

STRUCTURAL MONITORING SYSTEMS LIMITED
(ACN 067 556 245)

HALF -YEAR FINANCIAL REPORT

31 December 2001

Corporate Directory

Directors

Air Vice Marshal A R Reed (Chairman)
M J Wynne (Deputy Chairman)
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Review of Operations

During the six months to 31 December 2001 development of the Company's CVMTM technology continued with greater emphasis on the commercialisation potential in the aviation sector and industry generally.

Developments

Capital

The majority of holders of 31 October 2001 options exercisable at \$0.125c elected to exercise their options. This has placed the Company in a strong cash position to pursue the plans for the further development and commercialisation of the CVMTM technology.

Operations

A large part of the development plan for the period was directed at specific customer needs.

In particular, the demands put on SMS by Airbus Germany GmbH (Airbus) was the principal focus in the area of commercial aviation. Airbus had previously indicated an intention to acquire the SMS patents.

The immediate objective with Airbus has been to supply it with enough SMS product to undertake the evaluation of the CVMTM technology to its satisfaction - that evaluation process is continuing. Airbus has paid SMS \$1,239,238 for supply of equipment and technical support for the period 1 October 2001 to 31 March 2002, this is represented in the half yearly accounts as part income and part unearned income. The latter will be taken to income as at 31 March 2002.

The tragic events of the 11 September 2001 terrorist attack on the World Trade Centre have impacted on Airbus, who in the face of cancellation of new aircraft orders, has imposed budget cutbacks across the board. The immediate impact on SMS has been that Airbus on 25 February 2002 determined to continue evaluation of the CVMTM technology but has requested a delay in negotiation of the terms and conditions of any deal between Airbus and SMS while its budgets are revised. We are currently in discussions with Airbus to determine (a) the revised time line; and (b) whether that new time line is acceptable to the Company. In the meantime Airbus will also continue to pay for SMS services supplied.

In military aviation, the first installation of the CVMTM technology on an operating aircraft was completed for the United States Navy in January 2002. The installation was completed under an evaluation and demonstration agreement under which the Company recovers its costs. Following the successful evaluation we expect that the program will lead into a commercial contract for a fleet fit out.

The Company is in advanced discussions with the Republic of Singapore Air Force (RSAF) for the installation of the CVMTM technology on two types of aircraft. The technical data package has been lodged with RSAF, following acceptance of the technical data package the Company will lodge its quote for the installation.

We had previously reported on the execution of a contract with the Royal Australian Air Force for the installation of the CVMTM technology on four of its aircraft. The events of 11 September have delayed the timing of this installation it is now scheduled for late April 2002.

Scientific testing required for certification of the CVMTM technology has commenced. This program is being carried out utilising the facilities of RMIT and the Defence Science and Technical Organisation (DSTO) in Melbourne.

Discussions are advancing for installations for the United States Air Force (USAF) with further meetings between the Company's USA representatives and USAF scheduled for later this month. USAF is familiar with the CVMTM technology having used it in testing turbine blades last year.

Following the success of the first round of work under the Collaboration Agreement with DSTO for the development of a system to detect disbonding and delamination in composite fibre construction, we are moving into the second part of the program, further testing on disbonding of composite joints. This program now has more significance following the recent failure of the composite tail section on an Airbus A300 resulting in a crash shortly after takeoff from New York.

The above activity has kept our technical staff very busy and we are now looking to recruit more personnel to meet the demands that are being put on the Company.

The Company is also considering relocation to larger premises in the near future.

In view of the potential delay in reaching an agreement with Airbus, the Board has determined to continue the process for a listing of the Company on a Stock Exchange. The advantage of a listing will be access to capital markets to fund the overseas military marketing programs and to provide shareholders with a more liquid investment, pending further developments with aircraft manufacturers and fleet operators.

The Company's plans are still on track however it is clear now that the events of 11 September have impacted heavily on the aviation industry. In particular manufacturers of civilian aircraft are facing cancellation of orders for new aircraft. The resulting restructuring and cut backs in budgets has seen a change in their priorities in the short term.

The positive is the confirmation from all our counterparties that the level of interest in the CVMTM technology continues to increase as it becomes more widely understood and gains further acceptance by the aerospace industry.

Statement of Financial Performance

	6 months to 31 December 2001 \$	12 Months to 30 June 2001 \$
Revenue from ordinary activities		
Equipment hire and service income	619,618	41,215
Interest – other corporations	47,925	36,553
Export development grant	-	63,011
Total revenue from ordinary activities	667,543	140,779
Operating expenses		
Advertising, brochures and corporate image	44,849	53,832
Amortisation – Patents, technology licences and deferred research and development	236,806	446,062
Commission	68,145	-
Depreciation - Plant and equipment	7,959	16,741
Directors fees	77,500	35,700
Operating lease rental	54,199	60,000
Professional fees	356,366	597,082
Legal	14,722	31,823
Consultants	107,250	97,311
Contract managers	126,005	239,461
Other	108,389	228,487
Executive management fees	175,002	266,668
Patent registration costs and fees	50,965	103,712
Provision – Employee entitlements	6,786	15,182
Research and development	137,763	279,070
Royalty fees	39,953	65,600
Salaries and wages	180,855	337,071
Travel and accommodation	122,042	222,698
Other expenditure	112,943	289,680
Total operating expenses	1,672,133	2,789,098
Loss from ordinary activities, before income tax	1,004,590	2,648,319
Income tax attributable to operating loss	-	-
Net loss	1,004,590	2,648,319
Accumulated losses, at the beginning of the period	5,122,278	2,473,959

Accumulated losses, at the end of the period

6,126,868

5,122,278

Statement of Financial Position

	Note	31 December 2001 \$	30 June 2001 \$
Current assets			
Cash		4,429,518	1,709,765
Inventories, at cost		36,810	27,313
Other debtors and prepayments		72,203	58,599
Total current assets		4,538,531	1,795,677
Non-current assets			
Plant and equipment	2	204,299	201,772
Patents and technology licences, less amortisation \$822,164 (June 2001: \$639,853)		1,063,452	1,245,763
Deferred research and development costs	3	371,672	288,404
Total non-current assets		1,639,423	1,735,939
Total assets		6,177,954	3,531,616
Current liabilities			
Payables		233,786	244,786
Unearned income		619,619	-
Provision – Employee entitlements		30,882	25,882
Total current liabilities		884,287	270,668
NET ASSETS		5,293,667	3,260,948
Equity			
Contributed equity	4	11,420,535	8,383,226
Accumulated losses		(6,126,868)	(5,122,278)
TOTAL EQUITY		5,293,667	3,260,948

Statement of Cash Flows

	6 Months to 31 December 2001 \$	12 Months to 30 June 2001 \$
Cash flows from operating activities		
Receipts from customers	1,239,237	49,714
Royalty fee	(127,658)	-
Payments to suppliers and employees	(1,449,879)	(2,786,718)
Interest received	47,925	36,553
Other receipts	-	63,001
Net cash (outflows) from operating activities	(290,375)	(2,637,450)
Cash flows from investing activities		
Acquisition of plant and equipment	(13,356)	(86,756)
Deposits and advances	-	(8,500)
Net cash (outflows) from investing activities	(13,356)	(95,256)
Cash flows from financing activities		
Proceeds from issue of shares	3,037,865	3,560,991
Commission – capital raising	(14,381)	-
Other	-	11,195
Net cash flow from financing activities	3,023,484	3,572,186
Net increase in cash held	2,719,753	839,480
Cash at the beginning of the period	1,709,765	870,285
Cash at the end of the period	4,429,518	1,709,765

The above statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the Financial Statements

1. Summary of significant accounting policies

Basis of Accounting

The half-year financial report has been prepared in accordance with the historical cost convention.

The half-year financial report is a general purpose financial report made out in accordance with the requirements of the Corporations Act 2001, applicable Accounting Standards including AASB 1029 "Interim Financial Reporting" and other mandatory professional reporting requirements (Urgent Issues Group Consensus Views).

The accompanying financial statements have been prepared on a going concern basis which contemplates the realization of assets and the discharge of liabilities in the normal course of business for the foreseeable future. The Company has not attained commercial production and has incurred a significant deficit to 31 December 2001. The ability of the Company to continue as a going concern is dependent upon reaching satisfactory commercial production levels in order to produce a positive operating cash flow.

The outcome of these matters cannot be predicted at this time. This financial report does not give effect to any adjustment to the classifications and amounts of assets and liabilities that might be necessary should the Company be unable to continue as a going concern.

For the purpose of preparing half-year financial accounts, the half-year has been treated as a discrete reporting period. The accounting policies adopted are consistent with those of the previous financial year.

Cash

For the purposes of the statement of cash flow, cash includes cash on hand and in banks and bill of exchange.

Trade debtors

Trade debtors are recognised and carried at original invoice amount less a provision for any uncollectable debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off as incurred.

Recoverable Amount

Non-current assets are not carried at an amount above their recoverable amount, and where carrying values exceed this recoverable amount assets are written down. In determining recoverable amount the expected net cash flows have not been discounted to their present value.

Plant and Equipment

Cost

Items of plant and equipment acquired are carried at cost.

Depreciation

Depreciation is provided on a straight line basis on each item of plant and equipment over its expected useful life to the Company, that ranges from 2 ½ years (computer software) to 15 years.

Technology Licences

Technology licences are amortised over their useful lives, being 10 years.

Patents

Patents are amortised over their useful lives, being 5 years.

Deferred research and development

Approximately 50% of research and development costs incurred are carried forward as deferred expenditure and amortised over 5 years.

Payable

Liabilities for trade creditors and other amounts are carried at cost, which is the fair value of the consideration to be paid in the future for goods and services received.

Share capital

Ordinary share capital is recognised at the fair value of the consideration received by the Company. Any transaction costs arising on the issue of ordinary shares are recognised directly in equity as a reduction of the share proceeds received.

Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured.

Derivatives

The Company: (i) is exposed to changes in interest rates on its short term deposits; and (ii) does not use derivative financial instruments to hedge this risk.

	December 2001	June 2001
	\$	\$
2. Plant and equipment		
Plant and equipment		
At cost	114,154	97,994
Provision for depreciation	35,407	27,449
	<u>78,747</u>	<u>70,545</u>
Comparative vacuum monitoring units	123,618	129,293
Loose tools	1,934	1,934
	<u>204,299</u>	<u>201,772</u>
3. Deferred research and development costs		
Balance brought forward	288,404	92,772
Expenditure incurred during year	275,526	554,141
Less – costs written off	(137,763)	(277,070)
	<u>426,167</u>	<u>369,843</u>
Provision for amortisation	54,495	81,439
	<u>371,672</u>	<u>288,404</u>

	December 2001 \$	June 2001 \$
4. Contributed equity		
Issued and paid up capital 113,738,360 (June 2001: 91,061,920) ordinary shares.	11,420,535	8,383,226
	Number	\$
“A” class ordinary shares		
Balance 1 July 2001	25,001,200	2,500,120
Ordinary shares		
Balance 1 July 2001	66,060,720	5,883,106
Issued for cash	614,960	307,480
Exercise 31 October 2001 options	21,661,480	2,706,385
Exercise 30 December 2001 options	400,000	24,000
	<u>88,737,160</u>	<u>8,920,971</u>
Total issued and paid up capital	113,738,360	11,421,091
Less: Share issue costs		556
	<u>113,738,360</u>	<u>11,420,535</u>

Options

At 31 December 2001 the following options over unissued ordinary shares were outstanding:

Latest exercise date	Price	Number
30 June 2002	50.0 cents	1,000,000
31 October 2002	15.0 cents	1,000,000
1 June 2003	60.0 cents	100,000
30 June 2003	60.0 cents	100,000

5. Commitments

Royalty payments

The Company entered into an agreement dated 29 November 1999 with Tulip Bay Pty Ltd and Kenneth John Davey to acquire the patent and intellectual property rights of Tulip Bay. Under the terms of the agreement the Company will pay Tulip Bay an annual royalty, being the greater of:

- a) 3% of the payments received by the Company from the grant of licences to use the SMS technology plus 3% of the gross invoice price received by the Company from the sale of the SMS technology (less the cost of goods sold and certain other nominated costs); and
- b) \$60,000, adjusted for movements in the Cost of Living Index.

The royalty is payable annually on 31 October.

6. Related party disclosures

(a) Transactions with Directors and Director-related entities

Seabay Corporation Pty Ltd, a company in which R J Dean and M J Wynne are directors, received \$175,002 (June 2001: \$266,668 in satisfaction of the terms and conditions of a management agreement.

(b) Parent entity

The parent entity of Structural Monitoring Systems Limited is Sentry Holdings Pty Ltd, a company incorporated in Australia

7. Financial instruments

(a) Interest rate risk

Cash includes a short term call deposit and bills of exchange of \$4,486,900 paying interest at approximately 4.25% pa. All other financial assets and liabilities of the Company are non interest bearing.

(b) Credit risk exposures

The Company's maximum exposure to credit risk at balance date in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the balance sheet.

(c) Net fair values

The financial assets and liabilities included in current assets and current liabilities in the Balance Sheet are carried at amounts that approximate their net fair values.

9. Corporate information

Structural Monitoring Systems Limited is a company limited by shares that is incorporated and domiciled in Australia. Its parent entity is Sentry Holdings Pty Ltd.

The registered office of the Company is located at Level 1, 16 Ord Street, West Perth, Western Australia 6005

Directors' Declaration

In accordance with a resolution of the Directors of Structural Monitoring Systems Limited, I state that:

In the opinion of the Directors:

- (a) the financial report and notes of the Company:
 - (i) give a true and fair view of the financial position as at 31 December 2001 and the performance for the half-year ended on that date; and
 - (ii) comply with Accounting Standard AASB1029 "Interim Financial Reporting" and the Corporations Regulations; and
- (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

On behalf of the Board

R J Dean
Director
Perth, Western Australia
25 March 2002