Half-Year Report of *Electro Optic Systems Holdings Limited* for the Half-Year Ended 30 June 2006

ACN 092 708 364

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

Current Reporting Period:	Half year ended 30 June 2006
Previous Corresponding Period:	Half year ended 30 June 2005

Results for Announcement to the Market

Revenue and Net Profit/(Loss)

		Percentage Change %	Amount
Revenue from ordinary activities	up	50.3	To $21,804,254
Profit/(loss) from ordinary activities after tax attributable to members	down	104.4	To ($16,351,126)
Net profit/(loss) attributable to members	down	104.4	To ($16,351,126)

Dividends (Distributions)

	Amount per security	Franked amount per security
Final dividend	Nil¢	Nil¢
Interim dividend	Nil¢	Nil¢
Record date for determining entitlements to the dividend:		
• final dividend		N/A
• interim dividend		N/A

Net tangible assets at 30 June 2006	$27,171,977
Number of ordinary shares outstanding at 30 June 2006	51,316,494
NTA per ordinary share at 30 June 2006	52.95 cents
NTA per ordinary share at 30 June 2005	48.89 cents

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

Refer to Directors' Report

The loss for the half year includes a 100% impairment of the goodwill of $5,505,764.

Directors Report

The directors of Electro Optic Systems Holdings Limited submit herewith the financial report for the half-year ended 30 June 2006. In order to comply with the provisions of the Corporations Act 2001, the directors report as follows:

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

Mr Fred Bart (Chairman)
Dr Ben Greene (Chief Executive Officer)
Dr Bob Dean (Resigned 8 March 2006)
Mr Ian Dennis
Ms Cheryl Bart
Mr John Gordon
Mr Mark Ureda

Review of Operations

The consolidated entity continues to operate in the military, space surveillance and space systems business sectors. The performance of each sector in the half-year is summarised in the table below.

	Revenue	Profit/Loss
Military	17.8	-6.1
Space Surveillance	1.8	-2.1
Space Systems	1.7	-8.2
Unallocated	0.5	0
Half-Year Total A$ millions:	**21.8**	**-16.4**

In the June 2006 half-year an extremely disappointing result from the space systems sector overshadowed improving performance in the military sector and stable results from space surveillance.

The military sector produced a loss of $6.1m on revenue of $17.8m. This sector has strong contracts in hand for the second half when the company will show an improvement in both revenue and results.

The space surveillance sector made positive progress with both customer demonstrations and technology development.

Space Systems

This business produces telescopes and enclosures. During the half year to 30 June 2006 this business has suffered major setbacks in all of its projects.

- All project costs increased during the half-year due to project completion delays, vendor delays or failures, sector-specific inflation, inclement weather at installation sites, defence priority delays due to war, staff shortages and sub-contractor defaults.
- EOS executes space systems projects with a limited pool of skilled labour that is not readily expanded. An individual project delay requiring more human resources can add delay to all succeeding projects. If multiple project delays occur, the overall effect compounds quickly.
- A decision has been made by the Directors to restructure the business by completing existing contracts and only taking on new contracts with reduced risks which can make a positive contribution to earnings. This is likely to require a change in the customer base.

As a consequence of these factors, only $1.7 million of revenue was recognized in this half-year. Expenses were $9.9 million, resulting in a loss of $8.2 million which includes a 100% impairment of goodwill of $1.6 million for this business segment and a provision of $1,547,990 relating to loss making contracts that will be completed in future periods.

Military Business

During 2005 the Company completed a substantial investment program aimed at establishing a production capacity of A$5m per month of military products from new plants in Tucson [Az] and Queanbeyan [NSW]. After this successful expansion, a period of consolidation was required during the first half of 2006. The objectives of this consolidation were:

- Capacity. An increase in combined plant capacity to A$7.5m per month [a 50% increase] by Q3 2006 to meet growth in demand. By 30 June 2006 this demand had materialised and production capacity has been gradually expanded by 50% as required. This success has provided a platform for further upgrades to lift production capacity to A$10m per month [100% over 2005 levels] without additional capital expenditure.
- Capacity Leveling. The Company's USA and Australian plants have fundamentally different capabilities. The USA plant is designed for high volume lean production of stable product configurations. The Australian plant can more readily accommodate short production runs. With new product launches planned for 2007, an increase in output from the USA plant is required during 2006 to allow the low-rate production for new products to be taken up in Australia in 2008. During the first half of 2006 preparations for this increase in USA production were made.
- Repairs and Maintenance. Product support is a key factor in securing long-term delivery contracts. As more products are shipped and fielded, the flow of items for repair is increasing. This required an expansion of repair facilities in both plants to accelerate turn-around times for equipment in active service. During the first half of 2006 the flow of battle-damaged equipment increased, coinciding with major improvements in EOS repair capability. The net result was an improvement in turn-around time for all classes of repairs, even as repair volumes increased.
- Yield. The 2005 program focused on meeting customer wartime demands for quantity and quality through two new production facilities. The Company is now positioned to increase production to meet 2006 delivery obligations from a more cost-effective production base.
- Resilience. An important factor in the award of future contracts for the Company's military products is the resilience of its production process and capability. Improving this metric required training and multi-skilling of staff, stocking pipelines of parts, establishing alternate parts vendors where appropriate, consolidating the two-plant strategy and securing working capital.

New production contracts for military products for the US army, expected during the first half of 2006, were delayed by approximately two months. Although these contracts were in hand by 30 June 2006, the contracting delays could not be made up. In addition the dislocation in the customer order process impacted production flow in July and August. The net impact of these dislocations is, 22% of 2006 military revenue forecast at May 2006 will now slip into 2007.

After the unforeseen administrative delay in establishing the current production contract for deliveries for the US Army, this business is performing satisfactorily.

A transition to profitable operations is contingent upon the production yield improvements obtained in the first half being sustained as production reaches target volumes which are substantially higher.

The military business is a major component of the company's future growth plans. It intends to compete for the long-term production contract for the US Army program that presently represents most of its income in this sector. This contract is currently awarded on a short-term basis and the long-term arrangements will apply from Q4 2007 to 2011.

The loss for the half year includes a 100% impairment of goodwill of $2.2 million for this business segment.

Space Surveillance

The space surveillance business focuses on two key applications:

- the use of electro optic sensors to obtain space information; and
- the use of directed-energy in space for ablation.

EOS' space surveillance sensors were developed to meet a need for improved space information, and have demonstrated their capability and maturity in extensive trials in 2004 and 2005.

EOS is teamed with Northrop Grumman Space Technology ("NGST") in this sector. During the half-year to 30 June 2006 the NGST/EOS team made progress in demonstrating the long-range operability of EOS sensors, and the ease of integration into existing data networks. These are important steps towards market acceptance.

The potential market for space surveillance sensors and systems is substantial.

EOS' space ablation technology is not yet mature, but ongoing research and development continues to raise performance limits and lower system deployment costs. The price-performance levels achieved for space ablation are approaching viable levels for a large-scale prototype to be produced. EOS continues to execute risk reduction effort towards early deployment of this breakthrough technology.

There was a loss of $2.1 million on revenue of $1.8 million in this sector which includes a 100% impairment of goodwill of $1.7 million for this business segment.

Summary

The Company's long-term future lies in the military and space surveillance sectors, which are performing satisfactorily. These sectors have the potential to generate significant revenue and profits in future periods.

In the near term much depends on management's ability to contain and control the space systems business, and to execute the military sector strategy where the achievement of production efficiency improvements in the military sector is particularly important.

These factors gave rise to an operating loss of $16.4 million for the half-year period. Included in the operating loss for the half-year period is a charge of $0.7 million in relation to share based payments to directors' and staff and a charge of $5.5 million for impairment of goodwill. These expenses are non cash operating expenses.

Further information concerning the operations and financial condition of the consolidated entity can be found in the 2005 annual financial report and in releases made to the Australian Stock Exchange (ASX) during the half year.

Auditor's independence declaration

The auditor's independence declaration is included on page 6 of the half-year financial report.

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

On behalf of the Directors

I.A Dennis
Director
Sydney, 31 August 2006

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

31 August 2006

Dear Board Members

Electro Optic Systems Holdings Limited

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

As lead audit partner for the review of the financial statements of Electro Optic Systems Holdings Limited for the half-year ended 30 June 2006, I declare that to the best of my knowledge and belief, there have been no contraventions of:

(i) the auditor independence requirements of the Corporations Act 2001 in relation to the review; and

(ii) any applicable code of professional conduct in relation to the review.

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

D. Black.

D. Black
Partner
Chartered Accountants

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

Scope

The financial report and directors' responsibility

The financial report comprises the balance sheet, income statement, cash flow statement, statement of recognised income and expense, selected explanatory notes and the directors' declaration for the consolidated entity for the half-year ended 30 June 2006 as set out on pages 9 to 25. The consolidated entity comprises both Electro Optic Systems Holdings Limited (the company) and the entities it controlled at the end of the half-year or from time to time during the half-year.

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

Review Approach

We have performed an independent review of the financial report in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the financial report is not presented fairly in accordance with the Corporations Act 2001 and Accounting Standards AASB 134 "Interim Financial Reporting" and AASB 1 "First-time Adoption of Australian Equivalents to International Financial Reporting Standards", so as to present a view which is consistent with our understanding of the consolidated entity's financial position, and performance as represented by the results of its operations, its changes in equity and its cash flows, and in order for the company to lodge the financial report with the Australian Securities and Investments Commission.

Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements. A review is limited primarily to inquiries of the entity's personnel and analytical procedures applied to the financial data. These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Statement

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

(a) giving a true and fair view of the consolidated entity's financial position as at 30 June 2006 and of its performance for the half-year ended on that date; and

(b) complying with Accounting Standards AASB 134 "Interim Financial Reporting" and AASB 1 "First-time Adoption of Australian Equivalents to International Financial Reporting Standards" and the Corporations Regulations 2001.

Inherent Uncertainty Regarding Going Concern

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

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

D. Black.

David Black
Partner
Chartered Accountants
Canberra, 31 August 2006

Directors' Declaration

The directors declare that:

a) in the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable; and

b) in the directors' opinion, the attached financial statements and notes thereto are in accordance with the Corporations Act 2001, including compliance with accounting standards and giving a true and fair view of the financial position and performance of the consolidated entity.

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

On behalf of the Directors

I A Dennis
Director
Sydney, 31 August 2006

Consolidated income statement for the half-year ended 30 June 2006

	Note	Half-year ended 30 June 2006 $	Half-year Ended 30 June 2005 $
Revenue	2(a)	21,804,254	14,506,840
Other Income	2(b)	891,197	160,831
Changes in inventories of finished goods and work in progress		3,161,362	2,479,389
Raw materials and consumables used		(21,057,276)	(11,970,124)
Employee benefits expense		(10,506,790)	(9,497,008)
Administrative costs		(2,884,980)	(2,124,556)
Finance costs		(98,503)	(55,856)
Goodwill impairment	6	(5,505,764)	-
Depreciation expense		(869,669)	(407,191)
Lease expenses		(33,671)	(16,700)
Occupancy costs		(949,577)	(867,612)
Other expenses		(301,709)	(206,838)
Loss before income tax expense	2	(16,351,126)	(7,998,825)
Income tax expense		-	-
Loss for the period	4	(16,351,126)	(7,998,825)
Earnings per share:			
Basic (cents per share)	5	(31.9)	(20.0)
Diluted (cents per share)	5	(31.9)	(20.0)

Notes to the financial statements are included on pages 14 to 25

Consolidated balance sheet
as at 30 June 2006

	Note	30 June 2006 $	31 December 2005 $
Current Assets			
Cash and cash equivalents		15,600,157	21,434,803
Trade and other receivables		6,569,227	13,799,654
Inventories		12,350,789	9,189,427
Other		211,750	115,210
Total Current Assets		34,731,923	44,539,094
Non-Current Assets			
Property, plant and equipment		6,780,126	6,717,694
Goodwill	6	-	5,505,764
Total Non-Current Assets		6,780,126	12,223,458
Total Assets		41,512,049	56,762,552
Current Liabilities			
Trade and other payables		8,160,612	9,219,677
Borrowings		574,522	735,747
Provisions		4,654,766	2,492,132
Other		-	90,391
Total Current Liabilities		13,389,900	12,537,947
Non-Current Liabilities			
Borrowings		705,103	1,054,826
Other		245,069	263,943
Total Non-Current Liabilities		950,172	1,318,769
Total Liabilities		14,340,072	13,856,716
Net Assets		27,171,977	42,905,836
Equity			
Issued capital		67,913,451	67,833,722
Reserves	3	4,139,676	3,602,138
Accumulated losses	4	(44,881,150)	(28,530,024)
Total Equity		27,171,977	42,905,836

Notes to the financial statements are included on pages 14 to 25

Consolidated statement of recognised income and expense for the half-year ended 30 June 2006

	Note	Half-year ended 30 June 2006 $	Half-year Ended 30 June 2005 $
Translation of foreign operations:			
Exchange differences taken to equity		(154,805)	(13,934)
Net expense recognised directly in equity		(154,805)	(13,934)
Loss for the period		(16,351,126)	(7,998,825)
Total recognised income and expense for the period		(16,505,931)	(8,012,759)

Notes to the financial statements are included on pages 14 to 25

Consolidated cash flow
for the half-year ended 30 June 2006

	Note	Half-year ended 30 June 2006 $	Half-year ended 30 June 2005 $
Cash Flows From Operating Activities			
Receipts from customers		26,741,840	9,257,253
Payments to suppliers and employees		(31,645,712)	(17,797,625)
Interest and bill discounts received		511,985	466,118
Interest and other costs of finance paid		(98,503)	(55,856)
Net cash (used in) operating activities		(4,490,390)	(8,130,110)
Cash Flows From Investing Activities			
Payment for property, plant and equipment		(1,079,670)	(4,146,046)
Net cash (used in) investing activities		(1,079,670)	(4,146,046)
Cash Flows From Financing Activities			
Proceeds from the exercise of options		79,729	1,088,019
Proceeds from placement of shares		-	22,500,000
Proceeds from borrowings		-	694,958
Repayment of borrowings		(344,998)	-
Net cash (used in)/ provided by financing activities		(265,269)	24,282,977
Net (Decrease)/Increase In Cash Held		(5,835,329)	12,006,821
Cash and cash equivalents at the beginning of the half-year		21,434,803	3,686,742
Effects of exchange rate changes on the balance of cash held in foreign currencies		683	5,882
Cash and cash equivalents at the end of the half-year		15,600,157	15,699,445

Notes to the financial statements are included on pages 14 to 25

1. Summary of accounting policies

Basis of preparation

The half-year financial report is a general purpose financial report prepared in accordance with the Corporations Act 2001 and AASB 134 Interim Financial Reporting. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS34 Interim Financial Reporting. The half-year financial report does not include notes of the type normally included in an annual financial report and shall be read in conjunction with the most recent annual financial report. Except where indicated otherwise, all amounts are presented in Australian dollars.

Significant accounting policies

The financial statements have been prepared under the historical cost convention.

The accounting policies and methods of computation adopted in the preparation of the half-year financial report are consistent with those adopted and disclosed in the company's 2005 annual financial report for the financial year ended 31 December 2005 apart from the following:

Going Concern

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

The consolidated entity incurred a net loss during the half year of $16,351,126 (2005 - $7,998,825) including the write off of goodwill of $5,505,764 (2005 – Nil). Net cash used in operating activities was $4,490,390 (2005 - $8,130,110). As at 30 June 2006, the consolidated entity had cash of $15,600,157 (2005 - $21,434,803) which would be fully utilised in the first half of 2007 if the same level of losses and outflows of cash from operating activities continue. The directors are, however, of the view that the losses in the first half of 2006 were unusually high as a result of problems in the telescope and enclosure division as well as delays in the shipments of units in the military section.

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

- the ability to achieve target production levels for the military business in the second half-year period to 31 December 2006

1. Summary of accounting policies

Basis of preparation (cont)

The Directors believe that this is achievable based on the increased rate of production in the military business since 30 June 2006 and the expectation that on the basis that the production targets are met over the six months to 31 December 2006 the consolidated entity will be profitable and generate net cash inflows from operations in the fourth quarter.

- the ability to obtain further new profitable contracts

  The directors are in the process of bidding for new military and space contracts. The results of these bids will not be known until after these financial statements are signed.

- The successful restructure of the telescope and enclosure division

  The losses from the telescope and enclosure division which were substantially higher in the half year to 30 June 2006 than previously expected will not continue as all of the contracts which have suffered cost overruns will be completed in the first half of 2007 and the company has already provided for expected losses on contracts of $1,547,990 (31 December 2005: $883,315) in accordance with Australian Accounting Standard AASB111 "Construction Contracts". The company has developed plans to restructure the telescope and enclosure division such that revenue and costs in this business are bought into balance and net cash outflows cease.

- The ongoing support of the consolidated entity's bankers

  The Directors are in the process of arranging a standby credit facility for the military section which will be secured by the assets of that division and a parent company guarantee.

- The continued support of the Company's shareholders

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

If the consolidated entity is unable to continue as a going concern it may be required to realise its assets and extinguish its liabilities other than in the normal course of business and at amounts different from those stated in the financial report.

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

	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $

2. Loss From Ordinary Activities

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

	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $
(a) Revenue		
Contract receipts	21,292,269	14,040,722
Interest received	511,985	466,118
Total revenue	21,804,254	14,506,840
(b) Income		
Grant revenue	850,545	-
Profit on sale of fixed assets	26,927	33,305
Foreign exchange gain	-	94,546
Other revenue	13,725	32,980
	891,197	160,831
(c) Expenses		
Depreciation of non-current assets	869,669	407,191

3. Reserves

	30 June 2006 $	31 December 2005 $
Foreign currency translation reserve	(360,439)	(205,634)
Employee Equity settled benefits reserve	4,500,115	3,807,772
Balance at end of financial period	4,139,676	3,602,138

4. Accumulated Losses

	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $
Balance at beginning of financial period	(28,530,024)	(13,798,828)
Net loss for the period	(16,351,126)	(7,998,825)
Balance at end of financial period	(44,881,150)	(21,797,653)

5. Earnings Per Share

	2006 ¢ per share	2005 ¢ per share
Basic EPS	(31.9 cents)	(20.0 cents)
Diluted EPS	(31.9 cents)	(20.0 cents)

Basic Earnings per Share

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

	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $
Earnings (a)	(16,351,126)	(7,998,825)

	2006 No.	2005 No.
Weighted average number of ordinary shares used in the calculation of basic earnings per share	51,292,629	39,907,473

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

Diluted Earnings per Share

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

	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $
Earnings (a)	(16,351,126)	(7,998,825)

	2006 No.	2005 No.
Weighted average number of ordinary shares and potential ordinary shares (b) & (c)	51,292,629	39,907,473

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

5. Earnings Per Share (cont'd)

(b) The following are considered to be potential ordinary shares but are not dilutive and are therefore excluded from the weighted average number of ordinary shares used in the calculation of basic and diluted earnings per share.

	30 June 2006 Number	30 June 2005 Number
Vendor options at $0.20	-	295,967
Directors options at $1.64	600,000	600,000
Staff Share Plan at $1.64	347,104	459,500
Staff Share Plan at $2.58	626,000	672,500
Directors options at $2.85	300,000	300,000
Directors options at $2.56	200,000	200,000
Directors options at $3.06	1,815,600	688,800
Staff options at $3.06	162,000	-
Staff options at $3.50	900,000	-
Total unlisted options	4,950,704	3,216,767

(c) Weighted average number of ordinary shares and potential ordinary shares used in the calculation of diluted earnings per share reconciles to the weighted average number of ordinary shares used in the calculation of basic earnings per share as follows:

Weighted average number of ordinary shares used in the calculation of basic earning per share	51,292,629	39,907,473
Weighted average number of ordinary shares and potential ordinary shares used in the calculation of diluted earnings per share	51,292,629	39,907,473

	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $

6. Goodwill

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

Allocation of goodwill to cash-generating units

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

Space Systems - Global	-	1,652,153
Space Surveillance - Global	-	1,652,153
Fire Control Systems - Global	-	2,201,458
Balance at end of financial period	-	5,505,764

The basis for determining the recoverable amount of goodwill has been the assessment by the Directors that the fair value of the goodwill in each of these cash-generating units is not currently able to be supported by signed contracts on hand at the date of this report. Whilst the directors remain confident of achieving significant profitable contracts in the near future these contracts are not signed or otherwise assured as at the date of this report.

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

7. Contingent Liabilities

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

(b) Electro Optic Systems Pty Limited has engaged in Research and Development syndications during the period from 1992 through to 1996. The taxation treatment undertaken was in accordance with specific and general taxation rulings issued by the Australian Taxation Office. However, Electro Optic Systems Pty Limited has a contingent liability under indemnities given to Research and Development Investors in the event that the Australian Taxation Office reverses its rulings.

On 12 November 2004, the parent company received a letter from the Australian Taxation Office regarding a claim for a deduction for core technology of $5.3m in the financial year ended 30 June 1995 by a subsidiary company, FCS Technology Holdings Pty Limited. The letter offered the Company a choice of settling the matter on a prescribed formula amounting to some $881,000 plus interest and possible penalties or satisfying the Australian Taxation Office that the deduction claimed was reasonable and at arms length.

The Directors are of the view that the circumstances of this investment were significantly different from the majority of other syndications and based on legal advice the Company formally advised the Australian Taxation Office on 12 May 2005 that it would not accept the proposed settlement offer and that the Company would defend the position in respect of the claim. Legal counsel has been retained by the Company in the matter. The latest correspondence from the Australian Taxation Office was an email dated 10 July 2006 giving us an extension to lodge the Company's submission by 25 July 2006. The submission was lodged on 25 July 2006 and the Company is currently waiting for a review by the Australian Taxation Office.

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

The maximum liability is the amount received from the Commonwealth of Australia which was $6,343,173 as at 30 June 2006 although the directors are of the opinion that it is not possible to estimate any potential exposure, if any, to the consolidated entity under this undertaking.

8. Segment Information

	External Sales		Total	
	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $	Half-year to 30 June 2006 $	Half-year to 30 June 2005 $
Space systems	1,742,124	9,817,756	1,742,124	9,817,756
Space surveillance	1,793,250	1,303,247	1,793,250	1,303,247
Defence	17,756,895	2,919,719	17,756,895	2,919,719
Total of all segments	21,292,269	14,040,722	21,292,269	14,040,722
Eliminations	-	-	-	-
Unallocated	511,985	466,118	511,985	466,118
Consolidated	21,804,254	14,506,840	21,804,254	14,506,840

Segment Results

	Half year to 2006 $	Half year to 2005 $
Space systems	(8,195,017)	(1,853,939)
Space surveillance	(2,120,815)	(407,628)
Defence	(6,076,744)	(5,812,227)
Total of all segments	(16,362,576)	(8,073,794)
Unallocated	11,450	74,969
Loss before income tax expense	(16,351,126)	(7,998,825)
Income tax benefit	-	-
Loss after related income tax expense	(16,351,126)	(7,998,825)

8. Segment Information (cont'd)

Product and Services within each Business Segment

Space Systems

EOS is a supplier of large optical systems including telescopes and enclosures.

Space Surveillance

EOS has developed laser-based space surveillance systems which have been demonstrated in customer trials and EOS is now well-placed to be a contributor to the next generation of space tracking capability. EOS also manages and operates SLR laser tracking facilities in Australia.

Defence

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

9. Subsequent Events

Since 30 June 2006, the remaining 947,104 unlisted options exercisable at $1.64 expired on 1 July 2006.

On 31 July 2006 the company announced that it had entered into a new telescope contract for A$8.5 for the Thai National Telescope.

10. Issuance of Securities

2006

A total of 46,896 staff options were exercised at various exercise prices raising $79,729 during the half year resulting in the issue of 46,896 ordinary shares. There were no other movements in the ordinary share capital of the company in the current half year reporting period.

Electro Optic Systems Holdings Limited issued 600,900 share options over ordinary shares to Directors and staff under the Employee Share Option Plan during the half year. The issue of these options resulted in a charge to profit and loss during the half year of $692,343 which is included under employee compensation. This charge to profit and loss was based on the fair value of the options at grant date.

2005

On 31 January 2005, Electro Optic Systems Holdings Limited issued 5,000,000 ordinary shares at $4.50 each to Northrop Grumman Space and Mission Systems Corp for cash of $22,500,000. In addition to the placement of ordinary shares a total of 4,716,196 options (including 4,563,925 CEO options) were exercised at various exercise prices raising a further $1,088,019.

Electro Optic Systems Holdings Limited issued 1,188,800 share options over ordinary shares to Directors and staff under the Employee Share Option Plan during the half year. The issue of these options resulted in a charge to profit and loss during the half year of $2,333,881 which is included under employee compensation. This charge to profit and loss was based on the fair value of the options at grant date.

11. Other Significant Information

None

12. Information on Audit or Review

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

- ☐ The accounts have been audited.
- ☒ The accounts have been subject to review.
- ☐ The accounts are in the process of being audited or subject to review.
- ☐ The accounts have not yet been audited or reviewed.

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

Not applicable

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

Not applicable