



**Electro Optic Systems Holdings Limited**  
A.C.N. 092 708 364  
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<http://www.eos-aus.com>

28 February 2018

The Manager  
Company Announcements Office  
ASX Limited  
Exchange Centre  
20 Bridge Street  
Sydney NSW 2000

Dear Sir,

**Preliminary Final Report – Listing Rule 4.3A**

The Preliminary Final Report/ Appendix 4E for the year ended 31 December 2017 is attached.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Ian Dennis', with a stylized flourish at the end.

Ian Dennis  
Director

Preliminary Final Report of *Electro Optic Systems Holdings Limited* for the Financial Year Ended 31 December 2017

ACN 092 708 364

*This Preliminary Final Report is provided to the Australian Stock Exchange (ASX) under ASX Listing Rule 4.3A.*

Current Reporting Period: Financial Year ended 31 December 2017

Previous Corresponding Period: Financial Year ended 31 December 2016

# **ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED**

## **Results for Announcement to the Market**

### Revenue and Net (Loss)

		<b>Percentage Change %</b>	<b>Amount</b>
Revenue from ordinary activities	down	9.8	To \$23,259,794
(Loss) from ordinary activities after tax attributable to members	down	N/A	To (\$9,399,930)
Net (Loss) attributable to members	down	N/A	To (\$9,399,930)

### Dividends (Distributions)

	<b>Amount per security</b>	<b>Franked amount per security</b>
Final dividend	Nil¢	Nil¢
Interim dividend	Nil¢	Nil¢
Record date for determining entitlements to the dividend:		
• final dividend		N/A
• interim dividend		N/A
Net tangible assets at 31 December 2017		\$23,570,620
Number of ordinary shares outstanding at 31 December 2017		69,809,564
NTA per ordinary share at 31 December 2017		33.76 cents
NTA per ordinary share at 31 December 2016		7.12 cents

### **Brief Explanation of Revenue, Net Loss and Dividends (Distributions)**

Refer to Review of Operations on pages 17 to 21.

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

**Consolidated statement of profit or loss and other comprehensive  
income for the  
Financial Year ended 31 December 2017**

	Note	2017 \$	2016 \$
Revenue	2(a)	23,259,794	25,797,200
Changes in inventories of work in progress		(2,699,765)	(447,550)
Raw materials and consumables used		(8,473,543)	(10,346,026)
Employee benefits expense		(14,692,849)	(13,600,306)
Administrative costs		(4,304,914)	(3,756,612)
Finance costs		(34,985)	(27,663)
Depreciation expense	2(b)	(193,325)	(98,859)
(Loss)/ gain on disposal of fixed assets		(2,007)	(110)
Foreign exchange gain/ (losses)	2(b)	(695,061)	610,447
Occupancy costs		(1,188,969)	(796,222)
Other expenses		(374,306)	(252,776)
<b>(Loss) before income tax expense</b>	2	(9,399,930)	(2,918,477)
Income tax benefit		-	2,031,785
<b>(Loss) for the year</b>	4	(9,399,930)	(886,692)
<b>Other comprehensive income</b>			
<b>Items that may be reclassified subsequently to profit and loss</b>			
Exchange differences arising on translation of Foreign operations		363,703	(74,898)
Total comprehensive (loss) for the year		(9,036,227)	(961,590)
<b>(Loss) per share:</b>			
Basic (cents per share)	5	(15.1)	(1.6)
Diluted (cents per share)		(15.1)	(1.6)

Notes to the financial statements are included on pages 8 to 16

# ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED

## Consolidated statement of financial position as at 31 December 2017

	Note	2017 \$	2016 \$
<b><i>Current Assets</i></b>			
Cash and cash equivalents		9,989,953	8,874,967
Trade and other receivables		11,662,007	3,805,560
Inventories		13,795,574	3,478,996
Other		2,390,931	459,228
<b><i>Total Current Assets</i></b>		37,838,465	16,618,751
<b><i>Non-Current Assets</i></b>			
Property, plant and equipment		1,405,347	459,791
Trade and other receivables		609,864	-
Other		7,751,938	-
<b><i>Total Non-Current Assets</i></b>		9,767,149	459,791
<b><i>Total Assets</i></b>		47,605,614	17,078,542
<b><i>Current Liabilities</i></b>			
Trade and other payables		18,084,358	7,176,569
Provisions		5,091,560	5,553,555
<b><i>Total Current Liabilities</i></b>		23,175,918	12,730,124
<b><i>Non-Current Liabilities</i></b>			
Provisions		859,076	301,419
<b><i>Total Non-Current Liabilities</i></b>		859,076	301,419
<b><i>Total Liabilities</i></b>		24,034,994	13,031,543
<b><i>Net Assets</i></b>		23,570,620	4,046,999
<b><i>Equity</i></b>			
Issued capital		103,342,071	75,383,567
Reserves	3	9,344,928	8,379,881
Accumulated losses	4	(89,116,379)	(79,716,449)
<b><i>Total Equity</i></b>		23,570,620	4,046,999

Notes to the financial statements are included on pages 8 to 16

**ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED**

**Consolidated statement of changes in equity for the Financial  
Year ended 31 December 2017**

	<b>Total \$</b>	<b>Accumulated losses \$</b>	<b>Issued capital \$</b>	<b>Foreign currency translation reserve \$</b>	<b>Employee equity settled benefits reserve \$</b>
Balance at 1 January 2017	4,046,999	(79,716,449)	75,383,567	(604,840)	8,984,721
(Loss) for the period	(9,399,930)	(9,399,930)	-	-	-
Exchange differences arising on translation of foreign operations	363,703	-	-	363,703	-
Total comprehensive income for the year	(9,036,227)	(9,399,930)	-	363,703	-
Issue of 3,863,638 new shares at \$2.20 each	8,075,004	-	8,075,004	-	-
Issue of 9,100,000 new shares at \$2.30 each	19,883,500	-	19,883,500	-	-
Recognition of share based payments	601,344	-	-	-	601,344
<b>Balance as 31 December 2017</b>	<b>23,570,620</b>	<b>(89,116,379)</b>	<b>103,342,071</b>	<b>(241,137)</b>	<b>9,586,065</b>
Balance at 1 January 2016	3,751,671	(78,829,757)	75,383,567	(529,942)	7,727,803
(Loss) for the period	(886,692)	(886,692)	-	-	-
Exchange differences arising on translation of foreign operations	(74,898)	-	-	(74,898)	-
Total comprehensive income for the year	(961,590)	(886,692)	-	(74,898)	-
Recognition of share based payments	1,256,918	-	-	-	1,256,918
<b>Balance as 31 December 2016</b>	<b>4,046,999</b>	<b>(79,716,449)</b>	<b>75,383,567</b>	<b>(604,840)</b>	<b>8,984,721</b>

Notes to the financial statements are included on pages 8 to 16

# **ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED**

## **Consolidated statement of cash flows for the Financial Year ended 31 December 2017**

	<u>Note</u>	<u>2017</u> \$	<u>2016</u> \$
<b><i>Cash Flows From Operating Activities</i></b>			
Receipts from customers		22,253,859	26,238,130
Payments to suppliers and employees		(48,363,455)	(31,075,678)
Tax refund received		-	2,031,785
Interest and bill discounts received		194,888	159,939
Interest and other costs of finance paid		(34,985)	(27,663)
Net cash (used in) operating activities		<u>(25,949,693)</u>	<u>(2,673,487)</u>
<b><i>Cash Flows From Investing Activities</i></b>			
Proceeds from sale of property, plant and equipment			-
Payment for property, plant and equipment		(1,140,947)	(402,977)
Net cash (outflows) by investing activities		<u>(1,140,947)</u>	<u>(402,977)</u>
<b><i>Cash Flows From Financing Activities</i></b>			
Proceeds from issue of shares		27,958,504	-
Net cash inflows from financing activities		<u>27,958,504</u>	<u>-</u>
<b><i>Net (Decrease)/ Increase In Cash Held</i></b>		867,864	(3,076,464)
<b><i>Cash and cash equivalents at the beginning of the year</i></b>			
		8,874,967	11,894,300
Effects of exchange rate changes on the balance of cash held in foreign currencies		247,122	57,131
<b><i>Cash and cash equivalents at the end of the year</i></b>		<u>9,989,953</u>	<u>8,874,967</u>

Notes to the financial statements are included on pages 8 to 16

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

**Notes to the Financial Statements  
for the Financial Year ended 31 December 2017**

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**1. Basis of Preparation**

The preliminary final report has been prepared in accordance with ASX Listing Rule 4.3A and disclosure requirements of ASX Appendix 4E.

The accounting policies adopted in the preparation of the preliminary financial report are consistent with those adopted and disclosed in the 2016 annual report.

**Adoption of new and revised Accounting Standards**

The Group has adopted all of the new and revised Standards and Interpretations issued by the Australian Accounting Standards Board (the AASB) that are relevant to their operations and effective for the current year.

New and revised Standards and amendments thereof and Interpretations effective for the current year that are relevant to the Group include:

- AASB 2016-1 Amendments to Australian Accounting Standards – Recognition of Deferred Tax Assets for Unrealised Losses
- AASB 2016 -2 Amendments to Australian Accounting Standards – Disclosure Initiative: Amendments to AASB 107
- AASB 2017-2 Amendments to Australian Accounting Standards – Further Annual Improvements 2014-2016 Cycle

The application of the above has not had any material impact on the amounts recognised in the consolidated financial statements.



# ***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

## **Notes to the Financial Statements for the Financial Year ended 31 December 2017**

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### **1. Basis of Preparation (cont)**

#### **Going Concern**

The financial report has been prepared on the basis that the consolidated entity is a going concern, 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 \$9,399,930 (2016: \$886,692 – loss) and used net cash in operating activities of \$25,949,693 (2016: \$2,673,487 used by). As at 31 December 2017, the consolidated entity had cash of \$9,989,953 (2016: \$8,874,967) of which \$119,025 (2016: \$195,127) is restricted as it secures bank guarantees on existing contracts with local and overseas customers.

The consolidated entity made the following announcements to the ASX:

- On 30 January 2018, the company announced that it had been awarded an \$410 million contract to supply its new R-400S-Mk2 remote weapon system to an overseas customer;
- On 6 February 2018, the company announced a placement of 10,471,434 new ordinary shares at \$2.91. Funds will be used for working capital to lodge performance bonds and offset bonds in respect of the new contract announced on 30 January 2018 and optimising the supply chain. In the same announcement the company announced a further tranche of the placement of 10,147,123 new ordinary shares at \$2.91. These shares are proposed to be issued on 16 March 2018 following shareholder approval at an Extraordinary General Meeting called for 13 March 2018 to refresh the 15% placement ability; and
- On 6 February 2018, the Company also announced a Share Placement Plan to all existing shareholders registered on 5 February 2018 at the same price as the institutional placement of \$2.91 to raise a maximum of \$5m.

In the opinion of the directors, the ability of the consolidated entity to continue as a going concern and pay its debts as and when they become due and payable is dependent upon:

- The continued ability of the consolidated entity to deliver contracts on hand on time, to the required specification and within budgeted costs;
- the likelihood of key military and government customers to make timely payments for goods supplied in accordance with contractual terms;
- the future trading prospects of the consolidated entity including obtaining the required export licences, the successful lodgement of performance and offset bonds in relation to executed contracts and successfully obtaining and negotiating commercial contract terms in relation to potential customers; and
- the ability to raise capital from existing or new shareholders should the need arise.

In the opinion of the directors, the consolidated entity can continue as a going concern and pay its debts as and when they become due and payable.

Given the current financial position, performance and prospects of the consolidated entity the directors believe it is appropriate to prepare the financial report on the going concern basis.

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

**Notes to the Financial Statements  
for the Financial Year ended 31 December 2017**

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	<b>2017</b>	<b>2016</b>
	<b>\$</b>	<b>\$</b>
<b>2. (Loss) From Ordinary Activities</b>		
(Loss) from ordinary activities before income tax includes the following items of revenue and expense:		
<b>(a) Revenue</b>		
Contract receipts	23,063,818	25,635,805
Interest received	194,888	159,939
Other revenue		
Other	1,088	1,456
Total revenue	<u>23,259,794</u>	<u>25,797,200</u>
<b>(b) Expenses</b>		
Foreign exchange loss (gains)	695,061	(610,477)
Loss on sale of property, plant and equipment	2,007	110
Depreciation of property, plant and equipment	193,325	98,859
<b>3. Reserves</b>		
Foreign currency translation reserve	(241,137)	(604,840)
Employee equity settled benefits reserve	<u>9,586,065</u>	<u>8,984,721</u>
Balance at end of financial period	<u>9,344,928</u>	<u>8,379,881</u>
<b>4. Accumulated Losses</b>		
Balance at beginning of financial period	(79,716,449)	(78,829,757)
Net (Loss) for the year	<u>(9,399,930)</u>	<u>(886,692)</u>
Balance at end of financial period	<u>(89,116,379)</u>	<u>(79,716,449)</u>

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

**Notes to the Financial Statements  
for the Financial Year ended 31 December 2017**

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5. Earnings Per Share

	<b>2017</b>	<b>2016</b>
	<b>¢ per share</b>	<b>¢ per share</b>
Basic EPS	(15.1 cents)	(1.6 cents)

*Basic Earnings per Share*

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

	<b>2017</b>	<b>2016</b>
	<b>\$</b>	<b>\$</b>
(Loss) (a)	(9,399,930)	(886,692)

	<b>2017</b>	<b>2016</b>
	<b>No.</b>	<b>No.</b>
Weighted average number of ordinary shares used in the calculation of basic earnings per share	62,260,622	56,845,926

(a) Loss used in the calculation of basic earnings per share is the same as net (loss) in the profit and loss.

(b) There are no potential ordinary shares and hence diluted earnings per share is the same as basic earnings per share.

The unlisted options outstanding are not in the money at 31 December 2017 and are not considered dilutive.

6. Contingent Liabilities

a) Entities within the consolidated entity are involved in contractual disputes which are 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.

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

**Notes to the Financial Statements  
for the Financial Year ended 31 December 2017**

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7. 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.

	Revenue		Segment profit	
	2017 \$	2016 \$	2017 \$	2016 \$
Space	3,472,975	9,591,762	(2,893,122)	(2,146,398)
Defence systems	19,591,931	16,045,499	(5,701,590)	367,500
Total of all segments	23,064,906	25,637,261	(8,594,712)	(1,778,898)
Eliminations	-	-	-	-
Unallocated	194,888	159,939	(805,218)	(1,139,579)
Consolidated	23,259,794	25,797,200	-	-
(Loss) before tax	-	-	(9,399,930)	(2,918,477)
Income tax benefit	-	-	-	2,031,785
Consolidated segment revenue and (loss)/ for the year	23,259,794	25,797,200	(9,399,930)	(886,692)

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 three customers who provided in excess of 10% of consolidated revenue. Three customers are within the Defence segment and provided combined revenue of \$18,071,014.

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

**Notes to the Financial Statements  
for the Financial Year ended 31 December 2017**

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7. Segment Information (cont'd)

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

	<b>2017</b>	<b>2016</b>
	\$	\$
Space	552,047	1,327,933
Defence systems	37,063,614	6,875,642
Total segment assets	37,615,661	8,203,575
Unallocated assets	9,989,953	8,874,967
Total assets	47,605,614	17,078,542

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

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 for defence.

**Product and Services within each Business Segment**

**Space**

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

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

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

**Defence systems**

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

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***  
**Notes to the Financial Statements**  
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**8. Subsequent Events**

On 30 January 2018, the Company announced that it had been awarded an A\$410m contract to supply significant quantities of its new R-400S-Mk2 remote weapon systems to an overseas customer.

On 6 February 2018, the Company announced a placement of 10,471,434 new ordinary shares at \$2.91 to sophisticated and professional investor clients of Petra Capital Pty Limited raising a total of 30.5m. These new shares were allotted on 12 February 2018. These funds will be used for working capital to lodge performance bonds and offset bonds in respect of the new contract announced on 30 January 2018 and optimising the supply chain. Additionally in the same announcement the Company announced a further tranche of the placement of 10,147,123 new ordinary shares at \$2.91 to sophisticated and professional investor clients of Petra Capital Pty Limited raising a total of 29.5m. These shares are proposed to be issued on 16 March 2018 following shareholder approval at an Extraordinary General Meeting called for 13 March 2018 to refresh the 15% placement ability.

On 6 February 2018, the Company also announced a Share Placement Plan to all existing shareholders registered on 5 February 2018 at the same price as the institutional placement of \$2.91 to raise a maximum of \$5m.

On 6 February 2018, the Company announced a new restructure of the management team with Grant Sanderson appointed as Chief Executive Officer for EOS Defence and Peter Short being made Chief Operating Officer for the Group. Both of these positions report directly to Dr Ben Greene, Group Chief Executive Officer.

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

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***  
**Notes to the Financial Statements**  
**for the Financial Year ended 31 December 2017**

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9. Issuance of Securities

**2017**

On 30 March 2017, the Company issued 3,863,638 new ordinary shares at \$2.20 each raising \$8,075,004, net of issuance costs.

On 22 September 2017, the Company issued 9,100,000 new ordinary shares at \$2.30 each raising \$19,883,500, net of issuance costs.

No options were exercised during the year.

**2016**

No shares were issued during the financial year.

During the financial year, 3,000,000 unlisted options were issued to directors on 11 February 2016 following shareholder approval on 5 February 2016 and a further 200,000 unlisted options were issued on 30 May 2016 following shareholder approval. 2,515,000 unlisted options were also issued to staff on 5 February 2016. These 5,715,000 options issued under the Employee Share Option Plan have an exercise price of \$3.00 each and expire on 31 January 2019.

No options were exercised during the year.

***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

**Notes to the Financial Statements  
for the Financial Year ended 31 December 2017**

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10. Other Significant Information

None

11. Information on Audit or Review

This Preliminary Final report is based on accounts to which one of the following applies.

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

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

The audit is currently in progress and the directors continue to discuss a number of matters relating to the availability of working capital with the auditors.

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

Not applicable



## ***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

### **Review of Operations**

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#### **1. RESULTS FOR FULL-YEAR ENDING 31 DECEMBER 2017**

The consolidated entity (“EOS”) reported an operating loss after tax of \$9,399,930 for the year ended 31 December 2017 [2016: \$886,692] based on revenues totalling \$23,259,794 [2016: \$25,797,200].

- The consolidated entity reported net cash used by operations for the year totalling \$25,949,693 [2016: \$2,673,487]. At 31 December 2017, the consolidated entity held cash totalling \$9,989,953 [2016: \$8,874,967]. Cash of \$119,025 [2016: \$195,127] is restricted as it secures bank guarantees relating to performance on some contracts.
- The operating loss of \$9.4 million is due to losses in both the EOS Space Systems Sector [“EOS Space”] and EOS Defence Systems Sector [“EOS Defence”]. The EOS Defence loss of \$5.7 million was principally due to one-time costs associated with scaling production up x10 over 30 months from mid-2017 to early 2019. The EOS Space loss of \$2.9 million was principally due to transferring most effort in 2017 to testing of space network performance prior to committing the next phase of infrastructure deployment. Corporate unallocated overheads amounted to \$0.8 million.
- In each case the outlays were planned to reduce risk as part of the company’s preparation for a substantial period of further growth. The overall results are therefore in line with management expectations and the company is now well-positioned to undertake major new delivery programs.

#### **2. EOS DEFENCE**

This sector develops, markets, manufactures and supports remote weapon systems [RWS] and related products in selected global markets. The technology embodied in the products restricts EOS’ customers to countries which are approved by both the USA and Australia for receipt of advanced military technology. Additional filters related to sovereign risk, sovereign credit rating, and international corruption index are not often invoked due to the highly selective nature of the export license process.

Today over 15,000 RWS have been sold in the world-wide market and the replacement and upgrade cycle for this equipment will soon commence. In addition, countries aligned with the US and Australia are now faced with specific threats arising from new weapons provided by strategic competitors. Based on customer intelligence it was clear to EOS that a technological response was required to restore RWS over-match and tactical superiority to coalition forces.

Over the period 2010-2016 EOS Defence invested significant resources in the development of next-generation RWS which offer major improvements in size, weight, combat effectiveness, firepower, accuracy and cost over all existing RWS. This next-generation product’s outstanding performance was demonstrated to key customers from

## ***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

### **Review of Operations**

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2014 to encourage procurement activity. From 2016 it was offered in several significant competitive tenders to qualified sovereign customers.

The market response to this product has been exceptional. In the twelve months to 31 December 2017 EOS was selected as the preferred bidder in over \$1 billion of RWS tenders. This represented 100% of bids submitted by EOS.

For EOS selection as preferred bidder from a tender process usually leads to contract award within 12 months. At the date of this report around \$600 million of delivery contracts had been executed by EOS, and approximately \$400 million in further contract awards was proceeding normally towards contract during 2018.

None of these orders is associated with replacement or upgrade of the vast installed base of RWS globally.

RWS contracts are typically deliverable over 4-5 years with deliveries commencing 6-12 months after contract. The \$600 million of contracts on hand will require production at \$7 million per month from early 2018, rising to \$20 million per month from early 2019.

This represents x10 increase in RWS production over less than 30 months from Q3 2016 to Q1 2019. Risk associated with this ramp were addressed from 2016 by a series of risk mitigation activities:

- A new development and production facility was planned over many months and initiated in Q3 2017;
- An initial batch of around 100 units of next-generation RWS were produced from 2016-2017 to allow production issues to be addressed;
- A batch of 20 production units, representing one month of 2018 production, were manufactured multiple times [i.e. manufactured, dis-assembled and re-manufactured] in late 2017 to improve production processes;
- Investment in production documentation and training increased progressively from 2016;
- Supply chain management was intensified and single point failures received closer attention;
- Staff recruitment action was initiated for new positions identified as production increased;
- An organisational restructure to allow rapid expansion of internal production capacity as well as through leveraging existing product licensees in key foreign markets; and

## ***ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED***

### **Review of Operations**

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- Long term working capital arrangements were addressed through Australian government-sourced facilities which leverage the select nature of EOS customers.

This risk mitigation activity has caused disruption to 2017 operations resulting in a significant operating loss of \$5.7 million for this sector. At 31 December 2017 the risk mitigation effort was largely complete and the sector was on plan for production to commence from Q1 2018.

The company needed most of 2017 to prepare the production ramp. It is confident that the steps it has taken through 2017 will deliver long-term benefits to all its production programs going forward.

### **3. EOS SPACE**

The \$2.9 million operating loss from EOS Space arises from a transitional focus on new product testing and qualification at the expense of revenue generation.

EOS Space has developed tracking sensors that can cost-effectively obtain accurate orbital data for space debris and satellites. This information degrades rapidly after acquisition, so it must be continuously updated with new observations, almost daily. The requirement for high quality, fresh space data is persistent and long term.

On 1 February 2017 EOS announced that it had achieved initial operations at its new space tracking site at Learmonth in Western Australia [WA]. Since then full operational capability has been achieved and qualifying tests mandated and funded by key customers have commenced.

By mid-2018 EOS and its customers will complete an extended period of space data acquisition and analysis for a cluster of four [4] EOS space sensors deployed to the Learmonth site. These tests are extremely valuable because the WA site is an essential site but it is also a worst-case test site because:

- Coastal. The Learmonth site is at sea level, and within 1 km of the ocean. The combination of altitude, cyclone conditions and permanently salty air combine to make this site much higher in maintenance, and much lower in productivity, than any other site contemplated in the future.
- Remote. The transport access for the Learmonth site is permanently problematic, with EOS support staff requiring 24 hours of travel in each direction, if required. This remoteness enforces reliable, autonomous operation as required for high data yield and productivity.
- Communications. The site has the lowest bandwidth communications of all contemplated sites, forcing compressed bandwidth for both control and data transfer.

The technical performance, reliability, responsiveness and data quality observed over many months of testing so far meet all project requirements, with over 75% of all testing completed. Provided the last phases of testing are also successful the site will serve as the template for expansion of capacity by replication on other sites.

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EOS had until recently intended to deploy a new site for space operations in central Queensland by 2019. However recent results from the Learmonth testing are sufficiently strong, especially considering its worst-case status, to justify placing a temporary hold on this deployment pending a review of whether multiple sites [including the proposed Queensland site] should be added simultaneously in the next phase. The EOS Space team and its suppliers are evaluating the feasibility of this option.

#### **4. FORECAST AND OUTLOOK**

The operating loss of \$9,399,930 for the 12 months ending 31 December 2017 was within management expectations. This expense was used to position both EOS Defence and EOS Space for strong growth.

In the case of EOS Defence the growth will occur from early in 2018 as the sector has a backlog of \$600 million in orders for its R-400S Mk2 RWS product and reasonably expects to add around \$400 million more in orders during 2018 from the same product. Production of this pipeline of orders commences from February 2018 after the normal production plant closure for summer.

The company expects the new market opened by the R-400S Mk2 will increase rapidly from 2019, but the beneficial impact of this for EOS will be offset by competitors entering the market, initially with cheaper products offering lower performance. The company's cumulative market share for all permitted customers is expected to fall from 100% [2017] to below 50% by 2025. Because overall market addressable by EOS is expected to exceed \$5 billion EOS aims to achieve cumulative sales of around \$2.5 billion for the R-400S and its successor products.

EOS Defence plans to release another product in 2019 based on its R-2000 remotely operated turret which has undergone the same comprehensive development and testing process as the R-400S RWS. Based on customer plans, EOS expects the addressable market for this product type will exceed \$11 billion to 2025 and that competing products already surfacing will likely limit EOS market share to a specific segment of approximately 20%. Although this market share is smaller than in RWS, the addressable market is larger and the cumulative EOS sales revenue is expected to be similar to RWS in the long term.

Key competitors of EOS Defence are sovereign-owned companies which have access to almost unlimited funds at low, non-market rates. On 30 January 2018 the Commonwealth Government announced that defence export companies like EOS would have access to \$3.8 billion of sovereign funds through Efic [Export Finance and Insurance Corporation] for working capital for export sales. This is a positive development which will improve EOS' competitiveness.

In the medium term from 2021 EOS also expects revenue growth from the replacement or upgrade of many of the 15,000+ conventional RWS deployed before 2010. At around the

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same time [2021] revenue will commence from repairs, spares and support for R-400S RWS now deploying. EOS customers typically provision around 150% of the initial acquisition cost over 15 years for repairs, spare parts and other support. If EOS achieves its near-term sales targets there will be a very long period of sustained revenue.

EOS Defence expects to exceed \$90 million in 2018 revenue, biased towards the second half due to the continuous ramping of output volume. Revenue for 2019 is expected to exceed \$200 million based on current orders, and these may increase during 2018. Given substantial historic investment in risk and cost reduction, which has all been fully expensed, EOS expects to achieve EBIT margins of around 10% for the delivery of EOS Defence contracts going forward.

Based on the strong performance of the multi-sensor space site at Learmonth, the outlook for EOS Space is also positive. However this sector is not expected to transition through break-even to profit before late in 2019. The sector operating loss for 2018 is expected to be approximately \$4 million in the full year if planned outlays continue towards securing further network deployment and data contracts.

Financial uncertainties can adversely impact the governments which are EOS customers. The company cannot be certain that future customer procurements will continue as usual or that business conditions will not deteriorate from current expectations.

The financial statements have been prepared on the basis of a going concern as detailed in Note 1.

Ben Greene

Chief Executive Officer

28 February 2018