The sector has sufficient contract backlog to secure the forecast EBIT growth for 2019, 2020 and 2021. However EOS is actively seeking more contract awards which would add to revenue by 2020 and push production requirements well above current capacity.

The sector is currently competing in over \$2 billion of procurements globally. On average, around \$300 million of this pipeline is expected to be awarded during each quarter from early in 2020. Once awarded, most contracts require shipments to commence within nine months.

The company is confident of achieving all prior forecasts, and there is scope for even stronger results from 2020 provided the company maintains its historical success rate in tenders and the capacity increase is successfully executed.

Considering all aspects of the business, the outlook for the sector is positive with business volume and EBIT both expected to grow significantly going forward.

Space

In the second half the EOS Space Sector is expected to provide sufficient profit to erase its first half loss of \$1.2 million.

EOS Space Sector provides technology solutions to address global requirements for space debris mitigation, space traffic management, space situation awareness and space communications. These solutions typically comprise EOS sensors integrated with large EOS real-time software platforms that manage vast and rapidly-changing data sets.

After a lengthy development and testing period for its commercial solutions, EOS Space Sector is currently participating in over \$200 million of potential procurements globally.

Review of Operations

Most of these procurements are the lead element of a larger program requirement. For each of these opportunities EOS is either the sole source, or one of very few qualified bidders.

Negotiations with the initial customer group are expected to lead to contract awards to successful bidders within about six months.

The announcements of the formation of the US Space Corps and France's Space Force are indicative of the renewed emphasis on space as a critical domain for both commerce and national security. More programs of opportunity for EOS are emerging as customer needs escalate and EOS exposes its capabilities.

EOS continues to develop new technology for space applications. The company expects to announce late in Q3 2019 a major technical development with impact on a wide range of commercial operations in space. The new technology programs are independent of, but strongly complemented by, the EOS space sensor capabilities and infrastructure.

The outlook for the EOS Space Sector is positive and improving. EOS has previously indicated that this sector would transition from loss to profit from Q4 2019 and be profitable on an annual basis from 2020. The sector is now expected to be profitable for the full 12 month period ending 31 December 2019.

Forecast

EOS' fundamental objective is reliable long term profit growth.

Based solely on existing orders and contracts, the company expects to achieve EBIT of around \$20 million for the full year to 31 December 2019, and EBIT of around \$28 million for the full year ending 31 December 2020.

These existing forecasts represent the minimum expected performance of the company going forward. The company believes that new orders across both business sectors will allow forecasts to be exceeded from 2020.

Across both business sectors EOS is in contention for over \$1.2 billion of contract awards in each of 2020 and 2021. Tender activity for 2022 awards is already tracking beyond this level. For each individual contract award there are a maximum of three qualified competitors, and usually fewer.

In the past three years EOS has not participated in a substantial tender that was awarded to a competitor. This record is clearly not sustainable, but the EOS success rate over the long term in comparable circumstances is around 40%.

We expect the indicated rate of tenders and awards to be maintained well beyond 2021. As the proportion of revenue attributable to EOS Space Sector increases, so also will the margin achieved. This is because Space Sector margins are higher than for Defence Sector, due to significant investments already made and expensed.

Review of Operations

Forecasts assume no substantial change in the exchange rate of AU\$ against US\$. However exchange rates can be volatile and both gains and losses can arise from normal operations.



Ben Greene
Chief Executive Officer

30 August 2019

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ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Directors' Report

The directors of Electro Optic Systems Holdings Limited submit herewith the financial report for the half-year ended 30 June 2019. In order to comply with the provisions of the Corporations Act 2001, the directors report as follows:

The names of the directors of the company during or since the end of the half year are:

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

Review of Operations

A detailed review of operations is included on pages 3 to 7 of this financial report.

Auditor's independence declaration

The auditor's independence declaration is included on page 9 of the half-year financial report.

Signed in accordance with a resolution of the directors made pursuant to s.306(3) of the Corporations Act 2001.

On behalf of the Directors



I.A Dennis
Director
Sydney, 30 August 2019

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

30 August 2019

Dear Board Members

Auditor's Independence Declaration to Electro Optic Systems Holdings Limited

In accordance with section 307C of the Corporations Act 2001, I am pleased to provide the following declaration of independence to the directors of Electro Optic Systems Holdings Limited.

As lead audit partner for the review of the financial report of Electro Optic Systems Holdings Limited for the half year ended 30 June 2019, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- (i) the auditor independence requirements of the Corporations Act 2001 in relation to the review; and
- (ii) any applicable code of professional conduct in relation to the review.

Yours faithfully

DELOITTE TOUCHE TOHMATSU

DELOITTE TOUCHE TOHMATSU

David Salmon

David Salmon
Partner
Chartered Accountants

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

We have reviewed the accompanying half-year financial report of Electro Optic Systems Holdings Limited, which comprises the condensed consolidated statement of financial position as at 30 June 2019, and the condensed consolidated statement of profit or loss and other comprehensive income, the condensed consolidated statement of cash flows and the condensed consolidated statement of changes in equity for the half-year ended on that date, notes comprising a summary of significant accounting policies and other explanatory information, and the directors' declaration of the consolidated entity comprising the company and the entities it controlled at the end of the half-year or from time to time during the half-year as set out on pages 12 to 30.

Directors' Responsibility for the Half-Year Financial Report

The directors of the company are responsible for the preparation of the half-year 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 half-year financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 30 June 2019 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Electro Optic Systems Holdings Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Auditor's Independence Declaration

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of Electro Optic Systems Holdings Limited, would be in the same terms if given to the directors as at the time of this auditor's review report.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Electro Optic Systems Holdings Limited is not in accordance with the *Corporations Act 2001*, including:

- (a) giving a true and fair view of the consolidated entity's financial position as at 30 June 2019 and of its performance for the half-year ended on that date; and
- (b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

DELOITTE TOUCHE TOHMATSU

DELOITTE TOUCHE TOHMATSU

David Salmon

David Salmon
Partner
Chartered Accountants
Canberra, 30 August 2019

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Directors' Declaration

The directors declare that:

- a) in the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable; and
- b) in the directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the consolidated entity.

Signed in accordance with a resolution of the directors made pursuant to s.303(5) of the Corporations Act 2001.

On behalf of the Directors



I A Dennis
Director
Sydney, 30 August 2019

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Condensed Consolidated statement of profit or loss and other comprehensive income for the half-year ended 30 June 2019

	Note	Half-year ended 30 June 2019 \$	Half-year ended 30 June 2018 \$
Revenue	2(a)	57,433,610	35,439,848
Other Revenue	2(b)	355,677	321,219
Foreign exchange gains	2(c)	574,004	3,914,384
Changes in inventories of finished goods and work in progress		3,934,553	(796,684)
Raw materials and consumables used		(31,567,052)	(17,676,604)
Employee benefits expense		(13,392,597)	(9,404,112)
Administrative costs		(3,984,749)	(3,918,146)
Finance costs	2(d)	(1,510,882)	(177,565)
Depreciation and amortisation expense	2(d)	(1,456,691)	(197,255)
Lease expenses		(59,481)	(59,480)
Occupancy costs		(368,363)	(1,614,653)
Other expenses		(322,526)	(489,019)
Provision for doubtful debts		-	(458)
Profit before income tax expense	2	9,635,503	5,341,475
Income tax expense		(2,115,680)	-
Profit for the period	6	7,519,823	5,341,475
Attributable to:			
Owners of the Company		7,521,411	5,341,475
Non-controlling interests		(1,588)	-
		7,519,823	5,341,475
Other comprehensive income			
Items that may be reclassified subsequently to profit and loss			
Exchange differences arising on translation of foreign operations		185,812	(835,168)
Income tax relating to components of other comprehensive income		-	-
		185,812	(835,168)
Total comprehensive profit for the period		7,705,635	4,506,307
Attributable to :			
Owners of the Company		7,707,223	5,341,475
Non-controlling interests		(1,588)	-
		7,705,635	5,341,475
Profit per share:			
Basic (cents per share)	7	8.27	6.32
Diluted (cents per share)	7	8.27	6.32

Notes to the condensed consolidated financial statements are included on pages 17 to 30.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Condensed Consolidated statement of financial position as at 30 June 2019

	Note	30 June 2019 \$	31 December 2018 \$
Current Assets			
Cash and cash equivalents		36,234,727	40,538,225
Inventories		40,109,918	26,465,499
Trade and other receivables		19,987,176	26,819,746
Other		14,685,488	12,713,727
Total Current Assets		111,017,309	106,537,197
Non-Current Assets			
Investment in associate	3	494,053	-
Property, plant and equipment		5,279,061	3,960,849
Right of use asset		4,866,177	-
Security deposit		9,019,251	8,971,929
Trade and other receivables		10,820,936	7,146,990
Other		-	2,252,177
Total Non-Current Assets		30,479,478	22,331,945
Total Assets		141,496,787	128,869,142
Current Liabilities			
Trade and other payables		17,696,489	22,328,897
Lease liabilities		1,589,344	-
Current tax payable		2,115,680	-
Provisions		7,130,360	6,366,891
Total Current Liabilities		28,531,873	28,695,788
Non-Current Liabilities			
Lease liabilities		3,335,111	-
Provisions		5,432,663	3,891,770
Total Non-Current Liabilities		8,767,774	3,891,770
Total Liabilities		37,299,647	32,587,558
Net Assets		104,197,140	96,281,584
Equity			
Issued capital	4	161,784,727	161,784,727
Reserves	5	8,868,524	8,472,791
Accumulated losses	6	(66,292,754)	(73,814,165)
Equity attributable to owners of the Company		104,360,497	96,443,353
Non-controlling interests		(163,357)	(161,769)
Total Equity		104,197,140	96,281,584

Notes to the condensed consolidated financial statements are included on pages 17 to 30.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Condensed Consolidated Statement of changes in equity for the half-year ended 30 June 2019

	Total \$	Accumulated losses \$	Issued capital \$	Non- controlling interests	Foreign currency translation reserve \$	Employee equity settled benefits reserve \$
Consolidated						
Balance at 1 January 2019	96,281,584	(73,814,165)	161,784,727	(161,769)	(1,399,064)	9,871,855
Profit for the period	7,519,823	7,521,411	-	(1,588)	-	-
Other comprehensive income for the period	185,812	-	-	-	185,812	-
Total comprehensive income for the period	7,705,635	7,521,411	-	(1,588)	185,812	-
Recognition of share based payments	209,921	-	-	-	-	209,921
Balance at 30 June 2019	104,197,140	(66,292,754)	161,784,727	(163,357)	(1,213,252)	10,081,776
Consolidated						
Balance at 1 January 2018	23,570,620	(89,116,379)	103,342,071	-	(241,137)	9,586,065
Issue of 10,471,434 ordinary shares at \$2.91 each	28,948,278	-	28,948,278	-	-	-
Issue of 10,147,123 Ordinary shares at \$2.91 each	28,051,722	-	28,051,722	-	-	-
Issue of 495,758 at \$2.91 under the Small Shareholder Plan	1,442,656	-	1,442,656	-	-	-
Profit for the period	5,341,475	5,341,475	-	-	-	-
Other comprehensive income for the period	(835,168)	-	-	-	(835,168)	-
Total comprehensive income for the period	4,506,307	5,341,475	-	-	(835,168)	-
Recognition of share based payments	66,373	-	-	-	-	66,373
Balance at 30 June 2018	86,585,956	(83,774,904)	161,784,727	-	(1,076,305)	9,652,438

Notes to the condensed consolidated financial statements are included on pages 17 to 30.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Condensed Consolidated statement of cash flows for the half-year ended 30 June 2019

	Half-year ended 30 June 2019 \$	Half-year ended 30 June 2018 \$
Cash Flows From Operating Activities		
Receipts from customers	58,292,395	25,251,267
Payments to suppliers and employees	(58,416,940)	(32,908,948)
Interest and bill discounts received	355,677	321,219
Interest and other costs of finance paid	(1,510,882)	(552,367)
Net cash (used in) operating activities	(1,279,750)	(7,888,829)
Cash Flows From Investing Activities		
Payment for property, plant and equipment	(1,937,136)	(858,069)
Investments	(494,053)	-
Net cash (used in) investing activities	(2,431,189)	(858,069)
Cash Flows From Financing Activities		
Placement of new ordinary shares	-	58,442,656
Repayment of lease liabilities	(808,996)	-
Net cash provided by financing activities	(808,996)	58,442,656
Net (Decrease)/ Increase in Cash Held	(4,519,935)	49,695,758
Cash and cash equivalents at the beginning of the half-year	40,538,225	9,989,953
Effects of exchange rate changes on the balance of cash held in foreign currencies	216,437	(23,990)
Cash and cash equivalents at the end of the half-year	36,234,727	59,661,721

Notes to the condensed consolidated financial statements are included on pages 17 to 30.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Notes to the condensed consolidated Financial Statements for the half-year ended 30 June 2019

1. Significant accounting policies

1 (a) Statement of Compliance

The half-year financial report is a general purpose financial report prepared in accordance with the Corporations Act 2001 and AASB 134 Interim Financial Reporting. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS 34 Interim Financial Reporting. The half-year financial report does not include notes of the type normally included in an annual financial report and shall be read in conjunction with the most recent annual financial report.

1 (b) Basis of preparation

The condensed consolidated financial statements have been prepared on the basis of the historical cost convention. Cost is based on the fair values of the consideration given in exchange for assets. Except where indicated otherwise, all amounts are presented in Australian dollars.

With the exception of new policies outlined in Note 1(c) below, the accounting policies and methods of computation adopted in the preparation of the half-year financial report are consistent with those adopted and disclosed in the Group's 2018 annual financial report for the financial year ended 31 December 2018. These accounting policies are consistent with Australian Accounting Standards and with International Financial Reporting Standards.

1 (c) New accounting Standard- AASB 16 Leases

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

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

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

Impact on Lessee Accounting

Former operating leases

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

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

- a) recognises right-of-use assets and lease liabilities in the consolidated statement of financial position, initially measured at the present value of future lease payments;
- b) recognises depreciation of right-of-use assets and interest on lease liabilities in the consolidated statement of profit or loss; and

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Notes to the condensed consolidated Financial Statements for the half-year ended 30 June 2019

1. Significant accounting policies (cont)

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

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

Under AASB 16, right-of-use assets are tested for impairment in accordance with AASB 136 Impairment of Assets. This replaces the previous requirement to recognise a provision for onerous lease contracts.

For short-term leases (lease term of 12 months or less) and leases of low-value assets, the Group has opted to recognise a lease expense on a straight-line basis as permitted by AASB 16. This expense is presented within other expenses in the consolidated statement of profit or loss as applicable.

Financial impact of initial application of AASB 16

The initial application of AASB 16 resulted in:-

- i. The creation of a right-of-use asset of \$5,703,519 and a lease liability of \$5,733,451 as at 1 January 2019.
- ii. A difference of \$246,552 between the operating lease commitments disclosed in applying AASB 117 in the 31 December 2018 annual report, discounted using the rate implicit in the lease in (i) above, and the lease liability in (ii) above. This difference is primarily attributable to the inclusion of certain leases as part of the opening adjustment that were previously not disclosed as operating lease commitments.
- iii. When measuring lease liabilities, the Group discounted lease payments using the rate implicit in the lease. Where this could not be determined, the Group's incremental borrowing rate was used. The weighted average rate applied is 4.75%.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Notes to the condensed consolidated Financial Statements for the half-year ended 30 June 2019

1. Significant accounting policies (cont)

1 (d) Accounting policies applied from 1 January 2019

Leases

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

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

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

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

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

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

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

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

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

**Notes to the condensed consolidated Financial Statements
for the half-year ended 30 June 2019**

1. Significant accounting policies (cont)

The Group did not make any such adjustments during the period.

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

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

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

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

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

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

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

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

**Notes to the condensed consolidated Financial Statements
for the half-year ended 30 June 2019**

2. Profit From Ordinary Activities

Profit from ordinary activities before income tax includes the following items of revenue and expense:

(a) Revenue

Sale of goods	56,197,258	34,403,821
Providing services	1,236,352	1,036,027
Total revenue	57,433,610	35,439,848

Disaggregation of revenue

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

**Timing of revenue recognition
Over time**

	Revenue	Revenue \$
Defence segment – Sale of goods	50,399,957	32,788,346
Total Revenue recognise over time	50,399,957	32,788,346

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

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED
Notes to the condensed consolidated Financial Statements
for the half-year ended 30 June 2019

2. Profit From Ordinary Activities (cont)

	Half-year to 30 June 2019 \$	Half-year to 30 June 2018 \$
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All other revenue is recognised at a point in time.

At a point in time

	Revenue	Revenue
Defence segment – Sale of goods	5,797,301	1,408,860
Defence segment – Providing services	442,549	404,618
Space segment – Sale of goods	-	206,615
Space segment – Providing services	793,803	631,409
Total Revenue recognise at a point in time	<u>7,033,653</u>	<u>2,651,502</u>
Total Revenue	<u>57,433,610</u>	<u>35,439,848</u>

(b) Other Revenue

Interest received	<u>355,677</u>	<u>321,219</u>
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(c) Foreign Exchange Gains

Foreign exchange gains	<u>574,004</u>	<u>3,914,384</u>
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(d) Expenses

Profit for the period includes the following expenses:

	Half-year to 30 June 2019 \$	Half-year to 30 June 2018 \$
Interest paid	80,898	17,760
Other finance costs	<u>1,429,984</u>	<u>159,805</u>
Finance costs	<u>1,510,882</u>	<u>177,565</u>
Depreciation of property, plant and equipment and right of use assets	<u>1,456,691</u>	<u>197,255</u>

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Notes to the condensed consolidated Financial Statements for the half-year ended 30 June 2019

3. Investment in Associate

	As at 30 June 2019 \$	As at 30 June 2018 \$
Investment	494,053	-

- i. On 23 April 2019 the EOS Group entered into an Unsecured Convertible Note deed with a supplier ("supplier"). The terms of the deed are that the supplier agrees to issue to the EOS Group five convertible notes, subject to certain conditions, with a total value of \$3.6m. All five notes are convertible into such number of shares which represents 51% of the issued share capital of the supplier at the date of conversion.

The first note was issued to the Group on 23 April 2019 for a consideration of \$494,053. Following payment of this note the EOS Group appointed two out of five directors of the supplier and had the right to appoint, remove or replace such number of directors which represent 50% of the board of directors (equivalent to 50% of directors' voting rights under the revised articles of association). The combination of the consideration paid and the rights obtained resulted in the Group having significant influence over the supplier.

The issue of the second note was dependent upon certain performance conditions which were achieved post 30 June 2019. Issuance of notes three, four and five can only occur on the successful completion of further performance conditions and warranties and such issuance is at the discretion of the EOS Group.

The notes are redeemable upon an event of default or at the maturity date (being 36 months after date of issue of the first note above – 23 April 2019), the supplier must repay the face value of the notes to the EOS Group.

- ii. On the same date as entering into the above Unsecured Convertible Note deed the EOS Group entered into a Put and Call Option deed with the shareholders of the supplier. This deed allows the EOS Group to call the shareholders to sell their remaining 49% of the shareholding in the supplier (being those shares not subject to the convertible notes discussed in (i) above) at an aggregate exercise price based on an adjusted Net Profit after Tax (NPAT) multiple. The shareholders also have a put option over the same interest.

The back to back put and call options can be exercised by the Group (or the shareholders) at any time up to and including 30 June 2022 but only after all five Convertible Notes outlined in i) above have been converted.

Further, under this agreement, upon meeting certain conditions precedent, the EOS Group is required to advance loans totalling \$3.1m to the shareholders in four equal tranches of \$775,000. These loans will be set off against the aggregate exercise price of the above mentioned put and call options.

- iii. Refer to the subsequent events note (Note 11) for events relating to the supplier that occurred post reporting date.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

**Notes to the condensed consolidated Financial Statements
for the half-year ended 30 June 2019**

	30 June 2019 \$	31 December 2018 \$
4. Issued Capital		
Balance at the beginning of the financial year – Ordinary shares	161,784,727	103,342,071
Issue of 10,471,434 new shares at \$2.91 on 9 February 2018 (net of issuance costs)	-	28,948,278
Issue of 10,147,123 new shares at \$2.91 on 16 March 2018 (net of issuance costs)	-	28,051,722
Issue of 495,758 new shares at \$2.91 on 21 March 2018 under the Small Shareholder Plan	-	1,442,656
Issue of 5,180,000 new shares at \$2.99 on 20 June 2018 under the Loan Funded Share Plan	-	-
Balance at the end of the financial period	<u>161,784,727</u>	<u>161,784,727</u>
Fully Paid Ordinary Shares		
	Number	Number
Balance at the beginning of financial year	96,103,879	69,809,564
Issue of new shares at \$2.91 on 9 February 2018	-	10,471,434
Issue of new shares at \$2.91 on 16 March 2018	-	10,147,123
Issue on new shares at \$2.91 on 21 March 2018 under the Small Shareholder Plan	-	495,758
Issue of new shares at \$2.99 on 20 June 2018 under the Loan Funded Share Plan	-	<u>5,180,000</u>
Balance at end of financial period	<u>96,103,879</u>	<u>96,103,879</u>
Fully paid ordinary shares carry one vote per share and carry the right to dividends.		
	As at 30 June 2019 \$	As at 30 June 2018 \$
5. Reserves		
Foreign currency translation reserve	(1,213,252)	(1,076,305)
Employee equity settled benefits reserve	<u>10,081,776</u>	<u>9,652,438</u>
Balance at end of financial period	<u>8,868,524</u>	<u>8,576,133</u>

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

**Notes to the condensed consolidated Financial Statements
for the half-year ended 30 June 2019**

	As at 30 June 2019 \$	As at 30 June 2018 \$
6. Accumulated Losses		
Balance at beginning of financial period	(73,814,165)	(89,116,379)
Net Profit for the period	7,521,411	5,341,475
Balance at end of financial period	(66,292,754)	(83,774,904)

7. Profit Per Share

	2019 ¢ per share	2018 ¢ per share
Basic EPS	8.27	6.32 cents
Diluted EPS	8.27	6.32 cents

Basic Profit per Share

The earnings and weighted average number of ordinary shares used in the calculation of basic earnings per share are as follows:

	Half-year to 30 June 2019 \$	Half-year to 30 June 2018 \$
Profit (a)	7,519,823	5,341,475
	2019 No.	2018 No.
Weighted average number of ordinary shares used in the calculation of basic earnings per share	90,923,879	84,472,209

- (a) Profit used in the calculation of basic earnings per share is the same as net profit in the statement of profit or loss and other comprehensive income.
- (b) The 220,000 unlisted options outstanding are in the money at 30 June 2019 and are not considered dilutive as all the conditions of exercise have not been met at the reporting date.
- (c) The 5,180,000 ordinary shares issued on 20 June 2018 at a price of \$2.99 under the Loan Funded Share Plan are not included in the weighted average number of ordinary shares as they are treated as in substance options for accounting purposes. The conditions in relation to these in substance options have not been met at the reporting date.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

**Notes to the condensed consolidated Financial Statements
for the half-year ended 30 June 2019**

8. Contingent Liabilities and Commitments

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

b) The parent entity has provided a guarantee to the Commonwealth of Australia for \$2,750,000 in respect of advance payments received of \$3,950,000 (Inclusive of GST) in relation to a space sector project. Since the end of the financial period, the advance payments have been fully acquitted and the guarantee withdrawn.

c) A subsidiary company, EOS Defence Systems Pty Limited has provided a performance bond of US\$31,635,146.70 in relation to an overseas defence sector contract. This performance bond is secured by a security deposit of A\$9,019,251 and a fixed and floating charge over the assets of the Group.

d) Electro Optic Systems Holdings Limited entered into a deed of cross guarantee on 6 April 2018 with two of its wholly-owned subsidiaries, Electro Optic Systems Pty Limited and EOS Defence Systems Pty Limited, pursuant to ASIC Corporations (Wholly-owned Companies) Instrument 2016/785 and relieved from the requirement to prepare and lodge an audited financial report.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

**Notes to the condensed consolidated Financial Statements
for the half-year ended 30 June 2019**

9. Segment Information

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

	Revenue		Segment profit/ (loss)	
	Half-year to 30 June 2019 \$	Half-year to 30 June 2018 \$	Half-year to 30 June 2019 \$	Half-year to 30 June 2018 \$
Space	793,803	838,024	(1,223,534)	(1,215,354)
Defence	56,639,807	34,601,824	10,930,520	6,534,151
Total of all segments	57,433,610	35,439,848	9,706,986	5,318,797
Eliminations	-	-	-	-
Unallocated	355,677	321,219	(71,483)	22,678
Consolidated segment revenue and Profit before tax	57,789,287	35,761,067	9,635,503	5,341,475
Income tax expense	-	-	(2,115,680)	-
Consolidated segment revenue and profit for the period	57,789,287	35,761,067	7,519,823	5,341,475

The revenue reported above represents revenue generated from external customers. There were no intersegment sales during the period. There were no discontinued operations during the period.

Segment profit represents the profit earned by each segment without the allocation of central administration costs and directors' salaries, investment revenue and finance costs and income tax benefit. This is the measure reported to the chief operating decision maker for the purposes of resource allocation and assessment of segment performance.

The following is an analysis of the Group's assets and liabilities by reportable operating segment:

	Assets		Liabilities	
	30 June 2019 \$	31 December 2018 \$	30 June 2019 \$	31 December 2018 \$
Space	359,001	726,984	5,118,995	5,504,682
Defence	95,883,808	78,632,004	30,064,972	27,082,876
Total segment assets	96,242,809	79,358,988	35,183,967	32,587,558
Unallocated cash and security deposit	45,253,978	49,510,154	-	-
Taxation	-	-	2,115,680	-
Total	141,496,787	128,869,142	37,299,647	32,587,558

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Notes to the condensed consolidated Financial Statements for the half-year ended 30 June 2019

9. Segment Information (cont)

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

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

Product and Services within each Business Segment

Space

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

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

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

Defence

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

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

**Notes to the condensed consolidated Financial Statements for
the half-year ended 30 June 2019**

10. Issuance of Securities

2019

No new ordinary shares were issued during the period.

No options were exercised during the period.

Issued capital as at 30 June 2019 was \$161,784,727.

2018

On 9 February 2018, the Company issued 10,471,434 ordinary shares to institutional clients of Petra Capital Limited at \$2.91 each raising \$28,948,278 after fees.

On 16 March 2018, the Company issued 10,147,123 ordinary shares to institutional clients of Petra Capital Limited at \$2.91 each raising \$28,051,722 after fees.

On 21 March 2018, the Company issued 495,758 ordinary shares at \$2.91 each under the Small Shareholder Plan.

On 20 June 2018, the Company issued 5,180,000 ordinary shares at \$2.99 to Directors and Employees under the Loan Funded Share Plan.

220,000 Options were issued on 20 June 2018, exercisable at \$2.99 under the Employee Share Option Plan.

No options were exercised during the period.

Issued capital as at 30 June 2018 was \$161,784,727.

**Notes to the condensed consolidated Financial Statements for
the half-year ended 30 June 2019**

11. Subsequent events

On 8 July 2019 upon payment of \$412,778 as consideration, the Group was issued with the second of the five convertible notes described in note 3. Upon issue of this convertible note the Group is able, at its discretion, to call on the issue of the remaining three convertible notes and immediately convert all five notes. This gives the Group the right to 51% of the issued share capital, thereby obtaining control, of the supplier.

The total expected acquisition consideration is estimated to be \$6.726 million and includes a variable element dependent upon future performance. The net assets acquired are expected to comprise predominantly of working capital and goodwill. As at the time of this half-year report, the Group had not completed the acquisition accounting for the business combination, therefore cannot disclose the fair value of the net assets acquired.

On 20 August 2019, EOS Space Systems Pty Limited received a confirmation from the Department of Defence that advance payment received of \$3,950,000 had been fully acquitted and the guarantee from the parent company to the Commonwealth of Australia had been withdrawn.

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

12. Related party transactions

During the period, the Company paid a total of \$38,407 (six month period ended 30 June 2018 - \$38,407) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of directors fees and superannuation for Mr Fred Bart.

During the period, the Company paid a total of \$23,611 (six month period ended 30 June 2018 - \$23,611) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of directors fees and superannuation for Mr Ian Dennis.

During the period, the Company paid a total of \$69,071 (six month period ended 30 June 2018 - \$60,000) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of consulting fees for secretarial and accounting services.

During the period, the Company paid a total of \$23,611 (six month period ended 30 June 2018 - \$23,611) to GCB Stratos Consulting Pty Limited, a company associated with Mr Geoff Brown in respect of directors fees and superannuation for Mr Geoff Brown.

During the period, the Company paid a total of \$14,965 (six month period ended 30 June 2018 - \$13,129) to Audio Pixels Holdings Limited, a company which Fred Bart and Ian Dennis are directors and shareholders in respect of shared Sydney office facilities.

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

Information on Audit or Review

This half yearly report is based on accounts to which one of the following applies.

- | | |
|---|---|
| <input type="checkbox"/> The accounts have been audited. | <input checked="" type="checkbox"/> The accounts have been subject to review. |
| <input type="checkbox"/> The accounts are in the process of being audited or subject to review. | <input type="checkbox"/> The accounts have not yet been audited or reviewed. |

Description of likely dispute or qualification if the accounts have not yet been audited or subject to review or are in the process of being audited or subjected to review.

Not applicable

Description of dispute or qualification if the accounts have been audited or subjected to review.

Not applicable