

**Appendix 4E**  
**For the year ended 31 December 2019**

**DroneShield Limited**  
**ABN 26 608 915 859**

**1. Reporting period**

The financial information contained in the attached consolidated financial report is for the year ended 31 December 2019. The previous corresponding period was the year ended 31 December 2018.

<b>Results for announcement to the market</b>				
	Up/ Down	% Movement		2019 \$
<b>Revenue</b> from continuing activities	Up	200%	to	3,617,488
<b>Loss</b> from continuing activities after tax attributable to members	Up	21%	to	(7,695,080)
<b>Net loss</b> attributable to members	Up	21%	to	(7,695,080)
<b>Dividends:</b> No dividends are being proposed or have been paid	Nil	Nil		Nil

Additional information:

**2. Commentary related to the above results**

Refer to Directors Report in the attached Annual Report.

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

31 December 2019: \$0.03; 31 December 2018: \$0.01

**4. There was no change of control during the year**

**5. There were no payments of dividends during the year**

**6. There is no dividend reinvestment plan in operation**

**7. There are no associates or joint venture entities**

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

Further information regarding the company and its business activities can be obtained by visiting the company's website at [www.droneshield.com](http://www.droneshield.com)



**DRONESHIELD**

# Annual Report

For the Year Ended  
31 December 2019



*Image: DroneShield's RfZero™ counterdrone sensor deployed on an MRZR vehicle*

**DroneShield Limited (ASX:DRO)**

ASX Release

ABN 26 608 915 859

# Table of Contents

Corporate Information .....	2
Chairman's Review .....	3
About DroneShield .....	4
Board of Directors and Executives .....	9
Corporate Governance Statement .....	11
Directors' Report .....	20
Directors' Report- Remuneration Report (audited).....	32
Auditor's Independence Declaration .....	40
Consolidated Statement of Profit or Loss and Other Comprehensive Income .....	41
Consolidated Statement of Financial Position .....	42
Consolidated Statement of Changes in Equity .....	43
Consolidated Statement of Cash Flows .....	44
1. Summary of Significant Accounting Policies .....	45
2. Critical accounting judgements, estimates and assumptions .....	51
3. Revenue.....	52
4. Other gains (losses).....	52
5. Corporate and support expense.....	52
6. Corporate governance expense.....	53
7. Income taxes relating to continuing operations .....	53
8. Options issued .....	54
9. Cash and cash equivalents .....	56
10. Trade and other receivables .....	56
11. Inventories .....	56
12. Plant, equipment and intangible assets .....	57
13. Right-of-use asset.....	57
14. Provisions .....	58
15. Other liabilities .....	58
16. Borrowings .....	58
17. Lease liabilities.....	59
18. Contributed equity.....	59
19. Shares and options .....	60
20. Earnings (loss) per share .....	61
21. Key Management Personnel disclosures and related party transactions .....	61
22. Parent entity financial information .....	62
23. Financial risk management .....	62
24. Contingent liabilities .....	64
25. Commitments.....	64
26. Remuneration of auditor .....	64
27. Segment information.....	65
28. Reconciliation from loss after income tax to net cash outflow from operating activities .....	66
29. Events after the reporting date.....	67
Directors' Declaration .....	68
Independent Auditor's Report.....	69
Shareholder Information.....	73

# Corporate Information

## Directors & Management

**Peter James** Independent Non-Executive Chairman  
**Jethro Marks** Independent Non-Executive Director  
**Oleg Vornik** CEO and Managing Director

## Registered Office

Level 5, 126 Phillip St  
Sydney, NSW 2000  
Australia

Telephone: +61 2 9995 7280

Email: [info@droneshield.com](mailto:info@droneshield.com)  
Website: [www.droneshield.com](http://www.droneshield.com)

## Auditors

**HLB Mann Judd Assurance (NSW) Pty Ltd**  
Level 19, 207 Kent Street  
Sydney, NSW 2000  
Australia

## Bankers

**Commonwealth Bank of Australia**  
309-315 George Street  
Sydney, NSW 2000  
Australia

**Westpac**  
275 Kent Street  
Sydney, NSW 2000  
Australia

**PNC Bank**  
1405 P Street, NW  
Washington DC 20005  
United States of America

## Solicitors

**Baker & McKenzie LLP**  
452 Fifth Avenue  
New York NY 10018  
United States of America

**Steinepreis Paganin**  
16 Milligan Street  
Perth, WA 6000  
Australia

**K&L Gates**  
1601 K Street, NW  
Washington DC 20006  
United States of America

## Share Registry

**Automic Pty Ltd t/a Automic Registry Services**  
267 St Georges Terrace  
Perth WA 6000  
Australia

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

## Stock Exchange Listing

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

## Chairman's Review



*Peter James,  
Independent Non-  
Executive Chairman*

Dear Fellow Shareholders,

2019 has continued to be another year of rapid progress for DroneShield Ltd ("DroneShield" or the "Company") as a leader and early mover in the counterdrone industry, and a year of rapid growth for the industry itself.

Highlights for the year included:

- DroneShield generated total customer cash receipts of \$3,162,838 for the calendar year 2019 (in addition to R&D and other incentives, such as grants). These are the Company's highest annual customer cash receipts to date, approximately 2.5x higher than those generated the previous year.
- DroneShield raised \$10,849,696, enabling it to continue the global rollout of its product suite, as well as extensive R&D.
- The Company closed several sales opportunities that had been developed previously, developed a number of other sales opportunities, and continued to progress a number of previously developed near-term sales opportunities, with the Company's near-term high confidence sales pipeline estimated to stand at over \$80 million<sup>1</sup>.
- DroneShield won three contracts with the Australian military (100% of counterdrone tenders by the Australian DoD through 2019, based on the publicly released information), as well as orders from a number of other customers globally and across various industry verticals.

During the year, the Company released several new products in response to end-customer requests. The Company released DroneGun MKIII™ (a portable, pistol style drone disruptor weighing only 2kg), RfPatrol™ (body-worn passive drone detection device, weighing under 1kg), new generation software systems for its DroneSentinel™ and DroneSentry™ detection and detect-and-defeat systems, RfZero™ (rapidly deployable fixed site/mobile drone detector) and DroneSentry-X™ (vehicle based detect and defeat counterdrone system).

2019 witnessed continued rapid escalation of drones being used for terrorist activities, including an unprecedented drone attack undertaken by the Houthi rebels on a key oil facility in the Kingdom of Saudi Arabia in September 2019. The strike was reported to have sparked an enormous blaze and resulted in the Kingdom of Saudi Arabia temporarily shutting down about half of its crude output, equating to be about 5% of worldwide production, and causing substantial turbulence in the world energy markets. Following the strike, the Middle East is now experiencing a surge in demand for counterdrone products. In other segments, numerous airport shutdowns due to drones, prison contraband deliveries and other nefarious applications of drones have continued to rise.



*Damage caused by the September 2019 drone attacks on Saudi Arabian oil facilities*

In 2019, the Company announced several key partnerships, including with BT in September 2019 as their exclusive counterdrone supplier. The BT partnership provides a powerful platform for adoption and distribution of DroneShield's products across a range of Government and commercial customers in the UK. DroneShield has also entered into several other key partnerships including Bosch, Collins Aerospace and Saudi Telecom (STC), while continuing to advance its existing relationship with Thales, one of the largest defence companies globally.

The Company continued to benefit from the Australian Government's Defence Export Strategy and has consistently been selected as part of Team Defence Australia at key defence events globally, as well as having access to a network of Australian embassy defence attaches around the world. The Company received its second R&D Tax Incentive Grant from the Australian Government and is in the process of applying for a third grant for 2019 activities.

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

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

Peter James  
Independent Non-Executive Chairman

<sup>1</sup> Necessarily, not all (and there can be no assurance that any) of the Company's sales opportunities will result in sales.

# About DroneShield

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

## History of DroneShield

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

DroneShield Limited listed on the ASX on 22 June 2016, raising \$7 million through the issue of 35 million shares at \$0.20 per share in an oversubscribed initial public offer (‘IPO’). Most recently, DroneShield raised \$9.55 million in August 2019 via a placement.

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



## Business Model and Products

Affordable consumer-grade drones have become popular around the world, but they present unique and frequent threats to privacy, physical security and public safety in a wide variety of environments. DroneShield offers products that detect and defeat such drones to civil infrastructure operators, militaries, and other government and commercial users globally. DroneShield’s distribution channels focus on third party distributors, as well as direct relationships with various key customers, such as military, security and law enforcement agencies of various governments around the world and commercial civil infrastructure operators globally. With offices in Australia, the United States and the UK, DroneShield has an experienced salesforce with approximately 100 distribution partners across 70 countries. The ultimate end-users and potential end-users of DroneShield’s products come from a diverse array of global sectors, including the following:

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

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

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

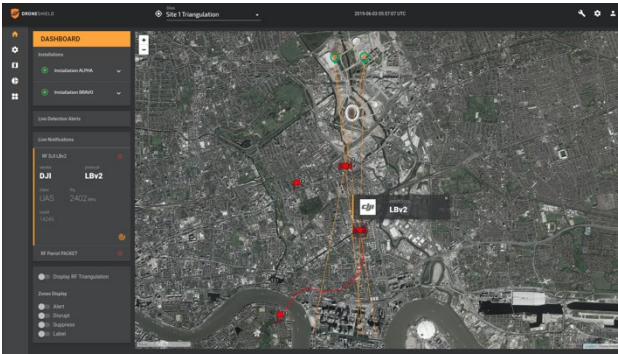
	<ul style="list-style-type: none"> <li>• Portable rifle shape drone disruptor, causing the drone (or swarm) to safely land, or fly back to the starting point (potentially identifying the pilot)</li> <li>• 7kg weight, no backpack</li> <li>• 70 units ordered by a Middle Eastern Ministry of Defence in 2018</li> <li>• Additional units sold to Australian, Asian, Latin American, and Western Governments</li> </ul>
	<ul style="list-style-type: none"> <li>• Pistol shaped drone disruptor, up to 1km range</li> <li>• Released in mid-2019</li> <li>• Only 2kg weight including battery</li> <li>• Unique patented design enabling to affect a wide range of drones with compact design</li> <li>• Suitable for mobile deployments, patrols, law enforcement and special forces types of customers</li> </ul>

DroneGun Tactical™

DroneGun MKIII™

 <p>RfPatrol™</p>	<ul style="list-style-type: none"> <li>• Body-worn drone detection device</li> <li>• 1km+ range</li> <li>• Can be used with a directional accessory (DAU™) to determine direction of the threat</li> <li>• Completely passive (no RF emissions)</li> <li>• CE certified</li> <li>• Deployed with Australian military (two tenders won in last 12 months) and other high-profile users</li> </ul>
 <p>RfZero™</p>	<ul style="list-style-type: none"> <li>• Rapidly deployable omni-directional drone detector</li> <li>• Completely passive, no emissions</li> <li>• Vehicle or fixed site mountable</li> <li>• Cost effective</li> <li>• 1km range in RF cluttered environments, with greater detection distance range elsewhere</li> <li>• Utilises DroneShield's proprietary DroneShieldComplete™ counterdrone software engine</li> <li>• Released in late 2019</li> </ul>
 <p>DroneSentry™</p>	<ul style="list-style-type: none"> <li>• Integrated detect-and-defeat system</li> <li>• 5km detection and 2km defeat range</li> <li>• Includes radiofrequency direction finders, radars and cameras in a modular manner, with an integrated DroneCannon™ drone disruptor</li> <li>• Utilises DroneShield's proprietary DroneShieldComplete™ counterdrone software engine</li> <li>• Successfully deployed in multiple locations globally</li> </ul>
 <p>DroneSentinel™</p>	<ul style="list-style-type: none"> <li>• Multi-sensor drone detection system</li> <li>• 5km detection range</li> <li>• Includes radiofrequency direction finders, radars and cameras in a modular manner</li> <li>• Utilises DroneShield's proprietary DroneShieldComplete™ counterdrone software engine</li> <li>• Deployed at the 2018 Olympic Winter Games</li> <li>• Publicly reported use includes utilisation in mid-2019 by the US law enforcement for drone pilot arrest during a major sporting event in the US</li> </ul>
 <p>DroneCannon RW™</p>	<ul style="list-style-type: none"> <li>• Drone disruptor module for a remote weapon station</li> <li>• Allows for a layered response to a drone threat, starting with soft defeat / drone target freeze via DroneCannon, followed by utilisation of the primary kinetic weapon if required</li> <li>• Can be utilised with a range of Remote Weapon Stations (RWSs)</li> </ul>
 <p>DroneNode™</p>	<ul style="list-style-type: none"> <li>• Covert portable drone disruptor</li> <li>• Suitable for counterdrone protection at public gatherings and other similar situations</li> <li>• Deployed at South East Asian (SEA) Games in late 2019, reportedly, to intercept drones in path of helicopter carrying President of Philippines and Sultan of Brunei</li> </ul>
 <p>DroneSentry-X™</p>	<ul style="list-style-type: none"> <li>• Integrated detect-and-defeat counterdrone solution</li> <li>• Deployable on a vehicle or fixed site platforms</li> <li>• First shipments expected mid-2020, with strong customer interest received</li> </ul>

Underpinning all DroneShield's detection products is the Company's proprietary software engine, DroneShieldComplete™. The engine is an intuitive interface with a comprehensive reporting suite, which can combine a number of customer sites deploying both DroneShield's and third-party sensor hardware. The software engine comes either included with DroneShield hardware purchases (with a subscription charge), or on a standalone basis as a subscription-based product.



*DroneShieldComplete™*

### *Revenue Model and Recurring Cashflows*

Importantly, both fixed site (DroneSentinel™, DroneSentry™, DroneSentry-X™, RfZero™) and body-worn (RfPatrol™) drone detection products have a recurring revenue element in that the Company charges its customers for updates to the drone libraries of the products. For example, the recently announced RfPatrol™ sale to the Australian department of Defence includes such subscription revenues. Over time, DroneShield expects to build a robust recurring revenue line as more products requiring library updates are sold.

Additionally, DroneShield has commenced offering leases of its product range to its in-country partners and end customers (where possession and use of a particular product is lawful for that customer according to local laws). The lease periods vary from weekly, to multi-year. Leasing may be suitable for event-based requirements, product evaluations without a commitment to purchase, or for customers who have a preference to lease vs outright purchase.

The Company does not believe that leasing would cannibalise its sales, as leasing would appeal to a different set of customers and utilise different deployment opportunities. Further, the Company believes that leasing is in fact complementary to its sales efforts as it will promote customer awareness of DroneShield's products and their applications.

### **Environment**

The overall global demand for drone detection and mitigation products continued to rapidly increase through 2019 and into 2020, against the backdrop of a nearly daily barrage of news about drone threats.

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

- On 14 September 2019, drone attacks on Saudi Aramco oil facilities, reportedly attributed to Houthi rebels, have disrupted approximately 50% of Saudi oil production capacity, and caused a major disturbance to world oil markets.
- In early January, a US drone strike killed Iranian General Qassem Soleimani, with the subsequent downing of a Ukrainian airliner in Iran. Iran has a track record of conducting warfare through its proxies in the region, including extensive use of weaponised off the shelf drones of the types that DroneShield's products protect against. The escalated security situation is positively correlated to demand for the Company's products.



*The wreckage of an airstrike that killed Iranian general Qassem Soleimani in Baghdad on January 3, 2020*

- Incidents involving drones continued into the end of the year as their accessibility and flight range further improve. Areas of conflict have seen the regular use of drones to conduct remote surveillance, coordinate large-scale attacks and deliver payloads directly to the target. Commercial venues and restricted airspace have also seen consistent breaches as both negligent and nefarious pilots violate these facilities. Close calls and minor collisions with aircraft have exposed the vulnerabilities of airports to potentially deadly incidents involving small to medium sized drones.
- On 30 November 2019, during the Southeast Asian Games opening ceremony, four drones appeared in the flight path of the Philippine's Presidential helicopter. The drones were disabled by DroneShield counterdrone equipment, which was deployed at the Games to provide counter drone protection.



*DroneShield's DroneGun Tactical™ system deployed at the 30<sup>th</sup> SEA Games event*

- Nefarious pilots put commercial and public individuals at risk, intruding in restricted airspace and conducting illegal activities using small consumer drones.
  - Criminal gangs utilised drones to drop swine fever infected items into pig farms. Farm owners attempted to disable drones using unknown counterdrone equipment but were forced to surrender this equipment to authorities as they were not permitted to use the devices.
  - More than 2,000 passengers were affected by a drone which intruded on Taiwan international airport. Police were unable to identify or locate the drone or pilot.
  - A drone pilot was arrested after his drone fell inside the Hong Kong army barracks.
  - Investigations commenced after a drone was spotted flying over the Newcastle 500 racetrack, at the same time Air Force Jets were performing low altitude manoeuvres for the event.
- Criminals continued to exploit drones to circumvent prison security measures, delivering illegal contraband to inmates.
  - Ex-convicts attempted to smuggle phones into a Russian prison using a commonly available DJI Phantom, modified to include a drop mechanism.
  - A drone was used to smuggle illicit contraband into a Queensland prison, causing a full prison lockdown.
  - Footage emerged online of a drone dropping contraband into a Dublin prison.
- Drones continued to be used by terrorists intent on causing harm in international conflicts. Reports showed groups continuing the development of long range, fast flying UAV's utilising off the shelf components. Incidents have proven the long ranges that terrorists are now capable of flying when delivering payloads to targets.
  - A custom-made drone was recovered in Syria, with off the shelf components consistent with other drones built by the Islamist terrorist organisation HTS.
  - A UAV flown by the Houthi-movement rebels was brought down in Yemen. Images show the inside of the device potentially carrying explosives.
  - A mid-sized drone developed in Turkey capable of carrying an automatic machine gun and 200 rounds of ammunition was released. The drone weighs 25kg and is configured in a quadcopter formation with dual propeller blades.
- A number of near misses and collisions between drones and commercial aircraft occurred during the quarter, with the risk of a major incident appearing imminent given the proximity in which drones are regularly flying to aircraft.

- An LA TV helicopter sustained significant damage to the rotor and wing after suffering a drone collision at 1,100ft AGL. The aircraft was able to land safely however the crew were placed in significant danger during the incident.
  - An unidentified drone flew dangerously close to a luxury jet flying from France to England. The drone came within 10ft of the aircraft as it was attempting to land at London's Luton airport.
  - A drone pilot was fined \$20,000 after his DJI drone landed next to an active runway at McCarran International Airport in Las Vegas.
- Numerous large drones with blinking lights and wingspans of up to 6 feet have been reported across western Nebraska and eastern Colorado, with numerous sightings between sunset to about 10pm across a number of days.



*The LA News Helicopter that was struck by a drone at 1,100 ft AGL. The closeup image shows puncture damage to the wing caused by the collision*

### Market Position

The Company is addressing what is believed to be a multibillion dollar addressable market, with hundreds of thousands of potential user installations.

As the counterdrone space continues to rapidly grow, new entrants attempt entering the market. Broadly, they can be classified into three groups:

- “Garage” businesses, which have limited product or a concept, and are not being considered by the end users due to immaturity of their offering and their inability to support customers. This group is not considered a competitive threat.
- Large defence and security integrators. Those companies are potential partners for DroneShield, with the potential for them to add the Company’s products into their overall offering. Due to the rapidly evolving nature of the counterdrone industry and competitive pricing, the integrators generally choose to partner with smaller agile providers such as DroneShield. DroneShield has established partnerships with several such companies, including Thales, Bosch and BT, as previously disclosed to the market. Additionally, DroneShield’s products are materially cheaper than most competing detection products that are being marketed (particularly, systems being marketed by larger defence contractors) and are in fact capable of being delivered.
- Mid-sized companies. There are several such companies globally, however DroneShield continues to outperform its peers due to:
  - Track record of sales/customer references in the sector.
  - Mature, highly innovative and well performing products – the Company has been in a number of competitive processes, having outperformed its peers.
  - The number of high-profile customer and integrator partner credentials, highlighting the quality of the DroneShield brand.
  - A full suite of counterdrone products, meaning that the Company has the ability to sell to the need of every counterdrone customer – as opposed to being a single product company.
  - A global network of 100 in-country partners in over 70 countries, as opposed to being more geographically narrow.
  - Safety certifications further underpin the Company’s position in government tenders.

DroneShield is an Australian company with meaningful U.S. operations, its origin is a positive factor in the decision-making process by allied country users, especially government users. It is prominently positioned as an Australian defence contractor, having been part of Team Defence Australia key global defence events, and having engaged in active dialogue with Austrade and Centre for Defence Industry Capability (CDIC).

## Board of Directors and Executives



### Peter James; Independent Non-Executive Chairman

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

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

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



### Oleg Vornik; CEO and Managing Director

Mr. Vornik is an experienced senior executive with previous roles at the Royal Bank of Canada, Brookfield, Deutsche Bank and ABN AMRO.

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

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



### Jethro Marks; Independent Non-Executive Director

Mr. Marks is a Sydney-based CEO and co-founder of the Mercury Retail Group, an eCommerce retail, services, logistics and outsourcing business. Over 17 years Mr. Marks has led, and continuously grown, the business at the forefront of digital commerce, marketing and international logistics, while competing with the largest retailers globally. Mr Marks brings to the Board extensive commercial experience in successfully scaling a multinational business.

Mercury Retail Group's global supply chain and award-winning logistics capability has extended to most consumer goods categories in multiple countries, and today carries 32 million products. This capability has extended to provisioning international logistics support to multinational brands and technology companies.

Mr. Marks graduated from the University of Auckland, with a Bachelor of Commerce (Honours).

Mr. Marks joined the Board on 16 January 2020.



**James Gatley; Chief Operating Officer**

James joined DroneShield after a highly successful career with the Australian Army. This experience saw James complete 17 years service, with 12 years of this time spent serving within Special Operations. He completed 11 operational deployments and took part in active service globally. At the conclusion of his career in the Australian Defence Force, James managed a sales portfolio for a company that included Defence, Law Enforcement and Government clients within Australia. He has conducted high level Security and Risk training for various Government clients.

James holds Diplomas in Business, Project Management and Security and Risk Management. He also holds a GradCert in Terrorism and Security Studies.



**Angus Bean; Chief Technology Officer**

With a background in Industrial Design and Mechanical Engineering, Angus Bean brings a wealth of knowledge in product development through to production management. Mr. Bean merges the various fields of mechanical hardware, electronics, software, digital interface and technology.

Mr. Bean joined DroneShield early in 2016, since then has been a driving force in DroneShield's technology team, working to build the team and the technology to deliver on key projects and milestones. Previous to DroneShield, Mr. Bean was the Development Lead for Australia's largest and most prominent industrial design and engineering consultancy.

Over his career, Mr Bean has adopted both a collaborative and leadership role on a number of projects which have attracted multiple Australian and International Awards in Innovation, Consumer Electronics, Defence and Cyber Security. Mr. Bean holds a BDesign in Industrial Design (First Class Hon) from the University of Technology, Sydney.



**Carla Balanco; CFO and Company Secretary**

Ms. Balanco joined DroneShield in mid-2018, since then she has been instrumental in scaling the Company's financial management systems and controls as DroneShield continues to grow. She has the responsibility of overseeing the Company's Financial Reporting, Financial Planning, Compliance, Human Resources, Administration, and Treasury functions.

Prior to DroneShield, Ms. Balanco gained experience working in Chartered, Commercial and Business Development roles. She gained an in-depth knowledge of the International Financial Reporting Standards (IFRS) whilst working as a Senior Auditor for mid-tier Chartered firms Crowe Horwath and HLB Mann Judd, auditing both private and public companies.

Ms. Balanco is a member of the South African Institute of Chartered Accountants and holds an Honours in Accounting from the University of Johannesburg and an Honours in Accounting Science from the University of South Africa.

# Corporate Governance Statement

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

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

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

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

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

The Company is pleased to report that its practices are largely consistent with the Recommendations of the ASX Corporate Governance Council and sets out below its compliance and departures from the Recommendations for the year ended 31 December 2019.

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

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
<b>Principle 1: Lay solid foundations for management and oversight</b>		
<b>Recommendation 1.1</b> A listed entity should disclose: <ol style="list-style-type: none"> <li>a) the respective roles and responsibilities of its board and management; and</li> <li>b) those matters expressly reserved to the board and those delegated to management.</li> </ol>	YES	The Board is responsible for the corporate governance of the Company. The Company has adopted a Board Charter which sets out, amongst other things, the specific responsibilities of the Board, the roles and responsibilities of the Chairman, Board and management, as well as the matters expressly reserved for the decision of the Board and those delegated to management. A copy of the Company’s Board Charter is contained in its Corporate Governance Plan which is available on the Company’s website: <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a> The Company is committed to the circulation of relevant materials to Directors in a timely manner to facilitate Directors’ participation in Board discussions on a fully informed basis. The Company intends to regularly review the balance of responsibilities between the Board and management to ensure that the division of functions remains appropriate to the needs of the Company.

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION												
<p><b>Recommendation 1.2</b> A listed entity should:</p> <p>(a) undertake appropriate checks before appointing a person, or putting forward to security holders a candidate for election, as a Director; and</p> <p>(b) provide security holders with all material information relevant to a decision on whether or not to elect or re-elect a Director.</p>	YES	<p>(a) The Company's Corporate Governance Plan requires the Board to undertake appropriate checks as to the character, experience, education, criminal record and bankruptcy history of the candidate before appointing a person or putting forward to security holders a candidate for election, as a Director.</p> <p>(b) All material information relevant to a decision on whether to elect or re-elect a Director will be provided to security holders in any notice of meeting pursuant to which the resolution to elect or re-elect such Director will be voted on.</p>												
<p><b>Recommendation 1.3</b> A listed entity should have a written agreement with each Director and senior executive setting out the terms of their appointment.</p>	YES	Each Director and senior executive of the Company is party to a written agreement with the Company which sets out the terms and conditions of that Director's or senior executive's appointment.												
<p><b>Recommendation 1.4</b> The company secretary of a listed entity should be accountable directly to the board, through the chair, on all matters to do with the proper functioning of the board.</p>	YES	The Board Charter outlines the role, responsibility and accountability of the Company Secretary. The Company Secretary is accountable directly to the Board, through the Chair, on all matters relating to the proper functioning of the Board. The Chairman and the Company Secretary co-ordinate the Board agenda.												
<p><b>Recommendation 1.5</b> A listed entity should:</p> <p>(a) have a diversity policy which includes requirements for the board or a relevant committee of the board:</p> <p>(i) to set measurable objectives for achieving gender diversity; and</p> <p>(ii) to assess annually both the objectives and the entity's progress in achieving them;</p> <p>(b) disclose that policy or a summary of it; and</p> <p>(c) disclose as at the end of each reporting period:</p> <p>(i) the measurable objectives for achieving gender diversity set by the board or a relevant committee of the board in accordance with the entity's diversity policy and its progress towards achieving them; and</p> <p>(ii) either:</p> <p>(A) the respective proportions of men and women on the board, in senior executive positions and across the whole organisation (including how the entity has defined "senior executive" for these purposes); or</p> <p>(B) if the entity is a "relevant employer" under the Workplace Gender Equality Act, the entity's most recent "Gender Equality Indicators", as defined in the Workplace Gender Equality Act 2012.</p>	<p>YES</p> <p>YES</p> <p>NO</p>	<p>(a) The Company has adopted a Diversity Policy which identifies gender diversity as a key area of focus for the Company. However, given the current size of the Company, the Board has determined that the benefits of the initiatives recommended by the ASX Corporate Governance Council in this regard are disproportionate to the costs involved in the implementation of such strategies.</p> <p>Accordingly, the Board has elected to adopt a tiered approach to the implementation of its Diversity Policy which is relative to the size of the Company and its workforce, such that:</p> <ul style="list-style-type: none"> <li>- Where the Company employs 20 or more employees, the Board will adopt practices in line with the Recommendations.</li> </ul> <p>(b) A copy of the Company's Diversity Policy is contained in its Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a></p> <p>(c)</p> <p>(i) As the Company did not employ 20 or more employees for the majority of the 2019 Financial Year, the Company did not formally define a set of measurable gender diversity objectives.</p> <p>(ii) During the reporting period (i.e. the year ended 31 December 2019), the respective proportions of men and women in the following roles were as follows:</p> <table border="1" data-bbox="938 1877 1422 2067"> <thead> <tr> <th></th> <th>Men</th> <th>Women</th> </tr> </thead> <tbody> <tr> <td>Board</td> <td>100%</td> <td>0%</td> </tr> <tr> <td>Senior executives</td> <td>67%</td> <td>33%</td> </tr> <tr> <td>Across the whole organisation</td> <td>87%</td> <td>13%</td> </tr> </tbody> </table>		Men	Women	Board	100%	0%	Senior executives	67%	33%	Across the whole organisation	87%	13%
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PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
<p><b>Recommendation 1.6</b> A listed entity should:</p> <p>(a) have and disclose a process for periodically evaluating the performance of the board, its committees and individual Directors; and</p> <p>(b) disclose in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.</p>	<p>YES</p> <p>YES</p>	<p>(a) The performance of the Board as a group and of individual Directors will be assessed each year for all future years. The Remuneration Committee (the function of which is currently performed by the full Board) is responsible for evaluating the performance of the Board and individual Directors on an annual basis. The process for this is set out in the Company's Performance Evaluation Procedures policy which is contained in its Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>(b) The Board undertook an evaluation of Board performance in 2019.</p>
<p><b>Recommendation 1.7</b> A listed entity should:</p> <p>(a) have and disclose a process for periodically evaluating the performance of its senior executives; and</p> <p>(b) disclose in relation to each reporting period, whether a performance evaluation was undertaken in the reporting period in accordance with that process.</p>	<p>YES</p> <p>YES</p>	<p>(a) The Managing Director of the Company is responsible for evaluating the performance of senior executives on an annual basis. The process for this is set out in the Company's Performance Evaluation Procedures policy which is contained in its Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>(b) A formal performance evaluation of senior executives was undertaken during the 2019 financial year.</p>
<b>Principle 2: Structure the board to add value</b>		
<p><b>Recommendation 2.1</b> The board of a listed entity should: have a nomination committee which:</p> <p>(i) has at least three members, a majority of whom are independent Directors; and</p> <p>(ii) is chaired by an independent Director, and disclose:</p> <p>(iii) the charter of the committee;</p> <p>(iv) the members of the committee; and</p> <p>(v) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or</p> <p>if it does not have a nomination committee, disclose that fact and the processes it employs to address board succession issues and to ensure that the board has the appropriate balance of skills, experience, independence and knowledge of the entity to enable it to discharge its duties and responsibilities effectively.</p>	<p>NO</p> <p>NO</p> <p>NO</p> <p>NO</p> <p>N/A</p> <p>YES</p>	<p>Due to its size, the Board has determined that the function of the Nomination Committee is most efficiently carried out with full Board participation and accordingly, the Board has elected not to establish a separate Nomination Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Nomination Committee under the Nomination Committee Charter are carried out by the full Board.</p> <p>A copy of the Nomination Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>The Board devotes time at Board meetings on at least an annual basis to discuss Board succession issues. Where appropriate, all members of the Board are involved in the Company's nomination process, to the maximum extent permitted under the Corporations Act and ASX Listing Rules.</p> <p>The Board also conducts an annual review of the Company's Board Skills Matrix (in accordance with Recommendation 2.2) to ensure the Board maintains an appropriate balance of skills, experience, independence and knowledge to discharge its duties and responsibilities effectively.</p>
<p><b>Recommendation 2.2</b> A listed entity should have and disclose a board skill matrix setting out the mix of skills and diversity that the board currently has or is looking to achieve in its membership.</p>	<p>YES</p>	<p>The Board of the Company is comprised of Directors with a broad range of technical, commercial, financial and other skills, experience and knowledge relevant to overseeing the business of a drone security company.</p> <p>The Company had developed a Board Skills Matrix which is used as a tool to assess the appropriate and</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
		<p>ideal balance of skills, experience, independence and diversity necessary for the Board to discharge its duties and responsibilities effectively.</p> <p>A summary of the collective skills, experience, independence and diversity of the Board is set in Annexure C of the Company's Corporate Governance Plan which is available on the Company's website:  <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p>
<p><b>Recommendation 2.3</b>  A listed entity should disclose:</p> <p>(a) the names of the Directors considered by the board to be independent Directors;</p> <p>(b) if a Director has an interest, position, association or relationship of the type described in Box 2.3 of the ASX Corporate Governance Principles and Recommendation (3rd Edition), but the board is of the opinion that it does not compromise the independence of the Director, the nature of the interest, position, association or relationship in question and an explanation of why the board is of that opinion; and</p> <p>(c) the length of service of each Director</p>	YES	<p>(a) During the 2019 financial year, the Independent Directors of the Company were:</p> <ul style="list-style-type: none"> <li>- Mr. Peter James (Non-Executive Chairman); and</li> <li>- Mr. Bradley Buswell (Non-Executive Director).</li> </ul> <p>Mr. Oleg Vornik, the Managing Director, was not considered to be independent during his tenure due to his executive role as Managing Director of the Company.</p> <p>(b) The Board has determined the independence of each of the Company's Directors in line with the guidance set out by the ASX's Corporate Governance Council and have not formed an opinion contrary to those guidelines.</p> <p>(c) The Directors who held office during and after the 2019 financial year have served continuously since their respective dates of appointment unless otherwise noted below:</p> <ul style="list-style-type: none"> <li>- Mr. Peter James: appointed 1 April 2016;</li> <li>- Mr. Oleg Vornik: appointed 24 January 2017;</li> <li>- Mr. Robert Clisdell: appointed 24 January 2017, resigned 16 January 2020;</li> <li>- Mr. Bradley Buswell: appointed 29 December 2017, resigned 3 October 2019, and</li> <li>- Mr Jethro Marks: appointed 16 January 2020.</li> </ul>
<p><b>Recommendation 2.4</b>  A majority of the board of a listed entity should be Independent Directors.</p>	NO	<p>The Board Charter requires that where practical the majority of the Board will be independent.</p> <p>During the 2019 financial year, the following two of the Company's four Directors were considered to be Independent Directors:</p> <ul style="list-style-type: none"> <li>- Mr. Peter James (Non-Executive Chairman); and</li> <li>- Mr. Bradley Buswell (Non-Executive Director) (resigned on 3 October 2019).</li> </ul> <p>Subsequent to the 2019 financial year, on 16 January 2020, the Company appointed Mr. Jethro Marks as a Non-Executive Director, who is also considered to be an Independent Director.</p>
<p><b>Recommendation 2.5</b>  The chair of the board of a listed entity should be an Independent Director and, in particular, should not be the same person as the CEO of the entity.</p>	YES	<p>The Chairman, Mr. Peter James is an Independent Non-Executive Director and is not the same person as the Managing Director of the Company.</p>
<p><b>Recommendation 2.6</b>  A listed entity should have a program for inducting new Directors and providing appropriate professional development opportunities for continuing Directors to develop</p>	YES	<p>The Company's program for the induction of new Directors is tailored for each new Director (depending on their personal requirements, background skills, qualifications and experience) and includes the provision of a formal letter of appointment and an induction package containing sufficient information to</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
and maintain the skills and knowledge needed to perform their role as a Director effectively.		<p>allow the new Director to gain an understanding of the business of the Company, and the roles, duties and responsibilities of Directors and the Executive team.</p> <p>All Directors are encouraged to undergo continual professional development and, subject to prior approval by the Chairman, all Directors may have access to various resources and professional development training to address any skills gaps.</p>
<b>Principle 3: Act ethically and responsibly</b>		
<p><b>Recommendation 3.1</b> A listed entity should:</p> <p>(a) have a code of conduct for its Directors, senior executives and employees; and disclose that code or a summary of it.</p>	YES	<p>(a) The Company has adopted a Corporate Code of Conduct which applies to Directors, employees and contractors of the Company.</p> <p>The Corporate Code of Conduct is contained in the Company's Corporate Governance Plan which is available on the Company's website at: <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p>
<b>Principle 4: Safeguard integrity in corporate reporting</b>		
<p><b>Recommendation 4.1</b> The board of a listed entity should: have an audit committee which:</p> <p>(i) has at least three members, all of whom are Non-Executive Directors and a majority of whom are Independent Directors; and</p> <p>(ii) is chaired by an Independent Director, who is not the chair of the board,</p> <p>and disclose:</p> <p>(iii) the charter of the committee;</p> <p>(iv) the relevant qualifications and experience of the members of the committee; and</p> <p>(v) in relation to each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or</p> <p>if it does not have an audit committee, disclose that fact and the processes it employs that independently verify and safeguard the integrity of its financial reporting, including the processes for the appointment and removal of the external auditor and the rotation of the audit engagement partner.</p>	<p>NO</p> <p>NO</p> <p>NO</p> <p>YES</p> <p>N/A</p> <p>N/A</p> <p>YES</p>	<p>Due to the current size of the Company, the Board has determined that the function of the Audit and Risk Committee is most efficiently carried out with full Board participation and accordingly, the Company has elected not to establish a separate Audit and Risk Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter are carried out by the full board.</p> <p>The Audit and Risk Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>The Board devotes time on at least an annual basis to consider the robustness of the various internal control systems it has in place to safeguard the integrity of the Company's financial reporting.</p> <p>In addition, following the completion of each half year review and annual audit review, the Company's external auditors confer with the Board on any matters identified during the course of the audit that have the potential to increase the Company's exposure to risks of material misstatements in its financial reports.</p> <p>The full Board also assumes responsibility for recommendations to security holders on the appointment and removal of the external auditor. Audit partner rotations will be enforced in accordance with the relevant guidelines.</p>
<p><b>Recommendation 4.2</b> The board of a listed entity should, before it approves the entity's financial statements for a financial period, receive from its CEO and CFO a declaration that the financial records of the entity have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the entity and that the opinion has been formed on the basis of a sound system of risk</p>	YES	<p>Prior to the execution of the financial statements of the Company, the Company's Managing Director and Chief Financial Officer provide the Board with written assurances that the financial records of the Company have been properly maintained and that the financial statements comply with the appropriate accounting standards and give a true and fair view of the financial position and performance of the Company and that the opinion has been formed on the basis of a sound system of risk management and internal control which is operating effectively in all material aspects.</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
management and internal control which is operating effectively.		
<p><b>Recommendation 4.3</b></p> <p>A listed entity that has an AGM should ensure that its external auditor attends its AGM and is available to answer questions from security holders relevant to the audit.</p>	YES	An external auditor will be present at the Company's Annual General Meeting ("AGM") and be available to answer questions from security holders relevant to the audit.
<b>Principle 5: Make timely and balanced disclosure</b>		
<p><b>Recommendation 5.1</b></p> <p>A listed entity should:</p> <ul style="list-style-type: none"> <li>- have a written policy for complying with its continuous disclosure obligations under the Listing Rules; and</li> <li>- disclose that policy or a summary of it.</li> </ul>	YES	<p>The Company has adopted a Continuous Disclosure Policy which details the processes and procedures which have been adopted by the Company to ensure that it complies with its continuous disclosure obligations as required under the ASX Listing Rules and other relevant legislation.</p> <p>The Company's Continuous Disclosure Policy is contained within the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p>
<b>Principle 6: Respect the rights of security holders</b>		
<p><b>Recommendation 6.1</b></p> <p>A listed entity should provide information about itself and its governance to investors via its website.</p>	YES	Shareholders can access information about the Company and its governance (including its constitution and adopted corporate governance policies) from the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a> . The Company will regularly update the website and contents therein as deemed necessary.
<p><b>Recommendation 6.2</b></p> <p>A listed entity should design and implement an investor relations program to facilitate effective two-way communication with investors.</p>	YES	<p>The Company has adopted a Shareholder Communications Strategy which aims to promote and facilitate effective two-way communication with investors. The Strategy outlines a range of ways in which information is communicated to Shareholders, including via its website, through announcements released to the ASX, its annual report and general meetings. Shareholders are also welcome to contact the Company or its registrar, Automic Registry Services, via email or telephone.</p> <p>The Company's Shareholder Communications Strategy is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p>
<p><b>Recommendation 6.3</b></p> <p>A listed entity should disclose the policies and processes it has in place to facilitate and encourage participation at meetings of security holders.</p>	YES	<p>As noted above, the Company's Shareholder Communications Strategy is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>Shareholders will be encouraged to participate at all general meetings of the Company by written statement contained in every Notice of Meeting sent to shareholders prior to each meeting.</p> <p>The Company intends to accommodate shareholders who are unable to attend general meetings in person by accepting votes by proxy.</p> <p>Further, any material presented to shareholders at the meeting will be released to the ASX immediately prior to the commencement of the meeting for the benefit of those shareholders who are unable to</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
		<p>attend in person. The Company will also announce to the ASX the outcome of each meeting immediately following its conclusion.</p> <p>At each general meeting, shareholders will be given an opportunity to ask questions in relation to the resolutions put to shareholders at that meeting, and in respect of the Company's business and operations generally.</p> <p>At each AGM, shareholders will also be invited by the Chairman to ask questions of the Company's external auditor and the Board in relation to the annual financial report of the Company and the conduct of the audit.</p>
<p><b>Recommendation 6.4</b></p> <p>A listed entity should give security holders the option to receive communications from, and send communications to, the entity and its security registry electronically.</p>	YES	<p>Shareholders have the option of electing to receive all shareholder communications by e-mail and can update their communication preferences with the Company's registrar, Automatic Registry Services, at any time.</p> <p>Security holders can also register with the Company at <a href="mailto:info@droneshield.com">info@droneshield.com</a> to receive email notifications following the release of a material announcement to the ASX.</p>
<p><b>Principle 7: Recognise and manage risk</b></p>		
<p><b>Recommendation 7.1</b></p> <p>The board of a listed entity should:</p> <p>have a committee or committees to oversee risk, each of which:</p> <ul style="list-style-type: none"> <li>(i) has at least three members, a majority of whom are Independent Directors; and</li> <li>(ii) is chaired by an Independent Director, and disclose:</li> <li>(iii) the charter of the committee;</li> <li>(iv) the members of the committee; and</li> <li>(v) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or</li> </ul> <p>if it does not have a risk committee or committees that satisfy (a) above, disclose that fact and the process it employs for overseeing the entity's risk management framework.</p>	<p>NO</p> <p>NO</p> <p>NO</p> <p>YES</p> <p>N/A</p> <p>N/A</p> <p>YES</p>	<p>Due to its size, the Board has determined that the function of the Audit and Risk Committee is most efficiently carried out with full Board participation and accordingly, the Company has elected not to establish a separate Audit and Risk Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter are carried out by the full Board.</p> <p>The Audit and Risk Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>The Board devotes time on at least an annual basis to fulfil the roles and responsibilities associated with overseeing risk and maintaining the Company's risk management framework and associated internal compliance and control procedures.</p>
<p><b>Recommendation 7.2</b></p> <p>The board or a committee of the board should:</p> <p>review the entity's risk management framework with management at least annually to satisfy itself that it continues to be sound, to determine whether there have been any changes in the material business risks the entity faces and to ensure that they remain within the risk appetite set by the board; and</p> <p>disclose in relation to each reporting period, whether such a review has taken place.</p>	YES	<p>During the 2019 financial year, the Board, in carrying out the duties typically assigned to the Audit and Risk Committee under the Audit and Risk Committee Charter, undertook a review of the Company's risk management framework in line with its Risk Management Policy.</p>
<p><b>Recommendation 7.3</b></p> <p>A listed entity should disclose:</p> <p>if it has an internal audit function, how the function is structured and what role it performs; or</p>	NO	<p>Due to the current size of the Company and the manageable scale of its operations, the Board, in carrying out the duties typically assigned to the Audit &amp; Risk Committee under the Audit &amp; Risk Committee Charter, have determined that the Company's existing risk management processes and internal</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.	YES	controls are sufficiently robust and as such, no internal audit committee is required at this stage.
<p><b>Recommendation 7.4</b></p> <p>A listed entity should disclose whether, and if so how, it has regard to economic, environmental and social sustainability risks and, if it does, how it manages or intends to manage those risks.</p>	YES	<p>The Company's Risk Management Policy details the Company's risk management systems which assist in identifying and managing potential or apparent business, economic, environmental and social sustainability risks (where appropriate).</p> <p>During the 2019 financial year, the Company undertook a review of the Company's risk management framework in line with its Risk Management Policy.</p> <p>All material risks are announced to the market, in accordance with the requirements of the ASX listing rules and otherwise.</p>
<b>Principle 8: Remunerate fairly and responsibly</b>		
<p><b>Recommendation 8.1</b></p> <p>The board of a listed entity should: have a remuneration committee which:</p> <ul style="list-style-type: none"> <li>(i) has at least three members, a majority of whom are Independent Directors; and</li> <li>(ii) is chaired by an Independent Director,</li> </ul> <p>and disclose:</p> <ul style="list-style-type: none"> <li>(iii) the charter of the committee;</li> <li>(iv) the members of the committee; and</li> <li>(v) as at the end of each reporting period, the number of times the committee met throughout the period and the individual attendances of the members at those meetings; or</li> </ul> <p>if it does not have a remuneration committee, disclose that fact and the processes it employs for setting the level and composition of remuneration for Directors and senior executives and ensuring that such remuneration is appropriate and not excessive.</p>	<p>NO</p> <p>NO</p> <p>YES</p> <p>N/A</p> <p>N/A</p> <p>YES</p>	<p>Due to the size of the Board and the scale of the Company's operations, the Board have determined that the function of the Remuneration Committee is most efficiently carried out with full Board participation (to the extent permitted under the Corporations Act and ASX Listing Rules), and accordingly has elected not to establish a separate Remuneration Committee at this stage.</p> <p>As a result, the duties that would ordinarily be assigned to the Remuneration Committee under the Remuneration Committee Charter are carried out by the full Board.</p> <p>The Remuneration Committee Charter is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>The Board devotes time on at least an annual basis to fulfil the roles and responsibilities associated with setting the level and composition of remuneration for Directors and senior executives and ensuring that such remuneration is appropriate and not excessive.</p>
<p><b>Recommendation 8.2</b></p> <p>A listed entity should separately disclose its policies and practices regarding the remuneration of Non-Executive Directors and the remuneration of Executive Directors and other Senior Executives and ensure that the different roles and responsibilities of Non-Executive Directors compared to Executive Directors and other Senior Executives are reflected in the level and composition of their remuneration.</p>	YES	<p>The Company's general policies and practices regarding the remuneration of Non-Executive and Executive Directors and other senior employees are set out in the Remuneration Policy which is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>Further information regarding the remuneration practices of the Company is contained in the Remuneration Report section of the Company's 2019 Annual Report.</p>
<p><b>Recommendation 8.3</b></p> <p>A listed entity which has an equity-based remuneration scheme should:</p> <ul style="list-style-type: none"> <li>(i) have a policy on whether participants are permitted to enter into transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme; and</li> </ul>	YES	<p>The Company's Remuneration Committee (the function of which is currently performed by the full Board) is responsible for the review and approval of any equity-based remuneration schemes offered to Directors and Employees of the Company. Further, in accordance with the Remuneration Committee Charter, the Remuneration Committee (the function of which is currently performed by the full Board) is also responsible for granting permission, on a case</p>

PRINCIPLES AND RECOMMENDATIONS	COMPLY (YES/NO)	EXPLANATION
(ii) disclose that policy or a summary of it.		<p>by case basis, for scheme participants to enter transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme.</p> <p>During the 2019 financial year, the Board of the Company authorised the issue of securities to Directors and employees under its shareholder approved Incentive Option Plan. To date, no participant to the Incentive Option Plan has sought (or been granted) approval to enter into transactions (whether through the use of derivatives or otherwise) which limit the economic risk of participating in the scheme.</p> <p>The Company's policy in this regard is set out the Company's Remuneration Committee Charter, a copy of which is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p> <p>The Company also has a Securities Trading Policy that prohibits Directors, Officers and employees from entering into transactions or arrangements which limits the economic risk of participating in unvested entitlements under any equity-based remuneration scheme. A copy of the Securities Trading Policy is contained in the Company's Corporate Governance Plan which is available on the Company's website <a href="https://www.droneshield.com/investors">https://www.droneshield.com/investors</a>.</p>

## Directors' Report

Your Directors present their report for DroneShield Limited (the "Company") and its controlled entities ("the Group") for the year ended 31 December 2019.

### Directors

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

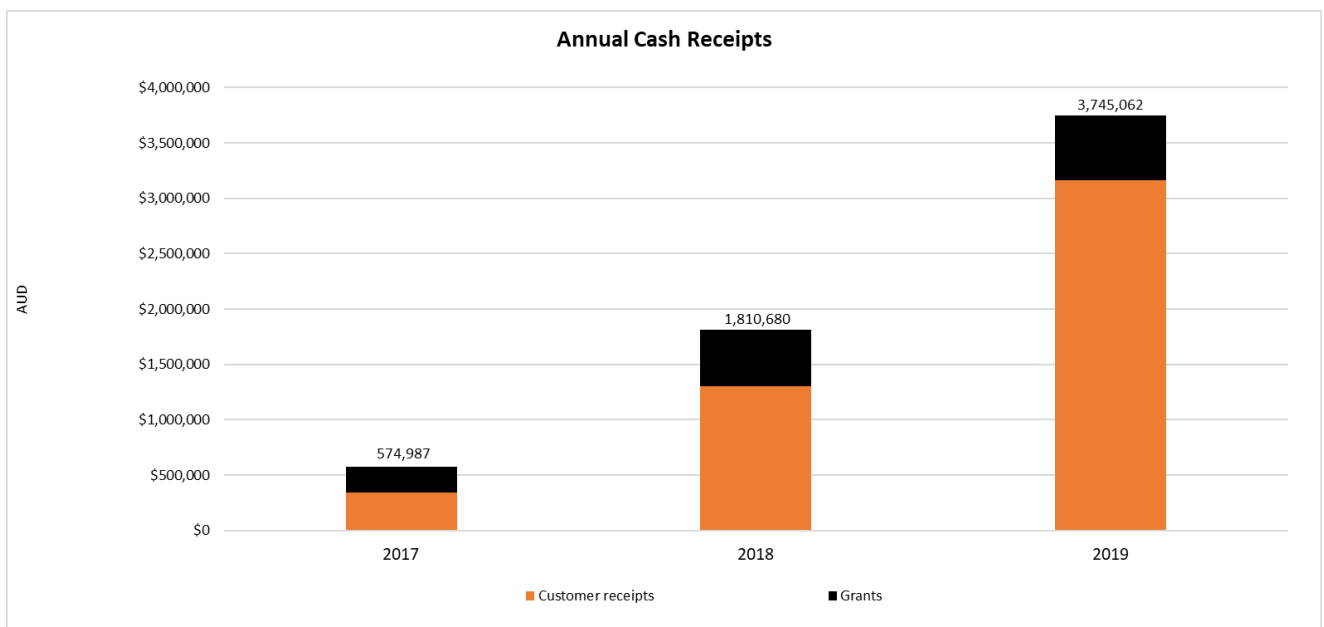
Name	Position	Effective date
Directors		
Peter James	Independent Non-Executive Chairman	Executive Chairman until 24 January 2017. Returned to Independent Non-Executive Chairman 24 January 2017.
Oleg Vornik	Executive Director, CEO and Managing Director	Appointed as CEO and Managing Director 24 January 2017.
Robert Clisdell	Non-Executive Director	Appointed 24 January 2017. Resigned 16 January 2020.
Bradley Buswell	Independent Non-Executive Director	Appointed 29 December 2017. Resigned 3 October 2019.
Jethro Marks	Independent Non-Executive Director	Appointed 16 January 2020.

### Meetings of Directors

Name	Meetings eligible to attend	Meetings attended
Directors		
Peter James	12	12
Robert Clisdell	12	12
Bradley Buswell	9	9
Oleg Vornik	12	12

Review of Operations and Financial Results

- **Approximately \$3.2 million in customer cash receipts in 2019 (before grants received), a substantial increase compared to the \$1.3 million of cash receipts in 2018.**
- **The Australian Department of Defence placed its third order with DroneShield in late 2019 – DroneShield has secured 100% of the DoD’s reported counterdrone business to date.**
- **DroneShield continues to work towards the execution of a formal contract in relation to the previously announced \$60 million - \$70 million Middle Eastern order.<sup>2</sup>**
- **The fact that DroneShield’s system purchased by the customer prevented a real-life threat to the President of the Philippines has highlighted DroneShield’s leadership position globally.**



*DroneShield’s growing customer cash receipts*

The net loss after tax for the year was \$7.69 million, an increase of 21% relative to the 2018 loss of \$6.33 million. That is, in 2019, DroneShield was able to substantially scale up its research and development (R&D) and sales and marketing activities, secure initial sizable orders for its products, and generate its first meaningful revenues, which were over double than those in the previous year, with only a marginal increase in its net loss for the year. Importantly, \$1.75 million of the loss related to non-cash share-based payments.

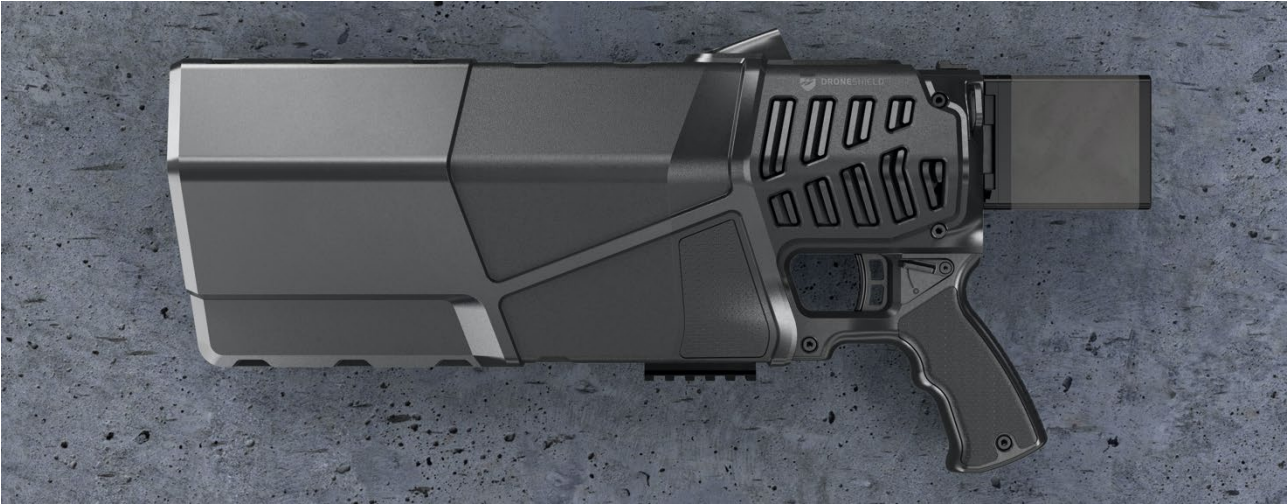
During 2019, the Company undertook a \$1.3 million and \$9.55 million placement in February and August. Related transaction costs amounted to \$1.88 million, including the value of options granted to brokers for these placements. The Company carries no meaningful financial debt, other than lease liabilities.

In October 2019 Bradley Buswell stepped down from his position as an Independent Non-Executive Director. In November 2019, Dean Jagger of Automic Group was replaced as Company Secretary by Carla Balanco, DroneShield’s CFO. In January 2020, Robert Clisdell stepped down as a Non-Executive Director and Jethro Marks joined the Board as an Independent Non-Executive Director. DroneShield’s Board currently comprises of Peter James (Independent Non-Executive Chairman), Oleg Vornik (CEO and Managing Director) and Jethro Marks (Independent Non-Executive Director).

During the year, DroneShield released several ground-breaking products, including DroneGun MKIII™ pistol, RfPatrol™ portable body-worn drone detector (with Australian military making two separate purchases of this product via tenders), RfZero™ rapidly deployable vehicle or fixed site based drone detector, and DroneSentry-X™ vehicle or fixed site detect-and-defeat system. Below is a summary on these newly released products.

<sup>2</sup> Necessarily, not all, and there can be no assurance that any, of the Company’s sales opportunities will result in sales. There is no assurance that the bid referenced in this paragraph will result in a sale.

- DroneGun MKIII™ is a portable pistol-shape drone jammer, weighing under 2kg. It is designed to be an alternate rather than replacing product for its highly successful DroneGun Tactical™ unit, having a shorter effective range of 500m-1km versus 2-3km for DroneGun Tactical™. DroneGun MKIII™ can also be used in combination with other DroneShield products, including the RfPatrol™ and the DroneSentinel™.



DroneShield's DroneGun MKIII™

- RfPatrol™ is a body-worn drone detection product. Weighing under 1kg, the product appeals to a range of DroneShield's customer base globally, across military, law enforcement, security and VIP markets. Importantly, RfPatrol™ is a completely passive (non-emitting) product, substantially broadening the range of customers to whom the product is lawfully available. The product carries a CE certification.



DroneShield's RfPatrol™

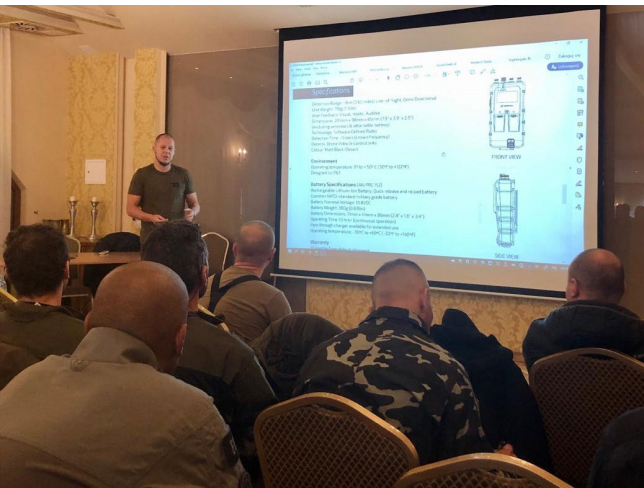
- RfZero™ is a rapidly deployable, omnidirectional drone detection device with a 1km range. It is designed to be a cost-effective fixed site alternative to DroneShield's higher end product, RfOne™ (a 5km radiofrequency direction finder). As such, RfZero™ responds to the needs of users with more substantial budgetary constraints. As is the case with the rest of DroneShield's fixed site product family, RfZero™ uses DroneShieldComplete™, DroneShield's proprietary counterdrone software user interface. It is also able to integrate with the rest of the fixed site DroneShield product suite, such as DroneCannon™ for either automated or manual drone defeat, once RfZero™ detects the drone. RfZero™ is completely non-emitting, thus allowing for a substantially larger customer universe. Given that the product thus lacks this regulatory constraint, and is marketed at a lower price point, the product is expected to be of substantial appeal to a wide array of customers.



*DroneShield's RfZero™*

**Key Sales Themes**

DroneShield expanded the range of its customers and sales during the quarter and has a substantial near-term sales pipeline.<sup>3</sup> The Company currently offers its products in approximately 70 countries and the diversity of its pipeline is one of its key strengths. Importantly, with a wide distribution network and a history of orders from a variety of customers, DroneShield is not dependent on any one customer or any one existing or potential contract for its success. This section does not seek to cover each of the Company's sales opportunities or even each type of the Company's sales opportunities, which are numerous.



*A European demo of DroneShield products*



*DroneShield Asian demo*



<sup>3</sup> Necessarily, not all, and there can be no assurance that any, of the Company's sales opportunities will result in sales.

Below are five key near term themes that the Company believes to be its major sales drivers:

### The Middle East

The \$3.2 million prior Middle Eastern defence order previously announced by the Company has established the Company's ability to sell in the Middle East. Several countries in the region have been the subject of highly publicised drone attacks by non-state actors. The current Iran situation (refer to the "Environment" section below) is also having a positive effect on DroneShield's business in the region.

The Company is in a number of sales processes in the Middle East, in multiple countries, across military, Ministry of Interior / law enforcement, and oil facility customers. These opportunities are at various stages of development, including progressing towards contract execution. New opportunities are being added to the pipeline frequently, as threats manifest themselves, and budgets get allocated.



10 million Kuwaiti Dinars (approx A\$50m) allocated in 2020 budget for counterdrone equipment

Among other potential orders, the Company has previously disclosed that it was working on a Middle Eastern sovereign order estimated to have a value of A\$60 million - \$70 million and that it had been awarded the preferred bidder status for the contract. The contract has undergone the negotiation process, its form has been agreed, and the contract is currently awaiting governmental approval and execution.<sup>4</sup>

It is important to note that the Middle Eastern procurement processes are generally not as streamlined or scheduled as is the case in the West, often resulting in delays in contract award and payment.

### The United States Department of Defense

During the December 2019 quarter, DroneShield bolstered its U.S. office by adding business development staff to support its focus on the U.S. military and Government agencies. The U.S. DoD has been increasing its focus on the counterdrone space, with a dedicated counterdrone office based in Arlington Virginia, which will be managed by the U.S. Army, currently being set up for the first time. The DoD's counterdrone office's initial focus, according to statements by Undersecretary of Defense for Acquisition and Sustainment, Ellen Lord, will include review of all counterdrone activities conducted to date across the U.S. military. Its brief is understood to include a recommendation for several selected systems that will be streamlined across the U.S. DoD.

"One of the challenges is that we know that the adversary is very agile and updates their [tactics, techniques and procedures] ... very quickly," Lord has been reported to have said. "We are looking at a very nimble system where we can push patches in the same day, if you will, so that we again can stay ahead of the threat". This agility requirement is expected to bestow a substantial advantage on a smaller contractor such as DroneShield. DroneShield is working on being selected to be part of this process, given that the process is likely to result in substantial contracts.

In the last month, DroneShield's U.S. subsidiary DroneShield LLC has been shortlisted by the U.S. Army for the xTechSearch, with Phase III to be held on 17-19 March at the 2020 Global Force Symposium & Exposition at Huntsville Alabama.

xTechSearch is sponsored by U.S. Army's Assistant Secretary of the Army for Acquisition, Logistics, and Technology. It enables the selected private sector companies to collaborate with the Army to tackle the most critical Army modernisation challenges. The program provides non-dilutive funding to selected private sector companies to demonstrate their technologies pertaining to Army challenges. The program also drives to integrate these businesses into the Army's Science and Technology ecosystem by providing research opportunities with Army labs, including authorised access to the Army's organic intellectual and technical capital.

<sup>4</sup> There can be no assurance that this potential contract will be signed or result in a sale.

There are a number of additional U.S. DoD and Government agency processes that DroneShield is participating in (directly and as a sub-contractor to defence primes) and in which DroneShield or its prime head contractor has been shortlisted by the U.S. DoD.

Australian Department of Defence

During the 2019 quarter, DroneShield won its second order with the Australian Department of Defence (DoD) for its RfPatrol™ portable unmanned aerial system (drone) detection devices. DroneShield won the contract following an open tender process. The contract was for approximately A\$700,000, consisting of a combination of an initial purchase price and an annual subscription component. DroneShield has received the payment of the initial purchase price. Additionally, during the quarter DroneShield won another contract for DroneGun Tactical™ rifle-shaped portable drone countermeasures from the Australian DoD, in the amount of approximately A\$300,000. DroneShield received payment for that contract in January 2020.

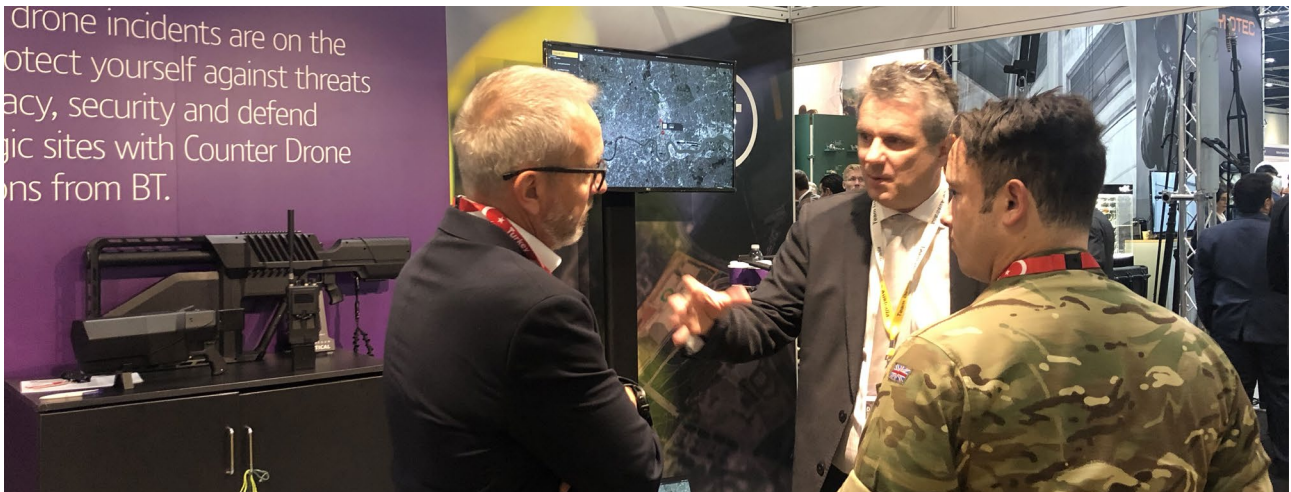


Having won all three publicly announced counterdrone contracts tendered by the Australian military in the last 12 months, the Company believes it is well placed for further business with this customer and is engaging in continuous contact with the Australian DoD in regards to additional contracts. DroneShield's status as the only native Australian counterdrone manufacturer, and the Australian Government's drive to grow its domestic defence industry, further cement DroneShield's ability to continue securing Australian DoD contracts.

*DroneShield's shipment to Australian DoD ready for dispatch*

The United Kingdom – Partnership with BT

During the September 2019 quarter, DroneShield announced a partnership with BT, a global leader in telecommunications solutions with operations in 180 countries, and the largest telecommunications company in the United Kingdom. During the 4Q19 quarter, a dedicated showcase test site for DroneShield's products was established by BT at a decommissioned UK Royal Airforce base. BT's salesforce has made substantial progress in developing the UK pipeline across a number of customer segments, including defence, law enforcement, airports, venues, critical infrastructure and others.



*BT's stand at DSEI exhibition in UK, exhibiting DroneShield's product*

The effect of the partnership is that BT, with its millions of customers in the UK and globally, including, notably, airports and other civil infrastructure, is rolling out an anti-drone service UK-wide, using DroneShield's products and technology. This partnership with BT, coupled with the urgent need for the solution across the UK, opens for DroneShield one of the world's largest anti-drone markets that is also ahead of other countries in adopting anti-drone technologies.



*Video: BT's promotional video for its counterdrone solutions, featuring DroneShield's products*

### Airports

Airports around the world continue to experience drone-related interruptions and have commenced equipment trialling and acquisition processes.

During 3Q19, DroneShield was accepted as a member of ACI (Airports Council International) Europe. ACI Europe represents over 500 airports in 45 European countries, including virtually every major European airport. DroneShield is the only counterdrone company that has been accepted for membership with ACI Europe.

Additionally, DroneShield has been accepted for membership with EUROCAE (European Organisation for Civil Aviation Equipment) in relation to its counterdrone strategy.

In December, DroneShield successfully completed trials of its detection equipment at a Tier 1 West European airport, as part of that airport's procurement process. The trial was closely observed by other airports in the region. Additional major trials are expected shortly.

### **Partnerships**

In addition to sales and other deployments, DroneShield achieved the following key partnerships during the year:

- Bosch, the world leader in security and safety solutions, entered into a partnership with DroneShield in the counterdrone space under the Bosch Integration Partner Program (IPP). Bosch Security and Safety Systems provides a range of surveillance solutions globally and leads with its range and customer adoption of its products across industries, including prison, airport, critical infrastructure, and other sectors. Moving forward, DroneShield will be offering an integrated system for drone detection and mitigation, with DroneShield's products integrated with Bosch's video surveillance products. This product integration of the two companies' offerings has been completed, and the combined solution is available to customers at present.
- Collins Aerospace Systems, a unit of United Technologies (NYSE: UTX) which recently announced a merger with Raytheon (NYSE:RTN), have entered into a Memorandum of Understanding ("MOU") with DroneShield to collaborate on opportunities with the Australian military and globally, with a focus on adding DroneShield's counter-drone capabilities to customers already utilising the broader surveillance systems produced by Collins Aerospace. Collins Aerospace is one of the world's largest suppliers of aerospace and defence products. In Australia, it holds a number of current contracts within the Australian Defence Force.

- Altitude Angel, the world's foremost unmanned traffic management (UTM) provider, also announced a partnership with DroneShield. Altitude Angel enables airport operators (among others) to integrate unmanned vehicles into their controlled airspace. Its traffic management system GuardianUTM (offering enhanced airport safeguarding and automated approvals to fly in controlled airspace) is being deployed by NATS, the UK's main air navigation service provider. Altitude Angel's companion product, GuardianUTM O/S, supports all the functionality required to deliver national-grade drone traffic management capabilities to any country that wishes to safely unlock the potential of drones. A joint offering of the two companies' systems as an integrated product to selected customers will bring 'single-point situational awareness' to managed airspace for users such as national governments and airport operators. This will provide aerodrome towers or those tasked with managing airspace with a clear, single source picture of the sky. By clearly distinguishing between known, authorised operations, and unknown, potential threats, support of effective responses without disrupting authorised activities can be quickly executed.
- The Company continued its active engagement with the Australian and the United States governments, and recently applied for several high-value R&D grants in both countries. It has been receiving the R&D Tax Incentive Grant from the Australian Government for several years, and expects to receive its next Grant shortly, covering the 2019 year.
- Additionally, DroneShield has been selected for a grant-based collaboration program by Defence Innovation Network (DIN), in conjunction with Innovation Connections. NSW Defence Innovation Network (DIN) is a university-led initiative of the NSW Government and the Defence Science and Technology Group to enhance NSW Defence industry capability through collaboration with government and academic research institutions. Supported by seven leading NSW universities, DIN focuses on bringing world-class research capabilities and innovation to the defence sector, supporting the Australian defence export industry. Under the program, DroneShield draws on the NSW universities' resourcing, in combination with its own engineering team, to design and develop a real-time optical drone-detection capability using recent advancements in machine Deep Learning and Convolutional Neural Networks. The collaboration is expected to result in a product that will be taken to market by DroneShield in 1Q-2Q 2020, further enhancing its existing suite of market-leading technologies.

The Company also continues to separately progress its relationship and sales opportunities with Thales, a major defence prime whom it announced a partnership with in late 2018. The BT partnership is covered separately in the Key Themes section.

## Certifications

DroneShield achieved a number of important testing, compliance and certification milestones throughout the year, including:

- RfPatrolTM was assigned a NATO Stock Number ("NSN") in October 2019, following on DroneGun TacticalTM having received an NSN in February 2019. An NSN is a 13-digit numeric code, identifying all the "standardised material items of supply" as they have been recognised by all NATO countries including the United States Department of Defense, and allows for any of the 29 NATO militaries to purchase RfPatrolTM on a "military catalogue" basis, significantly simplifying the procurement process. The NSN was assigned following a request for such assignment from the United States Department of Defense.
- RfPatrolTM has achieved accredited notified body compliance testing from the European Commission Electromagnetic Compatibility Directive 2014/30/EU. Along with compliance to the RoHS and applicable EN60950-1 Safety Directives as required for Article 30 of Regulation (EC) No 765/2008, the RfPatrolTM conforms to the requirements for CE marking for the product to be sold within the European Economic Area (EEA). The certification was obtained in response to DroneShield's European partner and end user feedback, as the product receives a high level of interest not only from military, but also civilian customers.
- In 4Q19, UK Government's Centre for Protection of National Infrastructure ("CPNI") has formally certified DroneShield's DroneSentinelTM multi-sensor counterdrone system. As a result, DroneSentinelTM has been included in the CPNI Catalogue of Security Equipment ("CSE"). CSE forms an approved list of products for deployment across various critical infrastructure customers in the UK, such as airports, stadiums, and other key sites. CPNI's certification is effectively the world's first formal Government certification in the industry, substantially reducing the procurement cycle in the nascent counterdrone space by giving prospective customers certainty of product quality. The Company expects this certification to drive significant additional end customer interest in the UK and also globally.

## Marketing

During 2019 and subsequently, DroneShield (directly or with its partners) participated in a number of high-profile events focusing on various customer market segments, including military and airports.

Importantly from effectiveness and cost saving perspective, DroneShield continues to be invited by the Australian Team Defence Australia (TDA) to high-profile exhibitions globally. TDA is a joint effort with the Australian Department of Defence and Austrade.



*DroneShield's DroneGun Tactical™ on display at the Ministry of Interior of Kingdom of Saudi Arabia stand at GITEX exhibition in Dubai*

The Company continues to work with its third-party partners across its sales partner network in approximately 70 countries, as well as its R&D and manufacturing partners to complement its in-house team, optimising its capital expenditure.

DroneShield continues to attract a significant amount of media interest globally.

**ROTOR TORQUE**  
ROB RICH

## Drone shield

**Forces move to defend against 'hostile' UAVs**

Armed forces and police services have purchased a number of DroneShield anti-drone devices. DRONESHIELD



**'In fewer than five years the Asia Pacific**

**Has the war of the drones started?**

The explosive expansion of the drone industry, driven by stunning technical innovations, has caught the global regulators off guard. Developers

In addition, 140,311 pilots were certified for beyond visual line of sight operations.

Global regulators are now struggling to combat criminal or

*Australian Aviation Magazine article*

DroneShield also continues to position itself as a thought leader in the counterdrone space. *Defence Connect* (a major Australian defence publication) podcast with DroneShield's CEO Oleg Vornik is available here:



*Podcast: Defence Connect interview with DroneShield's CEO Oleg Vornik*

### Intellectual Property

DroneShield holds several current counterdrone patents and is progressing the registration process in relation to several additional patents globally.

The Company does not file patents for all of its inventions, due to the requirement to publish the "secret sauce" as part of a patent filing.

### Principal Activities

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

### Significant Changes in the State of Affairs

Other than discussed in the Review of Operations above, there have been no significant changes in the state of affairs of the Company during the year ended 31 December 2019.



### Non-audit services

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

Details of the amounts paid or payable to the auditor (HLB Mann Judd Assurance (NSW) Pty Ltd) for audit and non-audit services provided during the year are outlined in Note 26 to the financial statements.

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

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

### Auditor's Independence Declaration

A copy of the auditor's independence declaration as required under the Section 307C of the *Corporations Act 2001* is set out on page 40.

## Directors' Report- Remuneration Report (audited)

### Executive remuneration governance

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

### Remuneration committee

Due to the size and nature of the existing Board and the magnitude of the Company's operations, the Company does not currently have a Remuneration Committee. In accordance with the Company's Corporate Governance Plan, which is available on the Company's website <https://www.droneshield.com/investors>, the full Board currently carries out the duties that would ordinarily be assigned to the Remuneration Committee under the written terms of reference for that committee.

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

### Directors' remuneration

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

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

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

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

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

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

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

### Executive remuneration framework

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

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

## Directors' Report- Remuneration Report *continued*

### Executive remuneration framework *continued*

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

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

### KMP remuneration disclosures in detail

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

Name	Position	Effective date
<b>Non-Executive Directors</b>		
Peter James	Independent Non-Executive Chairman	Executive Chairman until 24 January 2017. Returned to Independent Non-Executive Chairman 24 January 2017.
Robert Clisdell	Non-Executive Director	Appointed 24 January 2017. Resigned 16 January 2020.
Bradley Buswell	Independent Non-Executive Director	Appointed 29 December 2017. Resigned 3 October 2019.
Jethro Marks	Independent Non-Executive Director	Appointed 16 January 2020.
<b>Executive Director</b>		
Oleg Vornik	Executive Director, Managing Director and CEO	Appointed as CEO and Managing Director 24 January 2017.

## Directors' Report- Remuneration Report *continued*

### Shareholdings of KMP

The number of shares in the Company and subsidiary held during the financial year by each Director of DroneShield and other KMP (of which there are none), including their personally related entities, are set out in the following table:

31 December 2019	Opening balance (Number)	(a) Received during the year on exercise of options (Number)	Other changes during the year (Number)	Balance at 31 December 2019 (Number)
<b>Non-Executive Directors</b>				
Peter James	670,435	2,500,000	-	3,170,435
Robert Clisdell	245,435	500,000	-	745,435
Bradley Buswell	-	1,400,000	-	(b)
<b>Executive Director</b>				
Oleg Vornik	270,435	3,700,000	-	3,970,435
<b>Total</b>	<b>1,186,305</b>	<b>8,100,000</b>	<b>-</b>	<b>7,886,305</b>

### Notes

- (a) The options exercised during the year were exercised using limited recourse loans provided by the Company. The loans are interest free and due for repayment by September 2024. The loans are non-recourse except against the shares issued on exercise of the options and are held by the Director to which the loan relates.
- (b) Bradley Buswell resigned as a director on 3 October 2019 and therefore his share holdings are no longer shown in the table above as he no longer is a member of key management personnel.

31 December 2018	Opening balance (Number)	Received during the year on exercise of options (Number)	Other changes during the year (Number)	Balance at 31 December 2018 (Number)
<b>Non-Executive Directors</b>				
Peter James	313,292	250,000	107,143	670,435
Robert Clisdell	100,792	37,500	107,143	245,435
Bradley Buswell	-	-	-	-
<b>Executive Director</b>				
Oleg Vornik	113,292	50,000	107,143	270,435
<b>Total</b>	<b>527,376</b>	<b>337,500</b>	<b>321,429</b>	<b>1,186,305</b>

## Directors' Report- Remuneration Report *continued*

### Share options held by KMP

31 December 2019	Opening balance (Number)	Granted as compensation (Number)	Options lapsed (Number)	(a)(b) Options exercised (Number)	Balance at 31 December 2019 (Number)	Vested Options December 2019 (Number)	Unvested Options December 2019 (Number)
<b>Non-Executive Directors</b>							
Peter James	11,100,000	795,000	(2,000,000)	(2,500,000)	7,395,000	-	7,395,000
Robert Clisdell	2,100,000	195,000	-	(500,000)	1,795,000	-	1,795,000
Bradley Buswell	1,800,000	-	-	(1,400,000)	(c)	-	(c)
<b>Executive Director</b>							
Oleg Vornik	16,900,000	1,500,000	(800,000)	(3,700,000)	13,900,000	-	13,900,000
<b>Total</b>	<b>31,900,000</b>	<b>2,490,000</b>	<b>(2,800,000)</b>	<b>(8,100,000)</b>	<b>23,090,000</b>	<b>-</b>	<b>23,090,000</b>

### Notes

- (a) The options exercised during the year were exercised using limited recourse loans provided by the Company. The loans are interest free and due for repayment by September 2024. The loans are non-recourse except against the shares issued on exercise of the options and are held by the Director to which the loan relates.
- (b) The options exercised during the year by Directors were exercised at \$0.30 per share.
- (c) Bradley Buswell resigned as a director on 3 October 2019 and therefore his option holdings are no longer shown in the table above as he no longer is a member of key management personnel.

31 December 2018	Opening balance (Number)	Granted as compensation (Number)	Other option acquisitions (Number)	Options exercised (Number)	Balance at 31 December 2018 (Number)	Vested Options December 2018 (Number)	Unvested Options December 2018 (Number)
<b>Non-Executive Directors</b>							
Peter James	4,750,000	6,600,000	-	(250,000)	11,100,000	4,500,000	6,600,000
Robert Clisdell	537,500	1,600,000	-	(37,500)	2,100,000	500,000	1,600,000
Bradley Buswell	-	1,800,000	-	-	1,800,000	700,000	1,100,000
<b>Executive Director</b>							
Oleg Vornik	4,550,000	12,400,000	-	(50,000)	16,900,000	3,700,000	13,200,000
<b>Total</b>	<b>9,837,500</b>	<b>22,400,000</b>	<b>-</b>	<b>(337,500)</b>	<b>31,900,000</b>	<b>9,400,000</b>	<b>22,500,000</b>

## Directors' Report- Remuneration Report *continued*

### Performance based remuneration granted and exercised during the year

	31 December 2019		31 December 2018	
	(a) Value granted \$	(b) Value exercised \$	(a) Value granted \$	(b) Value exercised \$
<b>Non-Executive Directors</b>				
Peter James	141,906	750,000	1,188,000	55,000
Robert Clisdell	36,349	150,000	336,000	8,250
Bradley Buswell	-	420,000	209,408	-
<b>Executive Directors</b>				
Oleg Vornik	267,747	1,110,000	2,356,000	11,000
<b>Total</b>	<b>446,002</b>	<b>2,430,000</b>	<b>4,089,408</b>	<b>74,250</b>

### Notes

- (a) The value at grant date is calculated using the Black Scholes Model.  
 (b) The value of the options exercised is calculated using the exercise price.

### Terms and conditions of the share-based payment arrangements

The terms and conditions of each grant of options affecting remuneration in the current or a future reporting period are as follows:

Class of Options issued during 2019	Number of Options	Grant date	Vesting date	Expiry date	Exercise Price	Value per option at grant date \$	Performance achieved	% Vested during 2019
ZEPO	1,147,500	12-Dec-19	(a)	30-Nov-22	-	0.2550	determined to be	n/a
ZEPO	97,500	17-Dec-19	(a)	30-Nov-22	-	0.2650	determined to be	n/a
Q	382,500	12-Dec-19	30-Nov-20	30-Jun-23	0.65	0.1020	determined to be	n/a
Q	32,500	17-Dec-19	30-Nov-20	30-Jun-23	0.65	0.1078	determined to be	n/a
Q	382,500	12-Dec-19	30-Nov-21	30-Jun-23	0.65	0.1020	determined to be	n/a
Q	32,500	17-Dec-19	30-Nov-21	30-Jun-23	0.65	0.1078	determined to be	n/a
Q	382,500	12-Dec-19	30-Nov-22	30-Jun-23	0.65	0.1020	determined to be	n/a
Q	32,500	17-Dec-19	30-Nov-22	30-Jun-23	0.65	0.1078	determined to be	n/a

### Notes

- (a) Zero Price ("Zepo") options are subject to the following vesting conditions being satisfied: DroneShield achieving \$20m revenue or customer cash receipts (excluding any revenue or customer cash receipts which are applied towards satisfaction of the vesting condition attaching to the Tranche 1 Zepos) in any 12-month period within 36 months of the date of issue of the Options; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months.

## Directors' Report- Remuneration Report *continued*

### *Terms and conditions of the share-based payment arrangements continued*

Class of Options issued during 2018	Number of Options	Grant date	Vesting date	Expiry date	Exercise Price	Value per option at grant date \$	Performance achieved	% Vested
F	700,000	3-Jun-18	22-Jun-18	22-Jun-21	0.30	0.089	100% to be determined	100%
G	700,000	3-Jun-18	29-Mar-19	29-Mar-22	0.30	0.1015	to be determined	n/a
ZEPO	12,400,000	5-Jun-18	(a)	15-Aug-21	-	0.19	to be determined	n/a
ZEPO	6,600,000	7-Jun-18	(a)	15-Aug-21	-	0.18	to be determined	n/a
ZEPO	400,000	11-Jun-18	(a)	15-Aug-21	-	0.19	determined	n/a

### Notes

- (a) During the current year, the vesting conditions for Tranche 1 Zero Price options (Zepos) were amended. Tranche 1 Zepos will vest and become exercisable into Shares for nil consideration at any time on and from the earlier of the date the Company achieves \$10m of revenue or the date the Company achieves \$10m of customer cash receipts in any rolling twelve month period within 36 months of the date of issue of the Options; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction.

### *Remuneration details of KMP*

31 December 2019	Salary and fees \$	Cash bonus \$	Post-employment benefits \$	Termination payment \$	(a) Share based payments (options) \$	Total \$
<b>Non-Executive Directors</b>						
Peter James	100,000	-	-	-	380,773	480,773
Robert Clisdell	30,000	-	-	-	108,010	138,010
Bradley Buswell	-	-	-	-	83,984	83,984
<b>Executive Director</b>						
Oleg Vornik	303,135	-	27,484	-	770,674	1,101,293
<b>Total</b>	<b>433,135</b>	<b>-</b>	<b>27,484</b>	<b>-</b>	<b>1,343,441</b>	<b>1,804,060</b>

### Notes

- (b) Zero Price ("Zepo") options are subject to the following vesting conditions being satisfied: DroneShield achieving \$20m revenue or customer cash receipts (excluding any revenue or customer cash receipts which are applied towards satisfaction of the vesting condition attaching to the Tranche 1 Zepos) in any 12-month period within 36 months of the date of issue of the Options; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months.

## Directors' Report- Remuneration Report *continued*

### Remuneration details of KMP *continued*

31 December 2018	Salary and fees \$	Cash bonus \$	Post-employment benefits \$	Termination payment \$	(a) Share based payments (options) \$	Total \$
<b>Non-Executive Directors</b>						
Peter James	100,000	-	-	-	205,615	305,615
Robert Clisdell	30,000	-	-	-	56,518	86,518
Bradley Buswell	39,325	-	-	-	125,425	164,750
<b>Executive Director</b>						
Oleg Vornik	225,921	-	-	-	411,022	636,943
<b>Total</b>	<b>395,246</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>798,580</b>	<b>1,193,826</b>

### Notes

- (b) During the current year, the vesting conditions for Tranche 1 Zero Price options were amended. Tranche 1 Zepos will vest and become exercisable into Shares for nil consideration at any time on and from the earlier of the date the Company achieves \$10m of revenue or the date the Company achieves \$10m of customer cash receipts in any rolling twelve month period within 36 months of the date of issue of the Options; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months.

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

	Fixed		Performance	
	2018	2019	2018	2019
<b>Non-Executive Directors</b>				
Peter James	33%	21%	67%	79%
Robert Clisdell	35%	22%	65%	78%
Bradley Buswell	24%	n/a	76%	100%
<b>Executive Director</b>				
Oleg Vornik	35%	31%	65%	69%

The performance component of remuneration received by Directors relates to share options. The issue of share options to Directors is subject to shareholder approval. Remuneration in the form of DroneShield share options is used as a tool to align KMP remuneration with shareholder interests.

## Directors' Report- Remuneration Report *continued*

The employment agreement of the Executive Director during the year included the following key terms:

Name	Positions held during the year	Key terms of employment agreement
Oleg Vornik	CEO and Managing Director	<ul style="list-style-type: none"> <li>- Base remuneration of US\$197,200 p.a. from 1 January 2019 to 7 March 2019 (translated to \$275,506 p.a. at the average exchange rate)</li> <li>- Base remuneration of \$330,000 p.a. from 8 March 2019 to 31 December 2019</li> <li>- Eligible to participate in short term incentive program</li> <li>- Eligible to participate in long term incentive program</li> <li>- A notice period of 3 months, except in defined circumstances</li> <li>- No fixed term</li> </ul>

### Advisory Board remuneration

During the year, the Advisory Board included one individual who was remunerated as follows:

	Salary and Fees \$	Share based payments (options) \$	Total \$
<b>31 December 2019</b>			
Hon. Jay M Cohen	-	60,646	60,646
<b>Total</b>	-	<b>60,646</b>	<b>60,646</b>

	Salary and Fees \$	Share based payments (options) \$	Total \$
<b>31 December 2018</b>			
Hon. Jay M Cohen	-	-	-
Dr Samantha Ravich	-	-	-
<b>Total</b>	-	-	-

End of Remuneration Report.

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



Peter James  
Independent Non-Executive Chairman

Sydney, NSW  
26 February 2020



### **Auditor's Independence Declaration to DroneShield Limited**

As lead auditor for the audit of the consolidated financial report of DroneShield Limited for the year ended 31 December 2019, I declare that, to the best of my knowledge and belief, there have been no contraventions of:

- (a) the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and
- (b) any applicable code of professional conduct in relation to the audit.

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

A handwritten signature in black ink, appearing to read 'A G Smith'.

**Sydney, NSW  
26 February 2020**

**A G Smith  
Director**

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HLB Mann Judd is a member of HLB International, the global advisory and accounting network.

## Consolidated Statement of Profit or Loss and Other Comprehensive Income

	Note	31 December 2019 \$	31 December 2018 \$
<b>Revenue</b>	<b>3</b>	<b>3,617,488</b>	<b>1,207,203</b>
Other gains (losses)	4	(2,904)	(21,257)
Cost of sales		(1,610,636)	(511,454)
Product development expense		(3,177,227)	(2,190,863)
Sales and customer service expense		(1,896,707)	(1,052,993)
Corporate and support expense	5	(2,862,926)	(2,566,375)
Corporate governance expense	6	(495,342)	(473,718)
Share based payment expense	8	(1,752,177)	(1,124,193)
<b>Loss before income tax</b>		<b>(8,180,431)</b>	<b>(6,733,650)</b>
Income tax benefit	7	485,351	397,550
<b>Loss after income tax</b>		<b>(7,695,080)</b>	<b>(6,336,100)</b>
Other comprehensive income:			
<i>Items that may be reclassified to profit or loss</i>			
Adjustments on translation of foreign controlled entity		(21,800)	(16,366)
<b>Total comprehensive loss for the period</b>		<b>(7,716,880)</b>	<b>(6,352,466)</b>
Basic loss per share	20	(0.04)	(0.04)
Diluted loss per share	20	(0.04)	(0.04)

The above Consolidated Statement of Profit or Loss and Other Comprehensive Income should be read in conjunction with the accompanying notes.

## Consolidated Statement of Financial Position

	Note	31 December 2019 \$	31 December 2018 \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	9	5,485,000	1,229,499
Trade and other receivables	10	1,581,432	1,289,690
Inventories	11	725,920	642,502
<b>Total current assets</b>		<b>7,792,352</b>	<b>3,161,691</b>
<b>Non-current assets</b>			
Plant, equipment and intangible assets	12	1,158,642	806,251
Right-of-use assets	13	427,579	-
<b>Total non-current assets</b>		<b>1,586,221</b>	<b>806,251</b>
<b>Total assets</b>		<b>9,378,573</b>	<b>3,967,942</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade payables		397,993	184,317
Provisions	14	182,583	127,926
Other liabilities	15	1,666,940	1,593,358
Borrowings	16	32,707	-
Lease Liabilities	17	118,528	-
<b>Total current liabilities</b>		<b>2,398,751</b>	<b>1,905,601</b>
<b>Non-current liabilities</b>			
Lease Liabilities	17	328,709	-
<b>Total non-current liabilities</b>		<b>328,709</b>	<b>-</b>
<b>Total liabilities</b>		<b>2,727,460</b>	<b>1,905,601</b>
<b>Net assets (deficiency)</b>		<b>6,651,113</b>	<b>2,062,341</b>
<b>EQUITY</b>			
Share capital	18	21,012,607	11,628,172
Reserves		6,135,277	7,342,857
Accumulated losses		(20,496,771)	(16,908,688)
<b>Total equity (deficiency)</b>		<b>6,651,113</b>	<b>2,062,341</b>

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

## Consolidated Statement of Changes in Equity

	Contributed equity \$	Options reserve \$	Foreign currency translation reserve \$	Accumulated losses \$	Total equity \$
<b>Balance at 1 January 2018</b>	<b>7,533,586</b>	<b>5,941,579</b>	<b>16,076</b>	<b>(10,572,588)</b>	<b>2,918,653</b>
Transfer from option reserve to accumulated losses	-	-	-	-	-
<i>Transactions with owners in their capacity as owners:</i>					
Options exercised	306,711	-	-	-	306,711
Options issued	-	1,124,193	-	-	1,124,193
Contributions of equity, net of transaction costs	3,787,875	277,375	-	-	4,065,250
	<u>4,094,586</u>	<u>1,401,568</u>	<u>-</u>	<u>-</u>	<u>5,496,154</u>
Exchange difference on translation of foreign operations	-	-	(16,366)	-	(16,366)
Loss for the period	-	-	-	(6,336,100)	(6,336,100)
Total comprehensive loss for the period	-	-	(16,366)	(6,336,100)	(6,352,466)
<b>Balance at 31 December 2018</b>	<b>11,628,172</b>	<b>7,343,147</b>	<b>(290)</b>	<b>(16,908,688)</b>	<b>2,062,341</b>
<b>Balance at 1 January 2019</b>	<b>11,628,172</b>	<b>7,343,147</b>	<b>(290)</b>	<b>(16,908,688)</b>	<b>2,062,341</b>
Transfer from option reserve to accumulated losses	-	(4,106,997)	-	4,106,997	-
<i>Transactions with owners in their capacity as owners:</i>					
Options exercised	417,159	-	-	-	417,159
Options issued	-	1,752,177	-	-	1,752,177
Contributions of equity, net of transaction costs	8,967,276	1,169,040	-	-	10,136,316
	<u>9,384,435</u>	<u>2,921,217</u>	<u>-</u>	<u>-</u>	<u>12,305,652</u>
Exchange difference on translation of foreign operations	-	-	(21,800)	-	(21,800)
Loss for the period	-	-	-	(7,695,080)	(7,695,080)
Total comprehensive loss for the period	-	-	(21,800)	(7,695,080)	(7,716,880)
<b>Balance at 31 December 2019</b>	<b>21,012,607</b>	<b>6,157,367</b>	<b>(22,090)</b>	<b>(20,496,771)</b>	<b>6,651,113</b>

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

## Consolidated Statement of Cash Flows

	Note	31 December 2019 \$	31 December 2018 \$
<b>Cash flows from operating activities</b>			
Receipts from customers		3,162,838	1,252,123
Other receipts		-	52,690
Payments to suppliers and employees		(8,744,543)	(6,261,571)
Research and Development Tax and other incentives received		582,224	505,867
<b>Net cash flows from (used in) operating activities</b>	<b>28</b>	<b>(4,999,481)</b>	<b>(4,450,891)</b>
<b>Cash flows from investing activities</b>			
Purchase of plant and equipment		(1,044,592)	(1,059,704)
<b>Net cash flows from (used in) investing activities</b>		<b>(1,044,592)</b>	<b>(1,059,704)</b>
<b>Cash flows from financing activities</b>			
Interest income on cash deposits		35,702	30,603
Proceeds from option exercise		417,159	306,711
Proceeds from share and option issue		10,849,696	4,251,801
Proceeds from borrowings		500,000	-
Repayment of borrowings		(500,000)	-
Borrowings transaction costs		(155,580)	-
Payments for lease liabilities		(94,592)	-
Share issue transaction costs		(719,230)	(163,376)
<b>Net cash flows from (used in) financing activities</b>		<b>10,333,155</b>	<b>4,425,739</b>
<b>Cash and cash equivalents at beginning of period</b>		<b>1,229,499</b>	<b>2,362,894</b>
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>4,289,082</b>	<b>(1,084,856)</b>
<b>Exchange rate adjustments to balances held in foreign currencies</b>		<b>(33,581)</b>	<b>(48,539)</b>
<b>Cash and cash equivalents at the end of the year</b>	<b>9</b>	<b>5,485,000</b>	<b>1,229,499</b>

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

# Notes to the Financial Statements

## Corporate Information

The consolidated financial report of DroneShield Limited (“the Company”) and its controlled entities (“DroneShield” or “the Group”) for the year ended 31 December 2019 was authorised for issue in accordance with a resolution of the Directors on 26 February 2020.

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

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

## Statement of compliance

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

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

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

## 1. Summary of Significant Accounting Policies

### (a) Basis of preparation

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

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

### Going Concern

During the year ended 31 December 2019, the Group incurred losses of \$7,695,080 and net cash outflows from operating activities of \$4,999,481, with cash on hand at 31 December 2019 of \$5,485,000.

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

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

The Directors believe that there are reasonable grounds to believe that the Group will continue as a going concern post the 12-month period to February 2021, after consideration of the following factors:

- the Group expects to generate increased revenues from the sale of its products within the next 12 months and beyond;
- the Company has the ability to issue additional shares to raise further working capital and has been successful in doing this previously, as evidenced by the successful capital raising completed during financial year ended 31 December 2016, in June and October 2017, in March and November 2018, and in February and August 2019, including a \$9.55 million raise in August 2019 which reshaped the investor register bringing several institutional investors on-board;
- R&D and product development constitute a substantial part of the Company’s costs. The Company has applied for, and may apply for further, non-dilutive governmental grants. If such grants are awarded, the Company’s R&D and product development costs may be funded, in whole or in part, using such non-dilutive grants. The Company has already received \$485,351 in 2019 for the 2018 R&D activities and will be submitting a claim for the 2019 R&D activities;

## Notes to the Financial Statements *continued*

- As previously disclosed, the Company has undertaken a review of its strategic options. This type of review may result in a range of transactions, including, without limitation, a partnership with a larger industry participant with more substantial financial resources, a fund-raising, and/or a M&A transaction;
- The Company has approximately 20 million options excluding Zero Price Options. If in-the-money, exercise of these options is expected to bring additional proceeds to the Company.
- If required, the Group also has the ability to scale down its operations in order to curtail expenditure in the event insufficient cash is available to meet projected expenditure.

### (b) Principles of consolidation

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

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

### (c) Foreign currency translation

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

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

### (d) Revenue recognition

The Group recognises revenue from the following major sources:

- Sale of hardware
- Subscription services

Revenue is measured based on the consideration specified in a contract with a customer. The Group recognises revenue when it transfers control of a product or service to a customer.

#### *Sale of hardware*

The Group sells hardware to distributors and directly to customers. Sales-related warranties associated with hardware cannot be purchased separately and they serve as an assurance that the products sold comply with agreed-upon specifications. Accordingly, the Group accounts for warranties in accordance with AASB 137 Provisions, Contingent Liabilities and Contingent Assets consistent with its previous accounting treatment.

For sales of hardware to distributors, revenue is recognised when control of the hardware has transferred, being when the hardware has been shipped to the distributor's specified location (delivery) and collected from Customs by the distributor. Following delivery, the distributor has full discretion over the manner of distribution and price to sell the hardware, has the primary responsibility when on-selling the goods and where there is a risk of obsolescence and loss in relation to the goods. A receivable is recognised by the Group when the hardware is delivered to the distributor as this represents the point in time at which the right to consideration becomes unconditional, as only the passage of time is required before payment is due.

Contracts with customers have a variable sales element, dependent on volume sold. Currently, revenue from sales is fixed with no variable consideration. Contracts do not include financing components.

For sales directly to customers, revenue is recognised when control of the hardware has transferred to the customer, being at the point the hardware is delivered to the customer. Delivery occurs when the goods have been shipped to the customer's specified location. A receivable is recognised by the Group when the hardware is delivered to the customer as this represents the point in time at which the right to consideration becomes unconditional, as only the passage of time is required before payment is due.

As shipping income is directly related to the sale of hardware, it is not seen as a separate performance obligation and is recognised as and when the related hardware sale is recognised.

## Notes to the Financial Statements *continued*

Outside of warranties, customers do not have the right to return hardware sold therefore no “right to returned goods asset” is recognised.

### *Subscription services*

The Group provides a subscription service for software updates. Such services are recognised as a performance obligation satisfied over time.

The transaction price allocated to these services is recognised as deferred revenue at the time of the initial sales transaction and is released on a straight-line basis over the period of service

### *Interest income*

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

### **(e) Income tax**

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

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

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

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

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

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

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

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

### **(f) Goods and services and other value-added taxes (“GST”)**

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

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

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

### **(g) Cash and cash equivalents**

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

## Notes to the Financial Statements *continued*

### (h) Trade and other receivables

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

Payment for hardware sales and subscription services are due from the customer on the date the invoice is issued. Contracts do not include financing components.

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

The Group applies the AASB 9 simplified approach to measuring expected credit losses which uses a lifetime expected loss allowance for all trade receivables. To measure the expected credit losses, trade receivables have been grouped based on shared credit risk characteristics and the days past due. The expected loss rates are based on the payment profiles of sales over a period of 36 months before 31 December 2019 or 1 January 2019 respectively and the corresponding historical credit losses experienced within this period.

### (i) Trade and other payables

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

### (j) Inventories

Inventories are stated at the lower of cost and net realisable value. Costs of ordinarily interchangeable items are assigned using the average cost method. Net realisable value is the estimated selling price in the ordinary course of business less any applicable selling expenses.

### (k) Leases

The Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, and subsequently at cost less accumulated depreciation and impairment losses and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently increased by the interest cost on the lease liability and decreased by the lease payment made. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised.

The Group has applied judgement to determine the lease term for some lease contracts in which it is a lessee that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognised.

For short-term leases (lease term of 12 months or less) and leases of low-value assets the Group will recognise a lease expense on a straight-line.

### (l) Employee benefits

#### *Wages, salaries and annual leave*

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

#### *Long service leave*

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

## Notes to the Financial Statements *continued*

### *Post-employment benefits*

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

### (m) Provisions, contingent liabilities and contingent assets

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

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

### (n) Contributed equity

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

### (o) Plant and equipment

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

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

Office equipment	2 - 5 years
Plant & Equipment	2 - 5 years
Demonstration equipment	2 years

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

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

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

### (p) Intangible assets

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

### (q) Earnings per share

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

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

### (r) Research and development

Research is the original and planned investigation undertaken with the prospect of gaining new knowledge and understanding. Development is the application of research findings to a plan or design for the production of new or substantially improved processes or products prior to the commencement of commercial production. Research costs are expensed as they are incurred.

## Notes to the Financial Statements *continued*

### (s) Share-based payments

Share based compensation benefits are provided to employees via an Employee Option Plan. Information in relation to this plan is set out in Note 8.

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

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

### (t) Impairment of assets

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

### (u) Segment reporting

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

### (v) Comparative disclosures

Where appropriate, comparative disclosures have been reclassified/amended to be consistent with the current year's presentation.

### (w) New accounting standards and interpretations

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

In the current year, the Group adopted AASB 16 Leases from 1 January 2019 and has not restated comparatives for the 2018 reporting period, as permitted under the specific transition provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019. The new accounting policies are disclosed in note 1(k).

AASB 16 Leases, did not have any impact on the amounts recognised in prior periods.

On adoption of AASB 16, the Group recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of AASB 117 Leases.

In applying AASB 16 for the first time, the Group used the following practical expedient permitted by the standard:

- Accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases.

As all operating leases had a lease term of less than 12 months at 1 January 2019, there was no impact on opening accumulated losses at 1 January 2019.

## Notes to the Financial Statements *continued*

The Group has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date, the Group relied on its assessment made applying AASB117 and interpretation 4 *Determining whether an Arrangement contains a Lease*.

<b>Measurement of lease liabilities as at 1 January 2019</b>	<b>2019</b>
Operating lease commitments disclosed as at 31 December 2018	136,931
Add: finance lease liabilities recognised as at 31 December 2018	-
(Less): short-term leases not recognised as a liability	(136,931)
(Less): Low-value leases not recognised as a liability	-
Add / (less): contracts reassessed as lease contracts	-
Add / (less): adjustments as a result of a different treatment of extension and termination options	-
Add / (less): adjustments relating to changes in the index or rate affecting variable payments	-
<b>Lease liability recognised as at 1 January 2019</b>	<b>-</b>

There are no other Accounting Standards or interpretations that have been published, but not yet mandatory, that are expected to have a material impact on the Group.

### 2. Critical accounting judgements, estimates and assumptions

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

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

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

#### *Licence and patent expenses*

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

#### *Share based payments*

The Group measures the cost of equity settled transactions by reference to the fair value of the equity instruments at the date they are granted. The accounting estimates and assumptions relating to equity-settled share-based payments would have no impact on the carrying amounts of assets and liability within the next annual reporting period but may impact profit or loss and equity. Details of the key assumptions used are set out in Note 8.

#### *Inventories*

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

#### *Demonstration Units*

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

#### *Leases*

Management estimates the Group's incremental borrowing rate which is used as the discount rate to calculate the present value of the lease payments that are not paid at the commencement date.

Judgement is also applied by management to determine the lease term for some lease contracts, in which it is a lessee, that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognised.

## Notes to the Financial Statements *continued*

	31 December 2019 \$	31 December 2018 \$
<b>3. Revenue</b>		
Subscription services	1,699	38,256
Hardware sales	3,131,124	894,095
Shipping revenue	83,973	21,506
Demonstration revenue	72,689	-
<b>Total revenue from sales</b>	<b>3,289,485</b>	<b>953,857</b>
<p>The Group derives its revenue from the transfer of goods and services over time and at a point in time. This is consistent with the revenue information that is disclosed for each reportable segment. (see Note 27).</p>		
<b>Timing of revenue recognition</b>		
<b>At a point in time</b>		
Hardware sales including shipping income		
- <i>direct sales</i>	1,483,330	52,803
- <i>distributors</i>	1,804,456	862,798
<b>Over time</b>		
Subscription services		
- <i>distributors</i>	1,699	38,256
<b>Total revenue from sales</b>	<b>3,289,485</b>	<b>953,857</b>
<b>Other revenue</b>		
Awards and incentives revenue	96,873	94,956
Interest revenue	35,702	32,261
Other revenue	128,888	38,766
Sublease revenue	66,540	87,363
<b>Total other revenue</b>	<b>328,003</b>	<b>253,346</b>
<b>Total revenue</b>	<b>3,617,488</b>	<b>1,207,203</b>
<b>4. Other gains (losses)</b>		
Net foreign exchange gains (losses)	(2,904)	(21,257)
<b>Total other gains (losses)</b>	<b>(2,904)</b>	<b>(21,257)</b>
<b>5. Corporate and support expense</b>		
Office costs and communication	401,390	326,896
Payroll	1,060,964	815,445
Legal	200,897	655,307
Travel and entertainment	90,041	136,689
Professional expenses	628,337	524,486
Other	481,297	107,552
<b>Total corporate and support expense</b>	<b>2,862,926</b>	<b>2,566,375</b>

## Notes to the Financial Statements *continued*

	31 December 2019 \$	31 December 2018 \$
<b>6. Corporate governance expense</b>		
Audit	62,106	63,663
Board and Advisory Board expenses	129,993	182,302
Professional expenses	38,980	50,467
Insurance	91,117	72,382
ASX fees	126,674	82,670
Other	46,472	22,234
<b>Total corporate governance expense</b>	<b>495,342</b>	<b>473,718</b>

### 7. Income taxes relating to continuing operations

The components of tax recognised in profit or loss include:

Current tax	-	-
Deferred tax	-	-
Research and Development Tax Incentive <sup>5</sup>	(485,351)	(397,550)
<b>Total tax expense/(credit)</b>	<b>(485,351)</b>	<b>(397,550)</b>

The income tax for the year can be reconciled to the accounting profit as follows:

Income tax expense/ (credit) calculated at 27.5%	(2,249,619)	(1,851,754)
Tax effect of amounts which are not deductible (taxable)	481,849	313,986
Research and Development Tax Incentive	(485,351)	(397,550)
Effect of unused tax losses not recognised as deferred tax assets	1,767,770	1,537,768
Income tax expense/ (credit) recognised in profit or loss (relating to continuing operations)	<b>(485,351)</b>	<b>(397,550)</b>

The tax rate used for the 2019 and 2018 reconciliations above is the corporate tax rate of 27.5% payable by DroneShield Limited on taxable profits under Australian tax law.

The Company has unused tax losses of \$6,847,703 (2018: \$5,079,933). The benefit of these losses will only be recognised where it is probable that future taxable profit will be available against which the benefit of the deferred tax asset can be utilised. The deferred tax asset not recognised in relation to these tax losses is \$1,883,118 (2018: \$1,396,982).

<sup>5</sup> A tax credit of \$485,351 was received in the current year in relation to expenses incurred in the 31 December 2018 financial year.

## Notes to the Financial Statements *continued*

### 8. Options issued

During the year ended 31 December 2019, a number of options were issued to Directors, management and other employees of the Group as well as to brokers participating in the Share Placements that occurred in February and August 2019. Using the Black Scholes Model, the fair value of each option is as set out below and based on the following criteria/assumptions. The options below were issued at various dates between January and December 2019.

Options Issued 31 December 2019	Class G Options	Class K Options	Class M Options	Class N Options	Class O Options <sup>1</sup>	Class P Options	Class Q Options	Class R Options <sup>2</sup>	Zero Price Options <sup>3</sup>	Other Options <sup>4</sup>	Total option expense for the year <sup>5</sup>
<b>No of new options</b>	200,000	450,000	175,000	175,000	2,825,425	1,050,000	5,200,000	10,000,000	5,200,000		
<b>Expiry (years)</b>	3	2.75	2.93	3.93	2	2.82	3.54	2.63	3		
<b>Exercise price (\$)</b>	0.3	0.50	0.20	0.20	0.22	0.40	0.65	0.40	0		
<b>Vesting period (years)</b>	-	-	-	0.69	-	0.47	1.96	-	3		
<b>Underlying volatility</b>	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	87.7%	n/a		
<b>Average risk-free interest rate</b>	1.53%	0.78%	0.81%	0.83%	1.72%	0.78%	0.83%	1.72%	n/a		
<b>Average calculated fair value of each option (\$)</b>	0.0344	0.1659	0.1297	0.1434	0.0352	0.1467	0.1091	0.1118	0.2671		
<b>Total expense recorded for the period ended 31 December 2019 (\$)</b>	6,881	76,496	17,436	15,302	-	100,400	15,761	-	20,704	1,499,197	1,752,177

<sup>1</sup> Class O options were issued to brokers as part of the February 2019 capital raise and included as part of share transaction costs and treated as a deduction from equity (of \$99,344 see Note 18).

<sup>2</sup> Class R options were issued to brokers as part of the August 2019 capital raise and included as part of share transaction costs and treated as a deduction from equity (of \$1,118,195 see Note 18).

<sup>3</sup> Zero Price ("Zepo") options are subject to the following vesting conditions being satisfied: DroneShield achieving \$20,000,000 of revenue or customer cash receipts (excluding any revenue or customer cash receipts which are applied towards satisfaction of the vesting condition attaching to the Tranche 1 Zepos; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months.

<sup>4</sup> \$1,499,197 relates to the vesting expense from options issued in prior periods, comprising option expense for Tranche 1 Zepos, Classes G, H, M and N (issued in 2018), and H (issued in 2016). Refer to 2018 Annual Report for details of options issued in prior periods.

<sup>5</sup> During the year, limited-recourse loans were issued to certain employees and directors, where the company provided interest free loans for conversion of options previously issued by the company. In total, 9,575,000 options were converted into ordinary shares, at an exercise price of \$0.30. The loans are due for repayment by September 2024. The loans are non-recourse except against the shares issued on exercise of the options and are held by the participant to which the loan relates. Non-recourse loans issued are treated as a modification of the option under the Accounting Standards. No additional expense has been recognised in relation to these modifications.

## Notes to the Financial Statements *continued*

### 8. Options issued *continued*

During the year ended 31 December 2018, a number of options were issued to Directors, management and other employees of the Group as well as to brokers participating in the Share Placements that occurred in March and November 2018. Using the Black Scholes Model, the fair value of each option is as set out below and based on the following criteria/assumptions. The options below were issued at various dates between January and November 2018.

Options Issued 31 December 2018	Class A Options <sup>1</sup>	Class E Options	Class F Options	Class G Options <sup>2</sup>	Class H Options	Class L Options	Class M Options	Class N Options	Zero Price Options <sup>3</sup>	Other Options <sup>4</sup>	Total option expense for the year
No of new options	3,068,334	250,000	1,150,000	1,150,000	1,000,000	333,333	333,333	333,333	23,459,384		
Expiry (years)	1.24	3	3	4	4	3	4	5	3		
Exercise price (\$)	0.22	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0		
Vesting period (years)	0	0.02	0.21	0.87	0.39	0	0.68	1.68	2.93		
Underlying volatility	87.70%	87.70%	87.70%	87.70%	87.70%	87.70%	87.70%	87.70%	n/a		
Average risk-free interest rate	1.50%	2.10%	2.15%	2.28%	2.26%	2.06%	2.30%	2.30%	n/a		
Average calculated fair value of each option (\$)	0.0904	0.1433	0.0917	0.1157	0.0917	0.0854	0.0993	0.1102	0.1854		
<b>Total expense recorded for the period ended 31 December 2018 (\$)</b>	-	35,823	88,448	96,734	64,117	28,451	10,108	4,538	732,352	63,622	1,124,193

<sup>1</sup> Class A options were issued to brokers as part of the capital raises and included as part of share transaction costs and treated as a deduction from equity (of \$274,559 see Note 17).

<sup>2</sup> Class G options carry the escrow restrictions of continuous employment to 29 March 2019 and 22 June 2019 respectively.

<sup>3</sup> Zero Price ("Zepo") options are subject to the following vesting conditions being satisfied: DroneShield achieving \$10m revenue in any 12-month period within 36 months of the date of issue of the Options; or automatic vesting in the event that DroneShield is subject to a takeover or other change of control transaction. As there is no exercise price and no near-term expectations of dividends for DroneShield, the value of the option (excluding the impact of vesting conditions) determined using Black Scholes is equivalent to the price of a DroneShield share. The value of the Options is based on the spot price of a DroneShield share on the date at which the options were issued. Based on the sales pipeline and existing orders, management estimate that the options will vest within the expiry period. At this stage, the vesting period is assumed to be three years, which will be reviewed against updated pipeline and forecasts each six months. During the year-ended 31 December 2019, the vesting conditions for DroneShield achieving \$10m revenue in any 12-month period within 36 months of the date of issue of the Options was amended to DroneShield achieving \$10m revenue or \$10m customer cash receipts in any 12-month period within 36 months of the date of issue of the Options.

<sup>4</sup> \$63,622 relates to the vesting expense from options issued in prior periods, comprising option expense for Classes F and H (issued in 2016), and J and K (issued in 2017), offset by a credit to profit or loss from the lapse of some unvested Class J and K options during the period. Refer to 2017 Annual Report for details of options issued in prior periods.

## Notes to the Financial Statements *continued*

	31 December 2019 \$	31 December 2018 \$
<b>9. Cash and cash equivalents</b>		
Cash at bank and in hand	1,906,555	1,046,464
Short-term deposits	3,578,445	183,035
<b>Total cash and cash equivalents</b>	<b>5,485,000</b>	<b>1,229,499</b>

### 10. Trade and other receivables

Trade receivables	602,942	422,991
Deferred sales proceeds (see Note 15)	732,095	741,513
Other	-	9,858
Prepayments	246,395	115,328
<b>Total trade and other receivables</b>	<b>1,581,432</b>	<b>1,289,690</b>

Trade receivables disclosed above include amounts (see below for aged analysis) that are past due at the end of the reporting period for which the Group has not recognised an allowance for doubtful debts because there has not been a significant change in credit quality and the amounts are still considered recoverable.

#### *Age of receivables that are past due but not impaired.*

60 – 90 days	-	370,997
>120 days	601,753	-

Payment for hardware sales and subscription services are due from the customer as per the terms specified in the contract.

### 11. Inventories

Work in Progress	284,897	17,735
Finished goods inventory at cost	441,023	624,767
<b>Total Inventory</b>	<b>725,920</b>	<b>642,502</b>

## Notes to the Financial Statements *continued*

### 12. Plant, equipment and intangible assets

	Development equipment \$	Demonstration equipment \$	Office equipment \$	Plant & Equipment \$	Intangible Assets (software) \$	Total \$
<b>Balance at 1 January 2018</b>	<b>29,356</b>	<b>286,925</b>	<b>61,927</b>	-	<b>9,562</b>	<b>387,770</b>
Additions	163,242	765,686	27,055	137,081	11,441	1,104,505
Disposals	-	(28,393)	(1,272)	-	-	(29,665)
Transfers from (to) other fixed asset categories	(61,955)	58,047	3,908	-	-	-
Transfer from (to) inventory	(4,673)	(226,103)	-	-	-	(230,776)
Depreciation	(14,736)	(353,653)	(55,374)	(9,484)	(4,831)	(438,078)
Exchange differences	(1,295)	10,134	3,656	-	-	12,495
<b>Balance at 31 December 2018</b>	<b>109,939</b>	<b>512,643</b>	<b>39,900</b>	<b>127,597</b>	<b>16,172</b>	<b>806,251</b>
Additions	407,048	231,082	122,188	258,000	29,086	1,047,404
Disposals	-	(43,857)	(3,244)	-	-	(47,101)
Transfers from (to) other fixed asset categories	(288,447)	278,672	9,775	-	-	-
Transfer from (to) inventory	(10,903)	(128,409)	6,566	-	-	(132,746)
Depreciation	-	(424,347)	(52,358)	(33,697)	(7,626)	(518,028)
Exchange differences	-	2,580	282	-	-	2,862
<b>Balance at 31 December 2019</b>	<b>217,637</b>	<b>428,364</b>	<b>123,109</b>	<b>351,900</b>	<b>37,632</b>	<b>1,158,642</b>

### 13. Right-of-use asset

	31 December 2019 \$	31 December 2018 \$
<b>Balance at 1 January 2019</b>	-	-
Additions	541,829	-
Depreciation	(114,250)	-
<b>Balance at 31 December 2019</b>	<b>427,579</b>	-

The Group leases various assets including offices and storage units. The lease term is 4 years.

The total cash outflow for leases was \$222,127.

The maturity analysis of lease liabilities is presented in note 17.

## Notes to the Financial Statements *continued*

	31 December 2019 \$	31 December 2018 \$
<b>Amounts recognised in profit and loss</b>		
Depreciation expense on right-of-use assets	114,250	-
Interest expense on lease liabilities	39,030	-
Expense relating to short-term leases	86,328	-
<b>14. Provisions</b>		
Onerous contract	-	17,575
Employee entitlements	164,761	92,603
Other	17,822	17,748
<b>Total provisions</b>	<b>182,583</b>	<b>127,926</b>
<b>15. Other liabilities</b>		
Accrued expenses	413,148	149,115
Deferred Revenue		
- Hardware sales (i)	1,126,173	1,189,425
- Subscription services (ii)	2,567	4,248
- Other revenue	125,052	250,570
<b>Total other liabilities</b>	<b>1,666,940</b>	<b>1,593,358</b>
(i)	For hardware sales, revenue is recognised when control of the goods has transferred to the customer, being at the point the goods are delivered to the customer (distributor or direct customer). When the customer initially places the order, the customer is invoiced and the transaction price of the invoice at that point is recognised by the Group as deferred revenue, until the goods have been delivered to the customer. As shipping income is directly related to hardware sales, shipping income is recognised at the same point in time that the hardware sale is recognised.	
(ii)	Revenue relating to subscription services is recognised over time with the customer paying up-front in full for these services. Deferred revenue is recognised for subscription services at the time of the initial sales transaction and is released over the service period.	
<b>16. Borrowings</b>		
<b>Unsecured borrowing at amortised cost</b>		
Insurance Premium Finance	32,707	-
<b>Total borrowings</b>	<b>32,707</b>	<b>-</b>
Amount due for settlement within 12 months	32,707	-
Amount due for settlement after 12 months	-	-

## Notes to the Financial Statements *continued*

	31 December 2019 \$	31 December 2018 \$
Amounts due for settlement within 12 months	(118,528)	-
Amounts due for settlement after 12 months	<u>(328,709)</u>	<u>-</u>
<b>Total lease liabilities</b>	<b><u>(447,237)</u></b>	<b><u>-</u></b>

These liabilities were measured at the present value of the remaining lease payments, discounted using the weighted average incremental borrowing rate of 9%.

	No. of shares (Note a)	\$
<b>Balance at beginning of period (1 January 2019)</b>	<b>182,077,076</b>	<b>11,628,172</b>
Shares issued following option exercise during period (Note b)	11,333,359	417,159
Shares issued from Share Placement (Note c, Note d)	59,051,700	10,849,696
Transaction costs in relation to Shares issued from Share Placement (Note e)	<u>-</u>	<u>(1,882,420)</u>
<b>Balance at end of period (31 December 2019)</b>	<b><u>252,462,135</u></b>	<b><u>21,012,607</u></b>

Note (a): The number of shares disclosed is the number of shares in DroneShield Limited.

Note (b): During 2019, 11,333,359 unlisted options were exercised, resulting in the issue of one new share in DroneShield Limited for each option. The total cash received from the exercise of options during the period was \$417,159. 9,575,000 unlisted options were exercised by Directors and employees using the limited recourse loan provided by the Company.

Note (c): In February 2019, the Company issued 11,301,700 shares in a Share Placement. The issue price was \$0.115 per share and the total cash received from the placement of shares was \$1,299,696.

Note (d): In August 2019, the Company issued 47,750,000 shares in a Share Placement. The issue price was \$0.20, and the total cash received from the placement of shares was \$9,550,000.

Note (e): Included within transaction costs are the value of options issued to brokers of \$1,217,539. The assumptions used in valuing these options has been set out in Note 8.

## Notes to the Financial Statements *continued*

### 19. Shares and options

	Number of Shares	Number of Unlisted Options	Number of Performance Shares
<b>Opening balances at 1 January 2019</b>	182,077,076	60,127,717	30,000,000
February Placement shares and options issued	11,301,700	2,825,425	-
August Placement shares and options issued	47,750,000	10,000,000	-
Performance shares lapsed during the period	-	-	(30,000,000)
Options exercised during the period	11,333,359	(11,333,359)	-
Options lapsed during the period	-	(25,318,333)	-
Options issued to Directors and Management	-	12,450,000	-
<b>Closing balance at 31 December 2019</b>	<b>252,462,135</b>	<b>48,751,450</b>	<b>-</b>

#### *Unlisted Options:*

12,450,000 Unlisted Options were issued to Directors and Management during the year to 31 December 2019. These Options are subject to various escrow and vesting conditions relating to length of employment with the Company and performance of the Company. See Note 8 for further details.

2,825,425 Class O Options were issued to brokers who participated in the Share Placement that occurred in February 2019. These options have an exercise price of \$0.22 and expire on 21 February 2021.

10,000,000 Class R Options were issued to the Lead Manager of the August 2019 Share Placement. These options have an exercise price of \$0.40 and expire on 5 August 2022.

#### *Performance shares:*

As part of the acquisition of DroneShield LLC by DroneShield Limited, 45,000,000 Performance Shares were issued to DroneShield LLC's existing shareholders. 15,000,000 Class A Performance Shares lapsed in June 2018. The remaining 15,000,000 Class B and 15,000,000 Class C shares lapsed in June 2019.

## Notes to the Financial Statements *continued*

	31 December 2019 \$	31 December 2018 \$
<b>20. Earnings (loss) per share</b>		
<b>(a) Basic earnings (loss) per share</b>		
Total basic earnings (loss) per share attributable to the ordinary equity holders of the company	(0.04)	(0.04)
<b>(b) Dilutive earnings per share</b>		
Dilutive earnings (loss) per share attributable to the ordinary equity holders of the company	(0.04)	(0.04)
<b>(c) Weighted average number of shares used as the denominator</b>		
Weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share	214,031,563	168,492,973

### Options

Unlisted Options on issue (refer to Note 19) are not included in the calculation of diluted earnings per share because they are considered to be antidilutive for the period ended 31 December 2019. These options and shares could potentially dilute basic earnings per share in future periods.

## 21. Key Management Personnel disclosures and related party transactions

### (a) KMP Compensation

Salaries and fees	433,135	395,246
Post-employment benefits	27,484	-
Share-based payments	1,343,441	798,580
<b>Total KMP compensation</b>	<b>1,804,060</b>	<b>1,193,826</b>

Detailed remuneration disclosures are provided in the Remuneration Report on pages 32- 39.

### (b) Other transactions with related parties

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

- Mounthaven Consulting LLC, an affiliate of substantial shareholder Long Hill Capital LLC, received payments totalling \$225,000 in relation to consulting services provided to the Group. As of 1 October 2019, the Group no longer required their services and no further fees were payable.
- A termination payment of \$139,330 in relation to the loan facility announced in the December 2018 quarter was paid to an affiliate of substantial shareholder Long Hill Capital LLC.

## Notes to the Financial Statements *continued*

	31 December 2019 \$	31 December 2018 \$
<b>22. Parent entity financial information</b>		
The individual financial statements for the accounting parent entity, DroneShield LLC, show the following aggregate amounts:		
<b>Statement of financial Position</b>		
Current assets	31,066	96,266
Total assets	119,754	346,407
Current liabilities	(5,028,165)	(3,685,804)
Total liabilities	(5,028,165)	(3,685,804)
Net assets	(4,908,411)	(3,339,397)
Share Capital	1,322,547	1,322,547
Reserves	(36,968)	(291)
Accumulated losses	(6,193,990)	(4,661,653)
Total Equity	(4,908,411)	(3,339,397)
<b>Loss for the year</b>	<b>(1,532,336)</b>	<b>(2,171,757)</b>
<b>Other comprehensive loss</b>	<b>(36,676)</b>	<b>(16,367)</b>
<b>Total comprehensive loss</b>	<b>(1,569,012)</b>	<b>(2,188,124)</b>

DroneShield LLC, DroneShield Corporation Pty Ltd and DroneShield UK Limited are all legal subsidiaries of DroneShield Limited and are 100% owned by DroneShield Limited.

### 23. Financial risk management

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

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

#### *Credit risk*

With respect to credit risk arising from other financial assets, which comprise cash and cash equivalents and prepayments, the Company's exposure to credit risk arises in the form of default of the counter party, with a maximum exposure equal to the carrying amount of these instruments. Management has considered impairment, with none noted at 31 December 2019.

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

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

Cash and cash equivalents	5,485,000	1,229,499
Trade and other receivables	1,581,432	1,289,690

## Notes to the Financial Statements *continued*

### Liquidity risk

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

### Foreign exchange risk

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

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

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

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

	<b>31 December 2019</b>	<b>31 December 2018</b>
	\$	\$
Cash	19,370	391,127
Trade and other receivables	1,020,740	1,064,599
<b>Total Financial assets</b>	<b>1,040,110</b>	<b>1,455,726</b>
Trade and other payables	(197,770)	(133,343)
Provisions	(64,009)	(53,051)
Other liabilities	(277,063)	(41,379)
<b>Total Financial liabilities</b>	<b>(538,842)</b>	<b>(227,773)</b>

### Foreign exchange risk

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

	<b>31 December 2019</b>	<b>31 December 2018</b>
	\$	\$
+ 10%	143,103	80,132
- 10%	(762,258)	368,728

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

## Notes to the Financial Statements *continued*

### *Financial instrument composition and maturity analysis*

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

Contractual maturities of financial liabilities	Less than 6 months \$	6-12 Months \$	Between 1 and 2 years \$	Between 2 and 5 years \$	Over 5 years \$	Total contractual cash flows \$	Carrying amount (assets)/ liabilities \$
<b>As at 31 December 2018</b>							
Trade and other payables	184,317	-	-	-	-	184,317	184,317
Other financial liabilities	149,115	-	-	-	-	149,115	149,115
<b>Total</b>	<b>333,432</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>333,432</b>	<b>333,432</b>
<b>As at 31 December 2019</b>							
Trade and other payables	397,993	-	-	-	-	397,993	397,993
Other financial liabilities	470,095	61,582	135,260	193,448	-	860,385	860,385
<b>Total</b>	<b>868,088</b>	<b>61,582</b>	<b>135,260</b>	<b>193,448</b>	<b>-</b>	<b>1,258,378</b>	<b>1,258,378</b>

### 24. Contingent liabilities

As at 31 December 2019 there were no contingent liabilities.

### 25. Commitments

At 31 December 2019, contractual agreements existed to pay suppliers \$873,482 for the manufacturing of inventory to deliver on orders received. (2018: \$27,390).

### 26. Remuneration of auditor

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

	31 December 2019 \$	31 December 2018 \$
Audit and assurance services	62,106	63,663
Taxation services	12,168	7,772
<b>Total Auditor's remuneration</b>	<b>74,274</b>	<b>71,435</b>

## Notes to the Financial Statements *continued*

### 27. Segment information

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

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

The following tables present certain information regarding geographical segments for the years ended 31 December 2019 and 31 December 2018.

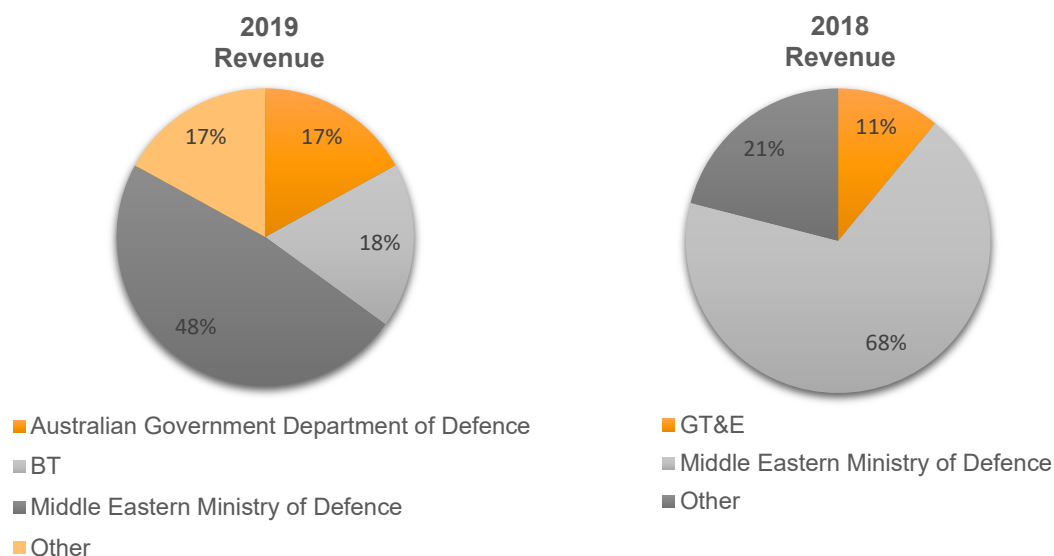
<b>Segment performance</b>	<b>USA</b>	<b>UK</b>	<b>Australia</b>	<b>Elimination</b>	<b>Total</b>
<b>31 December 2019</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Hardware sales including shipping income					
- <i>direct sales</i>	-	-	1,483,330	-	<b>1,483,330</b>
- <i>distributors</i>	-	-	1,804,456	-	<b>1,804,456</b>
Subscription services					
- <i>distributors</i>	1,699	-	-	-	<b>1,699</b>
Total revenue from sales	1,699	-	3,287,786	-	<b>3,289,485</b>
Other revenue	440,220	271,060	309,185	(692,462)	<b>328,003</b>
Total revenue	441,919	271,060	3,596,971	(692,462)	<b>3,617,488</b>
Depreciation	(185,843)	(929)	(445,506)	-	<b>(632,278)</b>
Loss after income tax expense	(1,532,336)	(136,365)	(6,026,379)	-	<b>(7,695,080)</b>
Assets and liabilities					
Segment assets	119,754	7,230	14,319,225	(5,067,636)	<b>9,378,573</b>
Segment liabilities	(5,028,165)	(150,227)	(2,616,704)	5,067,636	<b>(2,727,460)</b>
<b>Segment performance</b>	<b>USA</b>	<b>Australia</b>	<b>Elimination</b>	<b>Total</b>	
<b>31 December 2018</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	
Hardware sales including shipping income					
- <i>direct sales</i>	-	52,803	-	<b>52,803</b>	
- <i>distributors</i>	-	862,798	-	<b>862,798</b>	
Subscription services					
- <i>distributors</i>	1,559	36,697	-	<b>38,256</b>	
Total revenue from sales	1,559	952,298	-	<b>953,857</b>	
Other revenue	725,920	241,218	(713,792)	<b>253,346</b>	
Total revenue	727,479	1,193,516	(713,792)	<b>1,207,203</b>	
Depreciation	303,562	134,516	-	<b>438,078</b>	
Loss after income tax expense	(2,171,757)	(4,164,343)	-	<b>(6,336,100)</b>	
Assets and liabilities					
Segment assets	346,407	7,196,385	(3,574,850)	<b>3,967,942</b>	
Segment liabilities	(3,685,804)	(1,794,647)	3,574,850	<b>(1,905,601)</b>	

## Notes to the Financial Statements *continued*

### 27. Segment information *continued*

#### Information about major customers

The following chart presents certain information regarding customers/distributors who contributed 10 per cent or more to the Group's revenue for the years ended 31 December 2019 and 31 December 2018.



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

	31 December 2019 \$	31 December 2018 \$
<b>Operating loss for the year after tax</b>	<b>(7,695,080)</b>	<b>(6,336,100)</b>
Bad debts	35,516	13,118
Depreciation	632,278	438,078
Effects of foreign currency translation	73,872	(139,370)
Inventory impairment expense	40,000	273,439
Loss on disposal of fixed asset	41,262	34,353
Provisions	88,516	7,712
Share option expense	1,752,177	1,124,193
Transaction costs related to loans and borrowings	155,580	-
Interest income on cash deposits	(35,702)	-
<i>Change in operating assets and liabilities</i>		
Decrease/(Increase) in trade and other receivables	(291,742)	(1,081,839)
(Increase) in inventory	(83,417)	(143,308)
(Decrease)/increase in trade and other payables	213,677	19,645
(Decrease)/increase in other liabilities	73,582	1,339,188
<b>Net cash flows from (used in) operating activities</b>	<b>(4,999,481)</b>	<b>(4,450,891)</b>

## Notes to the Financial Statements *continued*

### 29. Events after the reporting date

Subsequent to 31 December 2019, the following occurred;

- The Company issued the following options;
  - Class Q options 550,000 unlisted and unvested employee options, issued on 7 February 2020, vesting (in equal tranches) on 30 November 2020, 30 November 2021 and 30 November 2022, each exercisable at \$0.65 per option, expiring on 30 June 2023.
  - Zero Exercise Price Options 550,000 unlisted and unvested zero exercise price options (being the ZEPOs), issued on 7 February 2020, vesting if certain performance milestones are met, each exercisable at \$0.00 per option, expiring on 30 November 2022.
- Non-Executive Director, Robert Clisdell resigned from the Board of Directors on 16 January 2020.
- Independent Non-Executive Director, Jethro Marks was appointed to the Board of Directors on 16 January 2020.

No other matter or circumstance has arisen since 31 December 2019 which has significantly affected or may significantly affect:

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

## Directors' Declaration

1. In the opinion of the Directors:
  - (a) the consolidated financial statements and notes set out on pages 41 to 67 are in accordance with the *Corporations Act 2001*, including:
    - (i) giving a true and fair view of the Group's financial position as at 31 December 2019 and of its performance for the financial year ended on that date; and
    - (ii) complying with Australian Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and
  - (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.
2. The notes to the consolidated financial statements include a statement of compliance with International Financial Reporting Standards.
3. The Directors have been given the declarations by the Chief Executive Officer and the Chief Financial Officer for the year ended 31 December 2019 required by section 295A of the *Corporations Act 2011*.

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



Peter James  
Independent Non-Executive Chairman

Sydney, NSW  
26 February 2020



## Independent Auditor's Report to the Members of DroneShield Limited

### REPORT ON THE AUDIT OF THE FINANCIAL REPORT

#### Opinion

We have audited the financial report of DroneShield Limited ("the Company") and its controlled entities ("the Group"), which comprises the consolidated statement of financial position as at 31 December 2019, the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and the directors' declaration.

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

- (a) giving a true and fair view of the Group's financial position as at 31 December 2019 and of its financial performance for the year then ended; and
- (b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

#### Basis for Opinion

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

We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of the Company, would be in the same terms if given to the directors as at the time of this auditor's report.

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

#### Material Uncertainty Regarding Going Concern

We draw attention to Note 1(a) in the financial report, which indicates that the Group incurred a net loss of \$7,695,080 and incurred cash outflows from operating activities of \$4,999,481 for the year ended 31 December 2019. As stated in Note 1(a), these events or conditions, along with other matters as set forth in Note 1(a), indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

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### Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial report of the current period. These matters were addressed in the context of our audit of the financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Material Uncertainty Regarding Going Concern* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Key Audit Matter	How our audit addressed the key audit matter
<b>Revenue recognition (Note 3)</b>	
<p>The Group recognised total revenue from sales of \$3,289,485 during the year ended 31 December 2019 (\$953,857 during the year ended 31 December 2018).</p> <p>We focussed on this area as a key audit matter due to the judgements involved in applying AASB 15 <i>Revenue from Contracts with Customers</i>.</p>	<p>We reviewed management's revenue recognition accounting policy to assess whether it complied with AASB 15.</p> <p>We reviewed a sample of revenue items recorded during the year and reviewed contracts or other documentation in relation to these to assess whether revenue recognised was in accordance with the requirements of AASB 15.</p> <p>We also reviewed disclosures in the financial statements to assess whether these were in accordance with AASB 15.</p>
<b>Capitalised Demonstration Equipment (Note 12)</b>	
<p>At 31 December 2019, the Group held demonstration equipment with a carrying value of \$428,364.</p> <p>We focussed on this area as a key audit matter as the carrying value of capitalised demonstration equipment at 31 December 2019 is a significant asset, and due to the judgement used by management in preparing its assessment of impairment.</p>	<p>We reviewed the cost of these items by agreeing a sample to purchase invoices.</p> <p>We assessed whether the policy to capitalise the demonstration equipment was in accordance with accounting standards.</p> <p>We discussed with management its plans to generate sales, and obtained sales forecasts prepared to identify if any impairment indicators existed.</p> <p>We reviewed sales made during the year to assess if any impairment indicators existed.</p> <p>We reviewed the useful life of these assets.</p> <p>We enquired of management whether there was any indication that the technological advances would indicate that the items capitalised were obsolete.</p>
<b>Value of Share Options (Note 8)</b>	
<p>The Company issued a number of share options to directors, management and brokers.</p> <p>The fair value of the options at grant date was determined by management, and used to account for the options.</p> <p>The key assumptions used in determining the fair value of the options are set out in Note 8 to the financial statements.</p> <p>We focused on this area as a key audit matter due to the judgement involved in assessing the fair value of the options.</p>	<p>We reviewed the valuation of the options, and the methodology used. We also reviewed the key assumptions in the valuation.</p> <p>We assessed whether the Group's disclosures met the requirements of accounting standards.</p>



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

The directors are responsible for the other information. The other information comprises the information included in the Group's annual report for the year ended 31 December 2019, but does not include the financial report and our auditor's report thereon.

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

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

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

### **Responsibilities of the Directors for the Financial Report**

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

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

### **Auditor's Responsibilities for the Audit of the Financial Report**

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

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

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



- Evaluate the overall presentation, structure and content of the financial report, including the disclosures, and whether the financial report represents the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

## REPORT ON THE REMUNERATION REPORT

### Opinion on the Remuneration Report

We have audited the Remuneration Report included in pages 32 to 39 of the directors' report for the year ended 31 December 2019.

In our opinion, the Remuneration Report of DroneShield Limited for the year ended 31 December 2019 complies with section 300A of the *Corporations Act 2001*.

### Responsibilities

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

**HLB Mann Judd Assurance (NSW) Pty Ltd**  
Chartered Accountants

Sydney, NSW  
26 February 2020

**A G Smith**  
Director

# Shareholder Information

## Holdings distribution at 26 February 2020

Holding Ranges	Holders	Total Shares	% Issued Share Capital
1 - 1,000	83	15,212	0.01%
1,001 - 5,000	1,229	3,781,287	1.50%
5,001 - 10,000	742	6,057,423	2.40%
10,001 - 100,000	1,445	50,425,581	19.97%
100,001 - over	232	192,182,632	76.12%
<b>Total</b>	<b>3,731</b>	<b>252,462,135</b>	<b>100.00%</b>

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

## Twenty largest shareholders at 26 February 2020

Position	Holder Name	Shares Held	% Issued Share Capital
1	BNP PARIBAS NOMS PTY LTD <DRP>	18,618,923	7.37%
2	BETA GAMMA PTY LTD	17,110,000	6.78%
3	MERRILL LYNCH (AUSTRALIA) NOMINEES PTY LIMITED	15,737,535	6.23%
4	UBS NOMINEES PTY LTD	14,815,521	5.87%
5	JOHN FRANKLIN	14,438,334	5.72%
6	BNP PARIBAS NOMINEES PTY LTD <IB AU NOMS RETAILCLIENT DRP>	14,236,412	5.64%
7	CS THIRD NOMINEES PTY LIMITED <HSBC CUST NOM AU LTD 13 A/C>	8,099,804	3.21%
8	HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED	7,319,864	2.90%
9	CITICORP NOMINEES PTY LIMITED	6,865,574	2.72%
10	J P MORGAN NOMINEES AUSTRALIA PTY LIMITED	5,900,875	2.34%
11	OLEG VORNIK	3,970,435	1.57%
12	PETER JAMES	2,500,000	0.99%
13	MR RICHARD GUY DARLING	2,294,729	0.91%
14	AZOTH LLC	2,250,000	0.89%
15	SARGON CT PTY LTD <CYAN C3G FUND>	2,000,000	0.79%
16	SOIRHU PTY LTD <THE BRAGG MCDONALD A/C>	1,232,500	0.49%
17	WRITEMAN PTY LIMITED <P L H A INVESTMENT A/C>	1,100,000	0.44%
18	LIM & LIU HOLDINGS PTY LTD <LIM & LIU FAMILY A/C>	950,000	0.38%
19	HSBC CUSTODY NOMINEES (AUSTRALIA) LIMITED - A/C 2	918,039	0.36%
20	MRS JUDITH MAREE DARLING	900,000	0.36%
<b>Total</b>		<b>141,258,545</b>	<b>55.95%</b>
Balance of register		111,203,590	44.05%
<b>Total issued capital</b>		<b>252,462,135</b>	<b>100.00%</b>