2010

# Metal Storm Limited

ABN 99 064 270 006

Half Year Report

30 June 2010

www.metalstorm.com

# METAL STORM LIMITED

***A.C.N. 064 270 006***

# *APPENDIX 4D*

***Pursuant to Listing Rule 4.2A.3***

**Half-year financial report for the six months ended 30 June 2010**
**(previous corresponding period 30 June 2009)**

*Results announcement to the market*

| | | | | Current Period |
|---|---|---|---|---|
| Revenues from ordinary activities *(item 2.1)* | Up/~~(down)~~ | 29.12% | to | 1,069,353 |
| Loss from ordinary activities after tax attributable to members *(item 2.2)* | ~~Up~~/(down) | (34.8%) | to | (4,806,969) |
| Net loss for the period attributable to members *(item 2.3)* | ~~Up~~/(down) | (34.8%) | to | (4,806,969) |

| **Dividends (distribution)** | Amount per security | Franked amount per security |
|---|---|---|
| Final dividend *(item 2.4)* | Nil ¢ | Nil ¢ |
| Interim dividend *(item 2.4)* | Nil ¢ | Nil ¢ |

The Company does not propose to pay dividends at this time *(item 2.4).*

| | |
|---|---|
| Record date for determining entitlements to the Dividend *(item 2.5)* | Not Applicable |

Brief explanation of the figures in 2.1 to 2.4 necessary to enable the figures to be understood (item 2.6).

| **NTA backing** | Current period | Previous corresponding period |
|---|---|---|
| Net tangible asset backing per ordinary security | (1.62¢) | (3.20¢) |

**Metal Storm Limited**

**Half year report – 30 June 2010**

## Contents



This interim financial report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 31 December 2009 and any public announcements made by Metal Storm Limited during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*.

# Directors' Report

Your directors present their report on the consolidated entity consisting of Metal Storm Limited and the entities it controlled at the end of, or during, the half-year ended 30 June 2010.

### Directors

The names of the Company's directors in office during the half-year and until the date of this report are as below. Directors were in office for this entire period unless otherwise stated:

Mr T J O'Dwyer ................(Chairman)
Mr J R Nicholls
Dr L J Finniear .................(Managing Director)
Mr T W Tappenden

### Review of operations

During 2010 the company has operated within very tight cash constraints. Despite this it has been able to progress the development of its weapon systems and ammunition, and it has achieved a number of important strategic successes in the acquisition of contracts.

- In March, it received a US$682K production contract from the US Marines to deliver 45 Improvised Explosive Device Training Kits. All of these substantial kits have now been delivered to US Marine bases across the world.
- In May this year the Company won the US$1.5 million Mission Payload Module – Non Lethal Weapon System contract. The Company is now in the process of designing a new multi-barrel weapon system and new enhanced non-lethal airburst ammunition under this contract.
- In August the Company won its first volume weapons production order from the Correctional Service of Papua New Guinea, US$3.4M for 500 MAUL weapons and 50,000 rounds of non-lethal ammunition.

Beyond these contracts, the company has continued the development of its 3GL 40mm grenade launcher and STORM40 high explosive ammunition, conducting extensive pre-qualification tests, and demonstrating the weapons firing to US and Australian military and law enforcement officers. Both Australian and US engineering teams are fully utilised on these contracts and product development initiatives.

The loss for the half year was ($4,806,969) with total revenue up to $1,069,353 and total expenses reduced to ($5,876,322). While the half year report has been prepared on a going concern basis we draw your attention to the disclosure in note 1 of the financial statements on page 9 in relation to the uncertainties regarding the Company's continued future operation.

### Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 4.

This report is made in accordance with a resolution of directors.

**Mr T J O'Dwyer**
Chairman

**31 August 2010**
Brisbane

PRICEWATERHOUSECOOPERS

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## Auditor's Independence Declaration

As lead auditor for the review of Metal Storm Limited for the half year ended 30 June 2010, I declare that to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and
b) no contraventions of any applicable code of professional conduct in relation to the *review.*

This declaration is in respect of Metal Storm Limited and the entities it controlled during the period.

Robert Hubbard
Partner
PricewaterhouseCoopers

Brisbane
31 August 2010

# Consolidated statements of comprehensive income

For the half-year ended 30 June 2010

| | Notes | Half-year 2010 $ | Half-year 2009 $ |
|---|---|---|---|
| Revenue | | 618,636 | 709,670 |
| Other Income | 4 | 450,717 | 118,505 |
| Net foreign exchange differences | | 19,818 | - |
| | | | |
| Fair value movement in conversion derivative | | 407,041 | 189,829 |
| Consumables used | | (197,267) | (63,096) |
| Finance costs | 4 | (2,518,673) | (3,553,825) |
| Employee expenses | | (1,956,215) | (2,491,127) |
| Professional fees | | (503,518) | (580,672) |
| Research and development | | (160,617) | (528,218) |
| Facility expenses | | (309,252) | (374,789) |
| Administrative expenditure | | (267,315) | (273,151) |
| Travel and entertainment | | (51,753) | (164,358) |
| Communication and technology | | (79,882) | (138,967) |
| Public relations and compliance | | (258,689) | (203,921) |
| Exchange differences on foreign translation | | - | (22,507) |
| **Loss before income tax** | | **(4,806,969)** | **(7,376,627)** |
| | | | |
| Income tax | | - | - |
| | | | |
| **Loss for the half year** | | **(4,806,969)** | **(7,376,627)** |
| | | | |
| **Other comprehensive income** | | | |
| Currency translation difference | | (6,049) | 25,977 |
| **Other comprehensive income for the half year** | | **(6,049)** | **25,977** |
| | | | |
| **Total comprehensive income for the half year** | | **(4,813,018)** | **(7,350,650)** |
| | | **Cents** | **Cents** |
| **Earnings per share for loss attributable to the ordinary equity holders of the parent** | | | |
| Basic and diluted earnings per share | | (0.5) | (1.2) |

*The above consolidated statements of comprehensive income should be read in conjunction with the accompanying notes.*

# Consolidated statements of financial position

As at 30 June 2010

| | Notes | 30 June 2010 $ | 31 December 2009 $ |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | | 37,948 | 67,350 |
| Trade and other receivables | | 549,593 | 309,284 |
| Inventories | | 338,316 | - |
| Total current assets | | **925,857** | **376,634** |
| **Non-current assets** | | | |
| Trade and other receivables | | 80,222 | 28,679 |
| Property, plant and equipment | | 367,220 | 423,715 |
| Intangible assets | | - | 612 |
| Total non-current assets | | **447,442** | **453,006** |
| **Total assets** | | **1,373,299** | **829,640** |
| **LIABILITIES** | | | |
| **Current Liabilities** | | | |
| Trade and other payables | | 1,403,143 | 1,417,188 |
| Conversion derivative | | 1,894,848 | 2,337,200 |
| Non-interest-bearing loans and borrowings | | 12,504,697 | 11,822,962 |
| Interest-bearing loans and borrowings | | 4,466,979 | 4,070,584 |
| Provisions | | 377,809 | 359,024 |
| Total current liabilities | | **20,647,476** | **20,006,958** |
| **Non-current liabilities** | | | |
| Interest-bearing loans and borrowings | | - | 7,630 |
| Other | | - | 16,056 |
| Total non-current liabilities | | **-** | **23,686** |
| **Total liabilities** | | **20,647,476** | **20,030,644** |
| **Net assets (liabilities)** | | **(19,274,177)** | **(19,201,004)** |
| **EQUITY** | | | |
| Contributed equity | 5 | 74,699,472 | 70,075,033 |
| Reserves | | 10,579,381 | 10,470,024 |
| Accumulated losses | | (104,553,030) | (99,746,061) |
| **Total equity (deficiency)** | | **(19,274,177)** | **(19,201,004)** |

*The above consolidated statements of financial position should be read in conjunction with the accompanying notes.*

# Consolidated statements of changes in equity

For the half-year ended 30 June 2010

| | Notes | Issued capital 2009 $ | Reserves 2009 $ | Accumulated losses 2009 $ | Total equity 2009 $ |
|---|---|---|---|---|---|
| At 1 January 2009 | | 66,209,718 | 9,035,414 | (88,438,397) | (13,193,265) |
| Total comprehensive income for the half year | | - | 25,977 | (7,376,627) | (7,350,650) |
| **Transactions with the owners in their capacity as owners** | | | | | |
| Value of employee share option grants | 5 | 37,050 | (37,050) | - | - |
| Issue of share capital | 5 | 557,720 | - | - | 557,720 |
| **At 30 June 2009** | | **66,804,488** | **9,024,341** | **(95,815,024)** | **(19,986,195)** |

| | Notes | Issued capital 2010 $ | Reserves 2010 $ | Accumulated losses 2010 $ | Total equity 2010 $ |
|---|---|---|---|---|---|
| At 1 January 2010 | | 70,075,033 | 10,470,024 | (99,746,061) | (19,201,004) |
| Total comprehensive income for the half year | | | (6,049) | (4,806,969) | (4,813,018) |
| **Transactions with the owners in their capacity as owners** | | | | | |
| Issue of Options | | - | 115,406 | - | 115,406 |
| Value of employee shares issued | 5 | 50,303 | - | - | 50,303 |
| Issue of share capital | 5 | 4,574,136 | - | - | 4,574,136 |
| **At 30 June 2010** | | **74,699,472** | **10,579,381** | **(104,553,030)** | **(19,274,177)** |

*The above consolidated statements of changes in equity should be read in conjunction with the accompanying notes.*

# Consolidated statements of cash flow

For the half-year ended 30 June 2010

| | Notes | Half-year 2010 $ | Half-year 2009 $ |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Receipts from customers | | 645,335 | 1,244,245 |
| Payments to suppliers and employees | | (3,904,341) | (4,902,506) |
| Interest and other costs of finance paid | | (215,796) | (984,225) |
| **Net cash outflow from operating activities** | | **(3,474,802)** | **(4,642,486)** |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment | | - | (77,427) |
| Interest received | | 7,004 | 159,329 |
| **Net cash inflow from investing activities** | | **7,004** | **81,902** |
| | | | |
| **Cash flows from financing activities** | | | |
| Proceeds from issue of shares | | 3,112,881 | - |
| Share issue costs | | - | (49,174) |
| Proceeds from borrowings | 6 | 384,024 | - |
| Repayment of borrowings | 6 | (59,078) | (2,441,900) |
| **Net cash inflow (outflow) from financing activities** | | **3,437,827** | **(2,491,074)** |
| | | | |
| **Net increase (decrease) in cash and cash equivalents** | | **(29,971)** | **(7,051,658)** |
| Cash and cash equivalents at beginning of the half-year | | 67,350 | 7,571,292 |
| Effect of exchange rate changes on cash and cash equivalents | | 569 | (28,768) |
| **Cash and cash equivalents at end of the half-year** | | **37,948** | **490,866** |

*The above consolidated statements of cash flow should be read in conjunction with the accompanying notes.*

# Notes to the financial statements

30 June 2010

## 1 Going Concern

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

Key financial data for the Group for the 2010 half year and 2009 full year is outlined in the table below:

| | 30 June 2010 $ | 31 December 2009 $ |
|---|---|---|
| Cash at Bank | 37,948 | 67,350 |
| Loss for the period | (4,806,969) | (11,307,664) |
| Net cash outflow from operating activities | (3,474,802) | (8,704,228) |
| Net liabilities | (19,274,177) | (19,201,204) |

To continue its operating activities and achieve its commercial objectives over the next 12 months the Directors have projected that the Group will require approximately $10 million of additional funding from external sources. Additionally, on 1 September 2011, convertible notes of $18.9 million will become due and payable unless they are converted to equity at the discretion of the noteholder prior to this date.

As such, there is significant uncertainty with regards to the Company and the Group continuing as a going concern, and therefore, whether they will realise their assets and settle their liabilities at amounts different from those stated in the financial report.

However, the Directors believe that the Company and Group have reasonable prospects of securing sufficient funding over the next 12 months and as a consequence they have no intention to liquidate or cease trading. The Directors believe they have reasonable grounds to expect that they can raise additional capital in the timeframes required in order to meet their debts as and when they fall due.

The Directors have formed this view on the basis of the following:

a) The Company signed an equity line agreement with Dutchess Opportunity Fund II on 22 June 2010 for a total facility of $25 million. The facility allows the Company, at its sole discretion, to draw down up to $200,000 every 5 days. Whilst the Company can issue draw down notices for up to $200,000, in certain circumstances the level of funding received under the Agreement is variable. For example, certain adjustment events, such as the share price trading below the floor price, can reduce the draw down by 1/5 for every day an adjustment event occurs. The Dutchess agreement replaces the GEM agreement as set out in the Explanatory Memorandum to Shareholders dated 19 July 2010.

b) On 3 August 2010, the Company announced a one for four rights issue offer of one new share and three attaching options, at an issue price of $0.01, for every four shares eligible shareholders hold. Shareholders may also apply for additional new shares beyond their entitlement. If fully subscribed the offer would raise approximately $3.1 million. The Rights Issue, unless extended, closes on 6 September 2010 and the final amount raised will not be known until after this date. However, on 27 August 2010, the Company signed subscription agreements for a total amount of up to $1.7 million to be used to fund any shortfall in Rights Issue subscriptions up to $1.7 million. Refer to note 8 for further details of the Rights Issue Prospectus lodged with ASIC on 3 August 2010.

c) The Company entered into its first product sales contract on 3 August 2010. The contract with the Correctional Services of Papua New Guinea, is to supply 500 MAUL weapons and 50,000 rounds of non-lethal ammunition for a total value of US$3,365,000. The Company expects to complete this contract over the course of the next 18 months following receipt of the initial deposit of US$673,000 due within 90 days of the contract date.

d) The Company continues to seek further more substantial capital raisings and management have continued their work in this area that commenced over 18 months ago.

The Directors have a responsibility to prepare the financial statements in accordance with accounting standards. Accounting Standard AASB 101 requires entities to prepare financial statements on a going concern basis unless they intend to liquidate, cease trading or have no alternative but to do so.

Due to the variable funding available from the equity line agreement and the need for a more substantial capital raising, there is significant uncertainty as to whether the Company and Group will continue as a going concern and, therefore whether they will realise their assets and settle their liabilities at amounts different from those stated in the financial report.

The directors believe they have reasonable grounds to expect that they can raise additional capital in the timeframes required in order to meet their debts as and when they fall due and therefore they have no intention to liquidate or cease trading.

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

## 2 Summary of Significant Accounting Policies

### a. Basis of preparation of half-year report

This general purpose financial report for the interim half-year reporting period ended 30 June 2010 has been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*.

This interim financial report does not include all the notes of the type normally included in the annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 31 December 2009 and any public announcements made by Metal Storm Limited during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*.

The accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period.

### b. Inventory

Raw materials, work in progress and finished goods are stated at the lower of cost and net realisable value. Cost comprises direct materials. Costs are assigned to individual items of inventory on the basis of weighted average costs. Costs of purchased inventory are determined after deducting rebates and discounts. Net realisable value is the estimated selling price in the ordinary course of the business less the estimated costs of completion and the estimated cost necessary to make the sale.

### c. Impact of new accounting standards and interpretations not yet applied

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2010 reporting periods. The group's assessment of the impact of these new standards and interpretations is set out below.

#### i) AASB 2009-8 Amendments to Australian Accounting Standards - Group Cash-Settled Share-based Payment Transactions AASB 2 (effective from 1 January 2010)

The amendments made by the AASB to AASB 2 confirm that an entity receiving goods or services in a group share-based payment arrangement must recognise an expense for those goods or services regardless of which entity in the group settles the transaction or whether the transaction is settled in shares or cash. They also clarify how the group share-based payment arrangement should be measured, that is, whether it is measured as equity- or a cash-settled transaction. The group will apply these amendments retrospectively for the financial reporting period commencing on 1 January 2011. There will be no impact on the group's financial statements.

#### ii) AASB 9 Financial Instruments and AASB 2009-11 Amendments to Australian Accounting Standards arising from AASB 9 (effective form 1 January 2013)

AASB 9 Financial Instruments addresses the classification and measurement of financial assets and is likely to affect the group's accounting for its financial assets. The standard is not applicable until 1 January 2013 but is available for early adoption. The group is yet to assess its full impact

#### iii) AASB 1053 Application of Tiers of Australian Accounting Standards and AASB 2010-2 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements

On 30 June 2010 the AASB officially introduced a revised differential reporting framework in Australia. Under this framework, a two-tier differential reporting regime applies to all entities that prepare general purpose financial statements. The Company is listed on the ASX and is therefore not eligible to adopt the new Australian Accounting Standards – Reduced Disclosure Requirements. As a consequence, the two standards will have no impact on the financial statements of the entity.

## Notes to the financial statements
30 June 2010 (continued)

### 3 Segment information

Management has determined the operating segments based on the reports reviewed by the CEO which are used to make strategic decisions.

The CEO monitors the performance of each segment independently. The Australia segment focuses on developing electronically initiated stacked projectile weapons systems for military and law enforcement markets. The United States segment pursue contracts with military customers and defence contractors where Metal Storm stacked projectile technology and component weapon systems can be applied for specific end-user requirements or where it enhances Metal Storm's presence in the defence industry.

| | Australia $ | United States $ | Inter-segment eliminations $ | Consolidated $ |
|---|---|---|---|---|
| **30 June 2010** | | | | |
| Segment loss | (5,543,682) | (27,947) | 764,660 | (4,806,969) |
| Items included in segment loss | | | | |
| *Revenue* | | | | |
| Revenue from external customers | - | 618,636 | - | 618,636 |
| Other income | 7,699 | 443,018 | - | 450,717 |
| *Expenses* | | | | |
| Interest expense | 225,847 | 5,922 | - | 231,769 |
| Accretion expense | 983,904 | - | - | 983,904 |
| Depreciation | 47,314 | 9,181 | - | 56,495 |
| Amortisation | 612 | - | - | 612 |
| Transaction Cost | 1,303,000 | - | - | 1,303,000 |
| **30 June 2009** | | | | |
| Segment loss | (7,181,108) | (894,550) | 699,031 | (7,376,627) |
| Items included in segment loss | | | | |
| *Revenue* | | | | |
| Revenue from external customers | - | 709,670 | - | 709,670 |
| Other income | 107,031 | 98 | - | 107,129 |
| *Expenses* | | | | |
| Interest expense | 984,225 | - | - | 984,225 |
| Accretion expense | 2,569,600 | - | - | 2,569,600 |
| Depreciation | 63,897 | 12,849 | - | 76,746 |
| Amortisation | 11,999 | - | - | 11,999 |
| **Balance Sheet Information** | | | | |
| **30 June 2010** | | | | |
| Segment assets | 519,208 | 1,134,475 | (280,384) | 1,373,299 |
| Segment liabilities | 20,098,073 | 23,319,525 | (22,770,122) | 20,647,476 |
| **31 December 2009** | | | | |
| Segment assets | 569,601 | 262,959 | (2,920) | 829,640 |
| Segment liabilities | 19,344,629 | 22,570,649 | (21,884,634) | 20,030,644 |

Revenue for the United States segment in 2010 involves revenues from the US Government totalling $618,636.

## Notes to the financial statements
30 June 2010 (continued)

### 4 Loss for the half-year

Loss for the half-year includes the following items that are unusual because of their nature, size or incidence:

Other income includes $442,953 resulting from the settlement of a legal action that was initiated against a trade debtor in 2008. The terms of the settlement remain confidential.

| | Half-year | |
|---|---|---|
| | 2010 | 2009 |
| **Finance costs** | $ | $ |
| Accretion expense | 983,904 | 2,569,600 |
| Interest expense | 231,769 | 984,225 |
| Transaction costs | 1,303,000 | - |
| | **2,518,673** | **3,553,825** |

Accretion expense relates to the accretion of convertible notes using an effective interest rate.

Interest expense predominately relates to interest payments to convertible note holders at a rate of 10%pa in accordance with terms and conditions of the convertible notes trust deed.

Transaction costs represent the fair value of share based payment expenses incurred in securing additional capital for the Company during the half year.

### 5 Equity securities issued

Issues of ordinary shares during the half year

| | | Number | Issue Price | Value |
|---|---|---|---|---|
| At 1 January 2009 | | 613,555,252 | | 66,209,718 |
| Conversion of notes first quarter | | 7,287,985 | $ 0.0400 | 269,982 |
| Conversion of notes second quarter | | 7,278,292 | $ 0.0400 | 287,738 |
| Issue of Shares – 8 April 2010 | | 950,000 | $ 0.0039 | 37,050 |
| At 30 June 2009 | | **629,071,529** | | **66,804,488** |
| | | | | |
| At 1 January 2010 | | 791,858,986 | | 70,075,032 |
| Exercise of listed options | | 12,332 | $ 0.1500 | 1,850 |
| Exercise of unlisted options | | 51,715,599 | $ 0.0010 | 51,716 |
| Conversion of notes first quarter | i | 2,201,216 | $ 0.0200 | 43,920 |
| Conversion of notes second quarter | i | 24,664,175 | $ 0.0100 | 229,740 |
| Issue of Shares – 4 January 2010 | ii | 12,500,000 | $ 0.0160 | 200,000 |
| Issue of Shares – 4 January 2010 | ii | 40,000,000 | $ 0.0174 | 697,226 |
| Issue of Shares – 4 January & 4 March 2010 | ii | 49,444,444 | $ 0.0162 | 800,000 |
| Issue of Shares – 5 March 2010 | ii | 52,669,568 | $ 0.0133 | 700,000 |
| Issue of Shares – 29 March 2010 | ii | 27,900,794 | $ 0.0143 | 400,000 |
| Issue of Shares – 13 April 2010 | ii | 2,022,592 | $ 0.0139 | 28,144 |
| Issue of Shares – 16 April & 14 May 2010 | ii | 25,000,000 | $ 0.0126 | 315,000 |
| Issue of Shares – 30 April 2010 | ii | 14,285,714 | $ 0.0140 | 159,787 |
| Issue of Shares – 14 May 2010 | ii | 33,333,333 | $ 0.0081 | 269,210 |
| Issue of Shares – 24 May 2010 | ii | 1,931,152 | $ 0.0115 | 22,159 |
| Issue of Shares – 23 June 2010 | ii | 25,510,203 | $ 0.0098 | 202,688 |
| Issue of Shares – 29 June 2010 | ii | 17,719,298 | $ 0.0171 | 303,000 |
| Issue of Shares – 30 June 2010 | ii | 20,636,715 | $ 0.0097 | 200,000 |
| At 30 June 2010 | | **1,193,406,121** | | **74,699,472** |

i Issue price is based on calculation according to Trust Deed. Value is based on the amortised cost of the notes converted.
ii Issue price has been rounded to 4 decimal places.

## Notes to the financial statements

30 June 2010 (continued)

### 6 Proceeds and repayment of borrowings

During the year the Company repaid $50,000 as partial payment of a loan to BL Capital (a related party) of which Mr Terence O'Dwyer is a principle.

BL Capital lent the Company a further $50,000 on the same terms as the existing loan which is non-interest bearing and has no fixed repayment dates. The loan is unsecured.

Separately, the Company borrowed $275,000 from an unrelated party with a final repayment date no later than 27 November 2010. Early repayment is allowed at no penalty.

Interest on the loan is $32,247 over the 7 months term. Interest can be paid to the holder in shares at the discretion of the lender calculated at issue price of 1 cent per share. The loan is unsecured.

### 7 Contingencies

There are no known contingent liabilities at 30 June 2010.

### 8 Events occurring after the balance sheet date

On 15 July 2010, the Company filed its Form 20-F with the United States Securities and Exchange Commission.

On 19 July 2010, the Company announced it would be holding a General Meeting on 19 August 2010 to seek shareholder approval for the issue of securities under the Dutchess Line Agreement, the issue of securities under subscription agreements as well as the previous issue of securities for a number of placements conducted in the first half of the year.

The meeting was held on 19 August 2010 and all resolutions were passed.

On 3 August 2010, the Company lodged a prospectus for a non-renounceable pro-rata rights issue with ASIC to raise up to $3.1 million.

The rights issue is an offer to shareholders in Australia, New Zealand and Singapore to subscribe for one new share and three attaching options, at an issue price of $0.01, for every four shares they held on the record date of 11 August 2010. Shareholders may also apply for additional new shares beyond their entitlement which will be subject to scale back if the offer is over subscribed. The new shares rank equally in all respects with the Company's existing ordinary shares.

The offer closes on 6 September 2010 and the new shares will be allotted on 8 September 2010.

Also on 3 August 2010, the Company announced it had been awarded a volume weapons production contract totalling US$3,365,000. The contract is for the supply of 500 MAUL and 50,000 rounds of non lethal ammunition to the Papua New Guinea Correctional Services.

The first 50 weapons are due to be delivered in February 2011.

The Company has also received confirmation of its registration under the R&D Tax Concession scheme under Section 39J of the Industry Research and Development Act 1986. The Company should receive a tax rebate worth approximately $620,000 after processing of its annual tax return.

The Company recently obtained $400,000 worth of unsecured loans from two existing Shareholders to assist the Company to continue operating until the general meeting to be held on 19 August 2010. The terms of the loans do not require repayment of the principal until after completion of the Rights Issue.

On 27 August 2010 the Company announced it had entered into subscriptions agreements totalling up to $1.7 million. The placements are to fund any shortfall in the rights issue to maximum of $1.7 million meaning the total funds that can be raise by these placements and the rights issue combined in $3.1 million. Under the subscription agreements, shares will be issued at $0.01 and have three attached options with the same terms and conditions as the rights issue. The subscription agreements can be called at the discretion of the Company over the next three months.

There has not been any other matter or circumstance, other than that referred to in the financial statements or notes thereto, that has arisen since the end of the half year, that has significantly affected, or may significantly affect, the operations of the consolidated entity, the results of those operations, or the state of affairs of the consolidated entity in future financial years.

## Directors' Declaration

In the directors' opinion:

(a) the financial statements and notes set out on pages 5 to 13 are in accordance with the *Corporations Act 2001*, including:
  (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and
  (ii) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the half-year ended on that date; and

(b) there are reasonable grounds to believe that Metal Storm Limited will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors.

**Mr T J O'Dwyer**
Chairman

**31 August 2010**
Brisbane

PRICEWATERHOUSECOOPERS

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# Independent auditor's review report to the members of Metal Storm Limited

## Report on the Half-Year Financial Report

We have reviewed the accompanying half-year financial report of Metal Storm Limited, which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, other selected explanatory notes and the directors' declaration for the Metal Storm Limited Group (the consolidated entity). The consolidated entity comprises both Metal Storm Limited (the company) and the entities it controlled during that half-year.

*Directors' responsibility for the half-year financial report*

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001* and for such control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement whether due to fraud or error.

*Auditor's responsibility*

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of an Interim Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Metal Storm Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. It also includes reading the other information included with the financial report to determine whether it contains any material inconsistencies with the financial report. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

Our review did not involve an analysis of the prudence of business decisions made by directors or management.

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*Independence*

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001.*

*Conclusion*

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

(a) giving a true and fair view of the consolidated entity's financial position as at 30 June 2010 and of its performance for the half-year ended on that date; and

(b) complying with Accounting Standard AASB 134 *Interim Financial Reporting* and *Corporations Regulations 2001.*

*Significant Uncertainty Regarding Continuation as a Going Concern*

Without qualifying our conclusion, we draw attention to Note 1 in the financial statements which indicates there is significant uncertainty as to whether the Group will continue as a going concern and, therefore, whether they will realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report.

PricewaterhouseCoopers

Robert Hubbard
Partner

Brisbane
31 August 2010