

DIRECTORS' REPORT

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

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

Name	Particulars
Fred Bart	Chairman and Chief Executive Officer. A director since 5 September 2000. He has been Chairman and Managing Director of numerous private companies since 1980, specialising in manufacturing, property and marketable securities. He is a member of the Australian Institute of Company Directors.
Ian Dennis	Non executive director and Company Secretary. Ian is a chartered accountant with experience as director and secretary in various public listed and unlisted technology companies. He has been involved in the investment banking industry and stockbroking industry for the past twenty five years. Prior to that, Ian was with KPMG, Chartered Accountants in Sydney. Appointed to the Board on 5 September 2000. He is a member of the Australian Institute of Company Directors.
Cheryl Bart AO	Non executive director. Appointed to the Board on 26 November 2001. Cheryl Bart is a lawyer and company director. She is Chairman of the South Australian Film Corporation, FARE (Alcohol Education and Rehabilitation Foundation) and ANZ Trustees Limited. She is a non-executive director of SA Power Networks (formerly ETSA Utilities), Spark Infrastructure Limited, Australian Himalayan Foundation, 2015 Australian Asian Cup and the Australian Broadcasting Corporation. She is a fellow of the Australian Institute of Company Directors.

Directorships of Other Listed Companies

Directorships of other listed companies held by directors in the 3 years immediately before the end of the financial year are as follows:

Name	Company	Period of directorship
Fred Bart	Electro Optic Systems Holdings Limited	Since May 2000
Ian Dennis	Electro Optic Systems Holdings Limited	Since May 2000
Cheryl Bart	Spark Infrastructure Group Limited	Since November 2005

Principal Activities

The principal activity of the Company is an investment in Audio Pixels Limited of Israel. Audio Pixels Limited is engaged in the development of digital speakers.

Results

The net loss for the financial year ended to 31 December 2012 was \$2,622,099 (31 December 2011 - \$2,930,697).

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Dividends

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

Review of Operations

On 20 December 2012, the company completed a successful private placement of 1,117,022 ordinary shares raising \$5,585,110 from institutional and sophisticated investors. The placement was made at \$5.00 per share. In addition to the above placement, interests associated with Mr Fred Bart agreed to take up a further 200,000 shares at \$5.00 each raising an additional \$1,000,000 which is subject to shareholder approval at a general meeting.

The Company continues to lease its commercial property known as Lots 3, 4, 25 and 45 at 360 Pacific Highway, Crows Nest to Sydneyside (Australia) Pty Limited. The property has been put up for sale.

Digital Speakers

During the reporting period the Company continued its development efforts to commercialise our digital speaker technologies into a high demand product; including but not limited to activities under a Joint Development Agreement with one of the world leading consumer electronic manufacturers and cooperative efforts with two of the worlds' leading MEMS fabricators.

The key highlight was the successful completion of the second of our four-phase product commercialisation plan. The first two phases of the plan were designed to focus on the optimisation of the electromechanical structures utilising mass-fabrication methods. For purposes of expediency and risk mitigation the initial phases utilised chip designs with various limitations, for example chips of the initial phases comprised of only 256 elements ("pixels"). **The positive results attained from Phase II, now enable the company to forge forward with the next phases, which are focused on the fabrication of mass-production versions of the product.** The next phases will for example expand the acoustic output and commercial appeal of the chip by increasing the element count to 1k "pixels".

Management is elated by the results of this phase of development. Not only have the results met all the original technical objectives, the success of the phase has empowered the company to advance from the crucial yet somewhat dreary task of optimising the structures, to the far more exciting and perceptible phases of fabricating working product.

During the latter weeks of the reporting period all three of our fabrication partners began delivering Phase II silicon chips, which were tested and measured using our newly designed proprietary test equipment. The equipment was redesigned to support the natural progression from prototype to playing chips, which demands a significant increase to number and complexity of mechanical, electrical and acoustic parameters that need to be measured and analysed under both static and dynamic conditions.

The chips overwhelmingly conformed to the targeted electromechanical specifications. We did however discover a small number of imperfections in the fabrication process of which the primary flaw manifested in electrical shorts occurring when applying the target operational voltages.

It is important to note MEMS device development, which is in relative infancy when compared to more traditional semiconductor fabrication, relies on the common practice of utilising "trial and error" methods of process development. In essence because the construction of each individual layer influences previous and future layers, certain fabrication flaws are unpredictable, as they tend to materialise in subsequent stages, or in some cases only after the device has completed its full fabrication. Therefore the common practice in MEMS device development is to initiate a new fabrication run in order to correct the fabrication process and/or design.

DIRECTORS' REPORT

Review of Operations (Cont.)

Audio Pixels being anything but ordinary, decided upon discovery of the flaw to first attempt the application of a particular technology used in other semiconductor segments to serve as a temporary measure to overcome the fabrication flaw. After considerable efforts fine tuning the process this approach ultimately allowed us to sidestep the shorts and enable the structures to operate sufficiently well as to obtain all required measurements. This highly creative approach, the result of our rather formidable knowledge in MEMS combined very close cooperation with our fabrication partners, **allowed us to save significant time and resources and successfully obtain all the measurement data needed to complete this phase of development**, without the need for corrective fabrication runs. Additionally the provisional solution worked well enough to apply our advancements in the field's of drive electronics and functional algorithms to successfully play music from the chips.

The summary of our test results reveal that our two backup manufacturers demonstrated significant advancements applying their process knowledge and fab capabilities toward meeting our specific requirements; while our lead fabrication partner was able to leverage their past experiences with our structures to exceed expectations and deliver full structures. The delivery of a full structure is exceptionally significant. In order to mitigate risks, fabrication of the full structure was originally targeted to commence in Phase III. However various circumstances and conditions evolved that enabled us to design, authorise and guide the development of a full structure, a whole phase earlier than originally planned. The early delivery of a full working structure provides the company with phenomenal head start for the next phase of fabrication, as it allowed us to principally debug both the design and the fabrication processes thereby dramatically reducing the potential for unanticipated flaws. This achievement will undoubtedly allow us to reduce the projected development time of Phase III, likely to a timeline very similar to Phase II, despite the considerable expanded intricacy of the Phase III device.

It should be noted that while the provisional measures were adequate to achieve all the technological objectives set for this Phase, they fell slightly short on our ability to provide a demonstration platform that management believes is worthy of public representation of our revolutionary technology. Management therefore decided to adhere to its original plan of public demonstration after the upcoming phase of development, which is wholly dedicated to the production of playing chips.

During the period, the market continued to evolve in accordance with management's projections; trending toward the sustained effort to bridge the chasm between the continual quest to improve audio output of devices and the pursuit of thinner, aesthetically pleasing devices. These two diametrically opposed objectives (from an audio perspective of course) along with other much sought after objectives (such as the constant need to reduce power consumption of devices), all play to the core strengths of Audio Pixels impending product offerings.

The recently completed Consumer Electronic Show (CES) highlighted the emergence of OLED television sets, devices that are simply far too thin to house any kind of speakers, let alone speakers capable of quality output that is worthy of the super-high-resolution (and cost) of the displays. Additional supporting news is the industry buzz that suggests Apple is extremely active developing a new audio format intended for delivery and playback of "high quality" 24bit audio for their devices and services. This of course is in addition to Apple's perpetual efforts to improve the audio experience in each new generation of device; often touting improved audio as a key feature (such as in the recently released iPhone 5). Additional indicators can be attained from companies such as Dover Electronics, a market leader of acoustic components including MEMS microphones and analog micro-speakers. Dover cited in their most recent annual report, not only the increasing popularity, acceptance and growth of MEMS acoustic devices, but also a clear emerging industry trend by leading OEM's to procure (at a premium) completed sound modules, especially those with improved acoustic capabilities, over the more cost effective individual speaker components. Industry and market eagerness to improve audio, even when it comes at a premium price, is perhaps best illustrated by Beats Electronics, a company founded by recording artist Dr. Dre and the Chairman of Interscope-Geffen Jimmy Lovine. Retail analysts at the NPD Group, recently cited the unprecedented growth of Beats Electronics, who in just over three years snapped up 51% of an estimated \$1 billion headphones segment. Of particular relevance is that Beats achieved these spectacular results by defying what some, perhaps many, considered to be the industry convention that "price is all that matters". Beats managed to lure customers away from flimsy \$20 earbuds, to quality headphones offered at a hefty price tag north of \$300; underlying yet again managements' assertion that the market is ready, willing and able to pay, even significant premiums, for a quality audio experience.

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Review of Operations (Cont.)

Throughout the period management has been proactive confirming such market trends in intimate conversations with our prospective customers, which if anything, have intensified their excitement and demand for our products as they gain an even clearer comprehension of the far-reaching and relevant value our impending products bring to the marketplace.

During the period of reporting the company received 6 patent grants of which two were granted in the Europe (one has been validated in 10 countries while the other in eight). The company further continued to expand its Intellectual Property portfolio, filing 14 applications during the reporting period for innovations in the fields of acoustic drive mechanisms, drive electronics, functional algorithms and packaging.

Changes in State of Affairs

There was no significant change in the state of affairs of the company other than that referred to in the financial statements or notes thereto.

Significant Events After Balance Date

Since the end of the financial year, the company agreed to the issue of 30,183 shares at an exercise price of A\$1.59 to a warrant holder in Audio Pixels Limited as a result the resolution of a previously disputed warrant agreement. The shares were issued on 1 February 2013 and raised cash of \$48,123.

Apart from the above, there has not been any matter or circumstance that has arisen since the end of the financial year which is not otherwise dealt with in this report or in the financial statements, that has significantly affected or may significantly affect the operations of the company, the results of those operations or the state of affairs of the company in subsequent financial years.

Future Developments

The company will continue to focus on the development of its digital speaker technology. The company has received MEMS chips from various suppliers which are being tested and evaluated and have played music under Phase II of the program. The positive results obtained from Phase II have now enabled the company to shift focus from structural optimisation to the production of a high performance end product. Planning for Phase III is well underway.

Environmental Regulations

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

Indemnification of Officers and Auditors

During or since the financial year, the company has not indemnified or made a relevant agreement to indemnify an officer or auditor of the company against a liability incurred as such an officer or auditor. In addition, the company has not paid, or agreed to pay, a premium in respect of a contract insuring against a liability incurred by an officer or auditor.

DIRECTORS' REPORT

Directors' Interests and Benefits

The relevant interest of each director in the share capital of the Company as notified by the directors to the Australian Stock Exchange in accordance with Section 205G(1) of the Corporations Act as at the date of this report are:

Name	Ordinary Shares
Fred Bart	5,291,250
Ian Dennis	520,050
Cheryl Bart	500,000

Since the end of the previous financial year no director of the company has received or become entitled to receive any benefit (other than a benefit included in the aggregate amount of remuneration received or due and receivable by directors as shown in the financial statements) because of a contract made by the company or related corporation with the director or with a firm of which the director is a member, or with a company in which the director has a substantial financial interest. There are no employment contracts for any of the directors.

Remuneration Report (Audited)

This report outlines the remuneration arrangements in place for Directors and key management personnel of the Company.

The Directors are responsible for remuneration policies and packages applicable to the Board members of the Company. The entire Board makes up the Nomination and Remuneration Committee. The broad remuneration policy is to ensure the remuneration package properly reflects the person's duties and responsibilities.

There are currently no performance based incentives to directors or executives based on the performance of the Company. There are no employment contracts in place with any Director of the Company. There are standard employment contracts for the three executives of Audio Pixels Limited in Israel including at will employment and a notice period of three months for termination.

The key management personnel of Audio Pixels Holdings Limited during the year were:

Name	Position
Fred Bart	Chairman and Chief Executive Officer
Cheryl Bart	Non executive director
Ian Dennis	Non executive director and company secretary
Danny Lewin	CEO and director of Audio Pixels Limited
Yuval Cohen	Chief Technical Officer of Audio Pixels Limited
Shay Kaplan	Chief Scientist of Audio Pixels Limited

The Directors fees are not dependent on the earnings of the company and the consequences of the company's performance on shareholder wealth. On 24 September 2010, the maximum total directors fees were increased to a total of \$250,000 per annum in line with the increased activities of the company. The actual directors fees paid were within the approved limit of \$250,000 per annum approved by shareholders at the Annual General Meeting held on 24 September 2010.

DIRECTORS' REPORT

Remuneration Report (Cont.)

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

	Year ended 31 December 2012	Year ended 31 December 2011	6 Months ended 31 December 2010	30 June 2010	30 June 2009	30 June 2008
	\$	\$	\$	\$	\$	\$
Revenue	161,986	269,534	143,207	563,842	438,819	344,384
Net profit/(loss) before tax	(2,622,099)	(2,931,907)	(557,129)	237,211	(246,279)	129,107
Net profit/(loss) after tax	(2,622,099)	(2,930,697)	(530,606)	197,489	(247,015)	90,375
Share price at start of year/period	6.00	4.60	0.260	0.160	0.205	0.270
Share price at end of year/period	5.60	6.00	4.60	0.260	0.160	0.205
Dividend Paid	0.00	0.00	0.000	0.000	0.000	0.000

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

	31 December 2012	31 December 2011
	\$	\$
Short-term employee benefits	553,453	600,964
Post employment benefits	108,821	117,788
Share-based payments	-	-
Termination benefits	-	-
	662,274	718,752

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Remuneration Report (Cont.)

	Short Term		Post Employment	Share Based Payments	Total
	Directors fees/ Salary \$	Non-monetary \$	Superannuation \$	Options \$	
December 2012					
Fred Bart	61,000	-	5,490	-	66,490
Cheryl Bart	37,500	-	3,375	-	40,875
Ian Dennis	67,500	-	3,375	-	70,875
Danny Lewin	107,019	23,223	32,202	-	162,444
Yuval Cohen	107,019	20,578	33,006	-	160,603
Shay Kaplan	102,312	27,302	31,373	-	161,987
	482,350	71,103	108,821	-	662,274
December 2011					
Fred Bart	61,000	-	5,490	-	66,490
Cheryl Bart	37,500	-	3,375	-	40,875
Ian Dennis	87,500	-	3,375	-	90,875
Danny Lewin	116,339	19,774	35,250	-	171,363
Yuval Cohen	116,339	25,975	35,951	-	178,265
Shay Kaplan	111,231	25,306	34,347	-	170,884
	529,909	71,055	117,788	-	718,752

Audit Committee

Due to the limitations imposed by size, the Company does not have a formally constituted audit committee.

Directors' Meetings

During the year the company held two meetings of directors. The attendances of the directors at meetings of the Board were:

	Attended	Maximum possible attended
Fred Bart	2	2
Ian Dennis	2	2
Cheryl Bart	2	2

No meetings of the Nomination and Remuneration Committee were held during the year. All current board members are on the Nomination and Remuneration Committee.

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Non-audit Services

Details of amounts paid or payable to the auditor for non-audit services provided during the year by the auditor are outlined in Note 5 to the financial statements.

The directors are satisfied that the provision of non-audit services, during the year, by the auditor (or by another person or firm on the auditor's behalf) is compatible with the general standard of independence for auditors imposed by the Corporations Act 2001.

The directors are of the opinion that the services disclosed in Note 5 to the financial statements do not compromise the external auditors' independence, based on a resolution of directors, for the following reasons:

- All non-audit services have been reviewed and approved to ensure that they do not impact the integrity and objectivity of the auditor, and
- None of the services undermine the general principles relating to auditor independence as set out in Code of Conduct APES 110 Code of Ethics for Professional Accountants issued by the Accounting Professional & Ethical Standards Board, including reviewing or auditing the auditor's own work, acting in a management or decision-making capacity for the company, acting as advocate for the company or jointly sharing economic risks and rewards.

Auditor's Independence Declaration

The auditor's independence declaration is included on page 10.

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

On behalf of the Directors



I A Dennis
Director

Dated at Sydney this 22 day of February 2013.