

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

1. Summary of Significant Accounting Policies

Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with the Corporations Act 2001, Accounting Standards and Interpretations, and complies with other requirements of the law. Accounting Standards include Australian equivalents to International Financial Reporting Standards ("AASBS"). Compliance with AASBS ensures that the financial statements and notes comply with International Financial Reporting Standards ("IFRS"). For the purposes of preparing the consolidated financial statements, the Company is a for profit entity.

The financial statements were authorised for issue by the Directors on 28 February 2018.

Basis of preparation

The financial report has been prepared on the basis of historical cost, except for the revaluation of the derivative liability. Cost is based on the fair values of the consideration given in exchange for assets. All amounts are expressed in Australian dollars.

(a) Borrowings

Borrowings are recorded initially at fair value, net of transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between the initial recognised amount and the redemption value being recognised in profit or loss over the period of the borrowing using the effective interest rate method.

(b) Going concern

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

The consolidated entity incurred a net loss during the year of \$5,914,957 (2016: \$5,054,771) and as at 31 December 2017 had net current liabilities of \$3,256,772 (2016: net current assets of \$239,476). Net cash used by operating activities was \$3,561,391 (2016: \$4,202,570). As at 31 December 2017, the consolidated entity had cash of \$2,700,577 (2016: \$5,083,948) of which \$53,092 (2016 - \$52,036) is restricted as it secures future lease payments. The cash will become unrestricted once the contracts are concluded or renegotiated. Further, in the

event that they are not converted to ordinary shares or the maturity date extended, the consolidated entity has \$7,500,000 due on convertible notes on 31 December 2018.

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

- the ability of the company to secure additional funding from existing or new investors to fund continued development and enable the repayment of convertible notes to the extent that they are not converted to ordinary shares. The directors consider that the company has a number of financing options available to it at this stage of the commercialisation of the product;
- the successful completion of the development stage of the technology; and
- the future trading prospects of the consolidated entity including obtaining commercial contracts.

If the company and the consolidated entity are unable to achieve successful outcomes in relation to the above matters, significant uncertainty would exist as to the ability of the company and the consolidated entity to continue as going concerns and therefore, they may be required to realise their assets and extinguish their liabilities other than in the normal course of business and at amounts different from those stated in the financial report.

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

(c) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, cash in banks and investments in money market instruments maturing within less than 3 months at the date of acquisition, net of outstanding bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities in the Statement of Financial Position.

(d) Employee benefits

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, and long service leave when it is probable that settlement will be required and they are capable of being measured reliably.

1. Summary of Significant Accounting Policies (Cont.)

Provisions made in respect of short term employee benefits are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of long term employee benefits are measured as the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Defined contribution plans - Contributions to defined benefit contribution superannuation plans are expensed when incurred.

(e) Financial assets

Financial assets are classified into loans and receivables. The classification depends on the nature and purpose of the financial assets and is determined at the time of the initial recognition.

Loans and receivables

Trade receivables, loans and other receivables are recorded at amortised cost less impairment.

(f) Financial instruments issued by the company

Debt and equity instruments

Debt and equity instruments are classified as either liabilities or as equity in accordance with the substance of the contractual arrangement and the definition of a financial liability and an equity instrument.

Transaction costs on the issue of equity instruments

Transaction costs arising on the issue of equity instruments are recognised directly in equity as a reduction of the proceeds of the equity instruments to which the costs relate. Transaction costs are the costs that are incurred directly in connection with the issue of those equity instruments and which would not have been incurred had those instruments not been issued.

Interest

Interest is classified as an expense consistent with the Statement of Financial Position classification of the related debt.

(g) Foreign currency

Foreign currency transactions

All foreign currency transactions during the financial year are brought to account using the exchange rate in effect at the date of the transaction. Foreign currency monetary items at reporting date are translated at the exchange rate existing at reporting date. Non-monetary assets and liabilities carried at fair value and historic cost that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined.

Exchange differences are recognised in profit and loss in the period they arise.

Foreign operations

On consolidation, the assets and liabilities of the consolidated entity's overseas operations are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are recognised in the foreign currency translation reserve, and recognised in profit and loss on disposal of the foreign operation.

(h) Goods and Services Tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except:

- i. where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- ii. for receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

Cash flows are included in the 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.

1. Summary of Significant Accounting Policies (Cont.)

(i) Goodwill

Goodwill arising in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

If, after reassessment, the Group's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Goodwill is not amortised but is reviewed for impairment at least annually. For the purpose of goodwill impairment testing, there was one cash-generating unit, relating to the digital speakers segment. The cash-generating unit is tested for impairment annually. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

(j) Impairment of assets

At each reporting date, the entity reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the entity estimates the recoverable amount of the cash-generating unit to which the asset belongs.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit or loss immediately.

(k) Income Tax

Current tax

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax

Deferred tax is recognised on temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities (other than as a result of business combination) which affects neither taxable income nor accounting profit.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the assets and liability giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the entity expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the company intends to settle its current tax assets and liabilities on a net basis.

1. Summary of Significant Accounting Policies (Cont.)

Current and deferred tax for the period

Current and deferred tax is recognised as an expense or income in profit or loss, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity, or where it arises from the initial accounting for a business combination, in which case it is taken into account in the determination of goodwill or excess.

(l) Intangible assets

Intangible assets acquired in a business combination

Intangible assets acquired in a business combination are identified and recognised separately from goodwill where they satisfy the definition of an intangible asset and their fair value can be measured reliably. Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets acquired separately. The intangible asset acquired is written off on a straight line basis. Expenditure on research activities is recognised as an expense in the period in which it is incurred.

(m) Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Group as lessor

Income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

The Group as lessee

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred. In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis, except where another systematic basis is

more representative of the time pattern in which economic benefits from the leased asset are consumed.

(n) Payables

Trade payable and other accounts payable are recognised when the entity becomes obliged to make future payments resulting from the purchase of goods and services.

(o) Provisions

Provisions are recognised when the entity has a present obligation as a result of a past event, the future sacrifice of economic benefits is probable, and the amount of the provision can be measured reliably.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that recovery will be received and the amount of the receivable can be measured reliably.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

(p) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company. Control is achieved when the Company:

- Has power over the investee;
- Is exposed, or has rights, to variable returns from its involvement with the investee; and
- Has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date the Company gains control until the date when the Company ceases to control the subsidiary.

All intragroup assets and liabilities, equity, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

1. Summary of Significant Accounting Policies (Cont.)

(q) Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation is recognised so as to write off the cost or valuation of assets less their residual values over their useful lives, using the straightline method. The estimated useful lives, residual values and depreciation method are reviewed at each year end, with the effect of any changes in estimate accounted for on a prospective basis.

Assets and disposal groups are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the non-current asset (or disposal group) is available for immediate sales in the present condition. Management must be committed to the sale, which should be expected to qualify as a completed sale within one year from the date of classification. Non-current assets (and disposal groups) classified as held for sale are measured at the lower of their previous carrying amount and fair value less costs to sell.

The following estimated useful lives are used in the calculation of depreciation:

| | |
|---------------------------------|---------------|
| Computers and related equipment | 5 to 15 years |
| Leasehold improvements | 3 to 5 years |
| Office furniture and equipment | 5 to 15 years |

(r) Financial liabilities

Classification as debt or equity

The Company has on issue convertible notes. The component parts of the convertible notes issued by the Group are classified separately as borrowings, derivative liability and equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

A conversion option that will be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is an equity instrument. A conversion option that will be settled by the exchange of a fixed

amount of cash or another financial asset for a variable number of the Company's own equity instruments is a derivative liability instrument. The value of a conversion option classified as a derivative liability instrument is recognised at fair value on issue. The derivative liability is subsequently measured at fair value through profit or loss.

The conversion option classified as equity is determined by deducting the amount of liability component from the fair value of the compound instrument as a whole. This is recognised and included in equity and is not subsequently remeasured. This will remain in equity until the conversion option is exercised or at maturity. No gain or loss is recognised in profit or loss upon expiration or conversion.

On initial recognition, the face borrowing or liability component is measured at fair value. This is subsequently recognised on an amortised cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date.

(s) Revenue Recognition

Revenue comprises interest income on bank deposits. Interest income received is recognised on an accrual basis.

(t) Application of New and Revised Accounting Standards

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

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

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

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

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

1. Summary of Significant Accounting Policies (Cont.)

(t) Application of New and Revised Accounting Standards (Cont.)

Standards and Interpretations in issue not yet adopted

At the date of authorisation of the financial statements, the Standards and Interpretations listed below were in issue but not yet effective.

| Standard/Interpretation | Effective for annual reporting periods beginning on or after | Expected to be initially applied in the financial year ending |
|---|--|---|
| AASB 9 Financial Instruments, and the relevant amending standards | 1 Jan 2018 | 31 Dec 2018 |
| AASB 15 Revenue from Contracts with Customers AASB 2014-5 Amendments to Australian Accounting Standards arising from AASB 15 and AASB 2015-8 Amendments to Australian Accounting Standards - Effective Date of AASB 15 AASB 2016-3 Amendments to Australian Accounting Standards - Clarifications to AASB 15 | 1 Jan 2018 | 31 Dec 2018 |
| AASB 16 Leases | 1 Jan 2019 | 31 Dec 2019 |
| 2017-1 Amendments to Australian Accounting Standards - Transfers of Investment Property, Annual Improvements 2014-2016 Cycle and Other Amendments | 1 Jan 2018 | 31 Dec 2018 |
| 2017-5 Amendments to Australian Accounting Standards - Effective Date of Amendments to AASB 10 and AASB 128 and Editorial Corrections | 1 Jan 2018 | 31 Dec 2018 |
| AASB 2016-5 Amendments to Australian Accounting Standards - Classification and Measurement of Share-based Payment Transactions | 1 Jan 2018 | 31 Dec 2018 |

The directors are still assessing the impact of AASB 9, AASB 15 and AASB 16. The directors anticipate that the adoption of all other Standards and Interpretations in future periods will have no material financial impact on the financial statements of the company or the consolidated entity but may change disclosures made.

(u) Share based payments

Equity-settled share-based payments are measured at fair value at the date of the grant. Fair value is measured by use of a Black-Scholes Option Pricing model. The expected life used in the model has been adjusted, based on management best estimates, for the effects of non-transferability, exercise restrictions and behavioural considerations. The fair value determined at the grant date of the equity-settled share based payments is expensed on a straight-line basis over the vesting period, based on the consolidated entity's estimate of shares that will eventually vest.

1. Summary of Significant Accounting Policies (Cont.)

(v) Critical accounting judgements

In the application of the consolidated entity's accounting policies, management is required to make judgements, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making these judgements. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Key sources of estimation uncertainty

The following are the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

Intangible asset/Goodwill

The directors made a critical judgement in relation to the value of the intangible asset included in Note 8 and the impairment model used in assessing the carrying amount of the goodwill (see Note 7).

Deferred tax

The directors made a critical judgement in relation to not recognising the deferred tax balances described in Note 3(b). Given the current stage of development, the directors do not currently consider it's probable that sufficient taxable amounts will be available against which deductible temporary differences can be utilised.

Valuation of face borrowing and derivative liability

The directors made a critical judgement in relation to the interest rate applied in valuing the face borrowing and the expected share price volatility used to value the derivative liability included in Note 11.

Functional Currency

The directors made a critical judgement in relation to the functional currency of Audio Pixels Holdings Limited. The directors consider AUD to be the appropriate functional currency, as financing activities of the entity occur in AUD.

Investment in subsidiary and intercompany receivable

The directors made a critical judgement in relation to the recoverability of the investment in subsidiary - Audio Pixels Limited and the receivable from this subsidiary. The assessment of the recoverability of these assets is considered concurrently with the recoverability of the intangible asset/goodwill. These assets are discussed in Note 23 as part of current and non-current assets:

- Investment in subsidiary - \$2,428,209 (non-current assets)
- Intercompany receivable - \$22,985,266 (included in current assets)

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | Consolidated Year ended 31 December 2017 \$ | Consolidated Year ended 31 December 2016 \$ |
|--|---|---|
| 2. (Loss) from Operations | | |
| (a) Revenue | | |
| Interest received - other entities | 65,624 | 103,630 |
| Total revenue | 65,624 | 103,630 |
| (b) Expenses | | |
| Amortisation | 79,637 | 80,483 |
| Depreciation | 79,639 | 73,493 |
| Interest expense | 593,179 | 419,595 |
| Rental payments | 123,375 | 116,770 |
| Rental amounts recharged to sub tenants | (97,533) | (93,248) |
| Net rental expense | 25,842 | 23,522 |
| Fair value movement in derivative liability | (157,996) | 511,648 |
| Employee benefits expense: | | |
| Salary and other employee benefits | 1,137,068 | 1,579,756 |
| Superannuation | 12,920 | 12,920 |
| | 1,149,988 | 1,592,676 |
| 3. Income Taxes | | |
| (a) Income tax recognised in profit or loss | | |
| Tax expense comprises: | | |
| Tax expense/(income) - prior year | - | - |
| Deferred tax expense/(income) | - | - |
| Total tax expense/(income) | - | - |
| The prima facie income tax expense on pre-tax accounting profit reconciles to the income tax expense in the financial statements as follows: | | |
| (Loss) from operations | (5,914,957) | (5,054,771) |
| Amortisation | 79,637 | 80,483 |
| Convertible note adjustments | 224,009 | 915,301 |
| | (5,611,311) | (4,058,987) |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|--|---------------------------|---------------------------|
| 3. Income Taxes (Cont.) | | |
| Income tax expense calculated at 30% | (1,683,363) | (1,217,696) |
| Effect of different tax rates of subsidiaries operating in other jurisdictions | 159,975 | 189,622 |
| Deferred tax benefit not brought to account | 1,523,388 | 1,028,074 |
| | - | - |

The tax rate used in the above reconciliation is the corporate tax rate of 30% payable by Australian corporate entities on taxable profits under Australian tax law and 25% under Israeli law. There has been no change in the corporate tax rate when compared with the previous reporting period.

(b) Unrecognised deferred tax balances

The following deferred tax assets have not been brought to account as assets:

| | | |
|-----------------------|-----------|-----------|
| Tax losses - revenue | 5,412,932 | 3,889,544 |
| Tax losses - capital | 168,038 | 168,030 |
| Temporary differences | 60,080 | (160,166) |
| | 5,641,050 | 3,897,408 |

(c) Franking account balance

| | | |
|-----------------------------------|--------|--------|
| Adjusted franking account balance | 86,721 | 86,721 |
|-----------------------------------|--------|--------|

(d) Israeli Tax Ruling

On July 16th 2012 a Tax Ruling was issued by the Israeli Tax Authorities (ITA) under which the ITA confirmed that the Merger carried out between Audio Pixels Ltd, a private Israeli company (P.C 513853606) and Audio Pixels Holdings Limited, a public Australian company, complied with the conditions stipulated in Section 103T of the Israeli Ordinance. Consequently, the transfer of the rights by the transferring rights holders in exchange for the issuance of shares in the Australian company is not taxable at the date of the Merger pursuant to the provisions of Section 103T of the Israeli Ordinance.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|--|---------------------------|---------------------------|
| 4. Remuneration of Auditors | | |
| (i) Auditor of the parent entity | | |
| Audit or review of the financial statements | 37,249 | 36,225 |
| Taxation service | 2,704 | 3,575 |
| | 39,953 | 39,800 |
| (ii) Network firm of the parent entity auditor | | |
| Audit or review of the financial statements | 17,998 | 18,625 |
| Taxation service | 2,000 | 2,070 |
| | 19,998 | 20,695 |

The auditor of Audio Pixels Holdings Limited is Deloitte Touche Tohmatsu.

5. Cash and Cash Equivalents

| | | |
|---|-----------|-----------|
| Cash on hand and at bank | 2,700,577 | 5,083,948 |
| Weighted average interest rate received on cash | 0.36% | 2.21% |

6. Trade and Other Receivables

| | | |
|--------------------------------------|-----------|--------|
| Current | | |
| GST receivable | 10,167 | 8,827 |
| Convertible note proceeds receivable | 3,000,000 | - |
| Prepayments and other debtors | 35,946 | 77,291 |
| | 3,046,113 | 86,118 |
| Non Current | | |
| Other debtors | 16,108 | 11,873 |

Other debtors comprise security deposits with government bodies.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|--|---------------------------|---------------------------|
| 7. Goodwill | | |
| Being goodwill acquired on the acquisition of Audio Pixels Limited. The goodwill is allocated to the cash generating unit of digital speakers by Audio Pixels Limited of Israel. | 2,189,025 | 2,300,905 |
| Balance at 1 January | 2,300,905 | 2,166,391 |
| Net foreign currency exchange | (111,880) | 134,514 |
| Balance at 31 December | 2,189,025 | 2,300,905 |

The recoverable amount of this cash generating unit is determined based on a fair value less costs of disposal calculation which uses cash flow projections based on financial budgets approved by the directors covering an 11 year period, with a growth rate reflecting the expected future growth in the product market, and a discount rate of 24% per annum. The assumed growth rate is based on the forecast future global MEMS market. Given the nature of the product, the forecast cash flows are managements' best estimate and reflect the risks inherent in the initial take up of the product. The cash flow projections used in the impairment model extend beyond 5 years as the intangible assets generating the cash flows within relate to new technology and hence reflect a longer operating cycle and time to market. Cash flow projections during the budget period are based on the same expected gross margins and raw materials price inflation during the budget period and factor in a probability of the viability of the product. The fair value less costs of disposal calculation is sensitive to changes in the percentage likelihood of completion. Increases in the percentage likelihood of completion increases the recoverable amount and vice versa. Movements in the value of the goodwill are a result of the retranslation of the goodwill from the functional currency of the cash generating unit to which it is attributed.

8. Intangible Asset

| | | |
|--|-----------|-----------|
| Being the independent valuation of In Process Development determined at the acquisition date of 24 September 2010 by Ernst & Young, Israel in their report dated 17 August 2011. | 868,000 | 868,000 |
| Exchange differences on translation | 151,987 | 198,427 |
| Less accumulated amortisation | (506,214) | (426,577) |
| | 513,773 | 639,850 |

The intangible asset is allocated to the digital speaker cash-generating unit when assessed for impairment. Refer to Note 7 for commentary on cash-generating unit.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|---|---------------------------|---------------------------|
| 9. Property, Plant and Equipment | | |
| Computers and related equipment - at cost | 351,372 | 362,977 |
| Less accumulated depreciation | (331,920) | (344,624) |
| | 19,452 | 18,353 |
| Leasehold improvements - at cost | 324,269 | 241,873 |
| Less accumulated depreciation | (216,887) | (226,061) |
| | 107,382 | 15,812 |
| Office furniture and equipment - at cost | 1,059,881 | 1,043,341 |
| Less accumulated depreciation | (862,105) | (910,919) |
| | 197,776 | 132,422 |
| Total net book value of Property, Plant and Equipment | 324,610 | 166,587 |
| Cost | | |
| Computers and related equipment | | |
| Balance at 1 January | 362,977 | 356,676 |
| Additions | 18,586 | 4,364 |
| Disposals | (4,744) | (3,068) |
| Net foreign currency exchange differences | (25,447) | 5,005 |
| Balance as at 31 December | 351,372 | 362,977 |
| Leasehold improvements | | |
| Balance at 1 January | 241,873 | 226,429 |
| Additions | 105,997 | 12,266 |
| Disposals | (4,760) | - |
| Net foreign currency exchange differences | (18,841) | 3,178 |
| Balance as at 31 December | 324,269 | 241,873 |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|--|---------------------------|---------------------------|
| 9. Property, Plant and Equipment (Cont.) | | |
| Office furniture and equipment | | |
| Balance at 1 January | 1,043,341 | 973,609 |
| Additions | 139,375 | 56,070 |
| Disposals | (38,732) | - |
| Net foreign currency exchange differences | (84,103) | 13,662 |
| Balance as at 31 December | 1,059,881 | 1,043,341 |
| Accumulated depreciation | | |
| Computers and related equipment - at cost | | |
| Balance as at 1 January | (344,624) | (327,468) |
| Net foreign currency exchange differences | 24,637 | (4,705) |
| Disposals | 3,994 | 3,068 |
| Depreciation expense | (15,927) | (15,519) |
| Balance at 31 December | (331,920) | (344,624) |
| Leasehold improvements | | |
| Balance as at 1 January | (226,061) | (223,338) |
| Net foreign currency exchange differences | 17,988 | (2,124) |
| Disposals | 911 | - |
| Depreciation expense | (9,725) | (599) |
| Balance at 31 December | (216,887) | (226,061) |
| Office furniture and equipment | | |
| Balance as at 1 January | (910,919) | (841,330) |
| Net foreign currency exchange differences | 75,893 | (12,214) |
| Disposals | 26,908 | - |
| Depreciation expense | (53,987) | (57,375) |
| Balance at 31 December | (862,105) | (910,919) |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|-------------------------------------|---------------------------|---------------------------|
| 10. Trade and Other Payables | | |
| Current | | |
| Trade payables and accruals | 887,770 | 471,870 |

The payables are non interest bearing and have an average credit period of 30 days.

11. Borrowings

On 4 May 2015, the Company announced its intention to issue two convertible notes of \$1,500,000 each at a coupon rate of 8% per annum, raising \$3,000,000.

One convertible note was issued to an unrelated party on 28 May 2015 and one convertible note was issued to 4F Investments Pty Limited, a company associated with Mr Fred Bart. The convertible note to 4F Investments Pty Limited received shareholder approval at an Extraordinary General Meeting held on 22 June 2015 and was issued on 26 June 2015.

The unrelated party holding one convertible note of \$1,500,000 agreed to extend their convertible note to 31 December 2016 on 22 March 2016. On 31 May 2016 shareholders approved the extension of the convertible note to 4F Investments Pty Limited to 31 December 2016.

On 28 December 2016, the Company reached agreement with both holders of the convertible notes to extend the expiry date by 12 months to 31 December 2017. Shareholder approval for the extension of the convertible note held by 4F Investments Pty Limited was received at the Annual General Meeting of the Company held on 31 May 2017.

On 29 December 2017, the Company reached agreement with both holders of the convertible notes to extend the expiry date by 12 months to 31 December 2018. Shareholder approval for the extension of the convertible note held by 4F Investments Pty Limited will be sought at the next Annual General Meeting of the Company.

For accounting purposes these extensions have been treated as the derecognition of the original convertible notes and the recognition of two new convertible note instruments. The difference in valuation is recognised as a gain or loss in the profit and loss.

The two convertible notes initially issued on 28 May 2015 and 22 June 2015 amounting to \$3,000,000 now have a term of 12 months to 31 December 2018. These notes are unsecured, not listed and are convertible to ordinary shares based on the lower of the five day volume weighted average share price of Audio Pixels Holdings Limited on the date of the original agreement (\$9.68) or the five day volume weighted average share price of Audio Pixels Holdings Limited immediately prior to conversion.

On 5 January 2018, The Company announced it had raised \$4,500,000 from a new convertible note issue to sophisticated unrelated investors pursuant to agreements dated 29 December 2017. In addition, 4F Investments Pty Limited, a company associated with Mr Fred Bart also agreed to take up a further \$500,000 of convertible notes on the same terms and conditions subject to shareholder approval at the next Annual General Meeting of the Company.

These new convertible notes have a term of 12 months to 31 December 2018, are unsecured, not listed and convertible into ordinary shares based on the five day volume weighted average share price of Audio Pixels Holdings Limited on the date of the agreement (\$16.71).

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|--|---------------------------|---------------------------|
|--|---------------------------|---------------------------|

11. Borrowings (Cont.)

Borrowings - Convertible note

| | | |
|---|-----------|-----------|
| Carrying amount at start of period | 2,648,387 | 2,735,439 |
| Face value of notes issued | 4,500,000 | - |
| Gain on derecognition of convertible notes | (444,618) | (267,305) |
| Convertible note equity reserve - fair value initially recognised | (666,893) | - |
| | 6,036,876 | 2,468,134 |
| Amortised interest | 351,613 | 180,253 |
| Current Liability at end of period | 6,388,489 | 2,648,387 |

Derivative liability

| | | |
|--|-----------|-----------|
| Carrying value at start of the period | 1,169,870 | 167,517 |
| Loss on derecognition of convertible notes | 159,018 | 490,705 |
| Fair value movement to the end of the reporting period | 157,996 | 511,648 |
| Derivative liability | 1,486,884 | 1,169,870 |
| Total borrowings | 7,875,373 | 3,818,257 |

12. Provisions

| | | |
|-------------------|---------|---------|
| Employee benefits | 240,319 | 640,463 |
|-------------------|---------|---------|

13. Issued Capital

Issued and paid up capital

Fully paid Ordinary Shares

| | | |
|--|------------|------------|
| Balance at the beginning of the financial year | 45,228,931 | 37,398,942 |
| Placement for cash at \$6.60 per share | - | 7,829,989 |
| Balance at the end of the financial year | 45,228,931 | 45,228,931 |

Fully paid Ordinary Shares

| | Number | Number |
|--|------------|------------|
| Balance at the beginning of the financial year | 26,893,409 | 25,707,047 |
| Placement for cash at \$6.60 per share | - | 1,186,362 |
| Balance at the end of the financial year | 26,893,409 | 26,893,409 |

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

Changes in the Corporations Law abolished the authorised capital and par value concept in relation to share capital from 1 July 1998. Therefore the company does not have a limited amount of authorised capital and issued shares do not have a par value.

In 2016, a share placement occurred. 151,515 shares were issued to a company associated with Fred Bart. 1,034,847 shares were issued to unrelated parties.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|---|----------------------------|----------------------------|
| 14. Reserves | | |
| Foreign currency translation | | |
| Balance at the beginning of the financial year | (3,251,993) | (3,115,487) |
| Translation of foreign operations | 1,676,117 | (136,506) |
| Balance at end of financial year | <u>(1,575,876)</u> | <u>(3,251,993)</u> |
| Foreign currency translation | | |
| Exchange differences relating to the translation of the results and net assets of the Group's foreign operations from their functional currencies to the Group's presentation currency (i.e. Australian dollars) are recognised directly in other comprehensive income and accumulated in the foreign currency translation reserve. Exchange differences previously accumulated in the foreign currency translation reserve are reclassified to profit and loss on the disposal of the foreign operation. | | |
| Equity settled option reserve | | |
| Balance at the beginning of the financial year | 4,512,898 | 4,512,898 |
| Balance at end of financial year | <u>4,512,898</u> | <u>4,512,898</u> |
| The above equity-settled option reserve relates to share options granted by the Company. | | |
| Minority acquisition reserve | | |
| Balance at the beginning of the financial year | (25,538,692) | (25,538,692) |
| Balance at end of financial year | <u>(25,538,692)</u> | <u>(25,538,692)</u> |
| The non-controlling interest reserve comprises amounts related to the acquisition of a non-controlling interest shareholding in a subsidiary company in a prior period. | | |
| Convertible Note Equity Reserve | | |
| Balance at the beginning of the financial year | - | - |
| Increase as a result of derivative liability recognised on the issue of convertible notes treated as equity | 666,893 | - |
| Balance at end of financial year | <u>666,893</u> | <u>-</u> |
| Total Reserves | <u>(21,934,777)</u> | <u>(24,277,787)</u> |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|---|---------------------------|---------------------------|
| 15. Accumulated Losses | | |
| Balance at the beginning of the financial year | (17,592,453) | (12,537,682) |
| (Loss) for the year attributable to owners of the company | (5,914,957) | (5,054,771) |
| Balance at the end of the financial year | (23,507,410) | (17,592,453) |

16. Notes to the Statement of Cash Flows

(a) Reconciliation of cash and cash equivalents

For the purposes of the statement of cash flows, cash includes cash on hand and at call deposits with banks or financial institutions, investments in money market instruments maturing within less than 3 months at the date of acquisition. Cash and cash equivalents at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:

| | | |
|---|-----------|-----------|
| Cash and cash equivalents | 2,700,577 | 5,083,948 |
| (b) Restricted cash | | |
| Cash held as security for future lease payments | 53,092 | 52,036 |

(c) Reconciliation of (loss) for the period to net cash flows from operating activities

| | | |
|---|-------------|-------------|
| (Loss) after related income tax | (5,914,957) | (5,054,771) |
| Amortisation | 79,637 | 80,483 |
| Convertible note adjustments | 224,009 | 915,301 |
| Depreciation | 79,639 | 73,493 |
| Foreign exchange gains | 1,918,755 | (286,844) |
| Changes in assets and liabilities | | |
| (Increase)/ decrease in assets | | |
| Current trade and other receivables | 40,005 | (42,392) |
| Non-current trade and other receivables | (4,235) | (5,036) |
| Increase /(decrease) in liabilities | | |
| Provisions | (400,144) | 115,556 |
| Current trade payables | 415,900 | 1,640 |
| Net cash (used in) operating activities | (3,561,391) | (4,202,570) |

17. Related Party Transactions

(a) Directors

The Directors of Audio Pixels Holdings Limited in office during the year were Fred Bart, Ian Dennis and Cheryl Bart.

(b) KMP Remuneration

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

| | 31 December 2017 \$ | 31 December 2016 \$ |
|------------------------------|---------------------------|---------------------------|
| Short-term employee benefits | 775,262 | 737,818 |
| Post employment benefits | 169,339 | 163,284 |
| | 944,601 | 901,102 |

The remuneration above relates to directors fees, consultancy fees and superannuation paid to entities associated with Fred Bart, Cheryl Bart and Ian Dennis and the remuneration of the three senior executives of Audio Pixels Limited in Israel.

(c) Transactions with related entities

During the year ended 31 December 2017, the Company paid a total of \$107,857 (year ended 31 December 2016 - \$107,857) to 4F Investments Pty Limited, a company associated with Mr Fred Bart in respect of directors fees and superannuation for Mr Fred Bart and Mrs Cheryl Bart.

During the year ended 31 December 2017, the Company paid a total of \$41,063 (year ended 31 December 2016 - \$41,063) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of directors fees and superannuation.

During the year ended 31 December 2017, the Company paid interest of \$119,407 (year ended 31 December 2016 - \$119,671) on a convertible note to 4F Investments Pty Limited, a company associated with Mr Fred Bart. The convertible note of \$1.5m was issued on 26 June 2015 following shareholder approval at an Extraordinary General Meeting. The convertible note was extended twice during the year ended 31 December 2016 and once during the year ended 31 December 2017, the most recent of which being on 29 December 2017, which is subject to shareholder approval. The note now expires on or before 31 December 2018.

During the year, the Company paid \$30,000 (31 December 2016 - \$30,000) to Dennis Corporate Services Pty Limited, a company associated with Mr Ian Dennis in respect of consulting fees for company secretarial and accounting services.

On 8 May 2014, the company entered into a lease in respect of office premises at Level 12, 75 Elizabeth Street Sydney for a period of forty eight months to 30 March 2018. The company recharged \$22,955 of the rent and other tenancy charges to Electro Optic Systems Holdings Limited, a company of which Fred Bart and Ian Dennis are directors, \$22,762 to 4F Investments Pty Limited, a company controlled by Fred Bart and \$45,910 to another tenant who is a shareholder in the company.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 | 31 December 2016 |
|--|---------------------|---------------------|
| 18. Earnings per Share | | |
| Basic (loss) per share | (21.99) cents | (19.02) cents |
| Diluted (loss) per share (b) | (21.99) cents | (19.02) cents |
| (Loss) (a) | (5,914,957) | (5,054,771) |
| Weighted average number of Ordinary Shares | 26,893,409 | 26,571,894 |

- (a) (Loss) used in the calculation of basic earnings per share are the same as the net (loss) in the Statement of profit or loss and other comprehensive income.
- (b) There are potential ordinary shares to be issued in relation to the convertible notes of \$3m which expire on 31 December 2018. The convertible note holders have the option of receiving their \$3m back with interest or converting their convertible notes into ordinary shares based on the lower of the five day volume weighted average share price of Audio Pixels Holdings Limited on the date of the agreement (\$9.68) or the five day volume weighted average share price of Audio Pixels Holdings Limited immediately prior to conversion. The convertible notes have not been included in dilutive EPS, as they are anti-dilutive.
- (c) There are potential ordinary shares to be issued in relation to the convertible notes of \$4.5m which expire on 31 December 2018. The convertible note holders have the option of receiving their \$4.5m back with interest or converting their convertible notes into ordinary shares based on the five day volume weighted average share price of Audio Pixels Holdings Limited on the date of the agreement (\$16.71). The convertible notes have not been included in dilutive EPS, as they are anti-dilutive.

19. Segment Information

AASB 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess performance.

The identification of the Group's reportable segments has not changed from those disclosed in the previous 2016 report.

The consolidated entity operates in Australia and Israel.

Products and services within each segment

Digital speakers

The subsidiary company in Israel is developing a digital speaker and has not reached the stage of generating any revenue from the technology.

Segment Revenues

| | | |
|-----------------------|--------|---------|
| Digital speakers | 65,624 | 103,630 |
| Total of all segments | 65,624 | 103,630 |

Segment Results

| | | |
|----------------------------|-------------|-------------|
| Digital speakers | (5,914,957) | (5,054,771) |
| (Loss) before income tax | (5,914,557) | (5,054,771) |
| Income tax gain/ (expense) | - | - |
| (Loss) for the period | (5,914,957) | (5,054,771) |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

19. Segment Information (Cont.)

Segment Assets and Liabilities

| | Assets | | Liabilities | |
|--------------------|------------------------|------------------------|------------------------|------------------------|
| | 31 December 2017 \$ | 31 December 2016 \$ | 31 December 2017 \$ | 31 December 2016 \$ |
| Digital speakers | 8,790,206 | 8,289,281 | 9,003,462 | 4,930,591 |
| Total all segments | 8,790,206 | 8,289,281 | 9,003,462 | 4,930,591 |
| Unallocated | - | - | - | - |
| Consolidated | 8,790,206 | 8,289,281 | 9,003,462 | 4,930,591 |

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

Other Segment Information

| | Depreciation and amortisation of segment assets | | Acquisition of segment assets | |
|--------------------|---|------------------------|-------------------------------|------------------------|
| | 31 December 2017 \$ | 31 December 2016 \$ | 31 December 2017 \$ | 31 December 2016 \$ |
| Digital speakers | 159,276 | 153,976 | 263,958 | 72,700 |
| Total all segments | 159,276 | 153,976 | 263,958 | 72,700 |
| Unallocated | - | - | - | - |
| Consolidated | 159,276 | 153,976 | 263,958 | 72,700 |

Information on Geographical Segments

| Geographical Segments | Revenue from External Customers \$ | Segment Assets \$ | Acquisition of Segment Assets \$ |
|-------------------------|---------------------------------------|----------------------|-------------------------------------|
| 31 December 2017 | | | |
| Australia | 65,624 | 8,028,778 | - |
| Israel | - | 761,428 | 263,958 |
| Total | 65,624 | 8,790,206 | 263,958 |
| 31 December 2016 | | | |
| Australia | 103,630 | 4,543,183 | - |
| Israel | - | 3,746,098 | 72,700 |
| Total | 103,630 | 8,289,281 | 72,700 |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

20. Financial Risk Management Objectives and Policies

The consolidated entity's principal financial instruments comprise receivables, payables, borrowings, derivative liabilities, cash and short term deposits.

Due to the small size of the group significant risk management decisions are taken by the board of directors. These risks include market risk (including fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Directors do not plan to eliminate risk altogether, rather they plan to identify and respond to risks in a way that creates value for the company and its shareholders. Directors and shareholders appreciate that in order for the consolidated entity to compete and grow, a long term strategy needs to involve risk taking for reward.

The consolidated entity does not use derivative financial instruments to hedge these risk exposures.

Risk Exposures and Responses

(a) Interest rate risk

The Group's exposure to market interest rates relates primarily to the consolidated entity's cash holdings and short term deposits.

At balance date, the consolidated entity had the following mix of financial assets exposed to Australian interest rate risk that are not designated in cash flow hedges:

| | 31 December 2017 \$ | 31 December 2016 \$ |
|---------------------------|---------------------------|---------------------------|
| Financial assets | | |
| Cash and cash equivalents | 2,700,577 | 5,083,948 |

The Group constantly analyses its interest rate exposure. Within this analysis consideration is given to potential renewals of existing positions, alternative financing and the mix of fixed and variable interest rates.

At 31 December 2017, if interest rates had moved, as illustrated in the table below, with all other variables held constant, post tax (loss) and equity would have been affected as follows:

| Judgements of reasonably possible movements | Post Tax Profit Higher/(Lower) | | Equity Higher/(Lower) | |
|---|--------------------------------|---------------------------|---------------------------|---------------------------|
| | 31 December 2017 \$ | 31 December 2016 \$ | 31 December 2017 \$ | 31 December 2016 \$ |
| Consolidated entity | | | | |
| +1% (100 basis points) | 27,006 | 50,839 | 27,006 | 50,839 |
| -0.5% (50 basis points) | (3,710) | (25,420) | (3,710) | (25,420) |

The movements in profits are due to higher/lower interest rates on cash and cash equivalents balances. The cash and cash equivalents balances were lower in December 2017 than in December 2016 and accordingly the sensitivity is lower.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

20. Financial Risk Management Objectives and Policies (Cont.)

(b) Foreign currency risk

The consolidated entity has a foreign currency risk since the acquisition of Audio Pixels Limited. Audio Pixels Limited operates in Israel and all transfer of funds to Audio Pixels Limited are denominated in US dollars. The consolidated entity does not hedge its US dollar exposure.

The carrying amounts of the Group's foreign currency (US\$) denominated monetary assets and monetary liabilities at the end of the reporting period are as follows:

| | Liabilities | | Assets | |
|-----------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| | 31 December 2017 \$ | 31 December 2016 \$ | 31 December 2017 \$ | 31 December 2016 \$ |
| Cash and cash equivalents | - | - | 406,585 | 745,611 |
| Trade and other receivables | - | - | 35,946 | 77,291 |
| Trade and other payables | 850,406 | 374,591 | - | - |

All US\$ denominated financial instruments were translated to A\$ at 31 December 2017 at the exchange rate of 0.7805 (2016: 0.7197).

At 31 December 2017 and 31 December 2016, had the Australian Dollar moved, as illustrated in the table below, with all other variables held constant, post tax loss and equity would have been affected as follows:

| Judgements of reasonably possible movements | Post Tax Loss Higher/(Lower) | | Equity Higher/(Lower) | |
|---|------------------------------|------------|-----------------------|------------|
| | 2017 \$ | 2016 \$ | 2017 \$ | 2016 \$ |
| Consolidated | | | | |
| AUD/USD +10% | 290,884 | 344,768 | 290,884 | 344,768 |
| AUD/USD -5% | (168,427) | (199,603) | (168,427) | (199,603) |

Management believes the balance date risk exposures are representative of risk exposure inherent in financial instruments.

(c) Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in a financial loss to the Group. The consolidated entity has adopted a policy of only dealing with creditworthy counterparties which are continuously monitored.

The credit risk on liquid funds is limited because the counterparties are major banks with high credit-ratings assigned by international credit agencies.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

20. Financial Risk Management Objectives and Policies (Cont.)

(d) Liquidity risk management

The consolidated entity's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due. The consolidated entity's investments in money market instruments all have a maturity of less than 3 months.

Ultimate responsibility for liquidity risk management rests with the board of directors, who have built an appropriate risk management framework for the management of the consolidated entity's short, medium and long term funding and liquidity requirements. The consolidated entity manages liquidity by maintaining adequate cash reserves by continuously monitoring forecast and actual cash flows and managing maturity profiles of financial assets.

The following tables detail the consolidated entity's remaining contractual maturity for its non-derivative financial assets and non-derivative financial liabilities. The tables have been drawn up based on the undiscounted contractual maturities of the financial assets and financial liabilities including interest that will be earned on these assets except where the consolidated entity anticipates that the cash flow will occur in a different period.

| | Weighted average effective interest rate % | Less than 1 month \$ | 1-3 months \$ | 3 months to 1 year \$ | 1-5 years \$ |
|-------------------------|---|----------------------------|------------------|-----------------------------|-----------------|
| 31 December 2017 | | | | | |
| Assets | | | | | |
| Non interest bearing | 0.00 | 306,095 | - | - | - |
| Fixed rate instruments | 0.36 | 2,394,462 | | | |
| Liabilities | | | | | |
| Convertible notes | 8.00 | - | 150,000 | 7,950,000 | - |
| 31 December 2016 | | | | | |
| Assets | | | | | |
| Non interest bearing | 0.00 | 714,569 | - | - | - |
| Fixed rate instruments | 2.21 | 4,378,720 | 18,375 | 84,306 | 499,633 |
| Liabilities | | | | | |
| Convertible notes | 8.00 | - | 60,000 | 3,180,000 | - |

All financial liabilities are expected to be settled under commercial terms of within 12 months. The derivative liability amount if converted will be settled in equity, so no associated cash outflows.

(e) Commodity price risk

The consolidated entity has no exposure to commodity price risk.

(f) Other price risks

The directors consider that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values.

21. Financial Instruments

Fair value of financial instruments

This note provides information about how the Group determines fair values of various financial assets and financial liabilities.

Financial liabilities

- (a) The original convertible note with a face value of \$3,000,000 derivative liability is valued as sold call options with a strike price of \$9.68 using the Black-Scholes option pricing model. An input into the Black-Scholes option pricing model is the expected share price volatility over the remaining term of the options. The expected share price volatility used in the option valuation at reporting date was 50.00% which was based on historical share price volatility.
- (b) The new convertible note with a face value of \$4,500,000 derivative liability is valued as sold call options with a strike price of \$16.71 using the Black-Scholes option pricing model. An input into the Black-Scholes option pricing model is the expected share price volatility over the remaining term of the options. The expected share price volatility used in the option valuation at reporting date was 59.65% which was based on historical share price volatility.

The fair value of the derivative liability is sensitive to changes in share price volatility. Increases in volatility increase the fair value of the derivative liability and vice versa.

The fair value hierarchy was Level 3. A movement schedule is included in Note 11.

22. Subsequent Events

The Directors are not aware of any significant events since the end of the financial year and up to the date of this report.

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

| | 31 December 2017 \$ | 31 December 2016 \$ |
|--|---------------------------|---------------------------|
| 23. Parent Entity Disclosures | | |
| Financial position | | |
| Assets | | |
| Current assets | 28,311,243 | 26,282,355 |
| Non-current assets | 2,428,209 | 2,428,209 |
| Total assets | 30,739,452 | 28,710,564 |
| Liabilities | | |
| Current liabilities | 7,912,737 | 3,915,537 |
| Non-current liabilities | - | - |
| Total liabilities | 7,912,737 | 3,915,537 |
| Net assets | 22,826,715 | 24,795,027 |
| Equity | | |
| Issued capital | 45,228,931 | 45,228,931 |
| Reserves | (20,358,901) | (21,025,794) |
| (Accumulated losses)/Retained earnings | (2,043,315) | 591,890 |
| Total equity | 22,826,715 | 24,795,027 |
| Financial performance | | |
| (Loss) for the period | (2,635,205) | (1,181,840) |
| Other comprehensive income | - | - |
| | (2,635,205) | (1,181,840) |

24. Controlled Entity

| Name of Entity | Country of Incorporation | 31 December 2017 % | 31 December 2016 % |
|--|-----------------------------|--------------------------|--------------------------|
| Parent Entity | | | |
| Audio Pixels Holdings Limited | Australia | | |
| Controlled Entities | | | |
| Audio Pixels Limited | Israel | 100.00 | 100.00 |
| Audio Pixels Technologies Pty Limited - incorporated on 11 May 2016 | Australia | 100.00 | 100.00 |

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

25. Leases

Operating leases - leasing arrangements (the Company as lessee)

On 8 May 2014, the parent company entered into a lease in respect of office premises at Level 12, 75 Elizabeth Street Sydney for a period of forty eight months from 31 March 2014 to 30 March 2018. The company recharges 20% of the rent and other tenancy charges to Electro Optic Systems Holdings Limited, a company of which Fred Bart and Ian Dennis are directors, 20% to 4F Investments Pty Limited, a company controlled by Fred Bart and 40% to another tenant who is a shareholder in the Company.

| | 31 December 2017 \$ | 31 December 2016 \$ |
|---|---------------------------|---------------------------|
| Non-cancellable operating lease payables | | |
| Not longer than 1 year | 31,125 | 102,321 |
| Longer than 1 year and not longer than 5 years | - | 21,879 |
| Longer than 5 years | - | - |
| | 31,125 | 124,200 |

The Company recovers 80% of the lease payments and other tenancy charges from director related entities and another party on a month to month basis.

26. Contingent Liability

The parent company has been advised of a potential derivative action in Israel by an individual shareholder of BE4 Limited (a company with no financial interest in Audio Pixels Holdings Limited), an Israeli company in bankruptcy proceedings. The Central District Court of Israel dismissed the motion to file a derivative action against Audio Pixels Limited and impose costs and expenses on the petitioner. At the date of this report the period in which to appeal the decision is still open. The Directors do not believe the Company has a case to answer, and is prepared to vigorously defend any action if commenced.

27. Commitments

The subsidiary company, Audio Pixels Limited of Israel has entered into various purchase orders and commitments of \$451,745 (2016: \$1,754,896) with various strategic partners which will become payable once qualified products are delivered to the company.

28. Additional Company Information

Audio Pixels Holdings Limited is a listed public company, incorporated and operating in Australia.

Registered Office and Principal Place of Business

Suite 3, Level 12
75 Elizabeth Street
Sydney NSW 2000
Australia

Tel: (02) 9233 3915
Fax: (02) 9232 3411

www.audiopixels.com.au

The Company has 11 (2016: 11) employees in Israel.