ELECTRO OPTIC SYSTEMS HOLDINGS LIMITED
ACN 092 708 364

ANNUAL REPORT 2006

CORPORATE DIRECTORY

Directors

Mr Fred Bart (Chairman)
Dr Ben Greene (Chief Executive Officer)
Mr Ian Dennis
Mr Mark Ureda
Mr Robert Schuitema

Company Secretary

Mr Ian Dennis

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Auditors

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REVIEW OF OPERATIONS

1. RESULTS FOR 2006

The company commenced operations in 2006 with a positive outlook based on growing market demand for EOS remote weapon systems products and two new production facilities that were meeting growing demand. In addition EOS' space business was on track for modest growth in 2006 as a pre-cursor to more rapid growth through the space surveillance sector, expected from 2008.

An improvement in operating result from a $14.7m loss in 2005 to break-even in 2006 was forecast in December 2005, based on these factors.

However during the first 8 months of 2006, the company's operations suffered significant setbacks. In April 2006 a recurrence of vendor failures and project over-runs in some telescope projects caused a chain reaction of schedule slips and missed milestones, resulting in a May revision of the 2006 earnings forecast. Then in August 2006 it became clear that the company's military business required re-positioning to accommodate changes to key programs. On 31 August 2006 a revision to earnings forecasts projected an operating loss of $24.1m for 2006.

For the full year ending 31 December 2006 EOS' audited operating loss was $29.0 million on revenues of $53.8 million. This loss was due to the adverse events in both space and military operations announced as they occurred, and ongoing investment in key growth areas.

The operating loss of $29.0m exceeds the $24.1m projection of 31 August 2006 due to unrealised foreign currency losses, reduced military product shipments, obsolescence for inventory held in excess of confirmed orders, provision for disputed space project income and impairment of assets used for production.

The company's cash balance of $6.8m at 31 December 2006 [$21.4m at 31 December 2005] reflects these losses as well as a significant increase in inventory, from $9.2m to $13.2m.

2. SPACE SYSTEMS BUSINESS [TELESCOPES]

EOS had experienced problems with several telescope projects in 2005. These projects were reviewed by management and the expected costs to complete at 31 December 2005 included in the 2005 result. In early 2006 new concerns arose in respect of these projects.

By April 2006 it was clear that a series of supplier delays and defaults had pushed several telescope projects over budget and behind schedule, causing further cost over-runs. The simultaneous impact of several such events overwhelmed EOS resources, and most telescope projects faltered.

The EOS response was:

- **Inject resources to stabilise the programs.** This was a significant cost, and when combined with the loss of milestone payments and cost over-runs, caused a revision to forecasts in May 2006 by the company.
- **Reschedule project completions.** The stabilised programs were re-scheduled for completion as quickly and effectively as possible. 50% of all programs were scheduled for completion by 31 December 2006 [achieved]. With new sub-contractors replacing those who failed, half the projects would require many extra months to complete.
- **Reduction in force.** A reduction in workforce from 50 staff positions to 22 staff positions was made in November 2006. Most remaining projects had long, built-in delays that could not be reduced by adding resources, so this action matched staff resources to the schedule of effort required. Less staff would work for a longer period to complete the projects.
- **Revision of processes.** This episode clearly signalled management and process failures. Management had been replaced in early 2006 and process revision commenced. Management tools to support better risk management in this sector will be available from mid-2007.

The EOS telescope business continues to produce world-class telescopes and observatories.

3. SPACE SURVEILANCE BUSINESS

In January 2005 EOS entered into a strategic agreement with Northrop Grumman Space and Mission Systems ["NGST"] for the joint exploitation of EOS space technology in the USA. During 2005 no contracts were awarded under the strategic agreement.

The EOS response to this was:

- **Intensify joint efforts.** Both EOS and NGST deployed more resources from early 2006 towards achieving an initial contract. Despite this, during 2006 no contracts were awarded under the strategic agreement, and there is little prospect of a contract being achieved during the first half of 2007.
- **Dedicate resources to EOS markets.** EOS increased its marketing in government and commercial space sectors where it operates without any partner. Efforts with key customers in these markets appear to be successful, and contract awards are likely from late in 2007, subject to the availability of funds to these customers.
- **Re-focus EOS research effort.** EOS R&D programs continued to provide promising developments to support the EOS space business. Research funds, including grant funds, were focused even closer on the requirements of key customers.

Although no new contracts were entered into in 2006, effort continued under existing multi-year long term space contracts. Strategically important new contracts are expected in 2007.

MILITARY BUSINESS

The key factors impacting EOS' military business in the first eight months of 2006 were strong but unstable demand volume and delivery schedule, variations in product configuration, deficiencies in EOS systems for management and information, and various vendor failures.

- **Unstable production requirements.** Although demand for EOS' military products increased throughout 2006, this demand was unstable in terms of product quantity and delivery schedule. This instability was caused by funding delays in Congress, and uncertainties in the face of legal challenges to the procurement process applied to EOS products. These issues resulted in delays in receiving orders for the US Army requirements, despite the eventual passage of funding bills in excess of US$200m for the procurement of CROWS.
- **Unstable product configuration.** This instability was driven by the urgent needs of wartime operations, which are the root cause of product demand. Small product changes were often sought to improve performance in a specific soldier application, and EOS sought to comply.
- **Management systems.** In 2006 the company continued to implement the SAP software for ERP. This installation was scheduled to be completed in 2005, but was not, exposing EOS to risk in supply chain management. During 2006 EOS implemented a risk mitigation strategy for production parts by increasing inventory to protect against shortages for production.
- **Vendors.** The EOS military product has over 2,500 parts that must be provided to a high quality standard. In early 2006 EOS was filtering low quality component vendors out of the supply chain, while at the same time moving to locate reliable manufacturers for outsourcing, to reduce the effective parts count. This was being managed without an operational SAP system, which simultaneously required intense effort for implementation from EOS. EOS experienced supplier failures in both components and outsourced production, along with supplier delays in implementation of SAP software.

During the first 8 months of 2006, while these issues were being managed, EOS continued to implement plans to achieve production volumes of 80-100 units per month by early 2007. The schedule to increase production capacity was based on the best information available to the company, and EOS facilities were therefore scaled for break-even from 60 units per month of production. During this 8-month period, production fluctuated around levels well below break-even, and the product configuration also varied. EOS infrastructure and management systems were unable to deal effectively with these variations, and production lost rhythm and efficiency.

By August 2006 it was clear that production volumes of 60 units per month were unlikely to be required before 2008 and that even minor changes in production quantity or configuration caused costly disruption to EOS production.

The EOS response to this situation was:

- **Set fixed production volumes.** Production volumes were set at 2 units per working day, or approximately 37 units per month. This production rate allows EOS to maintain continuous production well past the middle of 2007 using only the requirements of executed contracts, or contracts in execution. This level of production was well below earlier projections for 2006 and 2007.
- **Set fixed production configuration.** The production configuration was fixed and customers advised. Configuration changes are now accepted under defined terms including appropriate delays.
- **Revise forecasts.** In August 2006 EOS issued revised forecasts that included the impact of reduced military

production. The revised operating loss for 2006 was expected to be $24.1m.

- **Re-scale production for a lower threshold for break-even.** Sustained operation at 37 units per month of facilities designed for break-even at 60 units per month is not feasible, so changes were required. The program delays of around 12 months are allowing more outsourcing to be used to achieve lower costs at these lower volumes.

These steps are making an impact with supplier reliability, product quality and production costs all improving.

4. OUTLOOK FOR 2007

The 2006 result is clearly a major disappointment; however 2006 can also be seen as a year in three distinct parts. In the first 4 months, serious problems in space business surfaced. In the second 4 months, an accumulation of seemingly minor issues in a major military program resulted in firm revisions to the company's plans in the sector. Both of these events caused revisions to forecasts.

In the last 4 months of 2006 the company's success in dealing with these issues, as well as important successes in other key areas, became clearer:

- **Military Production.** The stabilised product configuration and demand fixed in August 2006 resulted in stable production of 37 units per month [or $4.5m in revenue] from November 2006. This stability will continue as long as required to allow fine tuning of production towards break-even within 2007. The stable environment is also contributing to the collection of metrics for quality, materiel management, and production cost models. It is important to note that at 37 units per month, EOS is by far the largest producer of remote weapon systems in the world at this time.

- **Materiel and financial management.** After a long and costly period of installation, the company's SAP systems began to come on line in the last quarter of 2006. This improved the timeliness and accuracy of financial data for management decisions, and the management of inventory. Inventory had grown to $13.2m in 2006 to mitigate production risk pending the completion of appropriate materiel management. The new inventory management systems should allow an orderly run-down of inventory, freeing $6m of cash during 2007 as inventory reduces to $7m.

- **CROWS proposal.** The resolution of the legal challenges to the US Army CROWS program procurement strategy allowed the release of a formal request for proposal [tender] for CROWS weapon systems by the Army. This is the key turning point for the program. EOS responded to the U.S. Army's request for proposal for up to 3,400 CROWS systems over 4 years from 2008 through Recon Optical Inc. as prime contractor, extending the successful 6-year subcontract relationship with Recon. A contract award for this program is expected in June 2007. By the end of 2006 EOS had invested heavily in production facilities and technology to optimise its position for CROWS and other major programs.

- **Military business expansion.** In October 2006 EOS won a $14m contract with Thales Australia to provide remote weapon systems for its Bushmaster Infantry Mobility Vehicle for the Australian Army. This contract is the first remote weapon systems win outside the USA for EOS, and is a strong reference program for regional sales. The company is competing significant program requirements outside the USA and expects other successes during 2007.

- **New military products.** During 2006 EOS continued the development of new remote weapons system technology to reinforce its market position and expand its product range. New CROWS-compatible systems developed in 2006 were the industry's most advanced thermal imaging system, an integrated moving-target engagement capability, and new lightweight sensor systems. These new products were developed in close consultation with EOS' customers and end-users, and have been very well received.

- **Redback™ weapon system.** In addition to developing significant CROWS-compatible technology, the company's progress on the all-new Redback™ weapon system was on budget and on schedule for production from 2008.

- **Telescope business stabilisation.** By 31 December 2006, 50% of all telescope projects in place at the commencement of 2006 had been completed, and reduced telescope resources in EOS were focused on completion of the balance of the projects, as well as implementation of management processes to allow new business to be prudently accepted in future. These new processes may be implemented in time to allow new projects to commence within 2007.

- **Space surveillance business.** Although technical progress was significant, little progress towards substantial revenue programs was made in this area in 2005, or the first half of 2006. However late in 2006 discussions commenced with key customers towards participation in programs to be funded from 2008. These programs, if funded, would engage the whole range of EOS space technology in operational deployments.

- **Cash.** At 31 December 2006 the company had $6.8m of cash. In addition it had $13.2m of inventory and a production environment and appropriate management systems to commence inventory reduction to recover cash. This process commenced in January 2007 and is expected to yield around $6m in the first half of 2007.

These factors surfacing in 2006 influence the outlook for 2007, but the dominant factors will be:

1. Management's execution of business plans.

- **Cash and inventory management.** The company plans to supplement cash with inventory reductions in 2007. The management of cash and inventory are both dependent on SAP-based processes.
- **Materiel and supply chain.** EOS production risk is falling through a simultaneous reduction in component complexity as value-adding suppliers are secured to reduce EOS effort and the increased facility offered by newly-available SAP-based processes for supply chain management. Further effort towards meeting plan objectives is required.
- **Production process improvement.** The EOS objective of achieving break-even at product volumes as low as 40 units per month is not yet secured, and requires ongoing execution of production plans in both the Tucson [USA] and Queanbeyan [AUS] plants.

2. New business.

- **CROWS contract.** This competitively bid program is valued at up to $440m in sales for EOS over the 4 years from 2008, if successful. Substantial investment in sunk costs by EOS should produce strong profits from this program. EOS has no reason to believe that the proposal put forward for this program by Recon and including EOS products is not competitive. The award of the competitive bid program is expected in June 2007.
- **Military business contracts.** EOS is well-placed to win new military business for weapon systems.
- **Space business contracts.** EOS expects to receive contract awards for both its telescope and space surveillance business from the second half of 2007. The overall operating result for 2007 will be impacted by these awards.

EOS looks forward to an improved 2007 performance based upon the successful award of the competitive CROWS program and new space contracts. The company expects to return to profitability in 2008.

Dr Ben Greene

Chief Executive Officer

28 February 2007

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 2006. 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 52). 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 was appointed a member of the Audit Committee on 5 December 2006.
Dr Ben Greene	BE (Hons), Phd in Applied Physics (Age 55) 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. Appointed to the Board on 11 April 2002.
Ian Dennis	BA, C.A. (Age 49) is a Chartered Accountant with experience as director and secretary in various public listed companies and trusts in Australia and overseas. He has been involved in the investment banking industry and stockbroking industry for the past twenty 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. He is also company secretary of Electro Optic Systems Holdings Limited.
Cheryl Bart	BCom, LLB Non-executive director. Appointed to the Board on 7 September 2001 and resigned on 5 December 2006. Cheryl Bart is a lawyer and Company Director. She is Chairman of South Australian Film Corporation and Adelaide Film Festival. She is a non-executive director of ETSA Utilities, the Alcohol Education and Rehabilitation Foundation, Defence Industry Advisory Board and Economic Development Board of South Australia. She is a fellow of the Australian Institute of Company Directors and was a member of the Audit Committee.
Dr Robert Dean	Non-executive director (Age 65). Appointed to the Board on 1 December 2002 and resigned on 8 March 2006. Dr Robert Dean is a former senior executive of Boeing, Lockheed-Martin and Ball Corporation. He has extensive experience with US Governments, Space agencies and US defense contractors. He ceased to be an executive in December 2005.
John Gordon	Non-executive director (Age 60). Appointed to the Board on 18 November 2004 and resigned on 5 December 2006. John Gordon has a distinguished career in US government service, retiring as a 4-star USAF General. He has served in senior positions in USAF Space Command, and brought strong technology and business credentials to the Board. He was Chairman of the Audit Committee.
Mark Ureda	Non-executive director (Age 52). Appointed to the Board on 28 April 2005. Mark is vice president, Strategy and Technology for Northrop Grumman Corporation, a global defence company. 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.
Robert Schuitema	BCom, CA. Non-executive director (Age 45). Appointed to the Board on 5 December 2006. He is currently Managing Director of Phoslock Water Solutions Limited and previously spent 14 years with Chase Manhattan Bank & JP Morgan, as Managing Director of its Mining and Metals business in the Asia-Pacific region. He was appointed Chairman of the Audit Committee on 5 December 2006.

The above named directors held office during and since the end of the financial year except for Dr Robert Dean who resigned on 8 March 2006, Ms Cheryl Bart who resigned on 5 December 2006 and Mr John Gordon who resigned on 5 December 2006. Mr Robert Schuitema was appointed a director on 5 December 2006.

Directorships of other listed companies

Name	Company	Period of directorship
Fred Bart	Genetic Technologies Limited	26 October 1996 to date
	Gtech International Resources Limited	7 November 1996 to date
	Global Properties Limited	5 September 2000 to date
Ian Dennis	Genetic Technologies Limited	24 November 1994 to 24 November 2005
	Gtech International Resources Limited	21 June 1996 to 30 June 2005
	Global Properties Limited	5 September 2000 to date
Cheryl Bart	Global Properties Limited	26 November 2001 to date
	Spark Infrastructure Group Limited	8 November 2005 to date
Robert Dean	Macdonald, Dettwiler and Associates Limited	22 October 2003 to date
John Gordon	Activcard Inc	18 August 2004 to 27 February 2006
Robert Schuitema	Phoslock Water Solutions Limited	6 April 2005 to date

Principal activities

The principal activities of the consolidated entity are in the space systems and surveillance and defence products business.

The company is listed on the Australian Stock Exchange.

Review of operations

A detailed review of operations is included as an attachment to this financial report.

Changes to the state of affairs

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

Subsequent events

On 13 February 2007, the parent entity issued 179,432 ordinary shares to University of Applied Sciences, Fachhochschule Deggendorf of Bavaria, Germany for services rendered to EOS Optronics GmbH in accordance with an agreement dated 1 June 2005.

Apart from the above, 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 and surveillance and defence products business.

Further disclosure of information regarding likely developments in the operations of the consolidated entity in future financial years and the expected results of those operations is likely to result in unreasonable prejudice to the consolidated entity. Accordingly, this information has not been disclosed in this report.

Environmental Regulations

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

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 an aggregate of 1,126,800 share options were granted to the following directors and executives of the company and consolidated entity as part of their remuneration:

Directors and executives	Number of options granted	Issuing entity	Number of ordinary shares under option
Dr Ben Greene	964,800	Electro Optic Systems Holdings Limited	964,800
Dr Robert Dean	54,000	Electro Optic Systems Holdings Limited	54,000
Dr Craig Smith	108,000	Electro Optic Systems Holdings Limited	108,000
	1,126,800		**1,126,800**

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	525,750	Ordinary	$2.58	30 April 2009
Electro Optic Systems Holdings Limited	2,298,000	Ordinary	$3.06	31 March 2009
Electro Optic Systems Holdings Limited	753,300	Ordinary	$3.50	30 September 2009
Electro Optic Systems Holdings Limited	216,000	Ordinary	$3.06	30 September 2009
Electro Optic Systems Holdings Limited	200,000	Ordinary	$2.56	31 March 2009
Electro Optic Systems Holdings Limited	300,000	Ordinary	$2.85	31 March 2009
	4,293,050			

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.

Details of shares or interests issued during the financial year as a result of exercise of an option are:

Issuing entity	Number of shares issued	Class of shares	Amount paid for shares	Amount unpaid on shares
Electro Optic Systems Holdings Limited	43,896	Ordinary	$1.64	Nil
Electro Optic Systems Holdings Limited	3,000	Ordinary	$2.58	Nil

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' 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, 17 Board meetings and 2 audit committee meetings were held.

	Board of directors		Audit committee	
Directors	Held	Attended	Held	Attended
Mr Fred Bart	17	17	-	-
Dr Ben Greene	17	17	-	-
Mr Ian Dennis	17	17	2	2
Ms Cheryl Bart	15	13	2	2
Dr Robert Dean	4	2	-	-
Mr John Gordon	15	11	2	2
Mr Mark Ureda	17	16	-	-
Mr Robert Schuitema	2	2	-	-

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	6,319,075	-
Dr Ben Greene	7,452,485	2,010,000
Mr Ian Dennis	170,050	-
Mr Mark Ureda	-	-
Mr Robert Schuitema	175,000	-

Remuneration report

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 does not have a separate Nomination and 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 Stock 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

Remuneration report (cont)

on 11 April 2002, when shareholders approved a maximum aggregate remuneration of $230,000 per year excluding options. The Board considers that in light of this level of fees, and the present situation of the Company, it is appropriate for options to be made available to Directors.

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 services provided to the Company.

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 during the 2006 financial year 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.

Director remuneration

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

2006	Short term		Post Employment	Equity	Termination	Total
	Salary & Fees $	Non-monetary $	Superannuation $	Options $	Benefits $	$
Mr Fred Bart	45,932	-	-	-	-	45,932
Dr Ben Greene*	268,160	65,171	23,040	313,319	-	669,690
Mr Ian Dennis	117,559	-	-	-	-	117,559
Ms Cheryl Bart	25,358	-	-	-	-	25,358
Dr Robert Dean	87,584	28,296	2,317	44,442	151,282	313,921
Mr John Gordon	25,079	-	-	187,077	-	212,156
Mr Mark Ureda	-	-	-	-	-	-
Mr Robert Schuitema	2,201	-	-	-	-	2,201
	571,873	**93,467**	**25,357**	**544,838**	**151,282**	

* Executive Directors during the financial year

Remuneration report (cont)

2005	Short term		Post Employment	Equity	Termination	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Benefits	
	$	$	$	$	$	$
Mr Fred Bart	30,000	-	-	-	-	30,000
Dr Ben Greene*	344,270	34,462	23,040	1,586,292	-	1,988,064
Mr Ian Dennis	78,000	-	-	-	-	78,000
Ms Cheryl Bart	17,500	-	-	-	-	17,500
Dr Robert Dean*	350,028	13,095	-	831,140	-	1,194,263
Mr John Gordon	17,573	-	-	472,923	-	490,496
Mr Mark Ureda	-	-	-	-	-	-
	837,371	**47,557**	**23,040**	**2,890,355**	**-**	**3,798,323**

* Executive Directors during the financial year

Executive remuneration

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

2006	Short term		Post Employment	Equity	Termination	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Benefits	
	$	$	$	$	$	$
Mr Ron Thompson	130,492	27,669	11,466	18,930	-	188,557
Dr Craig Smith	184,500	-	16,605	39,300	-	240,405
Ms Karen McGilvery	117,500	-	10,575	25,761	-	153,836
Mr Steven Juliver	159,244	-	3,185	36,716	-	199,145
	591,736	**27,669**	**41,831**	**120,707**	**-**	**781,943**

2005	Short term		Post Employment	Equity	Termination	Total
	Salary & Fees	Non-monetary	Superannuation	Options	Benefits	
	$	$	$	$	$	$
Mr Ron Thompson	127,838	-	11,210	5,287	-	144,335
Dr Craig Smith	182,475	-	16,301	143,640	-	342,416
Ms Karen McGilvery (1)	88,739	-	7,987	6,798	-	103,524
Mr Jack Elliot (2)	158,703	15,899	-	-	42,802	217,404
Mr Steven Juliver	134,571	14,251	-	13,931	-	162,753
	692,326	**30,150**	**35,498**	**169,656**	**42,802**	**970,432**

1. Commenced employment on 20 January 2005.
2. Commenced on 25 October 2004 and ceased on 12 December 2005.

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

Remuneration Report (cont)

Value of options issued to directors and executives

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

	Options Granted Value at grant date (i) $	Options Exercised Value at exercise date $	Total value of options granted and exercised (1) $	Value of options included in remuneration for the year (2) $	Percentage of total remuneration for the year that consists of options %
Dr Ben Greene	313,319	-	313,319	313,319	46.8
Dr Robert Dean	44,442	-	44,442	44,442	14.2
Mr John Gordon	187,077	-	187,077	187,077	88.2
Dr Craig Smith	39,300	-	39,300	39,300	16.3
Mr Ron Thompson	18,930	-	18,930	18,930	10.0
Ms Karen McGilvery	25,761	-	25,761	25,761	16.7
Mr Steven Juliver	36,716	-	36,716	36,716	18.4

(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

(1) The total value of options granted and exercised is calculated based on the following:

- Fair value of the option at grant date multiplied by the number of options granted during the year; plus
- Fair value of the option at the time it is exercised multiplied by the number of options exercised during the year.

(2) 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.
- The options issued to Dr Ben Greene, Dr Robert Dean and Dr Craig Smith vest at the date of issue. The options issued to Mr John Gordon vested over a two year period with the first tranche of 150,000 vesting on 18 November 2005 (one year after his appointment as a director) and the balance of 150,000 vesting on 18 November 2006. In respect of the 900,000 options issued to staff on 30 September 2005, these vest on the basis of 20% on 30 September 2006 (one year after the date of issue), 30% on 30 September 2007 and 50% on 30 September 2008.

Elements of remuneration related to performance

There are no performance conditions 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. 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. Options issued to certain directors and executives are also subject to vesting provisions as disclosed above.

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 Mr Robert Schuitema (Chairman), Mr Ian Dennis and Mr Fred Bart.

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 9 to the financial statements.

Auditor's independence declaration

The auditor's independence declaration is included on page 23 of the financial 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 28 day of February 2007

Deloitte.

Deloitte Touche Tohmatsu

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

28 February 2007

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 financial year ended 31 December 2006, 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

DELOITTE TOUCHE TOHMATSU

D. Black

David Black
Partner
Chartered Accountants

Deloitte.

Deloitte Touche Tohmatsu

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Independent audit report to the members of Electro Optic Systems Holdings Limited

Scope

The financial report and directors' responsibility

The financial report comprises the balance sheet, income statement, cash flow statement, statement of recognised income and expense, a summary of significant accounting policies and other explanatory notes and the directors' declaration for both Electro Optic Systems Holdings Limited (the company) and the consolidated entity, for the financial year ended 31 December 2006 as set out on pages 17 to 62. The consolidated entity comprises the company and the entities it controlled at the year's end or from time to time during the financial year.

The directors of the company are responsible for the preparation and true and fair presentation of the financial report in accordance with Accounting Standards in Australia and the Corporations Act 2001. This includes responsibility for the maintenance of adequate financial records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

We have conducted an independent audit of the financial report in order to express an opinion on it to the members of the company. Our audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal controls, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to form an opinion whether, in all material respects, the financial report is presented fairly in accordance with Accounting Standards in Australia and the Corporations Act 2001 so as to present a view which is consistent with our understanding of the company's and the consolidated entity's financial position, and performance as represented by the results of their operations, their changes in equity and their cash flows.

Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial report, and the evaluation of accounting policies and significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

The audit opinion expressed in this report has been formed on the above basis.

Audit Opinion

In our opinion, the financial report of Electro Optic Systems Holdings Limited is in accordance with the Corporations Act 2001, including:

(a) giving a true and fair view of the company's and consolidated entity's financial position as at 31 December 2006 and of their performance for the year ended on that date; and

(b) complying with Accounting Standards in Australia and the Corporations Regulations 2001.

Inherent Uncertainty Regarding Going Concern

Without qualification to the opinion expressed above, attention is drawn to the following matter. As a result of the matters described in Note 1 Going Concern, there is significant uncertainty whether the company and the consolidated entity will be able to continue as going concerns and therefore whether they will realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report.

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

D. Black

David Black
Partner
Chartered Accountants
Canberra, 28 February 2007

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; and

(c) the directors have been given the declarations required by s.295A of the Corporations Act 2001.

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 28 day of February 2007.

INCOME STATEMENT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2006

		Consolidated		Company	
	Note	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
Revenue	2	52,140,196	38,700,543	669,531	704,442
Other income	2	1,677,901	1,678,817	-	-
Changes in inventories of finished goods and work in progress		4,148,028	8,123,442	-	-
Raw materials and consumables used		(47,763,982)	(34,553,347)	-	-
Employee benefits expense		(20,345,578)	(20,508,777)	(1,107,985)	(3,614,474)
Administration expenses		(5,441,655)	(4,097,875)	(720,729)	(522,436)
Finance costs		(174,157)	(113,289)	-	-
Goodwill impairment		(5,505,764)	-	-	-
Depreciation and amortisation expense		(2,125,894)	(1,135,754)	(1,210)	(913)
Loss on disposal of fixed assets		-	(34,436)	-	-
Foreign exchange losses		(1,773,718)	-	-	-
Lease expenses		(71,228)	(31,294)	-	-
Occupancy costs		(2,530,319)	(1,646,994)	-	(21,640)
Provision for non-recovery of loan		-	-	(26,920,723)	(6,436,448)
Other expenses		(1,266,816)	(1,112,232)	-	(69,774)
(Loss) before income tax benefit	2	(29,032,986)	(14,731,196)	(28,081,116)	(9,961,243)
Income tax benefit	4	-	-	-	-
(Loss) for the period	21	(29,032,986)	(14,731,196)	(28,081,116)	(9,961,243)
Earnings per share					
Basic (cents per share)	3	(56.6)	(34.6)		
Diluted (cents per share)	3	(56.6)	(34.6)		

Notes to the financial statements are included on pages 22 to 62.

BALANCE SHEET AS AT 31 DECEMBER 2006

	Note	Consolidated		Company	
		31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
CURRENT ASSETS					
Cash and cash equivalents	23	6,814,343	21,434,803	1,359,168	17,976,534
Trade and other receivables	6	15,826,768	13,799,654	5,255	67,110
Inventories	7	13,195,838	9,189,427	-	-
Other	8	162,379	115,210	-	-
TOTAL CURRENT ASSETS		35,999,328	44,539,094	1,364,423	18,043,644
NON-CURRENT ASSETS					
Property, plant and equipment	10	5,556,607	6,717,694	1,816	3,026
Other financial assets	5	-	-	841,325	841,325
Other	8	-	-	13,706,002	24,114,006
Goodwill	11	-	5,505,764	-	-
TOTAL NON-CURRENT ASSETS		5,556,607	12,223,458	14,549,143	24,958,357
TOTAL ASSETS		41,555,935	56,762,552	15,913,566	43,002,001
CURRENT LIABILITIES					
Trade and other payables	12	17,567,772	9,219,677	117,262	96,165
Borrowings	13	503,290	735,747	-	-
Provisions	14	6,573,205	2,492,132	-	-
Other	17	77,056	90,391	-	-
TOTAL CURRENT LIABILITIES		24,721,323	12,537,947	117,262	96,165
NON-CURRENT LIABILITIES					
Borrowings	13	473,327	1,054,826	-	-
Provisions	14	377,415	-	-	-
Other	17	187,566	263,943	-	-
TOTAL NON-CURRENT LIABILITIES		1,038,308	1,318,769	-	-
TOTAL LIABILITIES		25,759,631	13,856,716	117,262	96,165
NET ASSETS		15,796,304	42,905,836	15,796,304	42,905,836
EQUITY					
Issued capital	18	67,913,451	67,833,722	67,913,451	67,833,722
Reserves	20	5,445,863	3,602,138	4,699,627	3,807,772
Accumulated losses	21	(57,563,010)	(28,530,024)	(56,816,774)	(28,735,658)
TOTAL EQUITY		15,796,304	42,905,836	15,796,304	42,905,836

Notes to the financial statements are included on pages 22 to 62.

STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	Consolidated		Company	
		31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
Translation of foreign operations:					
Exchange differences taken to equity		951,870	(194,860)	-	-
		951,870	(194,860)	-	-
Net income/(expense) recognised directly in equity					
Loss for the period		(29,032,986)	(14,731,196)	(28,081,116)	(9,961,243)
Total recognised income and expense for the period		(28,081,116)	(14,926,056)	(28,081,116)	(9,961,243)

Notes to the financial statements are included on pages 22 to 62.

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	Consolidated		Company	
		31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
Cash flows from operating activities					
Receipts from customers		51,220,412	29,345,111	8,858	-
Payments to suppliers and employees		(64,081,123)	(51,730,424)	(853,907)	(719,238)
Interest received		715,331	724,457	660,673	704,442
Interest and other costs of finance paid		(174,157)	(113,289)	-	-
Net cash outflows from operating activities	23(b)	(12,319,537)	(21,774,145)	(184,376)	(14,796)
Cash flows from investing activities					
Advances to wholly-owned controlled entities		-	-	(16,512,719)	(30,550,454)
Payment for property, plant and equipment		(1,625,627)	(4,701,980)	-	(3,311)
Net cash (outflows)/ inflows from investing activities		(1,625,627)	(4,701,980)	(16,512,719)	(30,553,765)
Cash flows from financing activities					
Proceeds from issue of ordinary shares		79,729	46,149,893	79,729	46,149,893
Payment for issue of shares		-	(1,122,000)	-	(1,122,000)
Repayment of borrowings		(617,532)	(809,675)	-	-
Net cash inflows/ (outflows) from financing activities		(537,803)	44,218,218	79,729	45,027,893
Net increase/ (decrease) in cash and cash equivalents		(14,482,967)	17,742,093	(16,617,366)	14,459,332
Cash and cash equivalents at the beginning of the financial year		21,434,803	3,686,742	17,976,534	3,517,202
Effects of exchange rate fluctuations on the balances of cash held in foreign currencies		(137,493)	5,968	-	-
Cash and cash equivalents at the end of the financial year	23(a)	6,814,343	21,434,803	1,359,168	17,976,534

Notes to the financial statements are included on pages 22 to 62.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

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. 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 consolidated financial statements and notes of the consolidated entity comply with International Financial Reporting Standards ("IFRS"). The parent entity financial statements and notes also comply with IFRS except for the disclosure requirements in IAS 32 "Financial Instruments: Disclosure and Presentation" as the Australian equivalent Accounting Standard, AASB 132 "Financial Instruments: Disclosure and Presentation" does not require such disclosures to be presented by the parent entity where its separate financial statements are presented together with the consolidated financial statements of the consolidated entity.

The financial statements were authorised for issue by the Directors on 28 February 2007.

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.

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 statements have been prepared on a going concern basis which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

In the opinion of the directors, the ability of the parent company and consolidated entity to continue as going concerns are dependent upon:

- The ability to achieve target production levels for the military business in the year to 31 December 2007

  The Directors believe that this is achievable based on the increased rate of production in the military business since 31 December 2006 and the expectation that on the basis that the production targets are met over the year to 31 December 2007, the consolidated entity will generate net cash inflows from operations during the year.

- 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 the directors' report.

- The successful restructure of the telescope and enclosure division

  The losses from the telescope and enclosure division which were substantially higher in the year to 31 December 2006 than previously expected will not continue as all of the contracts which have suffered cost overruns will be completed in 2007 and the company has already provided for expected losses on contracts of $2,588,515 (31 December 2005: $883,315) in accordance with Australian Accounting Standard AASB111 "Construction Contracts". The company has restructured the telescope and enclosure division such that revenue and costs in this business are bought into balance and net cash outflows cease.

1. Summary of Accounting Policies (cont)

- The ongoing support of the consolidated entity's bankers

  The Directors are in the process of arranging a standby credit facility for the military section which will be secured by the assets of that division.
- The continued support of the Company's shareholders

Notwithstanding the above, unless working capital and funding can be assured to meet the future working capital and funding requirements, then, in the opinion of the directors, significant uncertainty exists regarding the ability of the company and consolidated entity to continue as going concerns and pay their debts as and when they become due and payable.

If the company and consolidated entity are unable to continue as going concerns they may be required to realise their assets and extinguish their liabilities other than in the normal course of business and at amounts different from those stated in the financial report.

No adjustments have been made to the financial report relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the company and consolidated entity not continue as going concerns.

(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. Bank overdrafts are shown within borrowings in current liabilities in the balance sheet.

(d) Construction contracts and work in progress

Construction work in progress is valued at cost plus profit recognised to date, less any provision for anticipated future losses. Costs include both variable and fixed costs relating to specific contracts, and those costs that are attributable to the contract activity in general and can be allocated on a reasonable basis.

Construction profits are recognised on the percentage completion basis measured using the proportion of costs incurred to date as compared to expected total costs. Where losses are anticipated they are provided in full.

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

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 employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within 12 months 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.

1. Summary of Accounting Policies (cont)

(g) Financial assets

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

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.

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

Debts and equity instruments

Debts 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 balance sheet classification of the related debt.

(i) Foreign currency

Foreign currency transactions

All foreign currency transactions during the financial year are bought 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 cash flow statement 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.

1. Summary of Accounting Policies (cont)

(k) Goodwill

Goodwill, representing the excess of the cost of acquisition over the fair value of the identifiable assets, liabilities and contingent liabilities acquired, is recognised as an asset and not amortised, but tested for impairment annually and whenever there is an indication that the goodwill may be impaired. Any impairment is recognised immediately in the profit and loss and is not subsequently reversed. Refer also note 1(m).

(l) 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.

(m) 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.

(n) 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

1. Summary of Accounting Policies (cont)

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.

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 liability 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 settles 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 income statement, 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.

(o) 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.

(p) Inventories

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

(q) 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 balance sheet as a finance lease obligation.

1. Summary of Accounting Policies (cont)

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.

(r) 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.

(s) 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.

(t) 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.

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

(u) 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.

1. Summary of Accounting Policies (cont)

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 at the date of sale of the relevant products, at the directors best estimate of the expenditure required to settle the consolidated entity's liability.

Surplus lease space – The company has entered into contracts for the lease of premises in Tucson, USA which are surplus to the current requirements of the company. Present obligations under the onerous lease contract are recognised as a provision.

(v) 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.

(w) 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.

(x) 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:

- AASB7 'Financial Instruments: Disclosure' is effective for all periods commencing on or after 1 January 2007
- AASB 101 "Presentation of Financial Statements" revised standard is effective for all periods commencing on or after 1 January 2007
- AASB 2005-10 "Amendments to Australian Accounting Standards" – consequential amendments to other accounting standards resulting from the issue of AASB 7 is effective for all periods commencing on or after 1 January 2007
- Interpretation 7 "Applying the Restatement Approach under AASB 129 Financial Reporting in Hyperinflationary economies" is effective for annual reporting periods commencing on or after 1 March 2006
- Interpretation 8 "Scope of AASB 2" is effective for annual reporting periods commencing on or after 1 May 2006
- Interpretation 9 "Reassessment of Embedded Derivatives" is effective for annual reporting periods commencing on or after 1 June 2006
- Interpretation 10 "Interim Financial Reporting and Impairment" is effective for annual reporting periods commencing on or after 1 November 2006

The application of AASB 101 (revised), AASB 7 and AASB2005-10 will not affect any of the amounts recognised in the financial statements, but will change the disclosure presently made in relation to the company and the Group's financial instruments and the objectives, policies and processes for managing capital.

These Standards and Interpretations will be first applied in the financial report of the Group that relates to the annual reporting period beginning after the effective date of each pronouncement, which in all cases will be the Company's annual reporting period beginning on 1 January 2007.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONT)

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $	Company 31 December 2006 $	Company 31 December 2005 $
2. [Loss] from operations					
(a) Revenue					
Revenue from operations consisted of the following items:					
Revenue from the sale of goods		44,530,092	15,481,464	-	-
Revenue from the rendering of services		1,608,043	1,411,636	-	-
Construction contract revenue		5,262,793	21,038,378	-	-
		51,400,928	37,931,478	-	-
Interest revenue:					
Bank deposits		715,331	724,457	660,673	704,442
Other		23,937	44,608	8,858	-
		52,140,196	38,700,543	669,531	704,442
(b) (Loss) before income tax					
(Loss) before income tax has been arrived at after crediting the following gains and losses					
Profit on sale of property, plant and equipment		27,978	-	-	-
Grant revenue		1,649,923	1,037,883	-	-
Foreign exchange gain		-	640,934	-	-
		1,677,901	1,678,817	-	-
(Loss) before income tax has been arrived at after charging the following expenses:					
Borrowing costs					
Finance lease finance charges		105,967	113,248	-	-
Interest paid – Other entities		68,190	41	-	-
Contributions to defined contribution superannuation plans		996,216	873,213	-	-
Depreciation – property, plant and equipment		1,056,471	1,086,689	1,210	913
Impairment of property, plant and equipment		360,794	-	-	-
Amortisation – property plant and equipment		708,629	49,065	-	-
Provision for non-recovery of loan – wholly-owned controlled entity		-	-	26,920,723	6,436,44
Provision for contract loss		2,588,515	-	-	-
Provision for surplus lease space		674,606	-	-	-
Provision for warranty		1,015,117	754,787	-	-

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $	Company 31 December 2006 $	Company 31 December 2005 $
2. (Loss) from operations (cont)					
Research and development costs immediately expensed		6,561,211	3,695,575	-	-
Provision for doubtful debts		210,628	99,301	-	-
Writedown of inventory to net realisable value		1,341,732	-	-	-
Loss on sale of property, plant and equipment		-	34,436	-	-
Share based payments:					
Equity settled share-based payments		891,855	3,531,401	891,855	3,531,401
Termination benefits		151,282	42,802	-	-
Foreign exchange loss		1,773,718	-	-	-
Operating lease rental expenses:					
Minimum lease payments		1,003,388	1,649,425	-	21,640

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $
3. Earnings per Share			
Basic earnings (loss) per share		(56.6 cents)	(34.6 cents)
Diluted earnings (loss) per share		(56.6 cents)	(34.6 cents)
Basic Earnings per Share			
Earnings (loss) (a)		(29,032,986)	(14,731,196)
Weighted average number of ordinary shares (b)		51,304,774	42,601,805

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

(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 Earnings per Share

Earnings (a)	(29,032,986)	(14,731,196)
Weighted average number of ordinary shares (b)	51,304,774	42,601,805

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

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

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $
3. Earnings per Share (cont)			
Weighted average number of shares used in the calculation of basic earnings per share		51,304,774	42,601,805
Directors options		-	-
Staff Share plan		-	-
Weighted average number of shares used in the calculation of diluted earnings per share		51,304,774	42,601,805

(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:

	2006	2005
Directors options	2,798,000	2,379,200
Staff Share plan	1,495,050	2,017,500
	4,293,050	4,396,700

(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 dilutive.

	Consolidated		Company	
	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $

4. Income Tax

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

(Loss) from operations	(29,032,986)	(14,731,196)	(28,081,116)	(9,961,243)
Income tax benefit calculated at 30%	(8,709,896)	(4,419,359)	(8,424,335)	(2,988,373)
Non-deductible provision for non-recovery of loan	-	-	8,076,217	1,930,934
Share based payments	267,557	1,084,342	267,557	1,084,342
Effect of different tax rates of subsidiaries operating in other jurisdictions	(1,275,059)	-	-	-
Other non-deductible/ non assessable items	100,159	(16,468)	49,095	(81,223)
	(9,617,239)	(3,351,485)	(31,466)	(54,320)
Previously unrecognised and unused tax losses and tax offsets now recognised	-	-	-	-
Unused tax losses and tax offsets not recognised as deferred tax assets	9,617,239	3,351,485	31,466	54,320
Income tax attributable to operating loss	-	-	-	-

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. There has been no change in the corporate tax rate when compared with the previous reporting period. 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. The tax rate in Germany is 25%.

(b) Unrecognised deferred tax balances

The following deferred tax assets have not been bought to account as assets				
Tax losses - revenue	17,047 196	7,601,033	5,292,969	5,261,503
Temporary differences	781,250	1,041,894	-	-
	17,828,446	8,642,927	5,292,969	5,261,503

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 25.

Nature of tax funding arrangements and tax sharing agreements

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

	Consolidated		Company	
	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
5. Other financial assets				
Non-Current				
Unlisted shares in controlled entities – at cost (2005: cost)	-	-	841,325	841,325
6. Trade and other receivables				
Current				
Trade receivables	10,584,880	7,259,580	-	-
Allowance for doubtful debts	(309,929)	(99,301)	-	-
	10,274,951	7,160,279	-	-
GST receivable	114,992	194,824	5,255	10,259
Amounts due from customers under construction contracts (Note 31)	5,436,722	6,439,571	-	
Other debtors	103	4,980	-	56,851
	15,826,768	13,799,654	5,255	67,110

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. The allowance for doubtful debt is in respect of telescope contracts and the movement in the allowance of $210,628 (2005 - $99,301) was recognised in the profit and loss for the current financial year.

	Consolidated		Company	
	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
7. Current Inventories				
Finished goods – at cost	1,040,917	-	-	-
Raw materials – at cost	-	5,482,805	-	-
Raw materials – at net realisable value	5,341,188	-	-	-
Work in progress – at cost	6,813,733	3,706,622	-	-
	13,195,838	9,189,427	-	-
8. Other Assets				
Current				
Prepayments	162,379	109,091	-	-
Other	-	6,119	-	-
	162,379	115,210	-	-
Non-current				
Amounts due from wholly-owned controlled entity	-	-	63,378,661	46,865,942
Less Allowance for uncollectible amounts	-	-	(49,672,659)	(22,751,936)
	-	-	13,706,002	24,114,006

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (CONT)

	Consolidated		Company	
	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
9. Auditors Remuneration				
(a) Auditor of the Parent Entity				
Audit or review of the financial report	129,000	78,000	129,000	78,000
Taxation services	12,850	22,400	12,850	22,400
	141,850	100,400	141,850	100,400
The auditor of Electro Optic Systems Holdings Limited is Deloitte Touche Tohmatsu				
(b) Other Auditors				
Auditing the financial report	147,354	51,460	-	-
10. Property, Plant and Equipment				
(a) Plant and equipment – at cost	4,388,704	3,968,126	-	-
Less accumulated depreciation	(1,827,827)	(948,915)	-	-
	2,560,877	3,019,211	-	-
(b) Leased assets – at cost	2,151,689	2,792,086	-	-
Less accumulated amortisation	(1,078,551)	(892,315)	-	-
	1,073,138	1,899,771	-	-
(c) Office Equipment – at cost	1,838,692	2,252,869	5,491	5,491
Less accumulated depreciation	(992,626)	(1,331,960)	(3,675)	(2,465)
	846,066	920,909	1,816	3,026
(d) Furniture, fixtures and fittings – at cost	378,497	399,857	-	-
Less accumulated depreciation	(192,744)	(97,403)	-	-
	185,753	302,454	-	-
(e) Leasehold improvements – at cost	1,055,075	625,109	-	-
Less accumulated depreciation	(184,505)	(49,760)	-	-
	870,570	575,349	-	-
(f) Motor vehicle –at cost	23,311	-	-	-
Less accumulated depreciation	(3,108)	-	-	-
	20,203	-	-	
(g) Satellite	7,000,000	7,000,000	-	-
Less impairment	(7,000,000)	(7,000,000)	-	-
	-	-	-	-
Total net book value of Property, Plant and Equipment	5,556,607	6,717,694	1,816	3,026

	Consolidated		Company	
	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
10. Property, Plant and Equipment (cont)				
Cost				
Plant and equipment				
Balance as at 31 December 2005	3,968,126	1,132,503	-	-
Additions	720,945	2,958,578	-	-
Disposals	(1,055)	(152,970)	-	-
Net foreign currency exchange differences	(299,312)	30,015	-	-
Balance as at 31 December 2006	4,388,704	3,968,126	-	-
Leased Plant and equipment				
Balance as at 31 December 2005	2,792,086	1,432,868	-	-
Additions	129,198	1,657,373	-	-
Disposals	(681,760)	(340,011)	-	-
Net foreign currency exchange differences	(87,835)	41,856	-	-
Balance as at 31 December 2006	2,151,689	2,792,086	-	-
Office equipment				
Balance as at 31 December 2005	2,252,869	1,978,653	5,491	2,180
Additions	311,768	847,439	-	3,311
Disposals	(648,858)	(621,820)	-	-
Net foreign currency exchange differences	(77,087)	48,597	-	-
Balance as at 31 December 2006	1,838,692	2,252,869	5,491	5,491
Furniture, fixtures and fittings				
Balance as at 31 December 2005	399,857	221,854	-	-
Additions	6,067	270,854	-	-
Disposals	-	(104,333)	-	-
Net foreign currency exchange differences	(27,427)	11,482	-	-
Balance as at 31 December 2006	378,497	399,857	-	-
Leasehold improvements				
Balance as at 31 December 2005	625,109	-	-	-
Additions	562,496	625,109	-	-
Net foreign currency exchange differences	(132,530)	-	-	-
Balance as at 31 December 2006	1,055,075	625,109	-	-

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $	Company 31 December 2006 $	Company 31 December 2005 $
10. Property, Plant and Equipment (cont)					
Motor vehicle					
Balance as at 31 December 2005		-	-	-	-
Additions		23,311	-	-	-
Net foreign currency exchange differences		-	-	-	-
Balance as at 31 December 2006		23,311	-	-	-
Satellite					
Balance as at 31 December 2005		7,000,000	7,000,000	-	-
Balance as at 31 December 2006		7,000,000	7,000,000	-	-
Accumulated Depreciation/Amortisation					
Plant and equipment					
Balance as at 31 December 2005		(948,915)	(726,346)	-	-
Depreciation expense		(591,810)	(320,093)	-	-
Impairment losses charged to loss		(349,211)	-	-	-
Disposals		1,055	126,489		
Net foreign currency exchange differences		61,054	(28,965)	-	-
Balance as at 31 December 2006		(1,827,827)	(948,915)	-	-
Leased plant and equipment					
Balance as at 31 December 2005		(892,315)	(564,132)	-	-
Amortisation expense		(568,872)	(536,662)	-	-
Impairment losses charged to loss		(11,583)	-	-	-
Disposals		356,140	227,942	-	-
Net foreign currency exchange differences		38,079	(19,463)	-	-
Balance as at 31 December 2006		(1,078,551)	(892,315)	-	-
Office equipment					
Balance as at 31 December 2005		(1,331,960)	(1,661,870)	(2,465)	(1,552)
Depreciation expense		(355,946)	(204,322)	(1,210)	(913)
Disposals		648,858	566,161	-	-
Net foreign currency exchange differences		46,422	(31,929)	-	-
Balance as at 31 December 2006		(992,626)	(1,331,960)	(3,675)	(2,465)
Furniture, fixtures and fittings					
Balance as at 31 December 2005		(97,403)	(156,410)	-	-

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $	Company 31 December 2006 $	Company 31 December 2005 $
10. Property, Plant and Equipment (cont)					
Depreciation expense		(105,459)	(25,612)	-	-
Disposals		-	90,159	-	-
Net foreign currency exchange differences		10,118	(5,540)	-	-
Balance as at 31 December 2006		(192,744)	(97,403)	-	-
Leasehold improvements					
Balance as at 31 December 2005		(49,760)	-	-	-
Amortisation expense		(139,757)	(49,065)	-	-
Net foreign currency exchange differences		5,012	(695)	-	-
Balance as at 31 December 2006		(184,505)	(49,760)	-	-
Motor vehicle					
Balance as at 31 December 2005		-	-	-	-
Depreciation expense		(3,256)	-	-	-
Net foreign currency exchange differences		148	-	-	-
Balance as at 31 December 2006		(3,108)	-	-	-
Satellite					
Balance as at 31 December 2005		(7,000,000)	(7,000,000)	-	-
Balance as at 31 December 2006		(7,000,000)	(7,000,000)	-	-

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 manufacturing property, plant and equipment in the Queanbeyan and Tucson facilities and determined certain of these assets are impaired. 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. Based on this assessment the company has charged an amount of $360,794 to profit and loss as an impairment loss in the current financial year.

All the assets impaired were manufacturing plant and equipment and relate to the defence segment.

11. Goodwill

Gross carrying amount				
Balance at beginning of financial year	5,505,764	5,505,764	-	-
Amount written off during the year	(5,505,764)	-	-	-
Balance at end of financial year	-	5,505,764	-	-

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $	Company 31 December 2006 $	Company 31 December 2005 $

11. Goodwill (cont)

Allocation of goodwill to cash-generating units

Goodwill has been allocated for impairment testing purposes to three individual cash-generating units. The carrying value of goodwill allocated to the three cash-generating units that are significant individually or in aggregate is as follows:

Space Systems – Global	-	1,652,153	-	-
Space Surveillance – Global	-	1,652,153	-	-
Fire Control Systems – Global	-	2,201,458	-	-
	-	5,505,764	-	-

The basis for determining the recoverable amount of goodwill has been the assessment by the Directors that the fair value of the goodwill in each cash-generating unit is not currently able to be supported by the current or historic trading results or by foreseeable future results from signed contracts on hand at the date of this report.

Therefore, having reviewed recent trading results and signed contracts on hand the directors are of the opinion that the recoverable amount for each of the segments, either from fair value less costs to sell or from value in use, does not support the carrying of any amount of goodwill. Accordingly the directors determined that as at 30 June 2006 the goodwill amount of $5,505,764 was fully impaired and the goodwill was written off in the half year period to 30 June 2006.

12. Current trade and other payables

Trade payables	12,223,964	5,079,552	13,262	37,140
Accruals	1,873,874	729,294	104,000	59,025
Amounts due to customers under construction contracts (Note 31)	3,469,934	3,410,831	-	-
	17,567,772	9,219,677	117,262	96,165

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 – secured (Note 27)	503,290	735,747	-	-
Non-current				
Finance lease liabilities – secured (Note 27)	473,327	1,054,826	-	-

The finance lease liabilities are secured by the leased assets. The average weighted interest rate charged on the finance leases was 8.61% (2005 – 8.58%)

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $	Company 31 December 2006 $	Company 31 December 2005 $
14. Provisions					
Current					
Employee benefits (Note 16)		1,917,595	1,737,345	-	-
Surplus lease space		297,191	-	-	-
Contract losses		2,588,515	-	-	-
Warranty (Note 15)		1,769,904	754,787	-	-
		6,573,205	2,492,132	-	-
Non-current					
Surplus lease space		377,415	-	-	-
Number of employees at year end		218	238	-	-
Movement in surplus lease space provision – current					
Balance at 1 January 2006		-	-	-	-
Provision recognised in profit and loss		297,191	-	-	-
Balance as at 31 December 2006		297,191	-	-	-
Movement in surplus lease space provision – non current					
Balance at 1 January 2006		-	-	-	-
Provision recognised in profit and loss		377,415	-	-	-
Balance as at 31 December 2006		377,415	-	-	-

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

Movement in contract loss provision				
Balance at 1 January 2006	-	-	-	-
Provision recognised in profit and loss	2,588,515	-	-	-
Balance as at 31 December 2006	2,588,515	-	-	-

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

	Note	Consolidated 31 December 2006 $	Consolidated 31 December 2005 $	Company 31 December 2006 $	Company 31 December 2005 $
15. Warranty Provisions					
Movement in warranty provision					
Balance at 1 January 2006		754,787	-	-	-
Additional provisions recognised		1,015,117	754,787	-	-
Balance as at 31 December 2006		1,769,904	754,787	-	-

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 our military products. 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)		1,917,595	1,737,345	-	-
Non Current (Note 14)		-	-	-	-
		1,917,595	1,737,345	-	-

17. Other liabilities

Lease incentives		77,056	90,391	-	-
Current		187,566	263,943	-	-
Non Current		264,622	354,334	-	-

The lease incentives relate to the leased premises at 3160 East Transcon Way, Tucson, Arizona, USA.

		Consolidated		Company	
	Note	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $

18. Issued capital

Balance at the beginning of the financial year –Ordinary shares	67,833,722	22,805,829	67,833,722	22,805,829
Add				
Placement of Ordinary shares for cash at $4.50	-	22,500,000	-	22,500,000
Placement of Ordinary shares for cash at $3.40	-	22,440,000	-	22,440,000
Exercise of employee options for cash	79,729	226,360	79,729	226,360
Exercise of vendor options for cash	-	70,748	-	983,533
Exercise of CEO options for cash	-	912,785	-	-
Less				
Issue costs on placement of ordinary shares	-	(1,122,000)	-	(1,122,000)
Balance at the end of the financial year	67,913,451	67,833,722	67,913,451	67,833,722

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	51,269,598	34,621,935	51,269,598	34,621,935
Placement for cash at $4.50	-	5,000,000	-	5,000,000
Placement for cash at $3.40	-	6,600,000	-	6,600,000
Exercise of employee options	46,896	130,000	46,896	130,000
Exercise of CEO options	-	4,563,925	-	4,563,925
Exercise of vendor options	-	353,738	-	353,738
Balance at end of financial year	51,316,494	51,269,598	51,316,494	51,269,598

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

19. Vendor, Directors and Employee Share Option Plan

(a) Unlisted Vendor and CEO Options

As part of the acquisition of the issued capital of Electro Optic Systems Pty Limited in April 2002, the Company issued 4,563,925 unlisted CEO options to the Chief Executive Officer, Dr Ben Greene exercisable at an exercise price of 20 cents on or before 31 December 2005. All these CEO options were exercised prior to 31 December 2005. Each CEO option converted into one ordinary share of Electro Optic Systems Holdings Limited on exercise. There were also 353,738 unlisted options issued to vendors exercisable at an exercise price of 20 cents on or before 31 December 2005. All these vendor options were exercised prior to 31 December 2005. Each vendor option converted into one ordinary share of Electro Optic Systems Holdings Limited on exercise.

	2006 Number	2005 Number
Balance at the beginning of the financial year (i)	-	4,917,663
Exercised during the period (ii)	-	(4,917,663)
Balance at the end of the financial year (iii)	-	-

(i) Balance at the beginning of the year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date*
Vendor options	-	11/4/02	31/12/05	$0.20	-
CEO Options	-	11/4/02	31/12/05	$0.20	-
	-				-
2005					
Vendor options	353,738	11/4/02	31/12/05	$0.20	-
CEO Options	4,563,925	11/4/02	31/12/05	$0.20	-
	4,917,663				-

Vendor options carry no rights to dividends and no voting rights. In accordance with the terms of the vendor and CEO options, options can be exercised at any time from the date of their issue to the date of expiry.

* Issued and fully vested prior to the requirement to fair value options at grant date.

(ii) Vendor Options Exercised during the financial year

	Number of Options Exercised	Grant Date	Exercise Date	Expiry date	Exercise price	Fair Value Received	Share price at Exercise Date	Fair value of shares at Date of Issue 2005
2005								
Vendor Options	57,771	11/4/02	8/2/05	31/12/05	$0.20	$11,554	$5.10	$294,632
Vendor Options	295,967	11/4/02	30/12/05	31/12/05	$0.20	$59,194	$3.30	$97,669
CEO	4,563,925	11/4/02	20/5/05	31/12/05	$0.20	$912,785	$3.84	$17,525,472
	4,917,663					$983,533		$17,917,773

Fair value of consideration received is measured as the nominal value of the cash receipts on conversion. The fair value of shares at the date of issue is measured as the market value at the close of trade on the date of their issue.

19. Vendor, Directors and Employee Share Option Plan (cont)

(iii) Balance at the end of the financial year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date*
2005					
Vendor options	-	11/4/02	31/12/05	$0.20	-
CEO Options	-	11/4/02	31/12/05	$0.20	-
	-				-

Vendor options carry no rights to dividends and no voting rights.

In accordance with the terms of the vendor and CEO options, options can be exercised at any time from the date of their issue to the date of expiry.

* Issued and fully vested prior to the requirement to fair value options at grant date.

Consideration received on the exercise of the CEO and vendor options is recognised in issued capital. During the financial year $Nil (2005 – $983,533) was recognised in issued capital arising from the exercise of vendor options.

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

On 28 June 2002, shareholders approved the adoption of an Employee Share Option Plan. On 1 July 2002 the Company issued a total of 1,108,000 options exercisable at $1.64 per share on or before 1 July 2006. On 23 October 2003, at the Annual General Meeting, shareholders approved the issue of 200,000 unlisted options to Dr Robert Dean (Director) exercisable at $1.64 per share on or before 1 July 2006. On 7 May 2004 Directors approved the issue of 700,000 unlisted options to staff at an exercise price of $2.58 exercisable on or before 30 April 2009. On 30 September 2005, Directors approved the issue of 900,000 unlisted options to staff at an exercise price of $3.50 exercisable on or before 30 September 2009 as well as 108,000 unlisted options to one staff member at an exercise price of $3.06 exercisable on or before 30 September 2009. At the shareholders meeting held on 29 April 2005, shareholders approved the issue of options to directors expiring on 31 March 2009 as follows:

(a) 200,000 Options at an exercise price of $2.56 to Mr Robert Dean;

(b) 300,000 Options at an exercise price of $2.85 to Mr John Gordon;

(c) 80,400 Options per month at an exercise price of $3.06 to Dr Ben Greene, commencing on 1 December 2004 and issued quarterly at 241,200 options;

(d) 18,000 Options per month at an exercise price of $3.06 to Mr Robert Dean, commencing on 1 December 2004 and issued quarterly at 54,000 options.

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 quantitive criteria.

19. Vendor, Directors and Employee Share Option Plan (cont)

	2006		2005	
	Number	Weighted average exercise price $	Number	Weighted average exercise price $
Balance at the beginning of the financial year (i)	4,396,700	2.73	1,851,000	2.00
Granted during the year (ii)	1,126,800	3.06	2,787,200	3.15
Exercised during the year (iii)	(46,896)	1.70	(130,000)	1.73
Lapsed during the year (iv)	(1,183,554)	1.95	(111,500)	2.15
Balance at the end of the financial year (v)	4,293,050	3.04	4,396,700	2.73

(i) Balance at the beginning of the year

	Number	Grant date	Expiry date	Exercise Price	Fair Value at grant date
2006					
Option – Series					
Director options	400,000	1/7/02	1/7/06	$1.64	400,000
Director options	200,000	23/10/03	1/7/06	$1.64	330,000
Staff options	383,500	1/7/02	1/7/06	$1.64	383,500
Staff options	626,000	7/5/04	30/4/09	$2.58	788,760
Director options	200,000	29/4/05	31/3/09	$2.56	476,000
Director options	300,000	29/4/05	31/3/09	$2.85	660,000
Director options	393,600	29/4/05	31/3/09	$3.06	822,624
Director options	295,200	30/6/05	31/3/09	$3.06	410,328
Director options	295,200	30/9/05	31/3/09	$3.06	369,000
Director options	295,200	31/12/05	31/3/09	$3.06	359,480
Staff options	108,000	30/9/05	30/9/09	$3.06	143,640
Staff options	900,000	30/9/05	30/9/09	$3.50	1,044,000
	4,396,700				6,187,332

19. Vendor, Directors and Employee Share Option Plan (cont)

The options issued to directors from 29 April 2005 to 31 December 2005 were the monthly entitlement of options to Dr Ben Greene and Mr Robert Dean.

	Number	Grant date	Expiry date	Exercise Price	Fair Value at grant date
2005					
Option – Series					
Staff Options	551,000	1/7/02	1/7/06	$1.64	551,000
Staff Options	700,000	7/5/04	30/4/09	$2.58	882,000
Director Options	200,000	23/10/03	1/7/06	$1.64	330,000
Director Options	400,000	1/7/02	1/7/06	$1.64	400,000
	1,851,000				2,163,000

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

In accordance with the terms of the Employee Share Option Plan, options issued at $1.64 on 1 July 2002 can be exercised at any time from the date of their issue to the date of expiry. Options granted on 7 May 2004 at an exercise price of $2.58 vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

(ii) Granted during the year

	Number	Grant Date	Expiry Date	Exercise Price	Fair Value Received	Fair Value at grant date
2006						
Directors	295,200	31/3/06	31/3/09	$3.06	-	242,950
Directors	241,200	30/6/06	31/3/09	$3.06	-	48,964
Directors	241,200	30/9/06	31/3/09	$3.06	-	16,160
Directors	241,200	31/12/06	31/3/09	$3.06	-	49,687
Staff options	27,000	31/3/06	30/9/09	$3.06	-	24,408
Staff options	27,000	30/6/06	30/9/09	$3.06	-	6,561
Staff options	27,000	30/9/06	30/9/09	$3.06	-	2,646
Staff options	27,000	31/12/06	30/9/09	$3.06	-	7,155
	1,126,800					398,531
2005						
Directors	200,000	29/4/05	31/3/09	$2.56	-	476,000
Directors	300,000	29/4/05	31/3/09	$2.85	-	660,000
Directors	393,600	29/4/05	31/3/09	$3.06	-	822,624
Directors	295,200	30/6/05	31/3/09	$3.06	-	410,328
Directors	295,200	30/9/05	31/3/09	$3.06	-	369,000
Directors	295,200	31/12/05	31/3/09	$3.06	-	339,480
Staff options	108,000	30/9/05	30/9/09	$3.06	-	143,640
Staff options	900,000	30/9/05	30/9/09	$3.50	-	1,044,000
	2,787,200					4,265,072

The 900,000 options granted on 30 September 2005 at an exercise price of $3.50 to staff vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

All other options granted during the year to directors and staff vest immediately apart from the 300,000 options issued to John Gordon which vest over a two year period from his date of appointment which was 18 November 2004.

19. Vendor, Directors and Employee Share Option Plan (cont)

The weighted average fair value of the share options granted during the financial year is $0.35 (2005: 1.53). 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 (including the probability of meeting market conditions attached to the option), and behavioural conditions. Expected volatility is based on the historical share price volatility over a two year period adjusted for unusual events.

The following inputs were used in the model for grants during the years ended 31 December 2006 and 2005:

	2006	2005
Dividend yield	-	-
Expected volatility (linearly interpolated)	52% - 62%	36%
Risk free interest rate	5.50% - 6.25%	5.25%
Expected life of options	3 years	4 years

(iii) Exercised during the year

	Number of Options Exercised	Grant Date	Exercise Date	Expiry Date	Exercise Price	No. of Shares Issued	Fair Value Received	Value of Shares at Date of Issue
2006								
Staff	10,000	1/7/02	19/1/06	1/7/06	$1.64	10,000	16,400	32,600
Staff	15,000	1/7/02	7/4/06	1/7/06	$1.64	15,000	24,600	40,500
Staff	3,000	7/5/04	7/4/06	30/4/09	$2.58	3,000	7,740	8,100
Staff	4,000	1/7/02	12/4/06	1/7/06	$1.64	4,000	6,560	10,800
Staff	10,000	1/7/02	9/5/06	1/7/06	$1.64	10,000	16,400	25,500
Staff	4,896	1/7/02	18/5/06	1/7/06	$1.64	4,896	8,029	4,899
	46,896					46,896	79,729	122,399

19. Vendor, Directors and Employee Share Option Plan (cont)

(iii) Exercised during the year

	Number of Options Exercised	Grant Date	Exercise Date	Expiry Date	Exercise Price	No. of Shares Issued	Fair Value Received	Value of Shares at Date of Issue
2005								
Staff	20,000	1/7/02	27/1/05	1/7/06	$1.64	20,000	$32,800	85,000
Staff	1,500	7/5/04	27/1/05	30/4/09	$2.58	1,500	$3,870	6,375
Staff	17,500	1/7/02	1/2/05	1/7/06	$1.64	17,500	$28,700	96,250
Staff	12,000	1/7/02	7/2/05	1/7/06	$1.64	12,000	$18,680	63,600
Staff	10,000	1/7/02	15/2/05	1/7/06	$1.64	10,000	$16,400	50,500
Staff	12,000	1/7/02	24/2/05	1/7/06	$1.64	12,000	$18,680	61,800
Staff	5,000	7/5/04	4/3/05	30/4/09	$2.58	5,000	$12,900	25,250
Staff	5,000	1/7/02	10/3/05	1/7/06	$1.64	5,000	$8,200	25,000
Staff	1,000	1/7/02	24/3/05	1/7/06	$1.64	1,000	$1,640	4,910
Staff	5,000	1/7/02	2/5/05	1/7/06	$1.64	5,000	$8,200	19,750
Staff	3,000	7/5/04	30/5/05	30/4/09	$2.58	3,000	$7,740	11,100
Staff	1,500	7/5/04	29/6/05	30/4/09	$2.58	1,500	$3,970	5,550
Staff	10,000	1/7/02	4/8/05	1/7/06	$1.64	10,000	$16,400	41,500
Staff	7,000	1/7/02	9/8/05	1/7/06	$1.64	7,000	$11,480	28,910
Staff	7,500	1/7/02	28/10/05	1/7/06	$1.64	7,500	$12,300	25,050
Staff	3,000	7/5/04	21/11/05	30/4/09	$2.58	3,000	$7,740	10,920
Staff	5,000	1/7/02	25/11/05	1/7/06	$1.64	5,000	$8,200	19,000
Staff	4,000	1/7/02	7/12/05	1/7/06	$1.64	4,000	$6,560	14,000
	130,000					130,000	$224,460	594,465

Fair value of consideration received is measured as the nominal value of the cash receipts on conversion. The fair value of shares at the date of issue is measured as the market value at the close of trade on the date of their issue.

(iv) Lapsed during the year

2006								
Director	400,000	1/7/02	-	1/7/06	$1.64	-	-	-
Director	200,000	23/10/03	-	1/7/06	$1.64	-	-	-
Staff	339,604	1/7/02	-	1/7/06	$1.64	-	-	-
Staff	97,250	7/5/04	-	30/4/09	$2.58	-	-	-
Staff	146,700	30/9/05	-	30/9/09	$3.50	-	-	-
	1,183,554					-	-	-
2005								
Staff	51,500	1/7/02	-	1/7/06	$1.64	-	-	-
Staff	60,000	7/5/04	-	30/4/09	$2.58	-	-	-
	111,500					-	-	-

19. Vendor, Directors and Employee Share Option Plan (cont)

(v) Balance at the end of the financial year

	Number	Grant date	Expiry date	Exercise Price	Fair value at grant date
200					
Option – Series					
Staff options	525,750	7/5/04	30/4/09	$2.58	662,445
Director options	200,000	29/4/05	31/3/09	$2.56	476,000
Director options	300,000	29/4/05	31/3/09	$2.85	660,000
Director options	393,600	29/4/05	31/3/09	$3.06	822,624
Director options	295,200	30/6/05	31/3/09	$3.06	410,328
Director options	295,200	30/9/05	31/3/09	$3.06	369,000
Director options	295,200	31/12/05	31/3/09	$3.06	359,480
Staff options	108,000	30/9/05	30/9/09	$3.06	143,640
Staff options	753,300	30/9/05	30/9/09	$3.50	873,828
Director options	295,200	31/3/06	31/3/09	$3.06	242,950
Director options	241,200	30/6/06	31/3/09	$3.06	48,964
Director options	241,200	30/9/06	31/3/09	$3.06	16,160
Director options	241,200	31/12/06	31/3/09	$3.06	49,687
Staff options	27,000	31/3/06	30/9/09	$3.06	24,408
Staff options	27,000	30/6/06	30/9/09	$3.06	6,561
Staff options	27,000	30/9/06	30/9/09	$3.06	2,646
Staff options	27,000	31/12/06	30/9/09	$3.06	7,155
	4,293,050				5,175,876
2005					
Option – Series					
Director options	400,000	1/7/02	1/7/06	$1.64	400,000
Director options	200,000	23/10/03	1/7/06	$1.64	330,000
Staff options	383,500	1/7/02	1/7/06	$1.64	383,500
Staff options	626,000	7/5/04	30/4/09	$2.58	788,760
Director options	200,000	29/4/05	31/3/09	$2.56	476,000
Director options	300,000	29/4/05	31/3/09	$2.85	660,000
Director options	393,600	29/4/05	31/3/09	$3.06	822,624
Director options	295,200	30/6/05	31/3/09	$3.06	410,328
Director options	295,200	30/9/05	31/3/09	$3.06	369,000
Director options	295,200	31/12/05	31/3/09	$3.06	359,480
Staff options	108,000	30/9/05	30/9/09	$3.06	143,640
Staff options	900,000	30/9/05	30/9/09	$3.50	1,044,000
	4,396,700				6,187,332

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

In accordance with the terms of the Employee Share Option Plan, options issued at $1.64 on 1 July 2002 can be exercised at any time from the date of their issue to the date of expiry. Options granted on 7 May 2004 at an exercise price of $2.58 vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

19. Vendor, Directors and Employee Share Option Plan (cont)

Options granted on 30 September 2005 at an exercise price of $3.50 vest over a three year period with 20% vesting after 12 months, a further 30% after 2 years and the balance after 3 years.

All other options granted during the year ended 31 December 2005 to directors and staff vest immediately apart from the 300,000 options issued to John Gordon which vest over a two year period from his date of appointment which was 18 November 2004. All other options granted during the year ended 31 December 2005 to directors and staff vest immediately.

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 as disclosed in Note 20 to the financial statements. The amounts are disclosed in remuneration in respect of the financial year in which the entitlement was earned.

	Note	Consolidated		Company	
		31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
20. Reserves					
Foreign currency translation		746,236	(205,634)	-	-
Employee equity-settled benefits		4,699,627	3,807,772	4,699,627	3,807,772
		5,445,863	3,602,138	4,699,627	3,807,772
Foreign currency translation					
Balance at beginning of financial year		(205,634)	(10,774)	-	-
Translation of foreign operations		951,870	(194,860)	-	-
Balance at end of financial year		746,236	(205,634)	-	-

Exchange differences relating to the translation from US dollars, being the functional currency of the consolidated entity's foreign controlled entities in the USA, and from Euros, being the functional currency of the consolidated entity's foreign controlled entity in Germany, 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	3,807,772	276,371	3,807,772	276,371
Share based payment	891,855	3,531,401	891,855	3,531,401
Balance at end of financial year	4,699,627	3,807,772	4,699,627	3,807,772

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 19 to the financial statements.

21. Accumulated Losses

Balance at beginning of financial year	(28,530,024)	(13,798,828)	(28,735,658)	(18,774,415)
Net (loss) attributable to members of the parent entity	(29,032,986)	(14,731,196)	(28,081,116)	(9,961,243)
Balance at end of financial year	(57,563,010)	(28,530,024)	(56,816,774)	(28,735,658)

22. Key management personnel compensation

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

Mr Fred Bart (Chairman, non executive)

Dr Ben Greene (Chief Executive Officer)

Dr Robert Dean (Chief Executive Officer EOST until July 2005 and non-executive director until resigning on 8 March 2006

Mr Ian Dennis (Non-executive)

Ms Cheryl Bart (Non-executive) resigned on 5 December 2006

Mr John Gordon (Non-executive) resigned on 5 December 2006

Mr Mark Ureda (Non-executive) appointed 28 April 2005

Mr Robert Schuitema (Non–executive) appointed on 5 December 2006

Mr Ron Thompson (General Manager)

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

Ms Karen McGilvery (Director of Finance – Electro Optic Systems Pty Limited) appointed 20 January 2005

Mr Steven Juliver (Executive Vice President)

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	
	Note	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
Short-term employee benefits		1,284,745	1,607,404	216,129	143,073
Post-employment benefits		67,188	58,538	-	-
Share-based payment		665,545	3,060,011	665,545	3,060,011
Termination benefits		151,282	42,802	-	-
		2,168,760	4,768 755	881,674	3,203,084

22. Key management personnel compensation (cont)

The compensation of the directors is paid by the holding company and is the same for both the holding company and the consolidated entity.

	Short term		Post Employment	Equity settled Share based payments	Termination	Total
	salary & fees	Non-monetary	Super-annuation	Options	Benefits	
	$	$	$	$	$	$
2006						
Directors						
Mr Fred Bart	45,932	-	-	-	-	45,932
Dr Ben Greene*	268,160	65,171	23,040	313,319	-	669,690
Mr Ian Dennis	117,559	-	-	-	-	117,559
Ms Cheryl Bart	25,358	-	-	-	-	25,358
Dr Robert Dean	87,584	28,296	2,317	44,442	151,282	313,921
Mr John Gordon	25,079	-	-	187,077	-	212,156
Mr Mark Ureda	-	-	-	-	-	-
Mr Robert Schuitema	2,201	-	-	-	-	2,201
Executives						
Mr Ron Thompson	130,492	27,669	11,466	18,930	-	188,557
Dr Craig Smith	184,500	-	16,605	39,300	-	240,405
Ms Karen McGilvery	117,500	-	10,575	25,761	-	153,836
Mr Steven Juliver	159,244	-	3,185	36,716	-	199,145
	1,163,609	121,136	67,188	665,545	151,282	2,168,760
2005						
Mr Fred Bart	30,000	-	-	-	-	30,000
Dr Ben Greene*	344,270	34,462	23,040	1,586,292	-	1,988,064
Mr Ian Dennis	78,000	-	-	-	-	78,000
Ms Cheryl Bart	17,500	-	-	-	-	17,500
Dr Robert Dean*	350,028	13,095	-	831,140	-	1,194,263
Mr John Gordon	17,573	-	-	472,923	-	490,496
Mr Mark Ureda	-	-	-	-	-	-
Mr Ron Thompson	127,838	-	11,210	5,287	-	144,335
Dr Craig Smith	182,475	-	16,301	143,640	-	342,416
Ms Karen McGilvery (1)	88,739	-	7,987	6,798	-	103,524
Mr Jack Elliot (2)	158,703	15,899	-	-	42,802	217,404
Mr Steven Juliver	134,571	14,251	-	13,931	-	162,753
	1,529,697	77,707	58,538	3,060,011	42,802	4,768,755

* Executive directors

22. Key management personnel compensation (cont)

1. Commenced employment on 20 January 2005.

2. Commenced on 25 October 2004 and ceased on 12 December 2005.

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

Further details on options can be found in note 19.

23. 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	
	Note	31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
Cash and cash equivalents		6,814,343	21,434,803	1,359,168	17,976,534

(b) Reconciliation of (Loss) for the period to net cash flows from operating activities

(Loss) for the period	(29,032,986)	(14,731,196)	(28,081,116)	(9,961,243)
(Gain)/ Loss on write-off of fixed assets	(27,978)	34,436	-	-
Equity settled share-based payments	891,855	3,531,401	891,855	3,531,401
Depreciation, amortisation and impairment of fixed assets	2,125,894	1,135,754	1,210	913
Impairment of goodwill	5,505,764	-	-	-
Foreign exchange movements	1,581,737	(220,780)	-	-
Provision for non-recovery of loan	-	-	26,920,723	6,436,448
(Increase)/decrease in assets				
Current receivables	(2,027,114)	(9,607,416)	61,855	(57,633)
Inventories	(4,006,411)	(8,123,442)	-	-
Other current assets	(47,169)	55,769	-	-
Increase/(decrease) in liabilities				
Provisions	4,458,488	1,270,049	-	-
Lease incentives	(89,712)	354,334	-	-
Current trade and other payables	8,288,992	3,685,787	21,097	35,318
Leases	-	148,541	-	-
Deferred revenues	59,103	692,618	-	-
Net cash (outflows) from operating activities	(12,319,537)	(21,774,145)	(184,376)	(14,796)

23. Notes to the Cash Flow Statement (cont)

(c) Non-Cash Financing and Investing Activities

During the financial period, the consolidated entity acquired via finance leases property plant and equipment with a cost value of $129,198 (2005 - $1,657,373). These acquisitions are not reflected in the cash flow statement.

24. Related party disclosures

(a) Equity interests in related parties

Details of the percentage of ordinary shares held in subsidiaries are disclosed in Note 25.

(b) Key management personnel compensation

Details of key management personnel compensation are disclosed in Note 22.

(c) Loans to key management personnel

There is a loan receivable from Mrs Lynette Greene of $103.

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

	Balance at 1/1/06 No.	Granted as remuneration No.	Received on exercise of of options No.	Net other change No.	Balance at 31/12/06 No.
2006					
Mr Fred Bart	6,110,050	-	-	209,025	6,319,075
Dr Ben Greene	7,452,485	-	-	-	7,452,485
Mr Ian Dennis	160,050	-	-	10,000	170,050
Ms Cheryl Bart	290,000	-	-	-	290,000
Dr Robert Dean	-	-	-	-	-
Mr John Gordon	-		-	-	-
Mr Mark Ureda	-	-	-	-	-
Mr Robert Schuitema	-	-	-	175,000	175,000
Mr Ron Thompson	312,245	-	-	35,500	347,745
Dr Craig Smith	24,300	-	-	65,150	89,450
Ms Karen McGilvery	-	-	-	-	-
Mr Steven Juliver	-	-	-	-	-

24. Related party disclosures (cont)

	Balance at 1/1/05 No.	Granted as remuneration No.	Received on exercise of of options No.	Net other change No.	Balance at 31/12/05 No.
2005					
Mr Fred Bart	6,110,050	-	-	-	6,110,050
Dr Ben Greene	2,592,593	-	4,859,892	-	7,452,485
Mr Ian Dennis	160,050	-	-	-	160,050
Ms Cheryl Bart	290,000	-	-	-	290,000
Dr Robert Dean	-	-	-	-	-
Mr John Gordon	-		-	-	-
Mr Mark Ureda	-	-	-	-	-
Mr Ron Thompson	232,700	-	-	79,545	312,245
Dr Craig Smith	-	-	-	24,300	24,300
Ms Karen McGilvery	-	-	-	-	-
Mr Jack Elliot	-	-	-	-	-
Mr Steven Juliver	-	-	-	-	-

(e) Key management personnel Option holdings

	Balance at 1/1/06 No.	Granted as remuneration No.	Excercised (Lapsed) No.	Balance at 31/12/06 No.	Balance vested at 31/12/06 No.	Options vested during year
2006						
Mr Fred Bart	-	-	-	-	-	-
Dr Ben Greene	1,045,200	964,800	-	2,010,000	2,010,000	964,800
Mr Ian Dennis	200,000	-	(200,000)	-	-	-
Ms Cheryl Bart	200,000	-	(200,000)	-	-	-
Dr Robert Dean	634,000	54,000	(200,000)	488,000	488,000	54,000
Mr John Gordon	300,000	-	-	300,000	300,000	150,000
Mr Mark Ureda	-	-	-	-	-	-
Mr Robert Schuitema	-	-	-	-	-	-
Mr Ron Thompson	35,000	-	-	35,000	7,000	7,000
Dr Craig Smith	108,000	108,000	-	216,000	216,000	108,000
Ms Karen McGilvery	50,000	-	-	50,000	14,000	14,000
Mr Steven Juliver	75,000	-	-	75,000	24,000	24,000

24. Related party disclosures (cont)

The 108,000 options issued to Dr Craig Smith were fully vested. Refer to note 19 for further details.

In the previous financial period, Dr Ben Greene exercised 4,563,925 CEO options and 295,967 vendor options at an exercise price of $0.20 for a total of 4,859,892 ordinary shares.

All other options granted during the year to directors vest immediately apart from the 300,000 options issued to John Gordon which vested over a two year period from his date of appointment which was 18 November 2004.

	Balance at 1/1/05 No.	Granted as remuneration No.	Excercised No.	Balance at 31/12/05 No.	Balance vested at 31/12/05 No.	Options vested during year
2005						
Mr Fred Bart	-	-	-	-	-	-
Dr Ben Greene	4,859,892	1,045,200	4,859,892	1,045,200	1,045,200	1,045,200
Mr Ian Dennis	200,000	-	-	200,000	200,000	-
Ms Cheryl Bart	200,000	-	-	200,000	200,000	-
Dr Robert Dean	200,000	434,000	-	634,000	634,000	434,000
Mr John Gordon	-	300,000	-	300,000	150,000	150,000
Mr Mark Ureda	-	-	-	-	-	-
Mr Ron Thompson	-	35,000	-	35,000	-	-
Dr Craig Smith	-	108,000	-	108,000	108,000	108,000
Ms Karen McGilvery	-	50,000	-	50,000	-	-
Mr Jack Elliot	-	-	-	-	-	-
Mr Steven Juliver	15,000	60,000	-	75,000	-	3,000

The 108,000 options issued to Dr Craig Smith were fully vested. Refer to note 19 for further details.

Dr Ben Greene exercised 4,563,925 CEO options and 295,967 vendor options at an exercise price of $0.20 for a total of 4,859,892 ordinary shares.

All other options granted during the year to directors vested immediately apart from the 300,000 options issued to John Gordon which vest over a two year period from his date of appointment which was 18 November 2004.

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

(f) Transactions with other related parties

Other related parties includes:

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

During the year the Company paid $67,991 (2005: $72,900) to Mrs Lynette Greene, a related party of Dr Ben Greene, for business development and project management services. As at 31 December 2006, Mrs Lynette Greene owed the company $103.

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.

24. Related party disclosures (cont)

The ultimate parent entity in the wholly-owned group has provided for part of this amount based upon the net asset position of the controlled entities.

(g) Other transactions with key management personnel

During the year, the Company paid a total of $71,290 (2005: $47,500) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of directors fees for Fred Bart and Cheryl Bart.

During the year, the Company paid Nil (2005: $5,435) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of rental of the Sydney office premises.

During the year, the Company paid $Nil (2005: $15,807) to Genetic Technologies Limited, a company of which Mr Fred Bart is a director, in respect of the rental of the Sydney office premises.

During the year, the Company paid $117,559 (2005: $78,000) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of director and consulting fees.

During the year, the Company paid $2,201 (2005: Nil) to Sail Ahead Pty Limited, a company associated with Mr Robert Schuitema in respect of directors fees.

(h) Parent entity

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

25. Controlled Entities

Name of Entity	Country of Incorporation	December 2006 %	December 2005 %
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 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.

26. Contingent Liabilities

(a) Electro Optic Systems Pty Limited provided a guarantee to Fire Control Systems Pty Limited, a controlled entity, on 16 October 1996 to meet any genuine commitments of Fire Control Systems Pty Limited, either current or to be raised in the foreseeable future.

(b) On 8 December 2003, the parent company and the subsidiary company Electro Optic Systems Pty Limited entered into a Deed of Undertaking with the Industry Research and Development Board on behalf of the Commonwealth of Australia. The undertaking from the parent company was to ensure that the subsidiary company was able to contribute matching funding under the R & D Start Program for the Project.

26. Contingent Liabilities (cont)

The maximum liability is the amount received from the Commonwealth of Australia which was $6,948,878 as at 31 December 2006 although the directors are of the opinion that it is not possible to estimate any potential exposure, if any, to the consolidated entity under this undertaking.

(c) On 1 June 2005, Electro Optic Systems Pty Limited, a 100% owned subsidiary of Electro Optic Systems Holdings Limited, entered into a Joint Cooperation Agreement with the University of Applied Sciences, Fachhochschule Deggendorf of Bavaria, Germany ("FHD") for the formation of a new wholly owned subsidiary, EOS Optronics GmbH. Electro Optic Systems Pty Limited has agreed to contribute cash to fund the operations. FHD has agreed to contribute plant, facilities, offices and staff under the Joint Cooperation Agreement on a basis to be jointly agreed by the parties within 5 months after the end of the financial year (31 December). Charges for services commenced from 1 January 2006. In future financial periods, once the value of these services have been determined, Electro Optic Systems Holdings Limited will issue fully paid ordinary shares to FHD for the agreed value of these services based on the closing market price of Electro Optic Systems Holdings Limited shares on the Valuation date.

At 31 December 2006 an amount of $247,616 was included in trade and other payables of the consolidated entity representing an amount due to FHD for services for the 12 months ended 31 December 2006. This amount has been settled by the issue of 179,432 ordinary shares in Electro Optic System Holdings Limited on 13 February 2007.

	Note	Consolidated		Company	
		31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
27. Capital and Leasing Commitments					
(a) Finance leasing commitments					
Payable – minimum future lease payments					
not later than one year		576,973	910,565	-	-
later than one year and not later than five years		521,124	1,222,029	-	-
later than five years		-	-	-	-
Minimum lease payments		1,098,097	2,132,594	-	-
Less future finance charges		(121,480)	(342,021)	-	-
Total lease liability		976,617	1,790,573	-	-
(b) Finance leasing commitments					
Payable – Present value of minimum future lease payments not later than one year		513,144	735,747	-	-
later than one year and not later than five years		463,473	1,054,826	-	-
later than five years		-	-	-	-
Present value of minimum lease payments		976,617	1,790,573		
Represented by:					
Current liability (Note 13)		503,290	735,747	-	-
Non-current liability (Note 13)		473,327	1,054,826	-	-
		976,617	1,790,573	-	-

27. Capital and Leasing Commitments (cont)

(c) Operating lease commitments

Non-cancellable operating leases contracted for but not recognised in the financial statements:

	Note	Consolidated		Company	
		31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
Payable:					
not later than one year		997,471	1,017,463	-	-
later than one year and not later than five years		1,918,994	3,059,399	-	-
later than five years		-	-	-	-
		2,916,465	4,076,862	-	-

Operating Leases

Leasing arrangements

Operating leases relate to:

US premises at 325 West Grant Street, Tuscon, Arizona with a lease term of 10 years which expires on 15 March 2010. The consolidated entity has an option to renew for a further period of 5 years on expiry of the current lease. The rental is subject to annual reviews to CPI. There is no option to purchase the property.

Premises at 3160 East Transcon Way, Tuscon Arizona with a lease term of 5 years which expires on 30 November 2009. There is no option to renew after 5 years and future lease payments are fixed under the contract. There is no option to purchase the property. A liability has been recognised relating to the lease incentive received upon signing of the lease.

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.

Premises at 111 Canberra Avenue, Griffith, ACT Australia for a 5 year period to 31 December 2009 with a 5 year option. There is no option to purchase the property.

On 29 August 2005 a subsidiary company entered into a new lease for premises at Ulrichsberger Strasse 17, Deggendorf, Germany for an open ended term which can be cancelled by either party on six months notice. There is no option to purchase the property.

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.

28. Subsequent Events

On 13 February 2007, the parent entity issued 179,432 ordinary shares to University of Applied Sciences, Fachhochschule Deggendorf of Bavaria, Germany for services rendered to EOS Optronics GmbH in accordance with an agreement dated 1 June 2005.

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.

29. Financial Instruments

(a) Interest Rate Risk

The consolidated entity's exposure to interest rate risk, which is the risk that a financial instrument's value will fluctuate as a result of changes in market interest rates and the effective weighted average interest rates on classes of financial asset and financial liabilities, is as follows:

Cash assets totalling $6,814,343 (2005 - $21,434,803) attract variable interest at a weighted floating interest rate of 1.56% (2005 – 5.06%).

Finance leases totalling $976,617 (2005 - $1,790,573) incur fixed interest at a weighted average interest rate of 8.61% (2005- 8.58%)

Other receivables, investments, accounts payable, provisions and other financial items are non-interest bearing.

(b) Credit Risk

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance date to recognised financial assets is the carrying amount of those assets, net of any provisions for doubtful debts of those assets, as disclosed in the statement of financial position and notes to the financial statements.

Credit risk for derivative financial instruments arises from the potential failure of counterparties to the contract to meet their obligations. The consolidated entity measures credit risk on a fair value basis.

The consolidated entity does not have significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics.

(c) Net Fair Values

The net fair value approximates their carrying value.

No financial assets and financial liabilities are readily traded on organised markets in standardised form.

The aggregate net fair values and carrying amounts of financial assets and financial liabilities are disclosed in the balance sheet or in the notes to the financial statements.

	Consolidated		Consolidated	
	December 2006 Carrying amount	December 2006 Net fair value	December 2005 Carrying amount	December 2005 Net fair value
Financial assets				
Cash	6,814,343	6,814,343	21,434,803	21,434,803
Receivables	15,826,768	15,826,768	13,799,654	13,799,654
Financial liabilities				
Accounts payable	14,097,838	14,097,838	5,808,846	5,808,846
Interest bearing liabilities	976,617	976,617	1,790,573	1,790,573
Provisions	6,950,620	6,950 620	2,492,132	2,492,132

30. Segment Information

The consolidated entity operates in Australia, USA 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 Systems

EOS is a supplier of large optical systems. During the period the company wound down the telescope division and is in the process of completing existing contracts. Significant provisions for losses were taken up during the period. One new contract for a telescope was taken on during the period as it met the profit and risk criteria.

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.

EOS is producing these CROWS units for the US Army from its Queanbeyan facility and its Tucson production facility.

	12 Months Ended 31 December 2006	12 Months Ended 31 December 2005
Segment Revenues		
Space systems	5,126,195	19,538,378
Space surveillance	3,394,564	3,949,519
Defence	44,530,092	15,481,464
Total of all segments	53,050,851	38,969,361
Unallocated	767,246	1,409,999
Consolidated	53,818,097	40,379,360
Reconciled to Note 2 as follows:		
Revenue	52,140,196	38,700,543
Other income	1,677,901	1,678,817
	53,818,097	40,379,360
Segment Results		
Space systems	(13,615,540)	(6,335,767)
Space surveillance	(1,873,836)	105,664
Defence	(13,275,071)	(8,507,699)
Total of all segments	(28,764,447)	(14,737,802)
Unallocated	(268,539)	6,606
(Loss) before income tax expense	(29,032,986)	(14,731,196)
Income tax expense	-	-
(Loss) for the period	(29,032,986)	(14,731,196)

30. Segment Information (cont)

Segment Assets and Liabilities

	Assets		Liabilities	
	31 December 2006	31 December 2005	31 December 2006	31 December 2005
Space systems and surveillance	5,677,774	15,275,459	8,799,448	7,983,864
Defence	29,063,818	20,052,289	15,796,000	4,082,279
Total all segments	34,741,592	35,327,748	24,595,448	12,066,143
Unallocated	6,814,343	21,434,804	1,164,183	1,790,573
Consolidated	41,555,935	56,762,552	25,759,631	13,856,716

Other Segment Information

	Depreciation and amortisation of segment assets		Acquisition of segment assets	
	12 Months Ended 31 December 2006	12 Months Ended 31 December 2005	12 Months Ended 31 December 2006	12 Months Ended 31 December 2005
Space systems and surveillance	504,626	484,773	344,710	2,194,669
Defence	1,621,268	650,981	1,410,115	4,164,654
Total all segments	2,125,894	1,135,754	1,754,825	6,359,353
Unallocated	-	-	-	-
Consolidated	2,125,894	1,135,754	1,754,825	6,359,353

Information on Geographical Segments (secondary reporting format)

Geographical Segments	Revenue from External Customers	Segment Assets	Acquisition of Segment Assets
31 December 2006			
Australia	15,393,440	31,656,057	1,032,847
North America	36,746,756	9,742,751	677,046
Germany	-	157,127	44,932
Total	52,140,196	41,555,935	1,754,825
31 December 2005			
Australia	5,516,075	43,285,428	4,365,412
North America	33,184,468	13,405,479	1,971,284
Germany	-	71,645	22,657
Total	38,700,543	56,762,552	6,359,353

31. Construction Contracts

	Note	Consolidated		Company	
		31 December 2006 $	31 December 2005 $	31 December 2006 $	31 December 2005 $
Construction work in progress		34,637,154	49,968,444	-	-
Less					
Provision for losses		(2,588,515)	-	-	-
Progress billings		(30,081,861)	(46,939,704)	-	-
		1,966,778	3,028,740	-	-
Recognised and included in the financial statements as amounts due:					
From customers under construction contracts:					
Current (note 6)		5,436,722	6,439,571	-	-
To customers under construction contracts:					
Current (note 12)		(3,469,934)	(3,410,831)	-	-
		1,966,778	3,028,740	-	-
Retentions included in progress billings		-	-	-	-

32. 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 and Germany.

Registered Office

Suite 2, Level 12
75 Elizabeth Street
Sydney NSW 2000
Australia
Tel: 02 9233 3915
Fax: 02 9232 3411

Principal Place of Business

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Griffith
ACT 2603
Australia
Tel: 02 6222 7900
Fax: 02 6299 7687

USA Operations

3160 East Transcon Way
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Tucson, Arizona 85706
USA
Tel: +1 (520) 624 6399
Fax: +1 (520) 624 1906

German Operations

Ulrichsberger Str. 17 3 OG
94469 Deggendorf
Germany
Tel: +49 991 2910083
Fax: +49 991 2910399

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

ASX ADDITIONAL INFORMATION

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 12 February 2007 the following substantial shareholders were registered:

	Ordinary Shares	Percentage of total Ordinary Shares
Fred Bart Group	6,319,075	12.31%
Technology Investments Pty Limited	7,452,485	14.52%
Northrop Grumman Space and Mission		
Systems Corp.	5,000,000	9.74%
	18,771,560	36.57%

VOTING RIGHTS

At 12 February 2007 there were 1,481 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)."

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.

DISTRIBUTION OF SHAREHOLDINGS

At 12 February 2007 the distribution of share and option holdings were:

Range	Ordinary Shareholders	Number of Shares
1-1,000	245	161,658
1,001 – 5,000	539	1,598,704
5,001 – 10,000	318	2,719,750
10,001 – 100,000	323	9,936,408
100,001 and over	56	36,899,974
	1,481	51,316,494

TWENTY LARGEST SHAREHOLDERS - QUOTED

DISTRIBUTION OF SHAREHOLDINGS (CONT)

There were 47 ordinary shareholders with less than a marketable parcel.

There is no current on-market buy-back.

TWENTY LARGEST ORDINARY SHAREHOLDERS - QUOTED

At 12 February 2007 the 20 largest ordinary shareholders held 60.79 % of the total issued fully paid quoted ordinary shares of 51,316,494.

Shareholder	Fully Paid Ordinary Total	Percentage of Shares
1. Citicorp Nominees Pty Limited	5,269,311	10.27%
2. Benny Allan Greene	4,563,925	8.89%
3. N & J Properties Pty Limited	4,090,000	7.97%
4. ANZ Nominees Limited	3,549,291	6.92%
5. Technology Investments Pty Limited	2,888,560	5.63%
6. AWC Nominees Pty Limited	2,507,276	4.89%
7. Link Traders (Aust) Pty Limited	1,500,000	2.92%
8. Westpac Custodian Nominees Limited	909,387	1.77%
9. Innovation Investments Pty Limited	900,000	1.75%
10. National Nominees Limited	722,526	1.41%
11. Kam Superannuation Fund Pty Limited	693,000	1.35%
12. F & B Investments Pty Limited	580,125	1.13%
13. Dr Joshua Ehrlich	549,847	1.07%
14. Capitol Enterprises Limited	500,000	0.97%
15. RBS Dexia Investor Services Australia Limited	452,879	0.88%
16. Henry Herron	380,000	0.74%
17. Equity Trustees Limited	298,012	0.58%
18. Emichrome Pty Limited	290,988	0.57%
19. Winerust Pty Limited	279,231	0.54%
20. Brent McCarty, Yvonne McCarty and Zeljan Unkovich	278,847	0.54%
	31,203,205	60.79%

CORPORATE GOVERNANCE STATEMENT

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") "Principles of Good Corporate Governance and Best Practice Recommendations". 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. Encourage enhanced performance
- Principle 9. Remunerate fairly and responsibly
- Principle 10. Recognise the legitimate interests of stakeholders

Electro Optic Systems Holdings Limited's corporate governance practices were in place throughout the year ended 31 December 2006 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 Mr Robert Schuitema (Chairman), Mr Ian Dennis and Mr Fred Bart. The majority of the audit committee are independent directors and the Chairman is an independent person.

The Company has in place informal policies and procedures for risk management and during the current year the Directors will document and adopt 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 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 16. 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.

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
Mr Robert Schuitema	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	6 years 10 months
Dr Ben Greene	Executive Director	4 years 9 months
Mr. Ian Dennis	Non-Executive Director	6 years 10 months
Mr Mark Ureda	Non-Executive Director	1 year 10 months
Mr Robert Schuitema	Non-Executive Director	3 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. It is envisaged that a Nomination and Remuneration Committee will be established during the coming financial year.

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.

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. Whilst the Company does not currently have a formal Remuneration Committee, the nature and amount of Executive Directors' and Officers' emoluments are linked to the Company's financial and operational performance. Further, it is envisaged that a Nomination and Remuneration Committee will be established during the coming financial year. 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 22 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.

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.

Subject to the insider trading provisions of the Corporations Act outlined in Section 2 and the notification requirements of the Company set out in the "Insider Trading Policy", the recommended time (in order to minimize suggestions of insider trading) for any Director or employee to deal in Securities is during the four week period commencing on the second business day after:

(a) EOSH's annual general meeting;

(b) The release of EOSH's half-yearly announcement to the ASX;

(c) The release of EOSH's preliminary final statement or full year announcement to ASX (whichever is earlier);

(d) The release of a disclosure document (eg. a prospectus) by EOSH.

(e) The release of the quarterly commitments test report known as Appendix 4C.

The Chairman of the Board, or the Chairman's delegate, (eg. the Company Secretary) may also notify Directors and employees of EOSH in writing of other ad hoc "trading windows".

The complete Insider Trading Policy of the Company is available on the Company's website at **www.eos-aus.com**

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