



28 October 2008

The Listing Manager
Australian Stock Exchange Limited
Level 8, 2 The Esplanade
PERTH WA 6000

Annual General Meeting 2008 – Managing Director Report

Dear Sir

The Managing Director's report to shareholders at today's Structural Monitoring Systems plc Annual General Meeting is provided below.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Colin McDonald', written in a cursive style.

Colin McDonald
Company Secretary

MANAGING DIRECTOR'S REPORT

2008 has been a year of major achievements and challenges for Structural Monitoring Systems plc.

Significant progress has been made in the primary objective of having the Comparative Vacuum Monitoring (CVM™) technology accepted as a means of improving maintenance and reducing cost for both civil and military aircraft. On the other hand, the on-going crisis in the world's financial markets has required the reduction of operations to direct the funds remaining to protect the Company's Intellectual Property while additional funds are sought.

The year started well with the announcement that the Directorate General Technical Airworthiness (DGTA) of the Australian Defence Force (ADF) had given accreditation to the CVM technology for use on ADF aircraft. This was an important milestone as it meant that CVM was then available to be used as a structural integrity tool for use on ADF aircraft to reduce maintenance costs and improve fleet availability.

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An important element of introducing CVM into use by the ADF is the RAAF /RAF collaborative Hercules C-130J fatigue test program and an 'in-principle' agreement has been reached to proceed with the integration of CVM into this program subject to the Company stabilising its financial position. The USAF Air Force Research Laboratories have also been evaluating CVM for use on their aircraft in an on-going program of tests. In addition discussions have been on-going during the year with a number of other air forces around the world regarding opportunities for military aircraft fleet-wide CVM applications, although they are currently on-hold pending the outcome of the Company's capital raising activities..

In March the Company announced that Bombardier Aerospace of Montreal, Canada (the third largest aircraft manufacturing company in terms of workforce) was the latest major aircraft designer and manufacturer to evaluate CVM technology. The Company received orders from Bombardier Aerospace to enable them to evaluate the performance of CVM technology and as a result of this the Company is now working closely with Bombardier, a North American airline, and Transport Canada to certify CVM technology to improve the maintenance planning and enable the reduction of maintenance costs of Bombardier CRJ* Series aircraft, a fleet that comprises more than 1,500 aircraft worldwide.

The Company has received initial orders from a North American airline for a CVM sensor application kit and the lease of a PM200 instrument which is an important milestone for the Company as they are the first by an airline for a commercial CVM application. The Company is working with Bombardier and the airline to install the sensor application kit on an operating CRJ aircraft in the near future. The airline has been proactive and supportive of the introduction of CVM technology on to its fleet of aircraft, and recently demonstrated the use of the PM200 and CVM sensors at a conference of operators of the Bombardier CRJ* and Dash-8* Series aircraft.

In April the Company announced the first installation of a production CVM system on a Boeing commercial aircraft structure. The installation was conducted at the FAA Airworthiness Assurance NDI Validation Center at Sandia National Laboratories. This achievement was recognised by Sandia with an award to the team involved with the installation for producing "the first on-board structural health monitoring sensor ever deployed on commercial aircraft".

Despite the success of this program The Boeing Company notified the Company in August that the regulatory approval process for this initial application of CVM sensors has been put on-hold due to a major restructure of operations of one of the US airlines that have sponsored this application. This decision is due to the impact of high fuel prices on US airlines and as such beyond the control of the Company. Due to the progress that has been achieved thus far, The Boeing Company remains committed to the introduction of CVM technology on its commercial and large military aircraft.

The Company also announced in April that Airbus, the major European commercial aircraft manufacturer acknowledged CVM technology as being "Technology Ready" for inclusion in its commercial aircraft maintenance programs. This marked the achievement of another major milestone for the Company as this opens up the large worldwide fleet of Airbus aircraft to now use a range of CVM products and comes after three years of extensive testing simulating performance in the harshest aircraft operating environments. This significantly increases the market now available for the retrofit of the Company's CVM systems to existing civilian aircraft.

Airbus is currently planning an extension of its in-service trials of CVM sensors on its own A320 test bed aircraft with selected airlines in its Airbus Maintenance Operations Solutions & Technologies (@MOST) program to deliver benefits when compared conventional inspection techniques. In addition Airbus is conducting tests ahead of incorporating CVM sensors into a new-build aircraft to monitor a difficult to inspect location, and evaluating applications of CVM technology on new composite aircraft structures.

During the past year the Company received orders for US\$231,000 from Embraer, the Brazilian regional aircraft manufacturer. These orders are the first stage of a 3-year program to develop and qualify CVM systems to be incorporated into their existing and future Embraer aircraft as a condition monitoring structural health system. As a part of this program the largest ever installation of sensors using CVM technology was successfully completed at Embraer's facility in Sao Paulo, Brazil, and the system has performed well.

The Company successfully completed certification tests for the PM200 product to enable it to be used in hazardous locations that may be encountered in aircraft operational environments and an initial production of a batch of these units is in progress.

Successful demonstrations of the Company's on-board aircraft structural health monitoring system were given to Airbus, EADS Military Aircraft Systems and Embraer, and all three companies have plans to trial this new system either on ground fatigue test rigs or flying aircraft.

The Company has also invested in improvements to its quality and enterprise management systems to enable the supply of CVM products and services to the global aerospace industry.

Despite the progress that has been made, the Company reduced its staffing levels following the axing of the Commercial Ready Grant funding by the Federal Government in the May budget. The Company held discussions with various parties to raise capital to re-finance the Company and allow it to have sufficient cash reserves to continue commercialising the CVM technology. Due to the adverse financial market conditions these did not prove successful. Since the end of the financial year the Company has had to down-size operations to minimise costs while continuing to protect the Intellectual Property of the CVM technology while additional funds have been sought. This has unavoidably resulted in all employee contracts being terminated and other cost cutting measures being implemented.

During this challenging period the Company has still been receiving orders for CVM instrumentation and sensor products and has been filling these orders from stock on hand and manufacturing sensors as required. Since the 1 July 2008 the Company has received and processed orders for approximately AU\$300,000, with key administrative and technical staffs being employed on a casual basis.

The Company recently commenced a Non-Renounceable Rights Issue of one (1) New Share for every one (1) Existing Share at AU\$0.015 per share to raise up to AU\$ 3,810,371, with one (1) free attached Option with an Exercise Price of AU\$0.015 exercisable within a two year period. As advised the closing date of the Rights Issue is the 5 December.

The objective of the Rights Issue is to raise sufficient working capital to protect and maintain the patent protection of the Intellectual Property generated from the years of development and investment in the CVM technology, and also to provide the working capital to market and produce the Company's structural monitoring products.

The terms of the Rights Issue were enabled by the passing of a resolution to amend the “Nominal Value” of the Company’s shares to UK£0.005 at the Extraordinary General Meeting (EGM) held on 27 October 2008. As the Company’s shares have been trading below the previous Nominal Value of UK£0.05 since April, this had been a serious impediment to the Company raising capital during the on-going global financial crisis, and has led to the situation where the Company does not have sufficient working capital to continue its operations for much longer.

This situation has eventuated after years of development and incurring the considerable expense of meeting the strict regulatory requirements for accrediting CVM technology for use on in-service civil and military aircraft.

The Rights Issue is not underwritten. Shareholders can apply for unsubscribed shares and options over and above their allocation. The Board will reserve the right to place any short-fall of the issue with third-parties. The Board also reserves the right to refund monies raised from the Rights Issue if it is deemed that they are insufficient to enable the Company to adequately protect its Intellectual Property, and provide the required level of working capital to reasonably see the Company through to a cash positive position.

If sufficient funds are raised it is intended that the Company will operate on a greatly reduced cost structure, with non-customer funded research activities suspended, and with a focus on the production, sales and product support to meet future customer demand for CVM products.

The success of the Rights Issue is critical to the future of the Company, and Shareholders should give due consideration to the Offer Document that has been dispatched to them.

Notes:

Structural Monitoring Systems plc Australian Securities Exchange code: SMN

* Bombardier, CRJ and Dash-8 are either registered or unregistered trademarks of Bombardier Inc. or its subsidiaries.

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About Structural Monitoring Systems

Structural Monitoring Systems is a structural integrity sensor system company engaged in commercialising its leading edge Comparative Vacuum Monitoring (“CVM™”) technology, to produce remote crack detection sensor and instrument products based on the patented CVM™ principle that will radically reduce the cost of maintenance and vehicle or plant down-time associated with performing safety critical structural integrity NDT inspections. Durable, simple to design and manufacture, easy to install and use, highly reliable and with a benchmark crack detection capability, CVM™ technology has application in a broad range of

commercial, military and industrial market sectors, specifically in air, land and sea transportation systems, power-generation systems, and industrial processing plants.

Structural Monitoring Systems has received accreditations from The Boeing Company and the Australian Defence Force endorsing the use of CVM™ sensors and PM200 handheld monitoring instrument as a suitable means of performing structural integrity inspections. The Company has also achieved a major milestone with Airbus acknowledging CVM as being “Technology Ready” to be included in its commercial aircraft maintenance programs. In the commercial aircraft sector Structural Monitoring Systems has well established relationships with the four largest aircraft manufacturers: Boeing; Airbus; Embraer; Bombardier. Structural Monitoring Systems also has well established relationships with air forces in the US, UK, Europe, Australia, and Asia, and with whom CVM™ technology is being evaluated for various military aircraft structural integrity monitoring applications.

Company Web Site

www.smsystems.com.au

Disclaimer:

Any statements made herein that use the words “estimate”, “prospect”, “expect”, “believe” and similar expressions are intended to identify forward-looking statements. These forward-looking statements may be affected by inaccurate assumption or by known and unknown risks and uncertainties which could cause actual results, performance or achievements of the Company to be materially different from those which may be expressed or implied by such forward looking statements, including among others, risks or uncertainties associated with the development of the Company’s technology, the ability of the Company to meet its financial requirements, the ability of the Company to protect its proprietary technology, potential limitations on the Company’s technology, the market for the Company’s products, government regulation in Australia, the UK, the US or elsewhere, changes in tax and other laws, changes in competition and the loss of key personnel. For additional information regarding these and other risks and uncertainties associated with the Company’s business, reference is made to the Company’s reports filed from time to time with the Australian Securities Exchange. As a result of the predictive character of such forward looking statements, investors should not rely on such statements in making decisions about the Company’s prospects and / or the acquisition or disposal of the Company’s securities.