Palla Pharma Limited

ABN 26 107 872 453

Interim report
for the half-year ended 30 June 2020

Appendix 4D

The following information is presented in accordance with ASX listing rule 4.2A.3.

1. Details of the reporting period and previous corresponding period

Reporting period:	half-year ended 30 June 2020
Previous corresponding period:	half-year ended 30 June 2019

2. Results for announcement to the market

		Consolidated entity		
		30 June 2020 $	30 June 2019 $	Change %
2.1	Revenue from ordinary activities	**12,328,942**	27,357,107	-54.9%
2.2	Loss from ordinary activities after tax attributable to members	**(9,014,762)**	(4,083,709)	-120.7%
2.3	Net loss for the period attributable to members	**(9,014,762)**	(4,083,709)	-120.7%

2.4 There were no dividends paid, recommended or declared during the current or previous reporting period.

2.5 The record date for determining entitlements to dividends – not applicable.

2.6 Supplementary commentary on figures presented in 2.1 to 2.4 above – please refer to the Interim report for the half-year ended 30 June 2020 attached and Results Presentation issued 31 August 2020.

3. Net tangible assets

	Consolidated entity		
	30 June 2020 $	30 June 2019 $	Change %
Net tangible assets per security	0.34	0.36	-3.7%

4. Details of entities over which control has been gained or lost during the period

Not applicable.

5. Dividend payments

Not applicable.

6. Dividend reinvestment plans

Not applicable.

7. Associate or joint venture entities

Not applicable.

8. Foreign entities

Not applicable.

9. Independent review

The interim financial report contains an unqualified independent review report.

PALLA PHARMA

Palla Pharma Limited

ABN 26 107 872 453

Interim report
for the half-year ended 30 June 2020

Palla Pharma Limited ABN 26 107 872 453
Interim report for the half-year ended 30 June 2020

Contents

This interim financial report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report should be read in conjunction with the annual report for the year ended 31 December 2019 and any public announcements made by Palla Pharma Limited during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001.*

Palla Pharma Limited is a company limited by shares, incorporated and domiciled in Australia. The shares of Palla Pharma Limited are publicly traded on the Australian Securities Exchange under the ASX issuer code PAL.

Directors' report

The directors present their report on the consolidated entity (referred to hereafter as the Group) consisting of Palla Pharma Limited ("the Company") and the entities it controlled at the end of, or during, the half-year ended 30 June 2020.

Directors

The following persons were directors of Palla Pharma Limited for the half-year ended 30 June 2020 and up to the date of this report:

Mr. Simon Moore (Independent Non-Executive Chairman)
Mr. Jarrod Ritchie (Managing Director and CEO)
Mr. Todd Barlow (Non-Executive Director)
Mr. Stuart Black (Independent Non-Executive Director)
Ms. Sue MacLeman (Independent Non-Executive Director)

Review of operations

Financial Results Summary

	Consolidated entity	
	30 June 2020 $	30 June 2019 $
Sales of:		
Narcotic Raw Material ("NRM") and Poppy Seed	**2,484,293**	6,890,088
Active Pharmaceutical Ingredients ("API")	**5,976,262**	8,187,402
Finished Dosage Formulations ("FDF")	**3,792,890**	12,204,047
Total product sales	**12,253,445**	27,281,537
Statutory Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA)	**(6,660,764)**	(1,382,642)
Statutory Earnings Before Interest and Tax (EBIT)	**(8,015,396)**	(2,611,069)
Statutory (Loss) for the year after Interest and Tax	**(9,014,762)**	(4,083,709)
Net cash (outflow) from operating activities	**(5,438,063)**	(6,620,846)
Operating EBITDA	**(6,745,306)**	270,931

Operating EBITDA, a non-GAAP financial measure, is used internally within the Group to manage performance and is determined by adding back to Statutory EBITDA significant non-recurring items (2020: nil / 2019: litigation settlement and acquisition related expenses), and deducting other income and gains on non-core asset disposals of $(0.1) million (2019: $1.5 million). A $7.0 million decline in reported Operating EBITDA from $0.3 million for the 2019 half-year period to an Operating EBITDA loss of $6.7 million for the 2020 half-year period reflects a decline in Gross Profit due to reduced API sales volumes from a major customer which had committed contracted volumes to the Group having had their manufacturing license suspended for a prolonged period, production inefficiencies associated with the timing of the planned early exit from the legacy non-opiate based FDF supply agreement in Norway, and reduced margin contribution from poppy seed sales with a reduction in domestic harvest growing area last season.

Gross Profit margins are expected to significantly improve through the second half of 2020 due to improved product mix and supply of opiate based FDF products via newly acquired Marketing Authorisations. Indirect Overhead costs were reduced by $1.8 million compared to the previous half year period due to the reset cost base in Norway resulting from the non-opiate based supply agreement termination, and the $0.5 million contribution of wage subsidy receipts in Australia.

Review of operations (continued)

Sales revenue reduced to $12.3 million compared to $27.3 million for the corresponding half-year period. The reduction in sales was primarily driven by reduced API volumes from the major customer with contracted volumes having their manufacturing license suspended and the planned early exit from the legacy non-opiate based FDF supply agreement from February 2020. NRM and Poppy Seed sales revenue was down $4.4 million from the previous half-year period due to reduced domestic poppy straw growing area with an increased focus on offshore poppy straw supply that is in a pelletised form without seed.

A trade receivables impairment loss charge of $1.0 million was recognised during the half-year ended 30 June 2020 in relation to API product shipped in 2019 to the major customer that had its manufacturing license suspended; the matter is subject to debt recovery proceedings and the full amount owing is expected to be recovered.

Despite some of these short-term setbacks, the business strengthened its foundation for the future with an increased focus on downstream, margin accretive FDF sales, to be carried out through both contract manufacturing and Marketing Authorisation based supply arrangements. To support the strategy of increasing downstream margin accretive sales, the Group acquired seven opiate based marketing authorisations during the 2020 half-year period and expanded its API production capacity to 70 tonne per annum. The Group continues to focus on increased poppy straw supply diversification and alkaloid yields for its NRM operations, via its Australian and Northern Hemisphere supply sources.

The Group reported a statutory loss after income tax for the half-year ended 30 June 2020 of $9.0 million (2019: $4.1 million) and a statutory Earnings Before Interest, Tax, Depreciation and Amortisation (“EBITDA”) loss of $6.7 million (2019: $1.4 million).

Net finance expenses reduced for the 2020 half-year period to $1.0 million (2019: $1.6 million) due to reduced utilisation of working capital debt facilities. Net working capital reduced by $2.5m during the half-year period due to the cessation of the legacy non-opiate based FDF supply agreement and the reduction in a contractual requirement to hold a safety stock buffer; this was offset by an increase in raw materials and work in progress inventory to protect against any COVID-19 related supply chain disruptions.

Net debt increased during the period to fund net cash outflows from operating activities and capital expenditure associated with the acquisition of the Marketing Authorisations.

COVID-19 restrictions and impacts on operations

In March 2020, the World Health Organisation declared the COVID-19 outbreak a pandemic. In an effort to contain the spread of the virus, quarantine restrictions, travel restrictions, limitations on social gatherings, the closure of business and schools and other restrictive measures have been introduced across the world in jurisdictions in which the Group operates.

To date COVID-19 restrictions have had minor impacts on the financial performance of the Group, primarily from travel restrictions and social distancing limitations impacting on new market development activities, paracetamol shortages impacting Codeine Phosphate ordering patterns, the impact of potential new customers remaining focussed on managing their own businesses through the pandemic, along with some additional freight cost imposts due to late flight cancellations for air freight. It is not possible to quantify the possible impacts of COVID-19 from other external factors impacting on the business for the half-year reporting period.

The Group remains subject to possible supply chain interruptions during the pandemic and are mitigating these risks by holding higher than normal inventory levels across all aspects of the business, which has impacted the Group’s financial position. In many markets where the Group’s is active, its products are classified as essential medication consistent with the World Health Organisation essential medicines listing and are exempted from many of the COVID-19 restrictions industries are otherwise experiencing. A positive influence has been improved regulatory approvals, when required to keep essential medicines flowing.

Review of operations (continued)

In March 2020, the Group implemented strict COVID-19 safe operating procedures at its Melbourne and Norway production facilities, including the provision of additional Personal Protective Equipment, staggering shifts and breaks, and adherence to physical distancing requirements in shared working areas. To date these procedures have proved effective with minimal labour interruptions impacting manufacturing operations.

Under COVID-19 Stage 4 Stay at Home Restrictions that came into effect in the State of Victoria in August 2020, workplaces in metropolitan Melbourne were required to close under the directions of Victoria's Chief Health Officer, unless the workplace was part of a 'Permitted Industry'. Pharmaceutical product manufacturing is considered a Permitted Industry and can continue to remain open for on-site work provided a COVID Safe Plan is in place. The Group will continue to operate its Melbourne-based production facility to supply external customers as well as its Norway operations, subject to labour availability and government permission to operate remaining in place.

The Group continues to remain in contact with the Victorian Government to ensure its supply of an essential product to global pharmaceutical markets remains uninterrupted.

The Group has availed itself of COVID-19 government financial assistance measures in both Australia and Norway where applicable.

As a result of the evolving nature of the COVID-19 outbreak and rapidly evolving government policies of restrictive measures being put in place to contain it, as at the date of this report, it is not possible to reasonably estimate the potential financial effects of the COVID-19 outbreak on the future financial performance and financial position of the Group.

Marketing Authorisation acquisitions

During the half-year period, the Group acquired seven Marketing Authorisations for supply into the United Kingdom which all require an opiate based product as an excipient. The ownership of the Marketing Authorisations has been transferred to the Group and the Group is well progressed and on schedule in having its Norway site approved as a manufacturer by the United Kingdom regulator.

Raw Material Poppy Straw Supply and Poppy Seed

The Group had a reduced growing area for the 2019/20 domestic poppy growing season in Australia due to adverse weather events in NSW and a focus on further diversification of poppy straw sourcing towards Northern Hemisphere sources. The quality of Northern Hemisphere straw supply has improved further based on product received during the half-year period, with the securing of additional aggregator supply agreements and a continued focus on improving local expertise with increased farmer and aggregator engagement through the Group's on-the-ground agricultural expertise in Europe. The diversity of poppy straw supply sources continues to be of benefit in negating any impacts on domestic supply through climatic risks and events such as those that adversely impacted mainland growers in Australia for the 2019/20 growing season.

Although poppy seed sales pricing remained strong during the first half of 2020, with reduced domestic growing area, volumes sold were lower than during the first half of 2019. Northern Hemisphere sourced straw is in a pelletised form, and the Group does not benefit from poppy seed sales from this raw material input, but derives benefits from a reduced purchase price of the pellets and risk mitigation through dual hemisphere growing area diversification.

NRM production in Australia

The majority of the Group's NRM production is transferred to Norway for conversion into both Codeine Phosphate and Pholcodine API's. However, as the capacity of NRM production for the Group is currently greater than that of API production, external NRM sales will continue to be a revenue contributor in the short to medium term.

Review of operations (continued)

The Group continues to invest in research and development of its core NRM production process to further optimise the extraction process and increase production efficiencies. The unique water-based extraction process used is delivering a competitive cost advantage for the Group and when combined with a more reliable straw supply, has enabled increased sales volumes and long-term supply agreements to be secured throughout the supply chain.

API production in Norway

During the 2020 half-year period the Group experienced a slight decrease in API production and sales volumes compared to the previous half-year period due to the loss of manufacturing license by a major customer for a prolonged period. Despite this, a major enhancement in production capacity achieved in the latter part of 2019 was carried forward into the first quarter of 2020 until production was reduced to match the lower demand experienced due to the major customer loss of volume. Further market share gains and customer diversification have continued to be realised in both Codeine Phosphate and Pholcodine API markets during the half-year period.

While pricing across the industry remains at cyclical lows, the Group continues to attract new API volumes and grow market share at commercially attractive margins, demonstrating the Group's competitive cost advantage in API production.

FDF production in Norway

FDF production of non-opiate based products under contract manufacturing ("CMO") arrangements for third parties requires high levels of labour, working capital and generates lower margins than the core businesses of the Group; NRM production and downstream conversion of NRM into API.

During the half-year period non-opiate based production remained a challenge due to the bespoke nature of the legacy non-opiate based contract and range of products needing to be produced. This requires short production runs resulting in significant production downtime for product changeover and line cleaning. In late 2019 the Group successfully negotiated an early exit from its legacy non-opiate based CMO contract from February 2020. This planned transition has freed up significant tableting capacity to direct towards higher-margin opiate-based products, while reducing operational costs and inventory holdings that were required to be contractually maintained as a safety buffer for this supply agreement. Production inefficiencies were experienced during the transition out of the CMO agreement which impacted Direct materials and labour costs incurred, leading to a lower reported Gross Profit for the Group during the 2020 half-year period compared to the previous corresponding half-year period.

During the half-year period, a multi-year opiate based FDF CMO contract was extended to supply a volume of 270 million Codeine Phosphate tablets to a major customer in the United Kingdom. The contract extension equates to a minimum of eight tonnes of Codeine Phosphate equivalent and represents approximately 4 months of the Group's annual packaging capacity.

The early exit from the non-opiate based FDF supply agreement has positioned the Group well for increased future profitability by releasing significant FDF tableting and packaging capacity to direct towards higher margin contribution opiate based FDF production through supply of opiate based FDF products via existing CMO supply agreements and the newly acquired Marketing Authorisations.

The Group is well progressed with the validation of the acquired 30/500 Co-Codamol Marketing Authorised product (Codeine Phosphate/Paracetamol 30mg / 500mg), with validation batches having been completed for both tablet and caplet form meeting the required product specifications. Due to supply shortages in the United Kingdom, retail sales prices for these products have increased significantly during 2020 compared to 2018 based on United Kingdom pharmacy network and hospital data.

Review of operations (continued)

Reconciliation of Operating EBITDA to Statutory EBITDA and Loss After Tax

The consolidated financial statements comply with International Financial Reporting Standards (IFRS's) adopted by the International Accounting Standards Board (IASB). In the presentation of its financial results the Group uses a non-GAAP financial measure which is not prepared in accordance with IFRS being:

- Operating EBITDA: calculated by adding back (or deducting) finance expense / (income), income tax expense/(benefit), depreciation, amortisation, litigation settlement expenses, acquisition related expenses, transaction integration services, agricultural area trialling expenses, inventory impairments, losses from discontinued operations, gains/losses on disposal of non-core plant and equipment, and deducting other income and depreciation expense from discontinued operations, to net profit / (loss) after tax.

The Group uses this measure internally and believes that this non-GAAP financial measure provides useful information to readers to assist in the understanding of the Group's financial performance, financial position and returns, as it is the predominant measure of financial performance used by management. It represents the best measure of performance as a result of initiatives and activities directly controlled by management. Non-GAAP financial measures should not be viewed in isolation, nor considered as a substitute for measures reported in accordance with IFRS. Non-GAAP financial measures may not be comparable to similarly titled amounts reported by other companies.

The table below reconciles the Operating EBITDA to Statutory EBITDA and Loss After Tax:

	Consolidated entity	
	30 June 2020 $	30 June 2019 $
Statutory (Loss) after income tax	**(9,014,762)**	(4,083,709)
Less: Income tax benefit	**-**	(85,502)
Add: Net finance expenses	**999,366**	1,558,142
Statutory Earnings Before Interest and Tax (EBIT)	**(8,015,396)**	(2,611,069)
Add: Depreciation and amortisation expense	**1,354,632**	1,228,427
Statutory Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA)	**(6,660,764)**	(1,382,642)
Add:		
Acquisition related expenses - legal and other expenses	**-**	122,000
Gain on disposal of non-core property, plant and equipment	**(9,045)**	-
Litigation settlement expenses	**-**	1,607,143
Deduct:		
Other income	**(75,497)**	(75,570)
Operating EBITDA	**(6,745,306)**	270,931

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 7.

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

Mr. Simon Moore
Chairman

Melbourne
31 August 2020

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To the Directors of Palla Pharma Ltd

I declare that, to the best of my knowledge and belief, in relation to the review of Palla Pharma Ltd for the half-year ended 30 June 2020 there have been:

i. no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the review; and

ii. no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG

Tony Batsakis
Partner

Melbourne

31 August 2020

	Notes	Consolidated entity 30 June 2020 $	30 June 2019 $
Revenue			
Sale of goods		**12,253,445**	27,281,537
Other income		**75,497**	75,570
		12,328,942	27,357,107
Expenses			
Raw materials, consumables and other production expenses		**(7,213,427)**	(13,624,635)
Employee benefits (production) expenses	3	**(3,324,152)**	(4,224,819)
Employee benefits (non-production) expenses	3	**(4,836,481)**	(5,517,048)
Legal and listing compliance expenses		**(157,280)**	(542,428)
Market development expenses		**(195,378)**	(542,104)
Occupancy expenses		**(1,048,065)**	(1,016,064)
Contract research expenses		**(44,694)**	(74,051)
Acquisition related expenses - legal and other expenses		**-**	(122,000)
Gain on disposal of property, plant and equipment		**9,045**	-
Litigation settlement expenses		**-**	(1,607,143)
Consulting expenses		**(138,884)**	(291,665)
Outsourced quality consulting expenses		**(72,742)**	(189,599)
Impairment loss on trade receivables		**(1,050,000)**	-
Other expenses		**(917,648)**	(988,193)
Total expenses		**(18,989,706)**	(28,739,749)
Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA)		**(6,660,764)**	(1,382,642)
Depreciation and amortisation expense	3	**(1,354,632)**	(1,228,427)
Earnings Before Interest and Tax (EBIT)		**(8,015,396)**	(2,611,069)
Finance income		**11,635**	2,770
Finance expenses		**(1,011,001)**	(1,560,912)
Net finance expenses	3	**(999,366)**	(1,558,142)
(Loss) before income tax		**(9,014,762)**	(4,169,211)
Income tax benefit		**-**	85,502
(Loss) for the period		**(9,014,762)**	(4,083,709)
Other comprehensive income/(loss)			
Item that may be reclassified to profit or loss			
Exchange differences on translation of foreign operations		**(795,805)**	196,540
Total comprehensive (loss) for the period		**(9,810,567)**	(3,887,169)

The above consolidated statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes.

	Notes	**Consolidated entity 30 June 2020 $**	30 June 2019 $
(Loss) is attributable to:			
Owners of Palla Pharma Limited		**(9,014,762)**	(4,083,709)
Total comprehensive (loss) for the period is attributable to:			
Owners of Palla Pharma Limited		**(9,810,567)**	(3,887,169)
		Cents	Cents
Earnings per share for the (loss) from continuing operations attributable to the ordinary equity holders of the Company:			
Basic (loss) per share		**(7.16)**	(5.04)
Diluted (loss) per share		**(7.16)**	(5.04)

The above consolidated statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes.

	Notes	Consolidated entity 30 June 2020 $	31 December 2019 $
ASSETS			
Current assets			
Cash and cash equivalents	4	**1,644,223**	2,019,087
Trade and other receivables		**4,722,391**	11,507,068
Inventories	5	**27,212,550**	22,149,374
Contract assets		**3,154,314**	5,995,039
Prepayments		**2,427,174**	1,481,425
Total current assets		**39,160,652**	43,151,993
Non-current assets			
Other receivables		**397,420**	405,875
Investments		**103,272**	103,272
Property, plant and equipment	7	**25,656,107**	26,693,955
Intangible assets	8	**18,592,330**	16,967,608
Inventories	6	**2,255,455**	2,250,585
Total non-current assets		**47,004,584**	46,421,295
Total assets		**86,165,236**	89,573,288
LIABILITIES			
Current liabilities			
Trade and other payables		**8,601,693**	8,907,120
Borrowings	9	**540,360**	467,424
Provisions		**1,444,645**	1,847,235
Total current liabilities		**10,586,698**	11,221,779
Non-current liabilities			
Trade and other payables		**1,122,569**	1,563,462
Borrowings	10	**12,300,000**	5,000,000
Provisions		**415,928**	378,044
Total non-current liabilities		**13,838,497**	6,941,506
Total liabilities		**24,425,195**	18,163,285
Net assets		**61,740,041**	71,410,003
EQUITY			
Contributed equity	11	**210,994,087**	210,997,191
Reserves	12	**2,943,127**	3,595,223
(Accumulated losses)		**(152,197,173)**	(143,182,411)
Total equity		**61,740,041**	71,410,003

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

		Attributable to owners of Palla Pharma Limited				
Consolidated entity	Notes	**Contributed equity $**	**Share-based payments $**	**Foreign currency translation reserve $**	**(Accumulated losses) $**	**Total equity $**
Balance at 1 January 2019		181,482,260	2,448,159	915,308	(135,542,968)	49,302,759
(Loss) for the half-year		-	-	-	(4,083,709)	(4,083,709)
Other comprehensive income		-	-	196,540	-	196,540
Total comprehensive income/(loss) for the period		**-**	**-**	**196,540**	**(4,083,709)**	**(3,887,169)**
Transactions with owners in their capacity as owners:						
Share-based payments		-	174,161	-	-	174,161
Balance at 30 June 2019		**181,482,260**	**2,622,320**	**1,111,848**	**(139,626,677)**	**45,589,751**
Balance at 1 January 2020		210,997,191	2,791,792	803,431	(143,182,411)	71,410,003
(Loss) for the half-year		-	-	-	(9,014,762)	(9,014,762)
Other comprehensive (loss)		-	-	(795,805)	-	(795,805)
Total comprehensive (loss) for the period		**-**	**-**	**(795,805)**	**(9,014,762)**	**(9,810,567)**
Transactions with owners in their capacity as owners:						
Contributions of equity, net of transaction costs and tax	11	(3,104)	-	-	-	(3,104)
Share-based payments		-	143,709	-	-	143,709
		(3,104)	143,709	-	-	140,605
Balance at 30 June 2020		**210,994,087**	**2,935,501**	**7,626**	**(152,197,173)**	**61,740,041**

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

	Notes	Consolidated entity **30 June 2020** **$**	 30 June 2019 $
Cash flows from operating activities			
Receipts from customers (inclusive of GST and VAT)		**21,135,368**	28,665,032
Payments to suppliers and employees (inclusive of GST and VAT)		**(25,788,677)**	(33,727,736)
		(4,653,309)	(5,062,704)
Interest received		**11,635**	2,770
Interest and finance costs paid		**(796,389)**	(1,560,912)
Net cash (outflow) from operating activities	13	**(5,438,063)**	(6,620,846)
Cash flows from investing activities			
Payments for property, plant and equipment		**(478,501)**	(851,880)
Payments for capitalised development costs and patents		**(1,692,602)**	(339,790)
Proceeds from sale of non-current assets		**24,727**	-
Net cash (outflow) from investing activities		**(2,146,376)**	(1,191,670)
Cash flows from financing activities			
Share issuance transaction costs		**(3,104)**	-
Proceeds from borrowings	10	**7,300,000**	8,297,040
Proceeds from/(repayment of) borrowings		**72,936**	(76,711)
Net cash inflow from financing activities		**7,369,832**	8,220,329
Net (decrease) increase in cash and cash equivalents		**(214,607)**	407,813
Cash and cash equivalents at the beginning of the financial period		**2,019,087**	1,904,583
Effects of exchange rate changes on cash and cash equivalents		**(160,257)**	147,699
Cash and cash equivalents at end of period	4	**1,644,223**	2,460,095

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

1 Basis of preparation of half-year report

This consolidated interim report for the half-year reporting period ended 30 June 2020 has been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*. Compliance with AASB 134 ensures compliance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*.

This condensed interim report does not include all of the notes of the type normally included in an annual financial report, however selected explanatory notes are included to explain events and transactions that are significant to understanding the changes to the Group's financial position and performance since 31 December 2019. Accordingly, it should be read in conjunction with the Annual Report for the year ended 31 December 2019 and any public announcements made by Palla Pharma Limited, since 31 December 2019, in accordance with continuous disclosure requirements of the *Corporations Act 2001*. This interim report has been prepared in accordance with the measurement and recognition requirements of Australian Accounting Standards, Accounting Interpretations and the *Corporations Act 2001*.

This interim report has been prepared on the basis of historical cost, except for the revaluation of certain non-current assets and financial instruments. Cost is based on the fair values of the consideration given in exchange for the assets. All amounts are presented in Australian dollars, unless otherwise noted. All values are rounded to the nearest dollar.

The accounting policies and methods of computation adopted in the preparation of the interim report are consistent with those adopted and disclosed in the Group's annual financial report for the year ended 31 December 2019.

This interim report was authorised for issue by the Group's Board of Directors on 31 August 2020.

(a) Significant accounting policies

The accounting policies applied in this interim report are the same as those applied in the Group's consolidated financial report as at and for the year ended 31 December 2019.

(b) Use of estimates and judgements

The preparation of consolidated financial statements in conformity with Australian Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the half-year ended ending 30 June 2020 is included in the following notes:

Notes 7 and 8 - impairment test: key assumptions underlying recoverable amounts of property, plant and equipment and intangible assets.

1 Basis of preparation of half-year report (continued)

(c) Going concern

The consolidated financial statements have been prepared on a going concern basis, which assumes that the Group will be able to continue trading, realise its assets and discharge its liabilities in the ordinary course of business for a period of at least 12 months from the date that these financial statements are approved.

The Directors note the following events and conditions which have been considered in assessing the appropriateness of the going concern assumption:

- For the half-year ended 30 June 2020 the Group generated a loss after income tax of $9,014,762 (2019: $4,083,709) and had cash outflows from operations of $5,438,063 (2019: $6,620,846).

- As at 30 June 2020 the Group's current assets exceeded its current liabilities by $28,573,954 (31 December 2019: $31,930,214), with cash and cash equivalents of $1,644,223 (31 December 2019: $2,019,087).

- The Group has a standby debt facility in place with Washington H. Soul Pattinson and Company Limited to meet the Group’s short-term working capital requirements. As at the date of this report the facility has a limit of $16,000,000 and at 30 June 2020 the Group had drawn down $12,300,000 of the Facility. The remaining facility available for utilisation of $3,700,000 combined with cash and cash equivalents of $1,644,223 provides adequate funding to meet the Group’s immediate needs.

- The standby debt facility in place with Washington H. Soul Pattinson expires on 31 August 2021. The Directors acknowledge that prima facie a refinancing risk exists at 31 August 2021 if the facility is not renewed in line with past practice, repaid out of funds secured from an alternative source of debt or raised from the issue of additional equity.

- The Directors have confidence in the continuing support from existing shareholders and ability to attract new investors and debt providers to fund the Group’s future financing requirements, if required, as demonstrated by previous capital and debt raisings.

- The Directors have reviewed the basis of preparation and achievability of the business plans, cash flow and profit and loss forecasts prepared by management which project positive EBITDA and positive operating cash flows. The cashflow forecasts have considered the potential impact that may arise as a result of the COVID-19 pandemic and based on what is currently known, formed the view that there is unlikely to be a material impact on these forecasts.

After considering the above factors, the Directors have concluded that the use of the going concern assumption is appropriate.

In the event that the forecast financial performance of the Group is not met as anticipated, and the Group is unable to attract new debt or equity funding, material uncertainty exists as to whether the Group may be able to continue as a going concern, and therefore it may be required to realise its assets and extinguish its liabilities other than in the normal course of business, and at amounts different to those stated in the financial report.

2 Segment information

Operating segments are presented using the 'management approach', where the information presented is on the same basis as the internal reports provided to the Chief Operating Decision Maker ('CODM') of the Group. The CODM is responsible for the allocation of resources to operating segments and assessing their performance. The CODM has been identified as the CEO. Segment information is presented to the CEO comprising two segments: Australia and Norway.

Australia
Segment activities: Narcotic Raw Material and Poppy Seed production and distribution.

Norway
Segment activities: Active Pharmaceutical Ingredient and Finished Dosage Formulation production and distribution.

	Australia		Norway		Eliminations		Consolidated	
Consolidated entity	**30 June 2020 $**	**30 June 2019 $**	**30 June 2020 $**	**30 June 2019 $**	**30 June 2020 $**	**30 June 2019 $**	**30 June 2020 $**	**30 June 2019 $**
External revenue	**2,555,986**	**6,963,668**	**9,772,956**	**20,393,439**	**-**	**-**	**12,328,942**	**27,357,107**
Inter-segment revenue	**9,926,497**	**12,835,005**	**-**	**-**	**(9,926,497)**	**(12,835,005)**	**-**	**-**
Total segment revenue	**12,482,483**	**19,798,673**	**9,772,956**	**20,393,439**	**(9,926,497)**	**(12,835,005)**	**12,328,942**	**27,357,107**
Reportable segment (loss)/profit before tax	**(536,650)**	**886,955**	**(7,091,832)**	**(2,788,312)**	**(386,914)**	**(709,712)**	**(8,015,396)**	**(2,611,069)**
Unallocated amounts								
Net financing costs							**(999,366)**	**(1,558,142)**
Consolidated (loss) before tax							**(9,014,762)**	**(4,169,211)**

2 Segment information (continued)

Consolidated entity	Australia 30 June 2020 $	Australia 30 June 2019 $	Norway 30 June 2020 $	Norway 30 June 2019 $	Eliminations 30 June 2020 $	Eliminations 30 June 2019 $	Consolidated 30 June 2020 $	Consolidated 30 June 2019 $
Timing of External revenue recognition:								
Narcotic Raw Material & Poppy Seed								
- at a point in time	**2,484,293**	**6,890,088**	**-**	**-**	**-**	**-**	**2,484,293**	**6,890,088**
Active Pharmaceutical Ingredient								
- at a point in time	**-**	**-**	**5,976,262**	**8,187,402**	**-**	**-**	**5,976,262**	**8,187,402**
Finish Dosage Formulation - over time	**-**	**-**	**3,792,890**	**12,204,047**	**-**	**-**	**3,792,890**	**12,204,047**
Other revenue - at a point in time	**71,693**	**73,580**	**3,804**	**1,990**	**-**	**-**	**75,497**	**75,570**
	2,555,986	**6,963,668**	**9,772,956**	**20,393,439**	**-**	**-**	**12,328,942**	**27,357,107**

2 Segment information (continued)

	Consolidated entity	
	30 June 2020	31 December 2019
	$	$
Non-current assets		
Australia	**31,600,169**	29,706,630
Europe	**15,404,415**	16,714,665
	47,004,584	46,421,295

3 Expenses

	Consolidated entity	
	30 June 2020	30 June 2019
	$	$
(Loss) before income tax includes the following specific expenses:		
Employee benefits expenses		
Salaries and wages	**7,313,580**	8,647,563
Other associated personnel expenses	**165,704**	804,113
Defined contribution superannuation expenses	**304,014**	280,212
Increase in liability for long service leave	**37,884**	30,527
Increase/(decrease) in liability for annual leave	**195,742**	(194,709)
Share-based payments	**143,709**	174,161
Total employee benefits expenses	**8,160,633**	9,741,867

In the three months April to June 2020 the Group recognised $486,000 in government assistance in the form of the JobKeeper wage subsidy in Australia. This has been recognised as an offset to the salaries and wages expense line.

Depreciation		
Buildings	**204,732**	215,049
Contract equipment	**82,149**	85,933
Manufacturing plant and equipment	**882,642**	791,129
Office equipment	**109,125**	114,244
Motor vehicles	**12,685**	9,145
Total depreciation	**1,291,333**	1,215,500
Amortisation		
Patents, trademarks and other rights	**63,299**	12,927
Total amortisation	**63,299**	12,927
Total depreciation and amortisation	**1,354,632**	1,228,427

3 Expenses (continued)

(continued)

	Consolidated entity 30 June 2020 $	30 June 2019 $
Finance income		
Interest income	**(11,635)**	(2,770)
	(11,635)	(2,770)
Finance costs		
Interest and finance expenses on financial liabilities measured at amortised cost	**514,221**	1,478,856
Unwind of discount on trade payable	**214,612**	-
Net exchange losses on foreign currency	**282,168**	82,056
	1,011,001	1,560,912
Net finance expenses recognised in profit or loss	**999,366**	1,558,142

4 Current assets - Cash and cash equivalents

	Consolidated entity 30 June 2020 $	31 December 2019 $
Cash at bank	**1,644,223**	2,019,087

5 Current assets - Inventories

	Consolidated entity 30 June 2020 $	31 December 2019 $
Raw materials and consumables	**6,163,632**	6,607,925
Work in progress	**18,572,437**	15,194,810
Finished goods	**2,476,481**	346,639
	27,212,550	22,149,374

6 Non-current assets - Inventories

	Consolidated entity 30 June 2020 $	31 December 2019 $
Raw materials and consumables	**1,982,363**	1,977,493
Work in progress	**250,901**	250,901
Finished goods	**22,191**	22,191
	2,255,455	2,250,585

7 Non-current assets - Property, plant and equipment

	Land and buildings $	Manufacturing plant and equipment $	Office equipment $	Motor vehicles $	Contract plant and equipment $	Total $
At 31 December 2019						
Cost	18,192,282	29,124,070	2,149,354	258,748	2,233,692	51,958,146
Accumulated depreciation	(8,377,657)	(14,798,284)	(854,472)	(191,256)	(1,042,522)	(25,264,191)
Net book amount	9,814,625	14,325,786	1,294,882	67,492	1,191,170	26,693,955
Period ended 30 June 2020						
Opening net book amount	9,814,625	14,325,786	1,294,882	67,492	1,191,170	26,693,955
Exchange differences	(25,163)	(152,666)	(31,476)	(29)	-	(209,334)
Additions	-	318,137	49,876	110,488	-	478,501
Disposals	-	-	-	(15,682)	-	(15,682)
Depreciation charge	(204,732)	(882,642)	(109,125)	(12,685)	(82,149)	(1,291,333)
Closing net book amount	9,584,730	13,608,615	1,204,157	149,584	1,109,021	25,656,107
At 30 June 2020						
Cost	18,139,680	29,207,980	2,147,763	284,989	2,233,692	52,014,104
Accumulated depreciation	(8,554,950)	(15,599,365)	(943,606)	(135,405)	(1,124,671)	(26,357,997)
Net book amount	9,584,730	13,608,615	1,204,157	149,584	1,109,021	25,656,107

Impairment testing

During the half-year ended 30 June 2020, the Group continued to record operating losses and accordingly has performed impairment testing to assess whether the recoverable amount of its property, plant and equipment and intangible assets is in excess of carrying value.

For the purpose of impairment testing the Group has defined two Cash Generating Units (CGU), the Australia CGU and the Norway CGU.

The recoverable amount for the CGU's was determined based on value-in-use calculations which require the use of assumptions.

Value in use as at 30 June 2020 was determined for the Australia CGU, based on the following key assumptions:

- Cash flows were forecast based on the Group’s five-year business plan and risk adjusted to reflect uncertainty created by possible COVID-19 impacts, with the terminal value based on the fifth-year cash flow and a long-term growth rate of 2.5%, which is consistent with the long-term inflation and growth targets for Australia of between 2% and 3%.

- Forecast sales volumes are based on past performance and management’s expectations of market development.

7 Non-current assets - Property, plant and equipment (continued)

Impairment testing (continued)

- Forecast foreign currency rates are set based on a range of external market commentator forecasts.
- Sales prices are based on current industry trends for each sales territory and contracted pricing where applicable.
- Forecast gross margins are based on past performance and management's expectations for the future.
- Other operating costs of the CGU, which do not vary significantly with sales volumes or prices, have been forecast by management based on the current structure of the business, but not reflecting any future restructurings or cost saving measures.
- Poppy straw harvesting yields were considered based on historical yield performance, climate-induced variations such as severe weather events, past plant losses and new growing areas coming into production.
- Annual capital expenditure is based on the historical experience of management. No incremental cost savings are assumed in the value-in-use model as a result of this expenditure.
- An after-tax discount rate of 8.5% and 10% for the Australia and Norway CGU's respectively was applied in determining the recoverable amount of the CGU's based on an industry average weighted-average cost of capital and applying a premium to the industry average due to the Group's size and stage of lifecycle.

Significant assumptions used in the impairment testing referred to above are inherently subjective, and in times of economic uncertainty the degree of subjectivity is higher than it might otherwise be. Accordingly, it should be noted that the risks and uncertainties associated with the possible impacts of the COVID-19 pandemic and the economic environment could cause the actual results to differ from management's projections used in the assessment, which could lead to significant changes in the recoverable amount of the Australia CGU.

The recoverable amount of the Australia CGU which was most sensitive to changes in key assumptions was determined to be higher than its carrying amount, indicating that no impairment is evident. In addition, reasonably possible changes in key assumptions were considered, such as changes in the forecast sales volumes, foreign exchange rates and the discount rate; sufficient headroom exists and no impairment was noted.

8 Non-current assets - Intangible assets

	Goodwill $	Patents, trademarks and other rights $	Capitalised development costs $	Total $
At 31 December 2019				
Cost	13,955,503	2,287,492	799,481	17,042,476
Accumulated amortisation and impairment	-	(74,868)	-	(74,868)
Net book amount	13,955,503	2,212,624	799,481	16,967,608
Period ended 30 June 2020				
Opening net book amount	13,955,503	2,212,624	799,481	16,967,608
Exchange differences	-	(4,581)	-	(4,581)
Additions	-	11,722	1,680,880	1,692,602
Transfers between asset classes	-	799,481	(799,481)	-
Amortisation charge	-	(63,299)	-	(63,299)
Closing net book amount	13,955,503	2,955,947	1,680,880	18,592,330
At 30 June 2020				
Cost	13,955,503	3,089,494	1,680,880	18,725,877
Accumulated amortisation and impairment	-	(133,547)	-	(133,547)
Net book amount	13,955,503	2,955,947	1,680,880	18,592,330

Impairment testing

The Group reviewed the carrying value of its intangible assets at the reporting date and determined that the carrying value of these assets was appropriate. Refer to note 7 for further details of the Group's impairment testing for the half-year ended 30 June 2020.

9 Current liabilities - Borrowings

This note provides information about the Group’s current interest-bearing loans and borrowings, which are measured at amortised cost.

	Consolidated entity	
	30 June 2020 $	31 December 2019 $
Other loans	**540,360**	467,424
Total current borrowings	**540,360**	467,424

Refer to note 10 for movements during the half-year, and the contractual terms of the Group’s current borrowings.

10 Non-current liabilities - Borrowings

This note provides information about the Group's non-current interest-bearing loans and borrowings, which are measured at amortised cost.

	Consolidated entity	
	30 June 2020 $	31 December 2019 $
Shareholder loan facility	**12,300,000**	5,000,000
Total non-current borrowings	**12,300,000**	5,000,000

Washington H. Soul Pattinson and Company Limited, a substantial shareholder has provided the Group with a standby debt facility with a limit of up to $16,000,000 (2019: $31,000,000) to meet the Group's short term working capital needs. At 30 June 2020 the Group had drawn down $12,300,000 of the facility (2019: $31,000,000). The maturity date of this facility is August 2021. This facility is secured by mortgages over properties located in Australia.

(a) Movements during the half-year

	Currency	**Nominal interest rate**	**Year of maturity**	**Movement**	**Carrying amount ($)**
At 1 January 2020					**5,467,424**
(Repayments)/drawings					
Shareholder loan facility	AUD	8.25%	2021	7,300,000	12,300,000
Insurance premium funding	AUD	5.57%	2020	(183,797)	-
Insurance premium funding	AUD	3.75%	2020	(232,679)	38,780
Insurance premium funding	AUD	5.31%	2021	503,590	503,590
Corporate credit card	AUD		2020	(14,178)	(2,010)
Carrying amount 30 June 2020				7,372,936	**12,840,360**

(b) Terms and debt repayment schedule

Terms and conditions of outstanding loans were as follows:

				30 June 2020	**31 December 2019**
	Currency	**Nominal interest rate**	**Year of maturity**	**Carrying amount ($)**	**Carrying amount ($)**
Shareholder loan facility	AUD	8.25%	2021	12,300,000	5,000,000
Insurance premium funding	AUD	5.57%	2020	-	183,797
Insurance premium funding	AUD	3.57%	2020	38,780	271,459
Insurance premium funding	AUD	5.31%	2021	503,590	-
Corporate credit card	AUD		2020	(2,010)	12,168
Total interest bearing liabilities				**12,840,360**	**5,467,424**

The carrying value of financial assets and liabilities represents a reasonable approximation of fair value.

11 Contributed equity

	30 June 2020 Shares	31 December 2019 Shares	**30 June 2020 $**	31 December 2019 $
Ordinary shares				
Fully paid	**125,947,977**	125,947,977	**210,994,087**	210,997,191

Ordinary shares

The Company does not have authorised capital or par values in respect of its issued shares. All issued shares are fully paid. All shares rank equally.

Ordinary shares participate in dividends and the proceeds on winding up of the Company in equal proportion to the number of shares held. At shareholder meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands. In respect of the Company's shares that are held by the Company, all rights are suspended until those shares are reissued.

The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of the Company.

12 Reserves

Foreign currency translation reserve

Exchange differences relating to translation from functional currencies of the Group's foreign controlled entities into Australian Dollars are brought to account by entries made directly to the foreign currency translation reserve.

Other reserves

Other reserves comprise a share-based payment reserve.

13 Cash flow information

Reconciliation of (loss) after income tax to net cash (outflow) from operating activities

	Consolidated entity	
	30 June 2020 $	30 June 2019 $
(Loss) for the period	**(9,014,762)**	(4,083,709)
Depreciation expense	**1,291,333**	1,215,500
Amortisation expense	**63,299**	12,927
Net (gain) on sale of non-current assets	**(9,045)**	-
Unwind of discount on trade payable	**214,612**	-
Equity-settled share-based payment transactions	**143,709**	174,161
Income tax benefit	**-**	(85,502)
Foreign currency translation movement	**421,633**	-
Interest income	**(11,635)**	(2,770)
Interest expense	**796,389**	1,560,912
Change in operating assets and liabilities:		
Decrease/(increase) in trade, other receivables and contract assets	**9,633,857**	(1,024,887)
(Increase) in inventories	**(5,068,047)**	(8,639,338)
(Increase)/decrease in prepayments	**(945,749)**	2,039,019
(Decrease)/increase in trade and other payables	**(1,804,197)**	3,935,165
(Decrease) in other provisions	**(364,706)**	(164,182)
Interest received	**11,635**	2,770
Interest paid	**(796,389)**	(1,560,912)
Net cash (outflow) from operating activities	**(5,438,063)**	(6,620,846)

14 Contingencies

A claim for unspecified damages and remedies was lodged against the Group in August 2020 in relation to its decision not to exercise an option agreement to acquire the business of a major UK customer, a decision that was advised to the market via an ASX announcement on 1 April 2020. The plaintiff seeks to link their claim to a long overdue trade receivable owing to the Group and for which recovery action has been commenced. The Group has disclaimed liability and is defending the action. It is not practical to estimate the potential effect of this claim, but the Group has made a partial provision against the outstanding trade receivable. The Directors are of the opinion, based on external legal advice, that the claim will be successfully resisted.

The information usually required by AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* is not disclosed on the grounds that it can be expected to seriously prejudice the outcome of the litigation.

In the directors' opinion:

(a) the interim financial statements and notes set out on pages 1 to 24 are in accordance with the *Corporations Act 2001*, including:

   (i) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and 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 2020 and of its performance for the half-year ended on that date, 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.

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

Simon Moore

Mr. Simon Moore
Chairman

Melbourne
31 August 2020

Independent Auditor's Review Report

To the shareholders of Palla Pharma Ltd

Conclusion

We have reviewed the accompanying ***Interim Financial Report*** of Palla Pharma Ltd.

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the Interim Financial Report of Palla Pharma Ltd is not in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the ***Group's*** financial position as at 30 June 2020 and of its performance for the ***Interim Period*** ended on that date; and
- complying with *Australian Accounting Standard AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*.

The ***Interim Financial Report*** comprises:

- Consolidated statement of financial position as at 30 June 2020
- Consolidated statement of profit or loss and other comprehensive income, Consolidated statement of changes in equity and Consolidated statement of cash flows for the Interim Period ended on that date
- Notes 1 to 14 comprising a summary of significant accounting policies and other explanatory information
- The Directors' Declaration.

The ***Group*** comprises Palla Pharma Ltd (the Company) and the entities it controlled at the Interim Period's end or from time to time during the Interim Period.

The ***Interim Period*** is the 6 months ended on 30 June 2020.

Material uncertainty related to going concern – emphasis of matter

We draw attention to Note 1(c), "Going Concern" in the Interim Financial Report. The conditions disclosed in Note 1(c), indicate a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern and, therefore, whether it will realise its assets and discharge its liabilities in the normal course of business, and at the amounts stated in the Interim Financial Report. Our conclusion is not modified in respect of this matter.

Responsibilities of the Directors for the Interim Financial Report

The Directors of the Company are responsible for:

- the preparation of the Interim Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*
- for such internal control as the Directors determine is necessary to enable the preparation of the Interim Financial Report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility for the review of the Interim Financial Report

Our responsibility is to express a conclusion on the Interim Financial Report based on our review. We conducted our review in accordance with *Auditing Standard on Review Engagements ASRE 2410 Review of a 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 Interim Financial Report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Group's financial position as at 30 June 2020 and its performance for the interim period ended on that date; and complying with *Australian Accounting Standard AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of Palla Pharma Ltd, *ASRE 2410* requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of the Interim Period Financial Report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. 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.

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

KPMG

KPMG

Tony Batsakis
Partner

Melbourne

31 August 2020