Phoslock Environmental Technologies

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Company announcement

31 August 2021

Unaudited half year results for 6 months to 30 June 2021 and business update

- **First half revenues of $1.3 million; Net Profit after Tax of ($0.8 million)**
- **COVID-related impacts relating to project timing and business development activity**
- **Additional investments in support of diversification strategy**
- **R&D and manufacturing reviews progressed**

Phoslock Environmental Technologies (ASX:PET) today reported unaudited headline financial results for the six months ending 30 June 2021. As announced via the ASX on 13 August, the company has sought relief granted by ASIC under *ASIC Corporations (Extended Reporting and Lodgement Deadlines—Listed Entities) Instrument 2020/451*, as amended by *ASIC Corporations (Amendment) Instrument 2020/1080* and *ASIC Corporations (Amendment) Instrument 2021/315)*, to extend the lodgement date for its audited half-year accounts, and other documents required to be lodged under section 320 of the *Corporations Act 2001* (Cth), for the half-year period.

Unaudited headline results

Key Financial Results	6 months to 30 June 2021	6 months to 30 June 2020
Revenues	$1.3 million	$2.1 million
Gross Profit	$0.74 million	$1.1 million
Underlying EBIT[1]	($3.9 million)	($4.3 million)
NPAT[2]	($0.8 million)	($21.6 million)
Net Operating Cash Flow	($3.8 million)	($8.4 million)
Cash at bank	$26.3 million	$30.4 million
Receivables	$1.8 million	$2.7 million
Inventory	$4 million	$4 million

1. Underlying EBIT (Earnings before interest and tax) is a financial measure which is not prescribed by Australian Accounting Standards ('AAS') and represents the profit or loss under AAS adjusted for the add back of income tax, finance costs and certain non-cash income and expense items that are deemed to not have an ongoing affect to the underlying performance of the business. The Company believes that presenting Underlying EBIT provides a better understanding of its financial performance by facilitating a more representative comparison of financial performance between financial periods.

2. Net Profit after Tax

Revenue for the period was $1,326,000, which was down 37% on the $2,090,000 generated in the prior corresponding period. The business continued to face headwinds during the first half of 2021 as a result of global COVID-related impacts which contributed to project delays and the continued priority given by governmental authorities to manage COVID related health initiatives. The company continued to execute on its diversification strategy and generated sales across North and South America, Europe and China.

Gross profit was $744,000 for the six months (6 months to 30 June 2020: $1,120,000). The gross profit margin was 56%, slightly up on the prior period's 54% as a result of lower settlement discounts provided to customers to stimulate early payment in the prior period and slightly lower project application costs.

Underlying Earnings Before Interest and Tax (EBIT) for the period was a loss of $(3,886,000) compared to a loss of $(4,312,000) in the prior corresponding period. Lower sales revenue and gross margin was offset with lower operating expenses in the period. Whilst operating expenses were lower in the reporting period, they remained relatively high as a result of expenditure on interim management and restructuring costs in China, ongoing legal expenses as a result of the fraud and mismanagement investigations. and consultancy costs relating to reviews of the R&D program and the company's manufacturing/supply chain strategy. These reviews are expected to be completed within the 2021 financial year.

Net Profit after Tax (NPAT) for the six months amounted to a small loss of $(755,000). This compared to an NPAT loss of $(21,612,000) in the prior corresponding period. As foreshadowed in Subsequent Events in the 2020 full year accounts, the reporting period included one-off non-cash adjustments to right of use asset (lease) as a result of the Group signing a lease modification with its landlord in relation to the PETZ ('Zheijang Phoslock Environmental Technologies Ltd (China)') factory. The modification reduced the lease term, square footage and overall cost and is part of the ongoing effort to right-size the business. The value of this adjustment was $3,125,000.

The period also included the receipt of the Phase 1 payment ($500,000) relating to works completed at Xingyun Lake in China. Given circumstances and uncertainties at the time, the receivable relating to the full payment for this work was impaired in the first half of the 2020 financial year. Although the part-payment was a positive outcome, payment for the balance of the project remains outstanding and the company is yet to receive written confirmation of the receivable from the customer, or acknowledgment that it is past due, despite several requests to that effect.

Following the investigation of the Company's previously disclosed activities in China, the Company has launched legal actions to recover payment of outstanding amounts owing by a former substantial customer and related party, Beijing BHZQ Environmental Engineering Technology Co., Ltd (BHZQ). The outstanding amounts are for goods and services supplied by the Company's Chinese subsidiaries to BHZQ up until 2020. BHZQ has responded by making various counterclaims based on the quality of the goods and services. All of these matters have been listed for arbitration in China, except one which is to be adjudicated in the courts. A final determination is expected to be made by the end of 2021.

Cash Flows

Operating Cash Flow for the six months period was a cash outflow of $(3,848,000) (6 months to 30 June 2020: outflow of $8,387,000), representing an improvement of $4,499,000 over the prior period. Cash payments from customers for the six month period were $2,822,000 (6 months to 30 June 2020: $3,674,000). Cash payments to suppliers, consultants and employees for the six month period was $6,275,000 (6 months to 30 June 2020: $12,306,000). The decrease in cash outflow relates primarily to lower employee payments and lower manufacturing related activity. The prior period included higher spending on inventory levels as a result of the manufacturing plant building safety stocks as insurance against possible COVID-related shutdowns. The period also included higher tax payments as the company continued to resolve legacy tax issues identified in the accounting investigations.

Spending on new plant, equipment, and intangibles for the six months to 30 June 2021 totalled $45,000. This was mainly for the Chinese manufacturing facilities and R&D related activity.

Financial position of the Group

Current assets of the Group as at 30 June 2021 were $32,735,000, made up of cash ($26,299,000); trade and other receivables ($1,781,000) and inventories ($4,007,000) and other assets ($648,000).

Current liabilities of the Group as at 30 June 2021 were $4,243,000 made up of trade / other payables, lease liabilities and employee liabilities.

The net assets of the Group were $28,770,000 as of 30 June 2021, relatively unchanged from 31 December 2020 $29,473,000. The operating cash outflow of $3,848,000 over the period was largely offset by the revised lease adjustments.

Business Update

PET provides the following review of its operations for the six months ending 30 June 2021. The company will host a webcast to provide additional detail on the business update at 2.00 pm today. Registration details for the webcast are available via this link:

Click here to register for the Webinar:
https://zoom.us/webinar/register/WN_ZxHlnCd1TjqLpuyPhsAeYw

Overview

The key focus areas for the first six months of FY21 were the restructure and stabilising of the business in China; addressing various matters that will enable the relisting of the company's shares on the ASX; the implementation of improved governance, accounting and management standards across the business; and execution of the company's growth strategy.

To support those objectives, a review was undertaken of PET's operating model, with a focus on both internal capabilities and processes (relating to people, performance and culture) and on external customer relationships and service standards. The review has identified areas for development and improvement and a number of initiatives are now being put in place to address those opportunities.

The company is advancing its strategy for the China market which still represents a significant growth opportunity. A new country head is being recruited to replace the general manager with skills and experience better aligned to the strategy. It has been determined that the China operations will be more effectively led by an executive with broader management and leadership experience; demonstrated high standards of governance; and previous experience reporting to an overseas-based head office.

While the various investigations into the fraud and mismanagement issues relating to the China business have concluded, significant management time is still being expended in this area, particularly with respect to the audit process and other matters that will enable the company to have its shares relisted on the ASX. This remains a key priority.

Legal proceedings are underway in China to recover outstanding debts. The Company is well advanced in its strategy to persue certain individuals and recovering misappropriated funds.

During the first half, several important appointments were approved and/or made to support the geographic and product diversification strategy. These included the appointment of commercial leads in both the US and Europe and new distributers in Uruguay. A review of PET's R&D program and investment criteria was also concluded during the period, with changes made to ensure future investment is aligned with the company's expansion plans. Five key projects have been identified and approved to enable PET to more effectively, affordably and sustainably remediate polluted freshwater bodies and to broaden the product and service offering.

Project Update

In the first half of the financial year, PET continued to focus on developing business opportunities in key target markets around the world. The company's objective is to secure a more balanced geographic spread of sales, thereby reducing market risk in any one country. While COVID-related restrictions continued to impede normal business development activity, PET was able to secure agreements to undertake important demonstration trial work and contracts to undertake remediation works across a broad geographic base. Some examples of work undertaken or contracted during the first half period included:

Australia/New Zealand:

A contract was secured for remediation works to be undertaken for the City of Auckland, along with new projects in the Gold Coast area (Lake Hugh Muntz) and in the Perth region, WA. Trial work continues at Lake Wyangan, in the Griffith area. A local agent has been appointed in New Zealand to assist with business development.

China:

Approximately 15 projects are expected to be completed within China in the current financial year. This follows a comprehensive review of all China contracts. Trial work at Lake Dianchi has been completed and will now be reviewed with local authorities, however, any potential contracted remediation works at Lake Dianchi are not expected to be confirmed in the short term.

Europe:

Permits were issued for projects in Denmark (expected to be completed this year) and Finland (scheduled for 2022). Ongoing projects in Belgium, Netherlands and Germany progressed during the first half, with a number of those projects expected to be completed before the end of the current financial year. Subsequent to the end of the first half period, a large project in The Netherlands (Kraslingse Plas) was contracted, with a value of approximately $4 million.

South America:

A number of contracted remediation projects continued in Brazil during the period. Some challenges were encountered with higher shipping costs (COVID-related) and currency fluctuations. A distributor was appointed in Uruguay and is now working with local authorities to establish a pilot demonstration trial to be completed before the end of CY2021.

North America:

Contracted remediation works continued at both Kitsap Lake in Washington State and at Morrison Lake in Michigan (both in 2nd year of three-year projects). Work also commenced in June at Ladybird Lake in Texas and at the Prima Vista waterway near Port St Lucie in Florida. Other prospects in Minnesota, California and Indiana are also being developed with ongoing dialogue with the relevant local authorities.

Regulatory issues in Canada continue to be addressed and are being given a high priority in order that appropriate approvals can be secured and projects can commence.

Manufacturing Review

A detailed review of the company’s manufacturing and supply chain requirements continued during the period. While it remains the intention to continue manufacturing at PET’s existing plant in China, options for establishing a second manufacturing facility in a location outside of China are being assessed. Management is reviewing considerations relating to site and plant establishment costs; raw material access; customer transportation requirements; potential incentives; and a range of supply chain risks. Management expects to present recommendations to the Board by the end of the third quarter of this financial year.

Research & Development Review

The first stages of the R&D review announced at the last Annual General Meeting was also concluded during the first half period. Clear criteria have been established to govern R&D related investment, ensuring that projects are aligned with the company’s growth and expansion objectives. Five key projects were identified and will be pursued under the new framework. These include two projects aimed at enhancing the efficacy, cost-effectiveness and ease of use of Phoslock; a project relating to management of algae (adjacent opportunity) and two potential transformative projects involving new technologies, ‘Zeep’ and a product based on a different base material.

The company is now hiring for an executive to lead the R&D program and has also secured access to a PhD project through Monash University.

Outlook

The full year operating profit will be dependent on currently forecast projects being contracted and/or completed during the period, along with the ongoing impact of COVID-related interruptions, delays and cost implications. Those cost implications include significantly higher international freight charges and limited container space. Over the medium term, the company expects to continue building its portfolio of international projects and achieving profitability on a sustainable basis.

The resumption of trading of the company's shares on the ASX continues to be a key priority for management and the Board and shareholders will be updated on progress on a regular basis.

This announcement has been approved by the Chairman and Managing Director.

David Krasnostien
Chairman

Mr Lachlan McKinnon
Managing Director and CEO

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About PET

Phoslock Environmental Technologies Limited (ASX: PET) specialises in engineering solutions and water treatment products to remediate polluted lakes, rivers, canals and drinking water reservoirs.

Headquartered in Melbourne, PET has offices in Brisbane, Beijing, Bremen (Europe) and Manchester (UK). PET also has registered entities in Canada and the USA, and manufacturing operations based in Changxing, China. PET is represented by licensees, distributors and agents in ten other countries including SePRO Corporation in the United States and HydroScience in Brazil.

Phoslock® is a proprietary and unique water treatment product that permanently binds excess phosphorus in the water column and sediments.

Phoslock is certified for use in drinking water in North America, Europe, Brazil, Australia, and China. Along with Phoslock, PET also supplies zeolites and specialised strains of bacteria that address water pollution issues.

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