

ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED
ACN 092 708 364



2012

ANNUAL REPORT 2012



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REVIEW OF OPERATIONS

1. RESULTS FOR FULL-YEAR ENDING 31 DECEMBER 2012

The consolidated entity incurred a net loss during the year of \$10,179,823 (2011: \$180,188 profit) on revenues of \$21,919,748 (2011: \$32,775,391).

Net cash used by provided by operating activities was \$3,784,501 (2011 - \$3,778,311 used).

As at 31 December 2012, the consolidated entity had cash of \$6,686,194 (2011 - \$4,885,761) of which \$400,393 (2011 - \$496,296) is restricted as it secures bank guarantees on existing contracts with local and overseas customers. The cash will become unrestricted when the contract is concluded or renegotiated.

2. BACKGROUND TO RESULT

Overview:

These stark and disappointing results arise from the company executing a strategy from 2011 to achieve sustainability in a new sustaining fiscal reality of reduced defence expenditure globally. The company assumes this new reality will extend with globally uneven intensity until 2016 and have broad consequences such as reduced sector revenue, rising protectionism, tighter competition, and industry consolidation both locally and globally.

Notwithstanding the stresses there will also be opportunities for companies with genuine customer focus, advanced technology, lean processes, strong management and secure market access.

EOS has addressed this situation by executing an aggressive strategy aimed at positioning EOS for future growth even as constrained circumstances apply. The key objectives of this strategy were:

- A. **Production.** Achieve significant product cost reduction and quality improvement, at the same time as achieving scalability of output to match unstable demand, by out-sourcing production to major partners with existing plant capacity.
- B. **Costs.** Reposition the company for higher profits at any level of revenue by significantly and sustainably reducing fixed operating costs.
- C. **Segregation.** Complete the separation of the company into two independent sectors, called Defence Systems [for remote weapon systems] and Space Systems [for space technology and surveillance], to reflect the different customer bases, security requirements, technology and skill sets required in these

sectors as they mature. This specialization will drive further process improvement and cost reduction.

D. **Diversification.** Achieve diversification through targeting new geographic markets with emphasis on Asia and the Middle East where EOS networks are strong.

E. **Technology.** Accelerate product improvement programs for space surveillance and remote weapon systems, and bring the new turret product to production after 5 years of development.

This agenda is essentially about focusing on long-term strengths of technology and market access while refining business process and reducing costs. These strategic goals are being achieved. These costs which formed part of the loss for 2012 were allocated to meet the following five items required for this strategic re-positioning:

- **Production:** \$3.5 million for the relocation of most EOS production to partners.
- **Impairment:** \$1.3 million for impairments of all material for future contracts.
- **Depreciation:** \$2.6 million for accelerating depreciation, including licenses.
- **Marketing:** \$0.8 million for marketing.
- **Development:** \$1.9 million for product development costs.

Production \$3.5 million:

EOS production capacity in Arizona was relocated during 2012 to Northrop Grumman facilities in Alabama and to Hyundai facilities in Korea. These new licensed facilities are now in production. This transfer has involved a reduction in staff in EOS USA from over 140 at the peak of EOS production to only 10 staff now deployed to support Northrop and Hyundai. The total cost of the relocation in 2012 was \$3.5 million and it is now complete.

Both Northrop Grumman and Hyundai have their own existing, highly-qualified production facilities and resources, and can produce high quality products at low cost, and for scalable demand. The company's production is now much more scalable at short notice from low demand to high demand, and product quality is improved.

The overall outsourcing level for EOS across all programs and all Defence Systems products has increased from below 15% to above 50% in one calendar year, with no disruption to supply. The EOS production facility in Queanbeyan Australia remains in full production with current orders.

REVIEW OF OPERATIONS (CONT)

Impairment \$1.3 million:

The transfer of production capacity to partners and the inventory held by EOS without binding sales contracts required the impairment of inventory held by EOS, at a cost of \$1.5 million. It cannot be assumed that these parts will be used in the new production arrangements and accordingly impairment was appropriate. These impairment charges may be reversed in future if sales contracts for the existing inventory are received.

Including this impairment, the total cost of relocating production from Arizona to Alabama and Korea was approximately **\$4.8 million**. The annual saving in fixed costs attributable to the relocation of production and closing of the Tucson production facility is at least **\$5 million**.

The company has thus met its objective of improving remote weapon system production capacity, cost, quality, delivery risk, responsiveness and global market access, all through enhanced collaboration with strategic partners.

From 2013 the company will benefit from the reduction in fixed cost of \$5 million annually. This reduction in fixed costs will reduce the break-even revenue for EOS going forward.

Depreciation, amortisation and impairment \$2.6 million:

One impact of reduced revenue in 2012 with no early rebound in 2013 is an acceleration of depreciation and amortisation of company assets deployed to produce revenue. In 2012 depreciation was \$2.6 million [2011 \$0.4 million]. This included depreciation of \$1.8 million of tangible assets and \$0.8 million of amortisation and impairment of intangible assets. There is now no value ascribed to intangible assets in the financial statements.

Marketing \$0.8 million:

EOS outlays towards special marketing projects were a net \$0.8 million in 2012.

Development \$1.9 million:

In addition to ongoing development effort to maintain leading-edge military technology in EOS current weapon system products, in recent years EOS has undertaken development of a new product in the form of a remotely operated turret for a 30-40 mm canon.

EOS considers the market for this turret to be extremely large, and customers have reinforced this view by contributing over 70% of turret development costs over the past 4 years. Notwithstanding these contributions the cost to EOS in 2012 for turret development effort was \$1.9 million.

EOS expects to be in production with this new turret product in 2015.

Summary

EOS has completed its strategic adjustments in time to meet current circumstances and in advance of sequestration in the US and further expected cuts to government outlays both in Australia and internationally. The company has achieved lower costs and leaner operations while positioning new products in new markets, and bringing new production capacity on line. Beyond 2013 EOS still requires profitable new contract to meet future working capital and funding requirements to continue as a going concern as mentioned in Note 1(a).

3. EOS DEFENCE SYSTEMS

The EOS Defence Systems business is concentrated on the development, marketing, production and support of remote weapon systems [RWS] and related products. Significant developments over 2012 included initial steps into new markets, first product shipping from new production facilities, successful testing of the new turret, and the US Army CROWS program award to a competitor.

US Army CROWS

In May 2010 EOS and Northrop Grumman Corporation [NGC] agreed to jointly develop, produce and support RWS for the USA and certain export markets. Those arrangements included EOS and NGC teaming to compete for the US Army CROWS program requirement for RWS. NGC and EOS jointly submitted tenders [proposals] for the CROWS requirement in March 2012. In August 2012 the US Army awarded this contract to Kongsberg, the incumbent competitor. This award was a major setback to EOS long term plans in the US.

REVIEW OF OPERATIONS (CONT)

RWS Orders

EOS received orders in 2012 from international customers, such that backlog of undelivered orders at 31 December 2012 was at the historical average of 16 months of production. This was a significant achievement during a year when the budgets of every customer were reduced. There were no Australian Defence orders delivered in 2012 and no future Australian orders in backlog which was disappointing.

All orders in 2012 came from existing customers, with the exception of the Republic of Korea where Hyundai continued its success.

Market Diversification

During 2012 the EOS teaming relationship with Hyundai was formalised and the team achieved its first program success with defensive weapon systems for the Korean demilitarised zone [DMZ]. The scope of this program will change in 2013 because the production phase has been funded, and a separate competition for the production contract will take place in early 2013.

In a separate development, in late 2012 Hyundai was successful, after several years of intense competition, in achieving an award as prime contractor for up to 2,000 armoured vehicles for the Korean armed forces. These vehicles will require remote weapon systems and EOS is supporting Hyundai's efforts to offer an appropriate system for this program in 2014.

EOS made significant efforts to expand its existing business footholds in the Middle East in 2012. Small quantity sales of weapon systems have established EOS's reputation for technology and quality in this market over the past few years. This market is experiencing significant growth, and EOS is well positioned to meet customer requirements in specific programs.

Production Diversification

The transfer of US production of remote weapon systems from Arizona to a Northrop Grumman Corporation owned facility in Alabama was completed in Q3 2012 and the first products were completed in Alabama before 31 December 2012. This facility is now configured to meet demand from several EOS international customers.

The licensed facility established with Hyundai in Korea was also completed during 2012.

Product Development

EOS continues to improve and diversify its product range. In 2012 incremental improvements were made to the EOS range of remote weapon systems, but the major effort was concentrated on the new remote turret for 30-40 mm canon.

In 2006 EOS joined with a strategic partner to develop a new unmanned turret for armoured vehicles. EOS and its partner have developed an unmanned turret to meet these requirements in consultation with and with funding support from potential customers.

The ongoing impact of the global financial crisis has reduced global demand for this turret over the next 5 years from 4,000 units to around 1,500 [US\$3 billion]. This is still a significant market and EOS expects to achieve strong market share notwithstanding rapidly emerging competition.

The EOS turret underwent final operational testing to qualify for production, and these tests were successful. The turret is now expected to move to production from 2015.

4. SPACE BUSINESS

4.1 Commercial Space Operations

EOS space tracking technology is applied in two commercial domains: precision tracking and space debris tracking. These two domains use different equipment and infrastructure. In each domain there have been important developments during 2012.

Precision tracking delivers satellite orbit data which is accurate to better than 1 mm, and is used for a wide range of commercial and scientific applications, including navigation, banking transaction security, mapping, surveying, and climate change monitoring.

Only precision laser tracking, combined with precision laser altimeters flown on special-purpose satellites, can accurately measure ice mass and sea levels globally. Regardless of the cause of climate change, it is important to all societies to accurately determine whether sea levels are actually rising and how fast.

There are now several dedicated satellites in orbit for this purpose, and seven more will launch in the next 4 years. EOS does not manufacture the satellite equipment, but the ground stations globally must be upgraded to the accuracies now provided by EOS from Australia. Despite funding pressures,

REVIEW OF OPERATIONS (CONT)

this program has priority among all participating governments globally. An expansion of EOS activities in this segment is expected from late in 2013; however this is dependent on government funding being available.

This is a development with long-term implications for EOS.

In addition, EOS space debris tracking capabilities have been recognised by EOS being designated as the coordinating agency for the first-ever coordinated multi-lateral international effort to systematically track space debris to avoid collisions in space.

The Western Pacific Laser Tracking Network [WPLTN] is a multi-national agency responsible for coordinating laser tracking for the hemisphere including Australia. It includes member states Russia, China, Japan, India, Korea, Australia and Saudi Arabia. All of these countries have substantial laser space tracking capabilities.

In late 2012 EOS was designated by WPLTN as the planning and coordinating centre for WPLTN activities in space debris tracking for collision avoidance. This program will lead to multi-site, multi-country space debris tracking operations later in 2013. This will be the launch of laser tracking of space debris for collision avoidance, since the WPLTN mandate will create a commercial user portal for debris data.

This is a significant development in the deployment and application of laser debris tracking technology and EOS believes that this will lead to commercial contracts in the future.

The financial constraints on western governments have delayed all aspects of resolving the space debris issue, notwithstanding its urgency. EOS' space debris de-orbit effort remains unfunded, although background research continues. In practice there will likely not be demand for de-orbit capability before the tracking of space debris has been substantially improved globally.

4.2 Space Surveillance and Space Situation Awareness [SSA]

EOS is committed to meeting the requirements of Australia and its allies for SS and SSA optical data. On 14 November 2012 the US and Australian governments further publicly clarified their intention to deepen defence space cooperation, including optical space data operations.

Those intentions are now moving towards funding in both governments. The outcome of those funding processes is uncertain due to circumstances such as sequestration in the US, and the reduction of the Australian defence budget in 2012 and 2013.

4.3 Partnerships

EOS has long-term alliances with the Australian National University and the Royal Melbourne Institute of Technology. These collaborations are allowing progress towards collective technical objectives with reduced costs to each individual partner.

EOS will likely enter new strategic partnerships in space in 2013 as a means to further extend limited funding.

EOS has agreements with European and US aerospace agencies and entities continue, with the express purpose of facilitating EOS market access for its data and systems products.

5. SUMMARY AND OUTLOOK

Through 2012 the company implemented a radical transformation to meet unprecedented business conditions in its domestic and global markets. This company transformation has positioned EOS to ride out current market conditions which are already more severe than expected in 2011 when the process was planned and initiated.

Customer budgets will remain tightly constrained through 2014 and possibly beyond. Although further consolidation of EOS reforms is required through 2013, the associated costs will be low compared to 2012 and are expected to fall within the company's current funding capability.

The key issues facing the company in 2012 were customer budgets and the urgent execution of a reform agenda. The key issues in 2013 will be:

Defence Sector Revenue

EOS has made significant cuts to its fixed costs, and has orders which are deliverable over the next 2 years. These backlogged orders form the bulk of EOS activity in any year, and are usually supplemented by orders which arise within each year. Cost reductions have substantially reduced the volume of short term orders required to achieve sector profitability in 2013, but EOS expects that new orders will be more difficult to achieve in 2013 than previously.

REVIEW OF OPERATIONS (CONT)

The role of Australia in Defence Systems Business

The high Australian dollar and the deferral of key Australian defence programs place the future of Australian operations in this sector under some uncertainty. Because the value of Australian defence orders in 2012 was zero and there are no Australian defence orders for 2013 and beyond in hand, the sustainability of these local operations will come under pressure without new sales contracts.

Space Sector Revenue

Space sector commercialisation has been supported by grants and co-investment from customers towards achieving operational configurations which could integrate with existing customer infrastructure. However the operational deployment phases due from 2014 will be substantially more expensive than these upgrades and the ability of key customers to timely fund those deployments is presently in doubt. EOS is now working with those customers to develop more affordable business models for the customer needs to be achieved.

Growth Opportunities

The constrained fiscal reality in global defence and aerospace markets will create opportunities for companies like EOS which have taken early measures to adapt. EOS must ensure that it leverages its strengths through the industry consolidations expected through 2013 and 2014.

Further marketing investments will be required as EOS pushes forward in north Asia and the Middle East, and moves forward with the product releases required to capture new business. However these costs are expected to be met from normal business operations going forward.

The Company has scheduled orders to deliver under contract out to December 2014 utilising a leaner production and process model than in previous years. The Company is actively pursuing new orders in both sectors for 2013 and beyond which are required to ensure the ongoing financial viability of the Company and its continuation as a going concern. However the nascent global financial recovery is far from robust and although EOS selects its customers from the strongest economies, the company cannot be certain that future customer procurements will continue as usual or that business conditions will not further deteriorate.

The Directors continue to consider alliances and arrangements with existing customers and development partners to better the position the company for the future in these difficult times.



Ben Greene
Chief Executive Officer
27 March 2013

DIRECTORS' REPORT

The directors of Electro Optic Systems Holdings Limited submit herewith the annual financial report of the company for the year ended 31 December 2012. In order to comply with the provisions of the Corporations Act 2001, the directors report as follows:

Directors

The names and particulars of the directors of the company during or since the end of the financial year are:

Name	Particulars
Fred Bart	Chairman (Age 58). A director since 8 May 2000. He has been Chairman and Director of numerous private companies since 1980, specialising in manufacturing, property and technology. He is a member of the Australian Institute of Company Directors and is a member of the Audit Committee and Remuneration Committee.
Dr Ben Greene	BE (Hons), Phd in Applied Physics (Age 61) is the Chief Executive Officer of Electro Optic Systems. Dr Greene was involved in the formation of Electro Optic Systems. He is widely published in the subject areas of laser tracking, space geodesy, quantum physics, satellite design, laser remote sensing, and the metrology of time, and is currently regarded as a world leader in these fields. Dr Greene is a member of Australia's Space Industry Innovation Council. Appointed to the Board on 11 April 2002.
Ian Dennis	BA, C.A. (Age 55) is a Chartered Accountant with experience as director and secretary in various public listed companies and unlisted technology companies in Australia and overseas. He has been involved in the investment banking industry and stockbroking industry for the past twenty five years. Prior to that, he was with KPMG, Chartered Accountants in Sydney. Appointed to the Board on 8 May 2000. He is a member of the Australian Institute of Company Directors and is a member of the Audit Committee and Remuneration Committee. He is also company secretary of Electro Optic Systems Holdings Limited.
Mark Ureda	Non-executive director (Age 58). Appointed to the Board on 28 April 2005. Mark was vice president, Strategy and Technology for Northrop Grumman Corporation, a global defence company until August 2010. Mark is now Vice President and General Manager of the Harman Professional Loudspeaker Group. Mark received a bachelor's degree in Engineering from the University of California at Los Angeles, a master's degree in Acoustics from the Pennsylvania State University and a master's degree in Finance from the UCLA Graduate School of Management.
Lt Gen Peter Leahy AC	Non-executive director (Age 60). Appointed to the Board on 4 May 2009. Peter Leahy AC retired from the Australian Army in July 2008 as a Lieutenant General in the position of Chief of Army. As well as being Chairman of the Army's Advisory Committee he was also a Member of the Defence Committee, the Chiefs of Service Committee, the Council of the Australian War Memorial and the Board of Defence Housing Australia. Among his qualification he holds a BA (Military Studies), a Master of Military Arts and Science and is a member of the Australian Institute of Company Directors. In October 2008 he was appointed as a Professor and the foundation Director of the National Security Institute at the University of Canberra. He is a director of both Codan Limited and the Kokoda Foundation and a member of the Defence South Australia Advisory Board.
Kevin Scully	Non-executive director (Age 55). Appointed to the Board on 19 September 2011. Kevin Scully has more than 26 years of experience in equities research and analysis, corporate advisory and related matters, having worked for more than 12 years in various positions such as the head of research and director of Schroders and the Netresearch group (which he founded). Kevin is an advisor to two regulatory authorities of the Singaporean Government (Commercial Affairs Department and the Monetary Authority of Singapore) since 1999.

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

DIRECTORS' REPORT (CONT)

Directorships of Other Listed Companies

Directorships of other listed companies held by directors in the three years immediately before the end of the financial year were as follows:

Name	Company	Period of directorship
Fred Bart	Audio Pixels Holdings Limited	5 September 2000 to date
Ian Dennis	Audio Pixels Holdings Limited	5 September 2000 to date
Lt Gen Peter Leahy AC	Codan Limited	19 September 2008 to date
Kevin Scully	PNE Micron Holding Limited	11 April 2011 to date

Principal Activities

The principal activities of the consolidated entity are in the space systems, space surveillance and defence products business. The company is listed on the Australian Securities Exchange.

Review of Operations

A detailed review of operations is included on pages 1 to 5 of this financial report.

Changes to the State of Affairs

There was no significant changes in the state of affairs of the consolidated entity that occurred during the financial period.

Subsequent Events

There has not been any matter or circumstance that has arisen since the end of the financial year, that has significantly affected or may significantly affect the operations of the consolidated entity, the results of those operations or the state of affairs of the consolidated entity in future financial years.

Future Developments

The company will continue to operate in the space systems, space surveillance and defence products business.

Please see the review of operations for further details.

Environmental Regulations

In the opinion of the directors the consolidated entity is in compliance with all applicable environmental legislation and regulations.

DIRECTORS' REPORT (CONT)

Dividends

The directors recommend that no dividend be paid and no amount has been paid or declared by way of dividend since the end of the previous financial year and up to the date of this report.

Share Options

Share options granted to directors and executives

During and since the end of the financial year no share options were granted to any directors of the company and consolidated entity as part of their remuneration. On 10 December 2009 the Company issued 1,800,000 options to staff including the executives listed in the Remuneration Report under the terms of the Employee Share Option Plan. Since these options were issued, 775,000 have been cancelled due to staff resignations leaving a balance currently outstanding of 1,025,000 options. These options have an exercise price of \$1.30 and are exercisable on or before 8 December 2013. No options have been issued to executives since the end of the financial year.

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

Details of unissued shares or interests under option are:

Issuing entity	Number of shares under option	Class of shares	Exercise price of option	Expiry date of options
Electro Optic Systems Holdings Limited	1,025,000	Ordinary	\$1.30	8 December 2013

Options issued to executives and staff during 2009 were issued at an exercise price of \$1.30 determined by the directors. The holders of such options do not have the right, by virtue of the option, to participate in any share issue or interest issue of any other body corporate or registered scheme.

1,564,800 Options issued to directors at an exercise price of \$1.95 lapsed on 31 May 2011.

There were no shares or interests issued during the financial year as a result of exercise of an option.

Indemnification and Insurance of Officers and Auditors

During the financial year, the company paid a premium in respect of a contract insuring the Directors and Officers of the Company and any related body corporate against a liability incurred as such a Director or Officer to the extent permitted by the Corporations Act 2001. The contract of insurance prohibits disclosure of the nature of the coverage provided and the amount of the premium. The Company has agreed to indemnify the current Directors, Company Secretary and Executive Officers against all liabilities to other persons that may arise from their position as Directors or Officers of the Company and its controlled entities, except where to do so would be prohibited by law. The agreement stipulates that the Company will meet the full amount of any such liabilities, including costs and expenses.

The Company has not, during or since the financial year indemnified or agreed to indemnify an auditor of the company or of any related body corporate against any liability incurred as such an auditor.

DIRECTORS' REPORT (CONT)

Directors' Meetings

The following table sets out the number of directors' meetings (including meetings of committees of directors) held during the financial year and the number of meetings attended by each director (while they were a director or committee member). During the financial year, 12 Board meetings, 2 audit committee meetings and 2 Remuneration committee meetings were held.

Directors	Board of directors		Audit committee		Remuneration committee	
	Held	Attended	Held	Attended	Held	Attended
Mr Fred Bart	12	12	1	1	2	2
Dr Ben Greene	12	12	-	-	-	-
Mr Ian Dennis	12	12	2	2	2	2
Mr Mark Ureda	12	11	-	-	-	-
Lt Gen Peter Leahy AC	12	11	2	2	2	2
Mr Kevin Scully	12	10	1	1	-	-

Directors' Shareholdings

The following table sets out each Director's relevant interest in shares and options of the company or a related body corporate as at the date of this report.

Directors	Fully paid ordinary shares	Options
Mr Fred Bart	5,309,075	-
Dr Ben Greene	3,954,185	-
Mr Ian Dennis	170,050	-
Mr Mark Ureda	-	-
Lt Gen Peter Leahy AC	15,000	-
Mr Kevin Scully	-	-

Remuneration Report (Audited)

The key management personnel of Electro Optic Systems Holdings Limited during the year were:

Mr Fred Bart (Chairman, Non executive director)

Dr Ben Greene (Chief Executive Officer and director)

Mr Ian Dennis (Non-executive director)*

Mr Mark Ureda (Non-executive director)

Lt Gen Peter Leahy AC (Non-executive director)

Mr Kevin Scully (Non-executive director) - Commenced 19 September 2011

Mr Mark Bornholt (Chief Executive Officer of Defence Systems) - Commenced 21 March 2011

Dr Craig Smith (Chief Executive Officer of EOS Space Systems Pty Limited)

Mr John Palisi (Chief Financial Officer - Electro Optic Systems Pty Limited) - resigned 3 February 2012

Mr Scott Lamond (Chief Financial Officer - Electro Optic Systems Pty Limited) - appointed 10 August 2012 - Mr Scott Lamond was Acting Chief Financial Officer from 3 February 2012 to 10 August 2012

Mr Hugo Keyner (Chief Executive Officer EOS Technologies Inc) - Retired on 31 October 2012

*During the period from 3 February 2012 to 10 August 2012 whilst Mr Scott Lamond was Acting Chief Financial Officer, Mr Ian Dennis assumed an executive role to assist in the finance function.

DIRECTORS' REPORT (CONT)

Remuneration Report (cont)

This report outlines the remuneration arrangements in place for Directors and Executives of the Company.

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

Remuneration Structure

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

Non-Executive Director Remuneration

Objective

The Board seeks to set aggregate remuneration at a level which provides the Company with the ability to attract and retain directors of the highest calibre, whilst incurring a cost which is acceptable to shareholders.

Structure

The Company's Constitution and the Australian Securities Exchange Listing Rules specify the aggregate remuneration of Non-Executive Directors shall be determined from time to time by a General Meeting of shareholders. An amount not exceeding the amount determined is then divided between the Directors as agreed. The latest determination was at the Annual General Meeting held on 11 April 2002, when shareholders approved a maximum aggregate remuneration of \$230,000 per year excluding options.

The amount of aggregate remuneration sought to be approved by shareholders, the manner in which it is apportioned amongst Directors, and the policy of granting options to Directors, are reviewed annually.

Each Non-Executive Director receives a fee for serving as a Director of the Company. No additional fees are paid to any Director for serving on a committee of the Board. A company associated with Mr Ian Dennis receives a fee in recognition of additional services provided to the Group.

Executive Director and Senior Management Remuneration

Objective

The Company aims to award Executives with a level and mix of remuneration commensurate with their position and responsibilities within the Company and so as to:

- reward Executives for Company and individual performance against targets set by reference to suitable benchmarks;
- align the interests of Executives with those of shareholders; and
- ensure that the total remuneration paid is competitive by market standards.

Structure

The remuneration paid to Executives is set with reference to prevailing market levels and typically comprises a fixed salary and option component. Options are granted to Executives in line with their respective levels of experience and responsibility. Details of the amounts paid and the number of options granted to Executives are disclosed elsewhere in the Directors' Report.

Employment contracts

There are no employment contracts in place with any Non-Executive Director of the Company. There are standard Contracts of Employment with Executive Directors and Senior Management which contain no unusual terms. The contracts provide for a termination period in respect of Ben Greene of 180 days and 90 days in respect of other senior executives. The current employment contract with Ben Greene expires on 30 June 2013. There are no other termination payments or golden parachutes for any directors or senior executives.

DIRECTORS' REPORT (CONT)

Remuneration Report (cont)

Director Remuneration

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

	Short term		Post Employment	Equity	Other Long	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Term Benefits	
2012	\$	\$	\$	\$	\$	\$
Mr Fred Bart	61,000	-	5,490	-	-	66,490
Dr Ben Greene*	439,994	28,726	37,177	-	-	505,897
Mr Ian Dennis	197,500	-	3,375	-	-	200,875
Mr Mark Ureda	40,875	-	-	-	-	40,875
Lt Gen Peter Leahy AC	37,500	-	3,375	-	-	40,875
Mr Kevin Scully	40,875	-	-	-	-	40,875
	817,744	28,726	49,417	-	-	895,887

* Executive Director during the financial year

	Short term		Post Employment	Equity	Other Long	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Term Benefits	
2011	\$	\$	\$	\$	\$	\$
Mr Fred Bart	61,000	-	5,490	-	-	66,490
Dr Ben Greene*	300,000	39,182	27,000	-	-	366,182
Mr Ian Dennis	157,500	-	3,375	-	-	160,875
Mr Mark Ureda	40,875	-	-	-	-	40,875
Lt Gen Peter Leahy AC	37,500	-	3,375	-	-	40,875
Mr Kevin Scully	11,535	-	-	-	-	11,535
	608,410	39,182	39,240	-	-	686,832

* Executive Director during the financial year

DIRECTORS' REPORT (CONT)

Remuneration Report (cont)

Executive Remuneration

No executives are employed by the holding company. The following table discloses the remuneration of the executives of the consolidated entity:

	Short term		Post Employment	Equity	Other Long	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Term Benefits	
2012	\$	\$	\$	\$	\$	\$
Dr Craig Smith	210,000	-	18,900	18,152	-	247,052
Mr Mark Bornholt	210,000	-	18,900	-	-	228,900
Mr John Palisi **	80,324	-	2,326	-	-	82,650
Mr Scott Lamond **	167,556	-	15,080	3,630	-	186,266
Mr Hugo Keyner **	85,976	749	-	18,152	-	104,877
	753,856	749	55,206	39,934	-	849,745

** John Palisi, Scott Lamond and Hugo Keyner were executives for part of the financial year (See Note 21)

	Short term		Post Employment	Equity	Other Long	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Term Benefits	
2011	\$	\$	\$	\$	\$	\$
Mr Ron Thompson	172,083	-	13,288	35,597	42,760	263,728
Dr Craig Smith	197,532	-	17,750	35,597	-	250,879
Mr Mark Bornholt	128,423	-	11,340	-	-	139,763
Mr John Palisi	196,946	-	17,724	35,597	-	250,267
Mr Hugo Keyner	154,889	854	-	35,597	-	191,340
	849,873	854	60,102	142,388	42,760	1,095,977

Non-monetary includes the provision for motor vehicles and health benefits.

DIRECTORS' REPORT (CONT)

Remuneration Report (cont)

Value of Options Issued to Directors and Executives

The following table discloses the value of options granted and exercised during the 2012 year:

	Options Granted Value at grant date (i) \$	Options Exercised Value at exercise date \$	Total value of options granted and exercised \$	Value of options included in remuneration for the year (i) \$	Percentage of total remuneration for the year that consists of options %
Dr Craig Smith	-	-	-	18,152	7.35
Mr Hugo Keyner	-	-	-	18,152	17.31
Mr Scott Lamond	-	-	-	3,630	1.95

(i) The value of options granted during the period is recognised in compensation over the vesting period of the grant.

Value of Options - Basis of Calculation

The total value of options included in remuneration for the year is calculated as follows:

- The value of the options is determined at grant date, and are included in remuneration on a proportionate basis from grant date to vesting date. Where the options immediately vest the full value of the option is recognised in remuneration in the current year.

Elements of Remuneration Related to Performance

There are no performance conditions other than service attached to the above remuneration to directors and executives. Directors and senior executives receive options as disclosed in the above tables which are not subject to specific performance conditions other than service. The overall performance of the company as measured by the share price will determine whether the options are exercised and whether the director or executive receives any benefit from these options. The time service condition has been chosen by the Board as an appropriate condition as it helps in the retention and motivation of staff. Options issued to certain directors and executives are also subject to vesting provisions as disclosed below.

DIRECTORS' REPORT (CONT)

Remuneration Report (cont)

Key Management Personnel Option Holdings

2012	Balance at 1/1/12 No.	Granted as remuneration No	(Lapsed) No.	Balance at 31/12/12 No.	Balance vested at 31/12/12 No	Options vested during year
Mr Fred Bart	-	-	-	-	-	-
Dr Ben Greene	-	-	-	-	-	-
Mr Ian Dennis	-	-	-	-	-	-
Mr Mark Ureda	-	-	-	-	-	-
Lt Gen Peter Leahy AC	-	-	-	-	-	-
Mr Kevin Scully	-	-	-	-	-	-
Mr Mark Bornholt	-	-	-	-	-	-
Dr Craig Smith	160,000	-	-	160,000	160,000	80,000
Mr John Palisi	160,000	-	(160,000)	-	-	-
Mr Scott Lamond	32,000	-	-	32,000	32,000	16,000
Mr Hugo Keyner	160,000	-	-	160,000	160,000	80,000

On 10 December 2009, The Directors' issued 1,800,000 unlisted options to executives and staff. The options issued to executives and staff have an exercise price of \$1.30 and expire on 8 December 2013. These options vested 20% after 12 months, 30% after 2 years and the balance after 3 years.

2011	Balance at 1/1/11 No	Granted as remuneration No	(Lapsed) No.	Balance at 31/12/11 No.	Balance vested at 31/12/11 No.	Options vested during year
Mr Fred Bart	200,000	-	(200,000)	-	-	100,000
Dr Ben Greene	964,800	-	(964,800)	-	-	482,400
Mr Ian Dennis	200,000	-	(200,000)	-	-	100,000
Mr Mark Ureda	200,000	-	(200,000)	-	-	100,000
Lt Gen Peter Leahy AC	-	-	-	-	-	-
Mr Kevin Scully	-	-	-	-	-	-
Mr Ron Thompson	160,000	-	-	160,000	80,000	48,000
Mr Mark Bornholt	-	-	-	-	-	-
Dr Craig Smith	280,000	-	(120,000)	160,000	80,000	108,000
Mr John Palisi	160,000	-	-	160,000	80,000	48,000
Mr Hugo Keyner	160,000	-	-	160,000	80,000	48,000

DIRECTORS' REPORT (CONT)

Remuneration Report (cont)

All options issued during the year ended 31 December 2007 were issued on 31 May 2007. The options issued to directors have an exercise price of \$1.95 and expired on 31 May 2011. These options vested 20% after 12 months, 30% after 2 years and the balance after 3 years.

The 120,000 options issued to Dr Craig Smith during the year ended 31 December 2007 at an exercise price of \$1.95 vested 20% after 12 months, 30% after 2 years and the balance after 3 years. These options lapsed during the year.

Other Key Management Personnel options vest 20% after 12 months, 30% after 2 years and the balance after 3 years.

The percentage of the options granted on 10 December 2009 which vested in the current year to Mr Hugo Keyner and Dr Craig Smith was 50%.

All options outstanding were fully vested at 31 December 2012 and there are no further options to vest in the year ended 31 December 2013.

The Board policy is not to allow any person to hedge their exposure to risk in relation to the options granted. This policy may be reviewed should the options become in the money.

The table below sets out summary information about the company's earnings and movements in shareholder wealth for the last 5 financial years.

	31 December 2012 \$	31 December 2011 \$	31 December 2010 \$	31 December 2009 \$	31 December 2008 \$
Revenue	21,919,748	32,775,391	33,828,658	37,005,723	38,958,206
Net profit/(loss) before tax	(10,179,823)	180,188	3,175,142	2,436,249	2,213,006
Net profit/(loss) after tax	(10,179,823)	180,188	3,175,142	2,436,249	2,213,006

	31 December 2012 \$	31 December 2011 \$	31 December 2010 \$	31 December 2009 \$	31 December 2008 \$
Share price at start of year	0.55	1.35	1.05	0.41	0.50
Share price at end of year	0.30	0.55	1.35	1.05	0.41
Dividends paid	-	-	-	-	-

Audit Committee

The Board appointed three non-executive directors to form the committee, with a majority of independent directors and the Chairman being an independent person. The current members of the committee are Lt Gen Peter Leahy AC (Chairman), Mr Ian Dennis and Mr Kevin Scully. Mr Fred Bart retired from the Audit Committee on 6 June 2012 and was replaced by Mr Kevin Scully.

DIRECTORS' REPORT (CONT)

Non-audit services

The Directors are satisfied that the provision of non-audit services, during the year, by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001. The Directors have formed this view based on the fact that the nature and scope of each type of non-audit service provided means that the audit independence was not compromised.

Details of amounts paid or payable to the auditor for non-audit services provided during the year by the auditor are contained in Note 10 to the financial statements.

Auditor's Independence Declaration

The auditor's independence declaration is included on page 17 of the annual report.

Signed in accordance with a resolution of directors made pursuant to s.298(2) of the Corporations Act 2001.

On behalf of the Directors



I A Dennis
Director

Dated at Sydney this 27 day of March 2013

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

27 March 2013

Dear Board Members

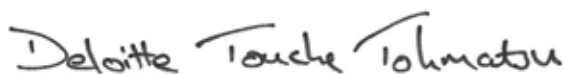
Electro Optic Systems Holdings Limited

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

As lead audit partner for the audit of the financial statements of Electro Optic Systems Holdings Limited for the year ended 31 December 2012, I declare that to the best of my knowledge and belief, there have been no contraventions of:

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

Yours sincerely



DELOITTE TOUCHE TOHMATSU



David Black
Partner
Chartered Accountants

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

Report on the Financial Report

We have audited the accompanying financial report of Electro Optic Systems Holdings Limited, which comprises the statement of financial position as at 31 December 2012, the statement of comprehensive income, the statement of cash flows and the statement of changes in equity for the 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 year's end or from time to time during the financial year as set out on pages 21 to 78.

Directors' Responsibility 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 Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control, relevant to the company's preparation of the financial report that gives a true and fair view, 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 company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited.

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

Auditor's Independence Declaration

In conducting our audit, 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 report.

Opinion

In our opinion:

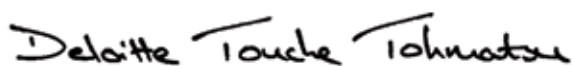
- (a) the financial report of Electro Optic Systems Holdings Limited is in accordance with the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the company's and consolidated entity's financial position as at 31 December 2012 and of their performance for the year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and
- (b) the financial statements also comply with International Financial Reporting Standards as disclosed in Note 1.

Report on the Remuneration Report

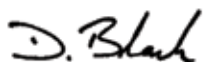
We have audited the Remuneration Report included in pages 9 to 15 of the directors' report for the year ended 31 December 2012. The directors of the company are responsible for the preparation and presentation of the Remuneration Report in accordance with section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with Australian Auditing Standards.

Opinion

In our opinion the Remuneration Report of Electro Optic Systems Holdings Limited for the year ended 31 December 2012, complies with section 300A of the *Corporations Act 2001*.



DELOITTE TOUCHE TOHMATSU



David Black
Partner
Chartered Accountants
Sydney, 27 March 2013

DIRECTORS' DECLARATION

The directors declare that:

- (a) in the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable;
- (b) in the directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the company and the consolidated entity;
- (c) the directors have been given the declarations required by s.295A of the Corporations Act 2001; and
- (d) the attached financial statements are in compliance with International Financial Reporting Standards, as stated in Note 1 to the financial statements.

Signed in accordance with a resolution of the directors made pursuant to s.295(5) of the Corporations Act 2001.

On behalf of the Directors



I A Dennis
Director

Dated at Sydney this 27 day of March 2013

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2012

		Consolidated		Company	
		31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Note					
Revenue	2	21,919,748	32,775,391	166,211	333,807
Changes in inventories of finished goods and work in progress		4,744,819	(164,152)	-	-
Raw materials and consumables used		(17,883,251)	(14,214,487)	-	-
Employee benefits expense	2(b)	(11,996,783)	(13,338,261)	(389,990)	(320,650)
Administration expenses		(2,723,142)	(3,210,571)	(394,804)	(436,729)
Amortisation of intangibles	2(b)	(131,519)	(131,533)	-	-
Finance costs	2(b)	(112,741)	(302,881)	-	-
Depreciation and amortisation of property, plant and equipment	2(b)	(1,886,926)	(426,512)	(657)	(1,095)
Impairment	2(b)	-	333,561	-	-
Impairment of intangibles	2(b)	(565,119)	-	-	-
Gain on disposal of fixed assets	2(b)	4,603	2,287	-	-
Foreign exchange (losses)/gains	2(b)	(196,299)	573,317	772	669
Occupancy costs		(1,136,400)	(1,356,956)	-	-
Reversal of/(provision for) non-recovery of loan	2(b)	-	-	2,824,983	(3,573,685)
Provision for non-recovery of investment	2(b)	-	-	(204,209)	(400,464)
Other expenses		(216,814)	(359,015)	-	-
(Loss)/Profit before income tax benefit	2	(10,179,823)	180,188	2,002,306	(4,398,147)
Income tax benefit	4	-	-	-	-
(Loss)/Profit for the period	20	(10,179,823)	180,188	2,002,306	(4,398,147)
Other comprehensive income					
Exchange differences arising on translation of foreign operations		4,173	(527,622)	-	-
Income tax relating to components of other comprehensive income		-	-	-	-
		4,173	(527,622)	-	-
Total comprehensive (Loss)/income for the period		(10,175,650)	(347,434)	2,002,306	(4,398,147)
(Loss)/Earnings per share					
Basic (cents per share)	3	(17.9)	0.3		
Diluted (cents per share)	3	(17.9)	0.3		

Notes to the financial statements are included on pages 25 to 78.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2012

		Consolidated		Company	
		December 2012 \$	December 2011 \$	December 2012 \$	December 2011 \$
Note					
CURRENT ASSETS					
Cash and cash equivalents	22	6,686,194	4,885,761	3,502,600	1,324,726
Trade and other receivables	6	1,874,896	9,835,027	26,983	21,156
Inventories	7	3,855,850	10,704,724	-	-
Other	8	588,939	101,316	-	-
TOTAL CURRENT ASSETS		13,005,879	25,526,828	3,529,583	1,345,882
NON-CURRENT ASSETS					
Property, plant and equipment	11	538,106	2,431,083	985	1,642
Intangibles	9	-	714,830	-	-
Other financial assets	5	-	-	-	-
Other	8	-	-	-	-
TOTAL NON-CURRENT ASSETS		538,106	3,145,913	985	1,642
TOTAL ASSETS		13,543,985	28,672,741	3,530,568	1,347,524
CURRENT LIABILITIES					
Trade and other payables	12	5,774,085	8,890,029	97,490	120,961
Borrowings	13	102,191	1,991 867	-	-
Provisions	14	4,670,600	4,763,852	-	-
TOTAL CURRENT LIABILITIES		10,546,876	15,645,748	97,490	120,961
NON-CURRENT LIABILITIES					
Borrowings	13	15,032	117,223	-	-
Provisions	14	293,271	249,523	-	-
TOTAL NON-CURRENT LIABILITIES		308,303	366,746	-	-
TOTAL LIABILITIES		10,855,179	16,012,494	97,490	120,961
NET ASSETS		2,688,806	12,660,247	3,433,078	1,226,563
EQUITY					
Issued capital	17	75,383,567	75,383,567	75,383,567	75,383,567
Reserves	19	7,777,756	7,569,374	7,727,803	7,523,594
Accumulated losses	20	(80,472,517)	(70,292,694)	(79,678,292)	(81,680,598)
TOTAL EQUITY		2,688,806	12,660,247	3,433,078	1,226,563

Notes to the financial statements are included on pages 25 to 78.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2012

	Total \$	Accumulated losses \$	Issued capital \$	Foreign currency translation reserve \$	Employee equity settled benefits reserve \$
Consolidated					
2012					
Balance at 1 January 2012	12,660,247	(70,292,694)	75,383,567	45,780	7,523,594
Loss for the year	(10,179,823)	(10,179,823)	-	-	-
Exchange differences arising on translation of foreign operations	4,173	-	-	4,173	-
Total comprehensive (loss)/income for the year	(10,175,650)	(10,179,823)	-	4,173	-
Recognition of share based payments	204,209	-	-	-	204,209
Balance at 31 December 2012	2,688,806	(80,472,517)	75,383,567	49,953	7,727,803
2011					
Balance at 1 January 2011	12,607,217	(70,472,882)	75,383,567	573,402	7,123,130
Profit for the year	180,188	180,188	-	-	-
Exchange differences arising on translation of foreign operations	(527,622)	-	-	(527,622)	-
Total comprehensive (loss)/income for the year	(347,434)	180,188	-	(527,622)	-
Recognition of share based payments	400,464	-	-	-	400,464
Balance at 31 December 2011	12,660,247	(70,292,694)	75,383,567	45,780	7,523,594
Company					
2012					
Balance at 1 January 2012	1,226,563	(81,680,598)	75,383,567	-	7,523,594
Profit for the year	2,002,306	2,002,306	-	-	-
Total comprehensive income for the year	2,002,306	2,002,306	-	-	-
Recognition of share based payments	204,209	-	-	-	204,209
Balance at 31 December 2012	3,433,078	(79,678,292)	75,383,567	-	7,727,803
2011					
Balance at 1 January 2011	5,224,246	(77,282,451)	75,383,567	-	7,123,130
Loss for the year	(4,398,147)	(4,398,147)	-	-	-
Total comprehensive income for the year	(4,398,147)	(4,398,147)	-	-	-
Recognition of share based payments	400,464	-	-	-	400,464
Balance at 31 December 2011	1,226,563	(81,680,598)	75,383,567	-	7,523,594

Notes to the financial statements are included on pages 25 to 78.

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2012

	Note	Consolidated		Company	
		31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Cash flows from operating activities					
Receipts from customers		28,382,072	36,594,370	13,868	4,361
Payments to suppliers and employees		(24,656,527)	(40,418,655)	(813,318)	(792,057)
Interest received		171,697	348,855	152,342	329,446
Interest and other costs of finance paid		(112,741)	(302,881)	-	-
Net cash inflows/(outflows) from operating activities	22(b)	3,784,501	(3,778,311)	(647,108)	(458,250)
Cash flows from investing activities					
Advances (to) from wholly-owned controlled entities		-	-	2,824,982	(3,573,685)
Proceeds from sale of property, plant and equipment		59,543	14,418	-	-
Payment for property, plant and equipment		(45,234)	(175,690)	-	-
Net cash inflows/(outflows) from investing activities		14,309	(161,272)	2,824,982	(3,573,685)
Cash flows from financing activities					
Proceeds of borrowings		-	739,020	-	-
Repayment of borrowings		(1,991,867)	-	-	-
Net cash (outflows)/inflows from financing activities		(1,991,867)	739,020	-	-
Net increase/(decrease) in cash and cash equivalents		1,806,943	(3,200,563)	2,177,874	(4,031,935)
Cash and cash equivalents at the beginning of the financial year		4,885,761	8,088,355	1,324,726	5,356,661
Effects of exchange rate fluctuations on the balances of cash held in foreign currencies		(6,510)	(2,031)	-	-
Cash and cash equivalents at the end of the financial year	22(a)	6,686,194	4,885,761	3,502,600	1,324,726

Notes to the financial statements are included on pages 25 to 78.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

1. Summary of Accounting Policies

Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with the Corporations Act 2001 and Accounting Standards and complies with other requirements of the law: The financial statements comprise the consolidated financial statements of the Group. For the purposes of preparing the consolidated financial statements, the Company is a for-profit entity. Accounting Standards include Australian equivalents to International Financial Reporting Standards ("A-IFRS"). The financial report includes the separate financial statements of the company and the consolidated financial statements of the group. Compliance with A-IFRS ensures that the financial statements and notes of the company and the consolidated entity comply with International Financial Reporting Standards ("IFRS").

The financial statements were authorised for issue by the Directors on 27 March 2013.

Basis of preparation

The financial report has been prepared on the basis of historical cost. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are presented in Australian dollars, unless otherwise stated.

In the application of A-IFRS management is required to make judgments, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making the judgments. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgments made by management in the application of A-IFRS that have significant effects on the financial statements and estimates with a significant risk of material adjustments in the next year are disclosed, where applicable, in the relevant

notes to the financial statements. The areas of judgement made by management are in the areas of asset impairment of property, plant and equipment, inventory obsolescence and percentage completion of construction contracts.

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

The following significant accounting policies have been adopted in the preparation and presentation of the financial report:

(a) Going Concern

The financial report has been prepared on the basis that the company and the consolidated entity are going concerns, which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

The consolidated entity incurred a net loss during the year of \$10,179,823 (2011: \$180,188 profit). Net cash provided by operating activities was \$3,784,501 (2011 - \$3,778,311 used). As at 31 December 2012, the consolidated entity had cash of \$6,686,194 (2011 - \$4,885,761) of which \$400,393 (2011 - \$496,692) is restricted as it secures bank guarantees on existing contracts with local and overseas customers. The cash will become unrestricted if the contracts are concluded or renegotiated.

In the opinion of the directors, the ability of the company and the consolidated entity to continue as going concerns and pay their debts as and when they fall due is dependent upon:

- The ability to achieve target production levels and the required technical/quality levels for the military business. The directors believe that this is achievable based on current production plans.
- The ability to obtain further new profitable contracts.

The directors are in the process of bidding for new military and space contracts. The results of these bids are not known as at the date of this financial report. The Directors are confident that new contracts will be received during the next 12 months from the current bids outstanding and from new contracts which have not been bid at the date of the directors' report.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(a) Going Concern (cont)

- The successful completion of the telescope and enclosure contracts on hand.

The space systems division has progressed the completion of the contracts on hand and the consolidated entity has already provided for expected losses on contracts in accordance with Australian Accounting Standard AASB111 "Construction Contracts".

- The willingness and ability of key military customers to make timely payments for goods supplied in accordance with agreed terms.

(b) Borrowings

Borrowings are recorded initially at fair value, net of transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between the initial recognised amount and the redemption value being recognised in profit and loss over the period of the borrowing using the effective interest rate method.

(c) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, cash in banks and investments in money market instruments, net of outstanding bank overdrafts. Cash and cash equivalents includes restricted cash to the extent it relates to operating activities.

(d) Construction contracts and work in progress

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the reporting date, as measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is

probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Deferred revenue is represented by advance billings on contracts and the basis of recognition is the percentage of completion basis.

(e) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not measured at fair value with changes in fair value recognised in profit and loss.

(f) Employee benefits

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of short term employee benefits are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of long term employee benefits are measured as the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Defined contribution plans - Contributions to defined benefit contribution superannuation plans are expensed when incurred.

(g) Financial assets

Subsequent to initial recognition, investments in subsidiaries are measured at cost less any impairment.

Other financial assets are classified into the following specified categories: held to maturity investments and loans and receivables. The classification depends on the nature and purpose of the financial assets and is determined at the time of the initial recognition.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(g) Financial assets (cont)

Held to maturity investments

Bills of exchange are recorded at amortised cost using the effective interest method less impairment, with revenue recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period.

Loans and receivables

Trade receivables, loans and other receivables are recorded at amortised cost less impairment.

(h) Financial instruments issued by the company

Debt and equity instruments

Debt and equity instruments are classified as either liabilities or as equity in accordance with the substance of the contractual arrangement.

Transaction costs on the issue of equity instruments

Transaction costs arising on the issue of equity instruments are recognised directly in equity as a reduction of the proceeds of the equity instruments to which the costs relate. Transaction costs are the costs that are incurred directly in connection with the issue of those equity instruments and which would not have been incurred had those instruments not been issued.

Interest

Interest is classified as an expense consistent with the statement of financial position classification of the related debt.

(i) Foreign currency

Foreign currency transactions

All foreign currency transactions during the financial year are brought to account using the exchange rate in effect at the date of the transaction. Foreign currency monetary items at reporting date are translated at the exchange rate existing at reporting date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined.

Exchange differences are recognised in profit and loss in the period they arise.

Foreign operations

On consolidation, the assets and liabilities of the consolidated entity's overseas operations are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are recognised in the foreign currency translation reserve, and recognised in profit and loss on disposal of the foreign operation.

(j) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except:

- i. where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- ii. for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

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

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(k) Government grants

Government grants are assistance by the government in the form of transfers of resources to the consolidated entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. Government grants include government assistance where there are no conditions specifically relating to the operating activities of the consolidated entity other than the requirement to operate in certain regions or industry sectors.

Government grants relating to income are recognised as income over the periods necessary to match them with the related costs. Government grants that are receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the consolidated entity with no future related costs are recognised as income in the period in which it becomes receivable.

(l) Impairment of assets

At each reporting date, the consolidated entity reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the consolidated entity estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Goodwill, intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually and whenever there is an indication that the asset may be impaired. An impairment of goodwill is not subsequently reversed. Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount

of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit and loss immediately.

(m) Income tax

Current tax

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities (other than as a result of business combination) which affects neither taxable income nor accounting profit. Furthermore, a deferred tax liability is not recognised in relation to taxable temporary differences arising from goodwill.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(m) Income tax (cont)

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries except where the consolidated entity is able to control the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets arising from deductible temporary differences associated with these investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the assets and liabilities giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the consolidated entity expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the company/consolidated entity intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred tax is recognised as an expense or income in the statement of comprehensive income, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity, or where it arises from the initial accounting for a business combination, in which case it is taken into account in the determination of goodwill or excess.

Tax consolidation

The company and all its wholly-owned Australian resident entities are part of a tax consolidated group under Australian taxation law. Electro Optic Systems Holdings Limited is the head entity in the tax-consolidated group. Tax expense/income,

deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'separate taxpayer within the group' approach.

Current tax liabilities and assets and deferred tax assets arising from unused tax losses and tax credits of the members of the tax-consolidated group are recognised by the company (as head entity in the tax-consolidated group).

There are no formal tax funding arrangements within companies within the tax-consolidated entity.

(n) Intangible assets

Research and development costs

Expenditure on research activities is recognised as an expense in the period in which it is incurred. Where no internally-generated intangible assets can be recognised, development expenditure is recognised as an expense in the period as incurred.

Intangible assets acquired in a business combination

Intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair value can be measured reliably.

Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets acquired separately.

(o) Inventories

Inventories are measured at the lower of cost and net realisable value. Costs are assigned on a first-in first-out basis. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(p) Leased assets

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Consolidated entity as lessee

Assets held under finance leases are initially recognised at their fair value or, if lower, at amounts equal to the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the statement of financial position as a finance lease obligation.

Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Finance leased assets are amortised on a straight line basis over the estimated useful life of the asset.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

Lease incentives

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefits of incentives are recognised as a reduction of rental expenses on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

(q) Payables

Trade payable and other accounts payable are recognised when the consolidated entity becomes obliged to make future payments resulting from the purchase of goods and services.

(r) Principles of consolidation

The consolidated financial statements are prepared by combining the financial statements of all the entities that comprise the consolidated entity, being the company (the parent entity) and its subsidiaries as defined in Accounting Standard AASB 127 Consolidated and Separate Financial Statements. Consistent accounting policies are employed in the preparation and presentation of the consolidated financial statements.

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. If, after reassessment, the fair values of the identifiable net assets acquired exceeds the cost of acquisition, the deficiency is credited to profit and loss in the period of acquisition.

The consolidated financial statements include the information and results of each subsidiary from the date on which the company obtains control and until such time as the company ceases to control such entity.

In preparing the consolidated financial statements, all inter-company balances and transactions and unrealised profits within the consolidated entity are eliminated in full.

(s) Property, plant and equipment

Plant and equipment, leasehold improvements and equipment under finance lease are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of an item. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of acquisition.

Depreciation is provided on property, plant and equipment. Depreciation is calculated so as to write off the net cost or other revalued amount of each asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter, using the straight line method. The estimated useful lives, residual values and depreciation method is reviewed at the end of each annual accounting period.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(s) Property, plant and equipment (cont)

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

Plant and equipment	5 to 15 years
Leasehold improvements	3 to 5 years
Equipment under finance lease	3 to 5 years
Office equipment	5 to 15 years
Furniture, fixture and fittings	5 to 15 years
Motor vehicles	3 to 5 years

(t) Provisions

Provisions are recognised when the consolidated entity has a present obligation, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is probable that recovery will be received and the amount of the receivable can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Warranties - Provisions for warranty costs are recognised as agreed in individual sales contracts, at the directors best estimate of the expenditure required to settle the consolidated entity's liability.

Surplus lease space - The consolidated entity entered into contracts for the lease of premises in Tucson, USA which were surplus to the requirements of the company. Present obligations under the onerous lease contract were recognised as a provision in 2011.

Redundancy costs - The consolidated entity recognised costs for redundancy costs in its Tucson, USA plant which was relocated to Huntsville, Alabama.

Onerous contracts - Present obligations arising under onerous contracts are recognised and measured as a provision. An onerous contract is considered to exist where the Group has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Decommissioning cost and make good of leased premises - a provision for decommissioning cost and make good of leased premises is recognised when there is a present obligation, it is probable that an outflow of economic benefits will be required to settle the obligation, and the amount of the provision can be measured reliably. The estimated future obligations include the costs of removing the facilities and restoring the premises.

(u) Revenue recognition

Construction revenue is recognised on the basis of the terms of the contract adjusted for any variations or claims allowable under the contract.

Revenue from contracts to provide services is recognised on a monthly basis in accordance with the services contracts.

Interest income is recognised as it accrues.

Revenue from the sale of goods is recognised when the consolidated entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

(v) Share based payments to employees

Equity-settled share-based payments are measured at fair value at the date of the grant. Fair value is measured by use of a modified Cox-Rubenstein binomial model. The expected life used in the model has been adjusted, based on management best estimates, for the effects of non-transferability, exercise restrictions and behavioural considerations. The fair value determined at the grant date of the equity-settled share based payments is expensed on a straight-line basis over the vesting period, based on the consolidated entity's estimate of shares that will eventually vest.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(w) AASB Accounting Standards not yet effective

The entity has not elected to early adopt the following Standards and Interpretations which have been issued or revised by the AASB but are not yet effective:

All other new and revised Standards and Interpretations effective for the period ended 31 December 2012 have been adopted with no material impact on the amounts or disclosures in the financial statements.

Standards and Interpretations in issue not yet adopted

At the date of authorisation of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective.

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
AASB 9 Financial Instruments	1-Jan-15	31-Dec-15
AASB 10 Consolidated Financial Statements	1-Jan-13	31-Dec-13
AASB 12 Disclosure of Interests in Other Entities	1-Jan-13	31-Dec-13
AASB 13 Fair Value Measurement	1-Jan-13	31-Dec-13
AASB 127 Separate Financial Statements	1-Jan-13	31-Dec-13
AASB 2010-2 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements [AASB 1, 2, 3, 5, 7, 8, 101, 102, 107, 108, 110, 111, 112, 116, 117, 119, 121, 123, 124, 127, 128, 131, 133, 134, 136, 137, 138, 140, 141, 1050 & 1052 and Interpretations 2, 4, 5, 15, 17, 127, 129 & 1052]	1-Jul-13	31-Dec-14
AASB 2010-7 Amendments to Australian Accounting Standards arising from AASB 9 (December 2010) [AASB 1, 3, 4, 5, 7, 101, 102, 108, 112, 118, 120, 121, 127, 128, 131, 132, 136, 137, 139, 1023 & 1038 and Interpretations 2, 5, 10, 12, 19 & 127]	1-Jan-15	31-Dec-15
AASB 2011-4 Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements [AASB 124]	1-Jul-13	31-Dec-14
AASB 2011-7 Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards [AASB 1, 2, 3, 5, 7, 101, 107, 112, 118, 121, 124, 132, 133, 136, 138, 139, 1023 & 1038 and Interpretations 5, 9, 16 & 17]	1-Jan-13	31-Dec-13
AASB 2011-8 Amendments to Australian Accounting Standards arising from AASB 13 [AASB 1, 2, 3, 4, 5, 7, 101, 102, 108, 110, 116, 117, 118, 119, 120, 121, 128, 131, 132, 133, 134, 136, 138, 139, 140, 141, 1004, 1023 & 1038 and Interpretations 2, 4, 12, 13, 14, 17, 19, 131 & 132]	1-Jan-13	31-Dec-13
AASB 2011-10 Amendments to Australian Accounting Standards arising from AASB 119 (September 2011) [AASB 1, AASB 8, AASB 101, AASB 124, AASB 134, AASB 1049 & AASB 2011-8 and Interpretation 14]	1-Jan-13	31-Dec-13
AASB 2011-11 Amendments to AASB 119 (September 2011) arising from Reduced Disclosure Requirements	1-Jul-13	30-Jun-14

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

1. Summary of Accounting Policies (cont)

(w) AASB Accounting Standards not yet effective (cont)

Standard/Interpretation	Effective for annual reporting periods beginning on or after	Expected to be initially applied in the financial year ending
AASB 2011-12 Amendments to Australian Accounting Standards arising from Interpretation 20 [AASB 1]	1-Jan-13	31-Dec-13
AASB 2012-1 Amendments to Australian Accounting Standards - Fair Value Measurement - Reduced Disclosure Requirements [AASB 3, AASB 7, AASB 13, AASB 140 & AASB 141]	1-Jul-13	31-Dec-14
AASB 2012-5 Amendments to Australian Accounting Standards arising from Annual Improvements 2009-2011 Cycle [AASB 1, AASB 101, AASB 116, AASB 132 & AASB 134 and Interpretation 2]	1-Jan-13	31-Dec-13
AASB 2012-7 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements [AASB 7, AASB 12, AASB 101 & AASB 127]	1-Jul-13	31-Dec-14
AASB 2012-10 Amendments to Australian Accounting Standards - Transition Guidance and Other Amendments [AASB 1, 5, 7, 8, 10, 11, 12, 13, 101, 102, 108, 112, 118, 119, 127, 128, 132, 133, 134, 137, 1023, 1038, 1039, 1049 & 2011-7 and Interpretation 12]	1-Jan-13	31-Dec-13
AASB 2012-11 Amendments to Australian Accounting Standards - Reduced Disclosure Requirements and Other Amendments [AASB 1, AASB 2, AASB 8, AASB 10, AASB 107, AASB 128, AASB 133, AASB 134 & AASB 2011-4]	1-Jul-13	31-Dec-14

The directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material financial impact on the financial statements of the company or the consolidated entity but may change disclosures made.

(x) Comparative amounts

Where the Group changes the presentation or classification of items in its financial statements, it reclassifies the comparative amounts for consistency and comparability between financial years.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

2. (Loss)/Profit from Operations

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
(a) Revenue				
Revenue from operations consisted of the following items:				
Revenue from the sale of goods	16,432,289	24,363,281	-	-
Revenue from the rendering of services	2,720,460	5,787,406	-	-
Construction contract revenue	2,575,955	2,227,355	-	-
	21,728,704	32,378,042	-	-
Interest revenue:				
Bank deposits	171,697	348,855	152,342	329,446
Other				
Other	19,347	48,494	13,869	4,361
	21,919,748	32,775,391	166,211	333,807

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

2. (Loss)/Profit from Operations (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
(b) (Loss)/profit before income tax has been arrived at after charging the following expenses:				
Borrowing costs				
Finance lease finance charges	104,363	111,371	-	-
Interest paid - Other entities	8,378	191,510	-	-
	112,741	302,881	-	-
Depreciation - property, plant and equipment	1,886,926	426,512	657	1,095
Impairment of property, plant and equipment	-	(333,561)	-	-
Amortisation - intangibles	131,519	131,533	-	-
Impairment of intangibles	565,119	-	-	-
(Reversal of)/provision for non-recovery of loan - wholly-owned controlled entity	-	-	(2,824,982)	3,573,685
Provision for non-recovery of investment in subsidiary	-	-	204,209	400,464
Writedown of inventory to net realisable value	1,342,530	1,650,540	-	-
Profit on sale of property, plant and equipment	(4,603)	(2,287)	-	-
Foreign exchange gain/(loss)	(196,299)	573,317	(772)	(669)
Operating lease rental expenses:				
Minimum lease payments	500,552	542,209	-	-
Employee benefit expense:				
Share based payments:				
Equity settled	204,209	400,464	-	-
Contributions to defined contribution superannuation plans	917,051	1,222,520	12,240	12,240
Other employee benefits	10,875,523	11,715,277	377,750	308,410
	11,996,783	13,338,261	389,990	320,650

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

3. (Loss)/Earnings per Share

	Consolidated	
	31 December 2012 \$	31 December 2011 \$
Basic (loss)/earnings per share	(17.9 cents)	0.3 cents
Diluted (loss)/earnings per share	(17.9 cents)	0.3 cents
Basic (Loss)/Earnings per Share		
(Loss)/Earnings (a)	(10,179,823)	180,188
Weighted average number of ordinary shares (b)	56,845,926	56,845,926

(a) (Loss)/Earnings used in the calculation of basic earnings per share are the same as the net (loss)/profit in the statement of comprehensive income.

(b) Options are considered to be potential ordinary shares and are therefore excluded from the weighted average number of shares used in the calculation of basic earnings per share. Where dilutive, potential ordinary shares are included in the calculation of diluted earnings per share (see below).

Diluted (Loss)/Earnings per Share		
(Loss)/Earnings (a)	(10,179,823)	180,188
Weighted average number of ordinary shares (b)	56,845,926	56,845,926

(a) (Loss)/Earnings used in the calculation of diluted earnings per share are the same as the net (loss)/profit in the statement of comprehensive income.

(b) The weighted average number of ordinary shares and potential ordinary shares used in the calculation of diluted earnings per share are as follows:

Weighted average number of shares used in the calculation of basic earnings per share	56,845,926	56,845,926
Staff Share plan	-	-
Weighted average number of shares used in the calculation of diluted earnings per share	56,845,926	56,845,926

(c) The following potential ordinary shares are not dilutive and therefore excluded from the weighted average number of ordinary shares and potential ordinary shares used in the calculation of diluted earnings per share:

Staff Share plan	1,025,000	1,538,000
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(d) Weighted average number of converted, lapsed, or cancelled potential ordinary shares used in the calculation of diluted earning per share:

None used as they are not considered dilutive.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

4 Income Tax

(a) The prima facie income tax benefit on pre-tax accounting profit/(loss) from operations reconciles to the income tax benefit in the financial statements as follows:

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
(Loss)/Profit from operations	(10,179,823)	180,188	2,002,306	(4,398,147)
Income tax (benefit)/expense calculated at 30%	(3,053,947)	54,056	600,692	(1,319,444)
Non-deductible provision for non-recovery of loan	-	-	(847,495)	1,072,106
Share based payments	61,263	120,139	61,263	120,139
Previously unrecognised and unused tax losses now recognised	-	-	-	-
Other non-deductible/non assessable items	(22,231)	(367,922)	(6,058)	5,626
	(3,014,915)	(193,727)	(191,598)	(121,573)
Unused tax losses and tax offsets not recognised as deferred tax assets	3,014,915	193,727	191,598	121,573
Income tax attributable to operating (Loss)/profit	-	-	-	-

The tax rate used in the above reconciliation is the corporate tax rate of 30% payable by Australian corporate entities on taxable profits under Australian tax law, 25% in Germany, 17% in Singapore and the federal tax rate applicable in the USA and the State of Arizona has been assumed to approximate a combined rate 40% as their tax rates apply on a sliding scale. There has been no change in the corporate tax rate when compared with the previous reporting period.

(b) Unrecognised deferred tax balances

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
The following deferred tax assets have not been brought to account as assets				
Tax losses - revenue	21,309,046	18,294,131	6,576,523	6,384,925
Temporary differences	1,489,161	1,504,013	-	-
	22,798,207	19,798,144	6,576,523	6,384,925

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

4 Income Tax (cont)

(b) Unrecognised deferred tax balances (cont)

Tax consolidation

Relevance of tax consolidation to the consolidated entity

The company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 1 January 2003 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Electro Optic Systems Holdings Limited. The members of the tax-consolidated entity group are identified in Note 24.

Nature of tax funding arrangements and tax sharing agreements

There are no formal tax funding or tax sharing arrangements within the tax-consolidated group.

5. Other Financial Assets

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Non-Current - at cost				
Unlisted shares in controlled entities at cost	-	-	4,016,132	3,811,923
provision for non recovery	-	-	(4,016,132)	(3,811,923)
	-	-	-	-
Carrying value at start of financial year	-	-	-	-
share options provided at no cost	-	-	204,209	400,464
provision for non recovery	-	-	(204,209)	(400,464)
	-	-	-	-

The directors have assessed the carrying value of the unlisted shares held in controlled entities and have determined that, as at 31 December 2012, based upon the net asset position of the controlled entities, the current and historic trading results and the foreseeable future results from signed contracts on hand the investments are fully impaired.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

6. Trade and Other Receivables

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Current				
Trade receivables	1,507,256	9,126,990	-	-
GST receivable	81,785	108,417	21,140	21,156
Rental deposit related party	5,843	-	5,843	-
Amounts due from customers under construction contracts (Note 30)	274,847	599,620	-	-
Other debtors	5,165	-	-	-
	1,874,896	9,835,027	26,983	21,156

The average credit period on sales of goods is 30 days. No interest is charged on late payments and no general allowance for doubtful debts has been made as most contracts are with governments and government agencies.

Ageing of past due not impaired				
31-60 days	344,008	772,031	-	-
61-90 days	1,217	5,148	-	-
120 days +	9,114	58,015	-	-
	354,339	835,194	-	-
Ageing of past due and impaired				
120 days +	-	-	-	-
Total	-	-	-	-
Movement in allowance for doubtful debts				
Balance at the beginning of the financial year	-	-	-	-
Amount released	-	-	-	-
Balance at the end of the financial year	-	-	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

7. Current Inventories

	Consolidated		Company	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
	\$	\$	\$	\$
Finished goods - at cost	-	2,354,511	-	-
Raw materials - at net realisable value	2,541,172	4,644,227	-	-
Work in progress - at cost	1,314,678	3,705,986	-	-
	3,855,850	10,704,724	-	-

8. Other Assets

Current				
Prepayments	588,939	101,316	-	-
Non-current				
Amounts due from wholly-owned controlled entity	-	-	65,258,001	68,082,984
Less Allowance for uncollectible amounts	-	-	(65,258,001)	(68,082,984)
	-	-	-	-
Movement in allowance for uncollectible amounts				
Balance at the beginning of the financial year	-	-	68,082,984	64,509,299
Reversal of provision recognised in profit and loss	-	-	(2,824,983)	3,573,685
Balance at the end of the financial year	-	-	65,258,001	68,082,984

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

9. Intangibles

	Consolidated		Company	
	31 December 2012	31 December 2011	31 December 2012	31 December 2011
	\$	\$	\$	\$
License agreement	-	714,830	-	-

On 3 December 2009 as part of the acquisition of the assets of Recon Optical Inc of the USA, the consolidated entity acquired a licence for the Kollmorgen Licensed patents. The license expires on the expiry of the patents which expire on 16 July 2017 and relates to the manufacturing of gimbals. The full value of the licence agreement was impaired during the period based on the forecasted future cash flows from signed contracts on hand.

Movement in intangible assets

Gross carrying amount

Balance at the beginning of the financial year	714,830	849,852	-	-
Amortisation	(131,519)	(131,533)	-	-
Impairment	(565,119)	-	-	-
Net foreign currency exchange differences	(18,192)	(3,489)	-	-
Balance at the end of the financial year	-	714,830	-	-
Net book value	-	714,830	-	-

10. Auditors Remuneration

(a) Auditor of the Parent Entity

Audit or review of the financial report	186,031	242,860	186,031	242,860
Taxation services	13,500	12,000	13,500	12,000
	199,531	254,860	199,531	254,860

(b) Network firm of the Parent Entity Auditor

Audit or review of the financial report	189	9,076	-	-
Taxation services	110	1,512	-	-
	299	10,588	-	-

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

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

11. Property, Plant and Equipment

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
(a) Plant and equipment - at cost	5,905,447	6,013,397	-	-
Less accumulated depreciation and impairment	(5,755,546)	(4,944,358)	-	-
	149,901	1,069,039	-	-
(b) Leased assets - at cost	361,997	362,181	-	-
Less accumulated amortisation and impairment	(144,845)	(77,607)	-	-
	217,152	284,574	-	-
(c) Office equipment - at cost	2,755,422	2,752,175	15,048	15,048
Less accumulated depreciation and impairment	(2,589,636)	(1,996,675)	(14,063)	(13,406)
	165,786	755,500	985	1,642
(d) Furniture, fixtures and fittings - at cost	280,703	300,212	-	-
Less accumulated depreciation and impairment	(275,436)	(274,814)	-	-
	5,267	25,398	-	-
(e) Leasehold improvements - at cost	1,128,493	1,140,721	-	-
Less accumulated depreciation and impairment	(1,128,493)	(844,149)	-	-
	-	296,572	-	-
(f) Motor vehicle - at cost	17,736	18,081	-	-
Less accumulated depreciation and impairment	(17,736)	(18,081)	-	-
	-	-	-	-
(g) Satellite - at cost	7,000,000	7,000,000	-	-
Less impairment	(7,000,000)	(7,000,000)	-	-
	-	-	-	-
Total net book value of Property, Plant and Equipment	538,106	2,431,083	985	1,642

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

11. Property, Plant and Equipment (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Cost				
Plant and equipment				
Balance at beginning of year	6,013,397	6,047,822	-	-
Additions	18,640	33,060	-	-
Asset transfers	9,730	-	-	-
Disposals	(65,066)	(62,168)	-	-
Net foreign currency exchange differences	(71,254)	(5,317)	-	-
Balance at end of year	5,905,447	6,013,397	-	-
Leased assets				
Balance at beginning of year	362,181	414,285	-	-
Asset transfer	-	19,315	-	-
Transfer to office equipment	-	(71,431)	-	-
Net foreign currency exchange differences	(184)	12	-	-
Balance at end of year	361,997	362,181	-	-
Office equipment				
Balance at beginning of year	2,752,175	2,601,098	15,048	15,048
Additions	26,594	115,149	-	-
Asset transfers	4,979	-	-	-
Transfer from leased assets	-	71,431	-	-
Disposals	(3,862)	(30,322)	-	-
Net foreign currency exchange differences	(24,464)	(5,181)	-	-
Balance at end of year	2,755,422	2,752,175	15,048	15,048

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

11. Property, Plant and Equipment (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Furniture, fixtures and fittings				
Balance at beginning of year	300,212	299,546	-	-
Additions	-	7,586	-	-
Disposals	-	(6,590)	-	-
Asset transfers	(14,709)	-	-	-
Net foreign currency exchange differences	(4,800)	(330)	-	-
Balance at end of year	280,703	300,212	-	-
Leasehold improvements				
Balance at beginning of year	1,140,721	1,142,806	-	-
Additions	-	19,895	-	-
Disposals	-	(21,159)	-	-
Net foreign currency exchange differences	(12,228)	(821)	-	-
Balance at end of year	1,128,493	1,140,721	-	-
Motor vehicle				
Balance at beginning of year	18,081	18,104	-	-
Net foreign currency exchange differences	(345)	(23)	-	-
Balance at end of year	17,736	18,081	-	-
Satellite				
Balance at beginning of year	7,000,000	7,000,000	-	-
Balance at end of year	7,000,000	7,000,000	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

11. Property, Plant and Equipment (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Accumulated Depreciation/ Amortisation/Impairment Plant and equipment				
Balance at beginning of year	(4,944,358)	(4,299,133)	-	-
Depreciation	(898,344)	(318,269)	-	-
Impairment	-	(371,085)	-	-
Disposals	12,305	50,711	-	-
Net foreign currency exchange differences	74,851	(6,582)	-	-
Balance at end of year	(5,755,546)	(4,944,358)	-	-
Leased plant and equipment				
Balance at beginning of year	(77,607)	(62,539)	-	-
Amortisation expense	(67,422)	(67,089)	-	-
Impairment	-	(83)	-	-
Asset transfer	-	(19,315)	-	-
Transfer to office equipment	-	71,431	-	-
Net foreign currency exchange differences	184	(12)	-	-
Balance at end of year	(144,845)	(77,607)	-	-
Office equipment				
Balance at beginning of year	(1,996,675)	(2,578,921)	(13,406)	(12,311)
Depreciation	(619,166)	(15,458)	(657)	(1,095)
Impairment	-	633,698	-	-
Transfer from leased assets	-	(71,431)	-	-
Disposals	1,683	30,322	-	-
Net foreign currency exchange differences	24,522	5,115	-	-
Balance at end of year	(2,589,636)	(1,996,675)	(14,063)	(13,406)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

11. Property, Plant and Equipment (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Furniture, fixtures and fittings				
Balance at beginning of year	(274,814)	(290,212)	-	-
Depreciation	(5,422)	(1,220)	-	-
Impairment	-	9,697	-	-
Disposals	-	6,591	-	-
Net foreign currency exchange differences	4,800	330	-	-
Balance at end of year	(275,436)	(274,814)	-	-
Leasehold improvements				
Balance at beginning of year	(844,149)	(912,916)	-	-
Amortisation	(296,572)	(24,476)	-	-
Impairment	-	60,534	-	-
Disposals	-	21,159	-	-
Net foreign currency exchange differences	12,228	11,550	-	-
Balance at end of year	(1,128,493)	(844,149)	-	-
Motor vehicle				
Balance at beginning of year	(18,081)	(18,104)	-	-
Net foreign currency exchange differences	345	23	-	-
Balance at end of year	(17,736)	(18,081)	-	-
Satellite				
Balance at beginning of year	(7,000,000)	(7,000,000)	-	-
Balance at end of year	(7,000,000)	(7,000,000)	-	-

The Group reassessed the remaining useful lives of assets during the current period.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

11. Property, Plant and Equipment (cont)

Aggregate depreciation, impairment and amortisation allocated during the period is recognised as an expense and disclosed in Note 2 to the financial statements.

Impairment of property, plant and equipment

The consolidated entity has assessed the carrying amount of plant and equipment in the Queanbeyan and Tucson facilities and determined an impairment (reversal) charge for the year of Nil (2011: reversal \$333,561). The basis to assess for any potential impairment was fair value less costs to sell and fair value determined by reference to an active market for second hand manufacturing equipment.

12. Current Trade and Other Payables

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Trade payables	1,473,693	3,223,921	10,831	6,802
Accruals	511,974	295,309	86,659	114,159
Amounts due to customers under construction contracts (Note 30)	3,788,418	5,370,799	-	-
	5,774,085	8,890,029	97,490	120,961

The average credit period on purchases of goods is 30 days and no interest is payable on goods purchased within agreed credit terms. The consolidated entity has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

13. Borrowings

Secured - At amortised cost				
Current				
Finance lease liabilities (Note 26)	102,191	113,524	-	-
Secured promissory Note 2	-	1,139,323	-	-
Secured promissory Note 3	-	739,020	-	-
	102,191	1,991,867	-	-
Non-current				
Finance lease liabilities (Note 26)	15,032	117,223	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

13. Borrowings (cont)

The finance lease liabilities are secured by the leased assets. The average weighted interest rate charged on the finance leases was 10.03% (2011 - 9.95%). The secured promissory Note 2 of \$1,139,323 (US\$1,159,375) was denominated in US dollars and attracted an interest rate of 5%. The secured promissory Note 3 of \$739,020 (US\$752,027) was denominated in US dollars and attracted an interest rate of 5%. The promissory notes were secured by the inventory purchased and a guarantee from the parent company. The promissory notes have been repaid in full during the year.

14. Provisions

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Current				
Employee benefits (Note 16)	2,382,606	2,126,061	-	-
Surplus lease space	-	87,642	-	-
Contract losses	222,191	22,422	-	-
Contract credit	308,776	-	-	-
Redundancy costs	-	201,185	-	-
Decommissioning costs	250,000	250,000	-	-
Make good of leased premises	-	29,481	-	-
Warranty (Note 15)	1,507,027	2,047,061	-	-
	4,670,600	4,763,852	-	-
Non-current				
Employee Benefits (Note 16)	293,271	249,523	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

14.Provisions (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Movement in surplus lease space provision - current				
Balance at 1 January	87,642	110,141	-	-
Payments made	(87,642)	(22,499)	-	-
Balance as at 31 December	-	87,642	-	-

The surplus lease space provisions related to the leased premises at 3160 East Transcon Way, Tucson, Arizona, USA.

Movement in contract loss provision				
Balance at 1 January	22,422	166,496	-	-
Additional provision recognised	222,191	-	-	-
Reductions resulting from re-measurement	(22,422)	(144,074)	-	-
Balance as at 31 December	222,191	22,422	-	-

The provision for contract losses is based on assessment by management of the additional costs to complete existing contracts not recoverable from the customer.

Movement in contract credit provision				
Balance at 1 January	-	-	-	-
Additional provision recognised	308,776	-	-	-
Balance as at 31 December	308,776	-	-	-

The provision is for an agreed credit to be provided to a customer.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

14. Provisions (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Movement on redundancy provision				
Balance at 1 January	201,185	-	-	-
Payments made	(201,185)	-	-	-
Additional provision recognised for Tucson relocation	-	201,185	-	-
Balance as at 31 December	-	201,185	-	-
Movement on decommissioning costs				
Balance at 1 January	250,000	250,000	-	-
Balance as at 31 December	250,000	250,000	-	-
The provision for decommissioning costs relate to an obligation to dismantle and refurbish a telescope at a future date.				
Movement on make good of leased premises				
Balance at 1 January	29,481	29,519	-	-
Reductions resulting from re-measurement	(29,481)	(38)	-	-
Balance as at 31 December	-	29,481	-	-

The provision for make good of leased premises costs related to an obligation to make good the premises in at 3160 East Transcon Way, Tucson, Arizona, USA on expiry of the lease.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

15. Warranty Provisions

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Movement in warranty provision				
Balance at 1 January	2,047,061	2,912,985	-	-
Reductions resulting from re-measurement	(1,212,164)	(1,835,221)	-	-
Additional provisions recognised	672,130	969,297	-	-
Balance as at 31 December	1,507,027	2,047,061	-	-

The provision for warranty claims represents the present value of the directors' best estimate of the future sacrifice of economic benefits that will be required under the consolidated entity's 12-month warranty program for military products and telescopes. The estimate has been made on the basis of historical industry accepted warranty trends and may vary as a result of new materials, altered manufacturing processes or other events affecting product quality.

16. Employee Benefits

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

Provision for employee entitlements

Current (Note 14)	2,382,606	2,126,061	-	-
Non-Current (Note 14)	293,271	249,523	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

17. Issued Capital

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Balance at the beginning of the financial year - Ordinary shares	75,383,567	75,383,567	75,383,567	75,383,567
Balance at the end of the financial year	75,383,567	75,383,567	75,383,567	75,383,567

Changes to the then Corporations Law abolished the authorised capital and par value concept in relation to share capital from 1 July 1998. Therefore, the company does not have a limited amount of authorised capital and issued shares do not have a par value.

Fully Paid Ordinary Shares	Number	Number	Number	Number
Balance at the beginning of financial year	56,845,926	56,845,926	56,845,926	56,845,926
Balance at end of financial year	56,845,926	56,845,926	56,845,926	56,845,926

Fully paid ordinary shares carry one vote per share and carry the right to dividends.

18. Directors and Employee Share Option Plan

(a) Unlisted Options issued under the Employee Share Option Plan

On 28 June 2002, shareholders approved the adoption of an Employee Share Option Plan.

On 10 December 2009 Directors approved the issue of 1,800,000 unlisted options to staff at an exercise price of \$1.30 exercisable on or before 8 December 2013.

The consolidated entity has an ownership-based compensation scheme for employees (including directors) of the company. In accordance with the provisions of the scheme, as approved by shareholders at a previous annual general meeting, employees with more than three months service with the company may be granted options to purchase ordinary shares at exercise prices determined by the directors based on market prices at the time the issue of options were made.

Each share option converts to one ordinary share in Electro Optic Systems Holdings Limited. No amounts are paid or payable by the recipient on receipt of the options. The options carry neither rights to dividends nor voting rights. Options may be exercised at any time from the date of vesting to the date of expiry.

The number of options granted is determined by the directors and takes into account the company's and individual achievements against both qualitative and quantitative criteria.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

18. Directors and Employee Share Option Plan (cont)

(b) Unlisted Options issued under the Employee Share Option Plan

	2012		2011	
	Number	Weighted average exercise price \$	Number	Weighted average exercise price \$
Balance at the beginning of the financial year (i)	1,538,000	1.30	3,393,800	1.62
Granted during the year (ii)	-	-	-	-
Exercised during the year (iii)	-	-	-	-
Lapsed during the year (iv)	(513,000)	1.30	(1,855,800)	1.89
Balance at the end of the financial year (v)	1,025,000	1.30	1,538,000	1.30
Exercisable at end of the year	1,025,000		769,000	

(i) Balance at the beginning of the year

2012	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
Staff options	1,538,000	10/12/09	8/12/13	\$1.30	\$1,481,094

2011	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
Staff options	60,000	31/5/07	31/5/11	\$1.95	\$44,100
Director options	1,564,800	31/5/07	31/5/11	\$1.95	\$1,150,128
Staff options	60,000	23/11/07	31/5/11	\$1.95	\$7,764
Staff options	1,709,000	10/12/09	8/12/13	\$1.30	\$1,645,767
	3,393,800				\$2,847,759

Staff and Director options carry no rights to dividends and no voting rights.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

18. Directors and Employee Share Option Plan (cont)

(b) Unlisted Options issued under the Employee Share Option Plan (cont)

(ii) Granted during the year

	Number	Grant Date	Expiry Date	Exercise Price	Fair Value Received \$	Fair value at grant date \$
2012	-	-	-	-	-	-
2011	-	-	-	-	-	-

There were no options issued during 2012 or 2011.

All the options granted to staff during 2009 vested over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

Options were priced using a modified Cox-Rubenstein binomial pricing model. Where relevant, the expected life used in the model has been adjusted based on management's best estimate for the effects of non-transferability, exercise restrictions and behavioural conditions. Expected volatility is based on the historical share price volatility over a two year period.

The following inputs were used in the model for grants during the year ended 31 December 2009:

Dividend yield	-
Expected volatility (linearly interpolated)	133.9%
Risk free interest rate	3.75%
Expected life of options	4 years
Grant date share price	\$1.20
Exercise price	\$1.30

(iii) Exercised during the year

Number of Options Exercised	Grant Date	Exercise Date	Expiry Date	Exercise Price	No. of Shares Issued	Fair Value Received	Fair Value of Shares at Date of Issue
2012							
Nil	-	-	-	-	Nil	Nil	Nil
2011							
Nil	-	-	-	-	Nil	Nil	Nil

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

18. Directors and Employee Share Option Plan (cont)

(b) Unlisted Options issued under the Employee Share Option Plan (cont)

(iv) Lapsed during the year

	Number of Options Lapsed	Grant Date	Exercise Date	Expiry Date	Exercise Price	No. of Shares Issued	Fair Value Received	Fair Value of Shares at Date of Issue
2012								
Staff	513,000	10/12/09	-	8/12/13	\$1.30	-	-	-
2011								
Staff	60,000	31/5/07	-	31/5/11	\$1.95	-	-	-
Staff	60,000	23/11/07	-	31/5/11	\$1.95	-	-	-
Directors	1,564,800	31/5/07	-	31/5/11	\$1.95	-	-	-
Staff	171,000	10/12/09	-	8/12/13	\$1.30	-	-	-
	<u>1,855,800</u>							

(v) Balance at the end of the financial year

2012	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
Staff options	<u>1,025,000</u>	10/12/09	8/12/13	\$1.30	<u>\$987,075</u>
2011					
Staff options	<u>1,538,000</u>	10/12/09	8/12/13	\$1.30	<u>\$1,481,094</u>

Staff and Director options carry no rights to dividends and no voting rights.

All the options granted to staff during 2009 vested over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years. No options were issued during 2010, 2011 and 2012.

The difference between the total market value of the options issued during the financial year, at the date of issue, and the total amount received from employees (nil) is recognised in the financial statements over the vesting period as disclosed in Note 18 to the financial statements.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

19. Reserves

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Foreign currency translation	49,953	45,780	-	-
Employee equity-settled benefits	7,727,803	7,523,594	7,727,803	7,523,594
	7,777,756	7,569,374	7,727,803	7,523,594
Foreign currency translation				
Balance at beginning of financial year	45,780	573,402	-	-
Translation of foreign operations	4,173	(527,622)	-	-
Balance at end of financial year	49,953	45,780	-	-

Exchange differences relating to the translation from US dollars, being the functional currency of the consolidated entity's foreign controlled entities in the USA, Euros, being the functional currency of the consolidated entity's foreign controlled entity in Germany and Singaporean dollars, being the functional currency of the consolidated entity's foreign controlled entity in Singapore, into Australian dollars are brought to account by entries made directly to the foreign currency translation reserve.

Employee equity-settled benefits

Balance at beginning of financial year	7,523,594	7,123,130	7,523,594	7,123,130
Share based payment	204,209	400,464	204,209	400,464
Balance at end of financial year	7,727,803	7,523,594	7,727,803	7,523,594

The employee equity-settled benefits reserve arises on the grant of share options to directors and executives under the Employee Share Option plan. Further information about share-based payments to employees is made in Note 18 to the financial statements.

20. Accumulated Losses

Balance at beginning of financial year	(70,292,694)	(70,472,882)	(81,680,598)	(77,282,451)
Net (Loss)/profit attributable to members of the parent entity	(10,179,823)	180,188	2,002,306	(4,398,147)
Balance at end of financial year	(80,472,517)	(70,292,694)	(79,678,292)	(81,680,598)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

21. Key Management Personnel Compensation

The key management personnel of Electro Optic Systems Holdings Limited during the year were:

Mr Fred Bart (Chairman, Non-executive director)
 Dr Ben Greene (Chief Executive Officer and director)
 Mr Ian Dennis (Non-executive director)*
 Mr Mark Ureda (Non-executive director)
 Lt Gen Peter Leahy AC (Non-executive director)
 Mr Kevin Scully (Non-executive director) commenced 19 September 2011
 Dr Craig Smith (Chief Executive Officer of EOS Space Systems Pty Limited)
 Mr Mark Bornholt (Chief Executive Officer Defence Systems) - commenced 21 March 2011
 Mr John Palisi (Chief Financial Officer - Electro Optic Systems Pty Limited) resigned 3 February 2012
 Mr Scott Lamond (Chief Financial Officer - Electro Optic Systems Pty Limited) appointed
 10 August 2012 - Mr Scott Lamond was Acting Chief Financial Officer from 3 February 2012 to 10 August 2012
 Mr Hugo Keyner (Chief Executive Officer EOS Technologies Inc) retired 31 October 2012

*During the period 3 February 2012 to 10 August 2012 whilst Scott Lamond was Acting Chief Financial Officer, Mr Ian Dennis assumed an executive role to assist in the finance function.

Key management personnel compensation policy

The board reviews the remuneration packages of all key management personnel on an annual basis. Remuneration packages are reviewed and determined with regard to current market rates and are benchmarked against comparable industry salaries, adjusted by a performance factor to reflect changes in the performance of the company.

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

	Consolidated		Company	
	2012 \$	2011 \$	2012 \$	2011 \$
Short-term employee benefits	1,601,075	1,498,319	377,750	308,410
Post-employment benefits	104,623	99,342	12,240	12,240
Share-based payment	39,934	142,388	-	-
Other long term benefits	-	42,760	-	-
	1,745,632	1,782,809	389,990	320,650

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

21. Key Management Personnel Compensation (cont)

The compensation of the non executive directors is paid by the holding company and is the same for both the holding company and the consolidated entity. The compensation for Dr Ben Greene and the senior executives are paid by subsidiary companies.

	Short term		Post Employment	Equity settled Share based payments	Other Long Term	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Benefits	
2012	\$	\$	\$	\$	\$	\$
Directors						
Mr Fred Bart	61,000	-	5,490	-	-	66,490
Dr Ben Greene*	439,994	28,726	37,177	-	-	505,897
Mr Ian Dennis	197,500	-	3,375	-	-	200,875
Mr Mark Ureda	40,875	-	-	-	-	40,875
Lt Gen Peter Leahy AC	37,500	-	3,375	-	-	40,875
Mr Kevin Scully	40,875	-	-	-	-	40,875
	817,744	28,726	49,417	-	-	895,887
Executives						
Dr Craig Smith	210,000	-	18,900	18,152	-	247,052
Mr Mark Bornholt	210,000	-	18,900	-	-	228,900
Mr John Palisi	80,324	-	2,326	-	-	82,650
Mr Scott Lamond	167,556	-	15,080	3,630	-	186,266
Mr Hugo Keyner	85,976	749	-	18,152	-	104,877
	753,856	749	55,206	39,934	-	849,745
	1,571,600	29,475	104,623	39,934	-	1,745,632

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

21. Key Management Personnel Compensation (cont)

	Short term		Post Employment	Equity settled Share based payments	Other Long	Total
	Salary & Fees \$	Non-monetary \$	Superannuation \$	Options \$	Term Benefits \$	
2011						
Directors						
Mr Fred Bart	61,000	-	5,490	-	-	66,490
Dr Ben Greene*	300,000	39,182	27,000	-	-	366,182
Mr Ian Dennis	157,500	-	3,375	-	-	160,875
Mr Mark Ureda	40,875	-	-	-	-	40,875
Lt Gen Peter Leahy AC	37,500	-	3,375	-	-	40,875
Mr Kevin Scully	11,535	-	-	-	-	11,535
	608,410	39,182	39,240	-	-	686,832
Executives						
Mr Ron Thompson	172,083	-	13,288	35,597	42,760	263,728
Dr Craig Smith	197,532	-	17,750	35,597	-	250,879
Mr Mark Bornholt	128,423	-	11,340	-	-	139,763
Mr John Palisi	196,946	-	17,724	35,597	-	250,267
Mr Hugo Keyner	154,889	854	-	35,597	-	191,340
	849,873	854	60,102	142,388	42,760	1,095,977
	1,458,283	40,036	99,342	142,388	42,760	1,782,809

* Executive director

Non-monetary includes the provision for motor vehicles and health benefits.

Further details on options can be found in Note 18.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

22. Notes to the Cash Flow Statement

(a) Reconciliation of Cash and cash equivalents

For the purposes of the cash flow statement, cash includes cash on hand and at call deposits with banks or financial institutions, investments in money market instruments maturing within less than two months and net of bank overdrafts. Cash at the end of the financial year as shown in the statements of cash flows is reconciled to the related items in the statement of financial position as follows:

	Consolidated		Company	
	2012	2011	2012	2011
	\$	\$	\$	\$
Cash and cash equivalents	6,686,194	4,885,761	3,502,600	1,324,726

(b) Reconciliation of (Loss)/profit for the year to net cash flows from operating activities

(Loss)/profit for the period	(10,179,823)	180,188	2,002,306	(4,398,147)
(Profit) on disposal of fixed assets	(4,603)	(2,287)	-	-
Equity settled share-based payments	204,209	400,464	-	-
Amortisation of intangibles	131,519	131,533	-	-
Impairment of intangibles	565,119	-	-	-
Depreciation of fixed assets	1,886,926	426,512	657	1,095
Impairment	-	(333,561)	-	-
Foreign exchange movements	25,220	(520,741)	-	-
Provision for non-recovery of loan	-	-	(2,824,982)	3,573,685
Provision for non-recovery of investment	-	-	204,209	400,464
Writedown of inventory	1,342,530	1,650,540	-	-
(Increase)/decrease in assets				
Current receivables	7,960,131	5,674,434	(5,827)	(6,603)
Inventories	5,506,344	(752,012)	-	-
Other current assets	(487,623)	152,204	-	-
Increase/(decrease) in liabilities				
Provisions	178,499	(747,650)	-	-
Current trade and other payables	(1,978,231)	(1,146,272)	(23,471)	(28,474)
Other	216,665	(608,056)	-	-
Borrowings for inventory	-	(4,182,672)	-	-
Deferred income and amounts due to customers under construction contracts	(1,582,381)	(4,100,935)	-	-
Net cash inflows/(outflows) from operating activities	3,784,501	(3,778,311)	(647,108)	(458,250)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

22. Notes to the Cash Flow Statement (cont)

(c) Non-Cash Operating Activities

In December 2010, a subsidiary company EOS Defense Systems, Inc acquired 32 completed inventory units for a purchase price of US\$5,300,000, payable in certain instalments in accordance with and under the terms of a promissory note executed by EOS Defense Systems, Inc. The promissory note provided for interest to be paid at 5% per annum. The principal and interest due and paid in full by 31 January 2012.

In September 2011, a subsidiary company EOS Defense Systems, Inc acquired 21 completed inventory units for a purchase price of US\$752,027, payable in certain instalments in accordance with and under the terms of a promissory note executed by EOS Defense Systems, Inc. The promissory note provided for interest to be paid at 5% per annum. The principal and interest due and paid in full by 31 January 2012.

23. Related Party Disclosures

(a) Equity interests in related parties

Details of the percentage of ordinary shares held in subsidiaries are disclosed in Note 24.

(b) Key management personnel compensation

Details of key management personnel compensation are disclosed in Note 21.

(c) Key management personnel equity holdings (represented by holdings of fully paid ordinary shares in Electro Optic Systems Holdings Limited)

2012	Balance at 1/1/12 No.	Granted as remuneration No.	Received on exercise of options No.	Net other change No.	Balance at 31/12/12 No.
Mr Fred Bart	5,309,075	-	-	-	5,309,075
Dr Ben Greene	3,954,185	-	-	-	3,954,185
Mr Ian Dennis	170,050	-	-	-	170,050
Mr Mark Ureda	-	-	-	-	-
Lt Gen Peter Leahy AC	15,000	-	-	-	15,000
Mr Kevin Scully	-	-	-	-	-
Mr Mark Bornholt	-	-	-	-	-
Mr John Palisi	-	-	-	-	-
Dr Craig Smith	89,450	-	-	-	89,450
Mr Scott Lamond	-	-	-	-	-
Mr Hugo Keyner	-	-	-	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

23. Related Party Disclosures (cont)

	Balance at 1/1/11 No.	Granted as remuneration No.	Received on exercise of options No.	Net other change No.	Balance at 31/12/11 No.
2011					
Mr Fred Bart	5,309,075	-	-	-	5,309,075
Dr Ben Greene	3,954,185	-	-	-	3,954,185
Mr Ian Dennis	170,050	-	-	-	170,050
Mr Mark Ureda	-	-	-	-	-
Lt Gen Peter Leahy AC	15,000	-	-	-	15,000
Mr Kevin Scully	-	-	-	-	-
Mr Mark Bornholt	-	-	-	-	-
Mr Ron Thompson	347,745	-	-	-	347,745
Dr Craig Smith	89,450	-	-	-	89,450
Mr John Palisi	-	-	-	-	-
Mr Hugo Keyner	-	-	-	-	-

(d) Key management personnel option holdings.

	Balance at 1/1/12 No.	Granted as remuneration No.	Exercised (Lapsed) No.	Balance at 31/12/12 No.	Balance vested and exercisable at 31/12/12 No.	Options vested during year
2012						
Mr Fred Bart	-	-	-	-	-	-
Dr Ben Greene	-	-	-	-	-	-
Mr Ian Dennis	-	-	-	-	-	-
Mr Mark Ureda	-	-	-	-	-	-
Lt Gen Peter Leahy AC	-	-	-	-	-	-
Mr Kevin Scully	-	-	-	-	-	-
Mr Mark Bornholt	-	-	-	-	-	-
Dr Craig Smith	160,000	-	-	160,000	160,000	80,000
Mr John Palisi	160,000	-	(160,000)	-	-	-
Mr Scott Lamond	32,000	-	-	32,000	32,000	16,000
Mr Hugo Keyner	160,000	-	-	160,000	160,000	80,000

The Company did not issue any options during the year ended 31 December 2010, 2011 and 2012 to Key management personnel. Refer to Note 18 for further details of options outstanding.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

23. Related Party Disclosures (cont)

2011	Balance at 1/1/11 No.	Granted as remuneration No.	Exercised (Lapsed) No.	Balance at 31/12/11 No.	Balance vested and exercisable at 31/12/11 No.	Options vested during year
Mr Fred Bart	200,000	-	(200,000)	-	-	-
Dr Ben Greene	964,800	-	(964,800)	-	-	-
Mr Ian Dennis	200,000	-	(200,000)	-	-	-
Mr Mark Ureda	200,000	-	(200,000)	-	-	-
Lt Gen Peter Leahy AC	-	-	-	-	-	-
Mr Kevin Scully	-	-	-	-	-	-
Mr Mark Bornholt	-	-	-	-	-	-
Mr Ron Thompson	160,000	-	-	160,000	80,000	48,000
Dr Craig Smith	280,000	-	(120,000)	160,000	80,000	48,000
Mr John Palisi	160,000	-	-	160,000	80,000	48,000
Mr Hugo Keyner	160,000	-	-	160,000	80,000	48,000

Refer to Note 18 for further details of options outstanding.

(e) Transactions with other related parties

Other related parties includes:

- the parent entity;
- entities with significant influence over the consolidated entity; and
- subsidiaries.

Amounts receivable from entities in the wholly-owned group are disclosed in Note 8 to the financial statements.

Certain entities within the group have lent money to other entities within the wholly-owned group on an interest free basis. The amounts receivable by the ultimate parent entity in the wholly-owned group are disclosed in Note 8 to the financial statements. The ultimate parent entity in the wholly-owned group has provided for this amount based upon the net asset position of the controlled entities.

On 18 March 2011, Fire Control Systems Pty Limited paid an unfranked dividend of \$26,500,000 to Electro Optic Systems Pty Limited. On 31 December 2011, Fire Control Systems Pty Limited paid an unfranked dividend of \$7,700,000 to Electro Optic Systems Pty Limited. Both these entities are wholly owned subsidiaries of the Group.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

23. Related Party Disclosures (cont)

(f) Other transactions with key management personnel

During the year, the Company paid a total of \$66,490 (2011: \$66,490) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of directors fees and superannuation for Fred Bart.

During the year, the Company received \$13,868 (2011: \$4,361) from 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of shared Sydney office facilities.

During the year, the Company paid \$40,875 (2011: \$40,875) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of directors fees and superannuation for Ian Dennis.

During the year, the Company paid \$160,000 (2011: \$120,000) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of consulting fees for company secretarial and accounting services.

During the year, the Company paid \$5,543 (2011: Nil) to Audio Pixels Holdings Limited, a company of which Fred Bart and Ian Dennis are directors and shareholders in respect of shared Sydney office facilities. The Company also paid a rental deposit of \$5,843 (2011: Nil) to Audio Pixels Holdings Limited included in Note 6.

(g) Parent entity

The parent entity in the consolidated group is Electro Optic Systems Holdings Limited.

24. Controlled Entities

Name of Entity	Country of Incorporation	December 2012 %	December 2011 %
Parent Entity			
Electro Optic Systems Holdings Limited	Australia #		
Controlled Entities			
Electro Optic Systems Pty Limited	Australia #	100	100
Fire Control Systems Pty Limited	Australia #	100	100
FCS Technology Holdings Pty Limited	Australia #	100	100
EOS Space Systems Pty Limited	Australia #	100	100
EOS Optronics GmbH	Germany	100	100
EOS Defense Systems Pte Limited	Singapore	100	100
EOS USA, Inc. (Inc in Nevada)	USA	100	100
EOS Technologies, Inc. (Inc in Arizona)	USA	100	100
EOS Defense Systems, Inc (Inc in Arizona)	USA	100	100

These companies form part of the Australian consolidated tax entity.

All entities are audited by Deloitte Touche Tohmatsu.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

25. Contingent Liabilities

(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.

26. Capital and Leasing Commitments

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
(a) Finance leasing commitments				
Payable - minimum future lease payments not later than one year	108,663	131,634	-	-
later than one year and not later than five years	17,038	125,701	-	-
later than five years	-	-	-	-
Minimum lease payments	125,701	257,335	-	-
Less future finance charges	(8,478)	(26,588)	-	-
Total lease liability	117,223	230,747	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

26. Capital and Leasing Commitments (cont)

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
(b) Finance leasing commitments				
Payable - Present value of minimum future lease payments not later than one year	102,191	113,524	-	-
later than one year and not later than five years	15,032	117,223	-	-
later than five years	-	-	-	-
Present value of minimum lease payments	117,223	230,747	-	-
Represented by:				
Current liability (Note 13)	102,191	113,524	-	-
Non-current liability (Note 13)	15,032	117,223	-	-
	117,223	230,747	-	-
(c) Operating lease commitments				
Non-cancellable operating leases contracted for but not recognised in the financial statements:				
Payable:				
not later than one year	500,552	556,453	-	-
later than one year and not later than five years	-	-	-	-
later than five years	-	-	-	-
	500,552	556,453	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

26. Capital and Leasing Commitments (cont)

Operating Leases

Leasing arrangements

Operating leases relate to:

Premises at 2500 N. Tucson Boulevard, Suite 100, Tucson Arizona with a lease term which expires on 30 September 2013. There is no option to renew after 30 September 2013 and future lease payments are fixed under the contract. There is no option to purchase the property.

Premises in Queanbeyan, Australia for a 5 year period to 31 December 2008 with a 5 year option. The Company has the first right of refusal in respect of the purchase of the property. The Company is on a month to month basis whilst a new lease is negotiated.

Premises at EOS House at Mt Stromlo, Australia are the subject of an expired leases. The Company occupies the premises on a month to month basis.

Shared premises in Sydney which are on a month to month arrangement with Audio Pixels Holdings Limited, a company associated with directors Mr Fred Bart and Mr Ian Dennis.

Finance Leases

Leasing arrangements

Finance leases relate to motor vehicles, computer and office equipment with lease terms of between one and three years. The consolidated entity has options to purchase the computer and office equipment for a nominal amount at the conclusion of the lease arrangements. The consolidated entity has options to purchase motor vehicles for agreed residual amounts at the conclusion of the lease arrangements.

27. Subsequent Events

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.

28. Financial Risk Management Objectives and Policies

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

Due to the small size of the group significant risk management decisions are taken by the board of directors. These risks include market risk (including currency risk, fair value interest rate risk and price risk), credit risk, liquidity risk and cash flow interest rate risk.

The Group does not use derivative financial instruments to hedge these risk exposures.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

28. Financial Risk Management Objectives and Policies (cont)

Risk Exposures and Responses

(a) Interest rate risk

The Group's exposure to market interest rates relates primarily to the Group's cash holdings.

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

	Consolidated		Company	
	2012 \$	2011 \$	2012 \$	2011 \$
Financial assets				
Cash and cash equivalents	6,686,194	4,885,761	3,502,600	1,324,726
Financial Liabilities				
Lease liabilities	(117,223)	(230,747)	-	-
	6,568,971	4,655,014	3,502,600	1,324,726

The Group constantly analyses its interest rate exposure. Within this analysis consideration is given to potential renewals of existing positions, alternative financing and the mix of fixed and variable interest rates.

At 31 December 2012, if interest rates had moved, as illustrated in the table below, with all other variables held constant, post tax profit and equity would have been affected as follows:

Judgements of reasonably possible movements	Post Tax Profit Higher/(Lower)		Equity Higher/(Lower)	
	2012 \$	2011 \$	2012 \$	2011 \$
Consolidated				
+1% (100 basis points)	66,862	48,858	66,862	48,858
-.5% (50 basis points)	(33,431)	(24,429)	(33,431)	(24,429)
Company				
+1% (100 basis points)	35,026	13,247	35,026	13,247
-.5% (50 basis points)	(17,513)	(6,624)	(17,513)	(6,624)

The movements in profits are due to lower interest rates on cash balances. The cash balances were higher in 2012 than in 2011 and accordingly the sensitivity is higher.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

28. Financial Risk Management Objectives and Policies (cont)

(b) Foreign currency risk

As a result of purchases of inventory denominated in United States Dollars, the Group's statement of financial position can be affected significantly by movements in the US\$/A\$ exchange rates. Exchange rates are managed within approved policy parameters using natural hedges and no derivatives are used.

The Group also has transactional currency exposures. Such exposures arise from sales or purchases by an operating entity in currencies other than the functional currency.

The policy of the Group is to convert surplus foreign currencies to Australian dollars. The group also holds cash deposits in US dollars to secure US dollar bank guarantees to overseas customers.

At 31 December 2012, the Group had the following exposure to US\$ foreign currency:

	Consolidated		Company	
	2012 \$	2011 \$	2012 \$	2011 \$
Financial assets				
Cash and cash equivalents	1,176,313	241,350	520	12,806
Trade and other receivables	1,155,120	4,350,913	-	-
	2,331,433	4,592,263	520	12,806
Financial liabilities				
Trade and other payables	554,568	3,504,284	-	-
Promissory note	-	1,878,343	-	-
Finance leases	-	-	-	-
	554,568	5,382,627	-	-
Net exposure	1,776,865	(790,364)	520	12,806

All US\$ denominated financial instruments were translated to A\$ at 31 December 2012 at the exchange rate of 1.0374 (2011: 1.0176).

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

28. Financial Risk Management Objectives and Policies (cont)

(b) Foreign currency risk (cont)

At 31 December 2012, had the Australian Dollar moved, as illustrated in the table below, with all other variables held constant, post tax profit and equity would have been affected as follows:

Judgements of reasonably possible movements	Post Tax Profit Higher/(Lower)		Equity Higher/(Lower)	
	2012 \$	2011 \$	2012 \$	2011 \$
Consolidated				
AUD/USD +10%	(275,905)	96,491	(275,905)	96,491
AUD/USD -5%	(38,911)	(13,068)	(38,911)	(13,068)
Company				
AUD/USD +10%	(64)	(1,165)	(64)	(1,165)
AUD/USD -5%	(7)	583	(7)	583

Management believes the balance date risk exposures are representative of risk exposure inherent in financial instruments.

As noted, foreign currency transactions entered into during the financial year are managed within approved policy parameters using natural hedges. The director's do not consider that the net exposure to foreign currency transactions is material after considering the effect of natural hedges.

(c) Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in a financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties which are continuously monitored.

The credit risk on liquid funds is limited because the counterparties are banks with high credit-ratings assigned by international credit agencies.

(d) Liquidity risk management

The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due.

Ultimate responsibility for liquidity risk management rests with the board of directors, who has built an appropriate risk management framework for the management of the Group's short, medium and long term funding and liquidity requirements. The Group manages liquidity by maintaining adequate cash reserves by continuously monitoring forecast and actual cash flows and managing maturity profiles of financial assets. Significant uncertainties relating to the ability of the company and the consolidated entity to continue as going concerns and pay their debts as and when they fall due are set out in Note 1(a).

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

28. Financial Risk Management Objectives and Policies (cont)

(d) Liquidity risk management (cont)

Liquidity and interest tables

The following tables detail the Company's and the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows.

	Weighted average effective interest rate %	Less than 1 month \$	1-3 months \$	3 months to 1 year \$	1-5 years \$
Consolidated					
2012					
Other non interest bearing liabilities	0.00	1,985,667	-	-	-
Finance lease liability	10.03	12,067	24,133	108,603	11,857
2011					
Other non interest bearing liabilities	-	3,519,230	-	-	-
Finance lease liability	9.95	10,970	21,940	98,730	125,701
Promissory note	5.00	1,925,302	-	-	-
Company					
2012					
Other non interest bearing liabilities	-	97,490	-	-	-
2011					
Other non interest bearing liabilities	-	120,961	-	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

28. Financial Risk Management Objectives and Policies (cont)

(d) Liquidity risk management (cont)

The following tables detail the Company's and the Group's remaining contractual maturity for its non-derivative financial assets. The tables have been drawn up based on the undiscounted contractual maturities of the financial assets including interest that will be earned on these assets except where the Company/Group anticipates that the cash flow will occur in a different period.

	Weighted average effective interest rate %	Less than 1 month \$	1-3 months \$	3 months to 1 year \$	1-5 years \$
Consolidated					
2012					
Non interest bearing	-	2,361,884	-	-	-
Variable interest rate instruments	-	-	-	-	-
Fixed interest rate instruments	3.10	4,320,267	15,197	-	-
		6,682,151	15,197	-	-
2011					
Non interest bearing	-	259,045	-	-	-
Variable interest rate instruments	-	-	-	-	-
Fixed interest rate instruments	3.64	4,434,199	40,336	-	-
		4,693,244	40,336	-	-
Company					
2012					
Non interest bearing	-	520	-	-	-
Variable interest rate instruments	-	-	-	-	-
Fixed interest rate instruments	3.22	3,496,714	19,270	-	-
2011					
Non interest bearing	-	12,806	-	-	-
Variable interest rate instruments	-	-	-	-	-
Fixed interest rate instruments	4.54	1,316,783	-	-	-

(e) Price risk

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

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

29. 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 performance. The identification of the Group's reportable segments has not changed from those disclosed in the previous Annual Report.

The consolidated entity operates in Australia, USA, 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 Segment

Space Systems

EOS is a global supplier of large optical systems. During the period the consolidated entity continued the process of completing existing contracts.

Space Surveillance

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

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

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 US, Australia and other markets.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

29. Segment Information (cont)

	Consolidated	
	31 December 2012 \$	31 December 2011 \$
Segment Revenues		
Space systems	338,889	824,200
Space surveillance	4,446,909	3,214,813
Defence	16,962,253	28,387,523
Total of all segments	21,748,051	32,426,536
Unallocated	171,697	348,855
Total	21,919,748	32,775,391
Segment Results		
Space systems	(1,272,474)	(577,615)
Space surveillance	107,423	(395,895)
Defence	(8,192,150)	1,978,160
Total of all segments	(9,357,201)	1,004,650
Unallocated	(822,622)	(824,462)
(Loss)/profit before income tax expense	(10,179,823)	180,188
Income tax expense	-	-
(Loss)/profit for the period	(10,179,823)	180,188

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

The consolidated entity has one customer (2011: two customers) who each provided in excess of 10% of consolidated revenue. These customer(s) are within the Defence segment with total revenue of \$15,475,370 (2011 - \$24,021,715).

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

29. Segment Information (cont)

	Assets		Liabilities	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Segment Assets and Liabilities				
Space systems	169,569	434,378	700,073	803,320
Space surveillance	375,689	1,090,208	2,593,756	2,966,952
Defence	6,312,533	22,262,394	7,444,127	12,011,474
Total all segments	6,857,791	23,786,980	10,737,956	15,781,746
Unallocated	6,686,194	4,885,761	117,223	230,748
Consolidated	13,543,985	28,672,741	10,855,179	16,012,494

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

	Depreciation, impairment and amortization of segment assets		Acquisition of segment assets	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Other Segment Information				
Space systems	6,659	1,619	3,048	7,953
Space surveillance	87,380	6,316	6,700	27,598
Defence	1,781,830	685,388	35,485	140,139
Total all segments	1,875,869	693,323	45,234	175,690
Unallocated	707,695	(600,372)	-	-
Consolidated	2,583,564	92,951	45,234	175,690

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

29. Segment Information (cont)

Information on Geographical Segments

31 December 2012

Geographical Segments	Revenue from External Customers \$	Segment Assets \$	Acquisition of Segment Assets \$
Australasia	21,420,123	11,276,983	30,223
North America	498,084	2,239,679	14,331
Germany	1,541	27,323	680
Total	21,919,748	13,543,985	45,234

31 December 2011

Geographical Segments	Revenue from External Customers \$	Segment Assets \$	Acquisition of Segment Assets \$
Australasia	28,942,040	22,878,566	138,444
North America	3,810,273	5,692,857	31,104
Germany	23,078	101,318	6,142
Total	32,775,391	28,672,741	175,690

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

30. Construction Contracts

	Consolidated		Company	
	31 December 2012 \$	31 December 2011 \$	31 December 2012 \$	31 December 2011 \$
Construction work in progress	12,481,076	9,662,837	-	-
Less				
Provision for losses	(221,191)	(22,422)	-	-
Progress billings	(15,773,456)	(14,411,594)	-	-
	(3,513,571)	(4,771,179)	-	-
Recognised and included in the financial statements as amounts due:				
From customers under construction contracts:				
Current (Note 6)	274,847	599,620	-	-
To customers under construction contracts:				
Current (Note 12)	(3,788,418)	(5,370,799)	-	-
	(3,513,571)	(4,771,179)	-	-
Retentions included in progress billings	-	-	-	-

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012 (CONT)

31. Additional Company Information

Electro Optic Systems Holdings Limited is a listed public company in Australia, incorporated in Australia. The company and its subsidiaries operate in Australia, North America, Singapore and Germany.

Registered Office

Suite 2, Level 12
75 Elizabeth Street
Sydney NSW 2000
Australia

Tel: 02 9233 3915

Fax: 02 9232 3411

USA Operations

2500 N. Tucson Boulevard
Suite 100
Tucson, Arizona 85716
USA

Tel: +1 (520) 624 6399

Fax: +1 (520) 624 1906

Singapore Operations

Co-Ord Centre Pte Ltd
4 Shenton Way #28-01
SGX Centre II
Singapore 068807

Tel: +65 6224 0100

Fax: +65 6227 6002

Principal Place of Business

EOS House
Mt Stromlo Observatory
Cotter Road
Weston Creek ACT 2611
Australia

Tel: 02 6222 7900

Fax: 02 6299 7687

German Operations

Ulrichsberger Str. 17 3 OG
94469 Deggendorf
Germany

Tel: +49 991 2910083

Fax: +49 991 2910399

ASX ADDITIONAL INFORMATION

Additional information required by the Australian Stock Exchange Listing Rules and not disclosed elsewhere in this report.

HOME EXCHANGE

The Company's ordinary shares are quoted on the Australian Stock Exchange Limited under the trading symbol "EOS". The Home Exchange is Sydney.

SUBSTANTIAL SHAREHOLDERS

At 11 March 2013 the following substantial shareholders were registered:

	Ordinary Shares	Percentage of total Ordinary shares
Fred Bart Group	5,309,075	9.33%
Technology Investments Pty Limited Group	3,954,185	6.96%
Northrop Grumman Space and Mission Systems Corp.	5,000,000	8.80%
	14,263,260	25.09%

VOTING RIGHTS

At 11 March 2013 there were 1,064 holders of fully paid ordinary shares.

Rule 74 of the Company's Constitution stipulates the voting rights of members as follows:

"Subject to any rights or restrictions for the time being attached to any class or classes of shares and to this Constitution:

- (a) on a show of hands every person present in the capacity of a Member or a proxy, attorney or representative (or in more than one of these capacities) has one vote; and
- (b) On a poll every person present who is a Member or proxy, attorney or Representative has member present has:
 - (i) For each fully paid share that the person holds or represents - one vote; and
 - (ii) For each share other than a fully paid share that the person holds or represents - that proportion of one vote that the amount paid (not credited) on the shares bears to the total amount paid and payable on the share (excluding amounts credited)."

ASX ADDITIONAL INFORMATION (CONT)

OTHER INFORMATION

In accordance with Listing Rule 4.10.19, the Company has used the cash and assets in a form readily convertible to cash that it had at the time of admission in a way consistent with its business objectives.

The Company has a sponsored Level 1 American Depositary Receipt (ADR) program on the Over-The-Counter (OTC) market in the USA with the ADR ticker symbol of EOPSY. The ration of ADR's to Ordinary shares is 1:5 and the CUSIP Number is 28520B1070. The local custodian is National Australia Bank Limited and the US Depositary Bank is BNY Mellon.

DISTRIBUTION OF SHAREHOLDINGS

At 11 March 2013 the distribution of share and option holdings were:

Range	Ordinary Shareholders	Number of Shares
1 - 1,000	182	105,103
1,001 - 5,000	362	1,076,920
5,001 - 10,000	211	1,836,319
10,001 - 100,000	236	7,765,787
100,001 and over	73	46,061,797
	1,064	56,845,926

There were 260 ordinary shareholders with less than a marketable parcel.

There is no current on-market buy-back.

TWENTY LARGEST SHAREHOLDERS - QUOTED

TWENTY LARGEST ORDINARY SHAREHOLDERS - QUOTED

At 11 March 2013 the 20 largest ordinary shareholders held 60.17% of the total issued fully paid quoted ordinary shares of 56,845,926.

Shareholder	Fully Paid Ordinary Shares	Percentage of Total
1. Citicorp Nominees Pty Limited	5,670,772	9.98%
2. N & J Properties Pty Limited	4,090,000	7.19%
3. Mr Kevin Tay Hak Leong	2,839,970	5.00%
4. Technology Transformations Pty Limited	2,509,905	4.42%
5. DBS Vickers Securities (Singapore) Pte Ltd	1,966,534	3.46%
6. Crea8ive Nominees Pty Limited	1,911,328	3.36%
7. Capitol Enterprises Limited	1,550,000	2.73%
8. Emichrome Pty Limited	1,516,488	2.67%
9. A & D Wire Limited	1,457,276	2.56%
10. Technology Investments Pty Limited	1,444,280	2.54%
11. Landed Investments Limited	1,255,201	2.21%
12. Madam Lim Gek Kuan	1,171,493	2.06%
13. Landed Investments NZ Limited	1,010,000	1.78%
14. Rinfast Pty Limited	1,000,000	1.76%
15. Emichrome Pty Limited <Super Fund A/C>	997,450	1.75%
16. National Nominees Limited	964,409	1.70%
17. Mr Teo Kian Giap	807,238	1.42%
18. Justin Casey+Anne-Marie Debelak	788,500	1.38%
19. Kam Superannuation Fund Pty Limited	693,000	1.22%
20. Justin Casey <2 A/C>	558,600	0.98%
	34,202,444	60.17%

CORPORATE GOVERNANCE STATEMENT

The Board of Directors of Electro Optic Systems Holdings Limited is responsible for the corporate governance of the consolidated entity. The Board guides and monitors the business and affairs of Electro Optic Systems Holdings Limited on behalf of the shareholders by whom they are elected and to whom they are accountable.

The Directors are committed to protecting stakeholders' interests and keeping investors fully informed about the performance of the Company, while meeting stakeholders' expectations of sound corporate governance practices. To ensure the best representation of Shareholder interests, the Board will regularly review its corporate governance practices.

The Corporate Governance Statement follows the Australian Stock Exchange Corporate Governance Council's (the "Council's") amendments to the 2nd edition of the Corporate Governance Principles and Recommendations released 30 June 2010 in relation to diversity, remuneration, trading policies and briefings.

In accordance with the Council's recommendations, the Corporate Governance Statement must now contain certain specific information and must disclose the extent to which the Company has followed the guidelines during the period. Where a recommendation has not been followed, that fact must be disclosed, together with the reasons for the departure. Electro Optic Systems Holdings Limited's Corporate Governance Statement is now structured with reference to the Corporate Governance Council's principles and recommendations, which are as follows:

- Principle 1. Lay solid foundations for management and oversight
- Principle 2. Structure the Board to add value
- Principle 3. Promote ethical and responsible decision making
- Principle 4. Safeguard integrity in financial reporting
- Principle 5. Make timely and balanced disclosure
- Principle 6. Respect the rights of shareholders
- Principle 7. Recognise and manage risk
- Principle 8. Remunerate fairly and responsibly

Electro Optic Systems Holdings Limited's corporate governance practices were in place throughout the year ended 31 December 2012 and embrace the Council's best practice recommendations which are being put in place as appropriate.

The Audit Committee was formed on 28 April 2005 and consists of three non-executive directors. The members of the Audit Committee are Lt Gen Peter Leahy AC (Chairman), Mr Ian Dennis and Mr Kevin Scully. The majority of the Audit Committee are independent directors and the Chairman is an independent person.

The Remuneration Committee was formed on 23 March 2007. The members of the Remuneration Committee are Lt Gen Peter Leahy AC (Chairman), Mr Ian Dennis and Mr Kevin Scully. The majority of the Remuneration Committee are independent directors and the Chairman is an independent person.

The Company has documented risk management policies and procedures in accordance with its ISO 9001 certification for its operating activities which are regularly reviewed. During the current year the Directors have adopted a formal risk assessment plan in order to comply with Principle 7.

Additional information regarding the Company's corporate governance policies, its Directors, Insider Trading Policy, Equality and Diversity in the Workplace Policy and other relevant information can be found on the Company's website: www.eos-aus.com

Structure of the Board

The skills, experience and expertise relevant to the position of director held by each Director in office at the date of this Annual Report is included in the Directors' Report on pages 6 and 7. Directors of Electro Optic Systems Holdings Limited are considered to be independent when they are independent of management and free from any business or other relationship that could materially interfere with, or could reasonably be perceived to materially interfere with, the exercise of their unfettered and independent judgement.

In the context of director independence, "materiality" is considered from both the Company and individual director perspective. The determination of materiality requires consideration of both quantitative and qualitative elements. An item is presumed to be quantitatively immaterial if it is equal or less than 5 percent of the appropriate base amount. It is presumed to be material (unless there is qualitative evidence to the contrary) if it is equal to or greater than 10 percent of the appropriate base amount. Qualitative factors considered include whether a relationship is strategically important, the competitive landscape, the nature of the relationship and the contractual or other arrangements governing it and other factors which point to the actual ability of the director in question to shape the direction of the Company's loyalty.

CORPORATE GOVERNANCE STATEMENT (CONT)

In accordance with the definition of independence above, and the materiality thresholds set, the following Directors of Electro Optic Systems Holdings Limited are considered to be independent:

Name	Position
Mr. Ian Dennis	Non-Executive Director and Company Secretary
Lt Gen Peter Leahy AC	Non-Executive Director
Mr Kevin Scully	Non-executive Director

There are procedures in place, agreed by the Board, to enable directors, in furtherance of their duties, to seek independent professional advice at the Company's expense.

The term in office held by each Director in office at the date of this report is as follows:

Name	Position	Term in Office
Mr Fred Bart	Non-Executive Chairman	12 years 10 months
Dr Ben Greene	Executive Director	9 years 9 months
Mr. Ian Dennis	Non-Executive Director	12 years 10 months
Mr Mark Ureda	Non-Executive Director	8 years 10 months
Lt Gen Peter Leahy AC	Non-Executive Director	3 year 9 months
Mr Kevin Scully	Non-Executive Director	1 year 6 months

For additional details regarding board appointments, please refer to the Company's website.

Nomination Committee

The Board does not currently have a formal Nomination Committee. However, the Board continues to operate within the established guidelines, including when necessary, selecting candidates for the position of Director and, where appropriate, seeking the services of an independent consultant who is not a director of the Company to provide assistance in the recruitment of potential Directors.

Performance

The performance of the Board and key executives is reviewed regularly against both measurable and qualitative indicators. During the reporting period, an assessment of the performance of each Board member and key executive against specific and measurable qualitative and quantitative performance criteria was undertaken. The performance criteria against which directors and executives are assessed is aligned with the financial and non-financial objectives of Electro Optic Systems Holdings Limited. Directors whose performance is consistently unsatisfactory may be asked to retire.

CORPORATE GOVERNANCE STATEMENT (CONT)

Remuneration

One of the Company's key objectives is to provide maximum stakeholder benefits from the retention of a high quality Board and executive team by remunerating Directors and key executives fairly and appropriately with reference to relevant employment market conditions. A Remuneration Committee was formed on 23 March 2007. The nature and amount of Executive Directors' and Officers' emoluments are linked to the Company's financial and operational performance. The expected outcomes of the remuneration structure are:

- Retention and motivation of key executives;
- Attraction of quality management to the Company; and
- Performance incentives which allow executives to share the rewards of the success of Electro Optic Systems Holdings Limited.

For details regarding the amount of remuneration and all monetary and non-monetary components for Directors and executives, refer to Note 21 of the Notes to the Financial Statements. In relation to the payment of bonuses, options and other incentive payments, discretion is exercised by the Board, having regard to the overall performance of Electro Optic Systems Holdings Limited and the performance of the individual during the period.

There is no scheme to provide retirement benefits, other than statutory superannuation, to non-executive directors.

The Board is responsible for determining and reviewing compensation arrangements for the Directors themselves, the Chief Executive Officer and the executive team.

Equality and Diversity Policy

The Company values diversity and recognises the benefits it can bring to the organisation's ability to achieve its goals. Accordingly, the Company has issued the Equality and Diversity Policy which outlines its equality and diversity objectives in relation to gender, sexual preference, transgender status, marital status, disability, religion, cultural and racial background, political preference, trade unionism, pregnancy and age. It includes requirements for the Board to establish measurable objectives for achieving diversity, and for the Board to assess annually both the objectives, and the Company's progress made in achieving them.

EOS Group has a publicly accessible diversity policy which complies with the recommendations of the Australian Stock Exchange Corporate Governance Principles. In relation to the achievement of the diversity policy objectives, as at 31 December 2012, EOS Group employed 104 staff. 17% (18) of these staff were female and 6% (6) of these women were employed in management roles with management defined as staff having direct report employees. There were no female directors. In 2012 three workplace harassment complaints were investigated and concluded through mediation. 19% (20) of employees accessed flexible workplace arrangements including early commencement times and alternative work days. 4 employees accessed company education assistance for tertiary study.

The Equality and Diversity Policy of the Company is available on the Company's web site at www.eos-aus.com

Safeguard Integrity in Financial Reporting

The chief executive officer and the chief financial officer are required to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards.

Policy on Trading in Securities

Directors and employees of EOSH should not buy or sell securities in EOSH, when EOSH is in possession of price sensitive information that is not generally available to the market.

The Securities Trading Policy of the Company is available on the Company's website at www.eos-aus.com and has been lodged with ASX Limited.

CORPORATE DIRECTORY

Directors

Mr Fred Bart (Chairman)
Dr Ben Greene (Chief Executive Officer)
Mr Ian Dennis
Mr Mark Ureda
Lt Gen Peter Leahy AC
Mr Kevin Scully

Company Secretary

Mr Ian Dennis

Registered Office

Suite 2, Level 12
75 Elizabeth Street
Sydney NSW 2000
Australia

Telephone +61 2 9233 3915
Facsimile +61 2 9232 3411
Website www.eos-aus.com

Share Registry

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street
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GPO Box 7045
Sydney NSW 1115
Australia

Telephone 1300 855 080 or +61 3 9611 5711 outside Australia
Facsimile 1300 137 341

Auditors

Deloitte Touche Tohmatsu
Chartered Accountants
Eclipse Tower
Level 19, 60 Station Street
Parramatta NSW 2150
Australia





www.eos-aus.com

