Mercer

Six Months Ended 31 December 2016 Interim Report

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Mercer Group Limited

Six Months Ended 31 December 2016

Overview:

Mercer Group is continuing its transition to a technology led food processing and packaging solutions provider, while also further investing resource in the S-Clave as we drive that exciting product towards commercialisation.

During the half year to 31 December 2016 we were focused on the following:

1. The continued restructuring of the core businesses.
2. The further development of the S-Clave, with a highlight being the ongoing partnership with A.E.Atherton's in Australia.
3. The successful rights issue that has provided much needed capital to our balance sheet.
4. The acquisition of Haden & Custance ("H&C") in December 2016 which was aligned with our stated growth strategy.

In particular, the acquisition of H&C has allowed us to separate the fabrication business from our technology led equipment range. This means that the AiCo, Titan and Beta ranges of equipment are now part of H&C, which has the appropriate skill sets, operational structure and focus to continue to develop and grow. H&C also has a deeper pool of controls and mechanical design resource than Mercer, which is critical to ensure our products have the resource available to continue their development.

The fabrication business can now focus on its core business as a manufacturer of stainless equipment for the dairy, wine and food sectors in New Zealand.

Financial Performance:

For the six months to 31 December 2016, Mercer generated a net after tax loss of $2.6m

While this is a disappointing result, the group is anticipating a return to positive EBITDA for the second half of the financial year to 30 June 2017. This is a positive step forward following the extensive strategic review, the restructuring carried out over the past 18 months and the acquisition of Haden & Custance.

The principal factors which contributed to this result are:

1. A decline in our machinery business sales, particularly Titan sales as a result of which we have agreed to terminate the relationship with our US distributor Nu-Meat.
2. The underutilisation of our fabrication workshops in both Christchurch and New Plymouth.

During the reporting period the group also incurred significant non-recurring costs as follows:

EBITDA normalised for non-recurring costs

		$000
Reported EBITDA		(1,477)
Capital raising costs[1]	391.7	
Cost relating to acquisition	80	
Restructuring costs	120	
Discontinued	200	
Total non-recurring items	792	792
Normalised EBITDA		(685)

S-Clave

We have continued to make progress with the S-Clave. Working closely with our Australian partner Atherton's we now have the design locked down for the S-Clave unit. Importantly, the S-Clave technology will be a retrofit to existing autoclaves in the marketplace, reducing the initial upfront cost to customers for adopting the technology. We are also working through the final structure and prototyping of the plastic containers and expect to be running final testing in the next six months.

In order to ensure we can get the S-Clave to market as rapidly as possible we are actively reviewing proposals for capital raising options on a standalone basis from Mercer.

Haden & Custance

H&C sells automated de-cartoning and de-bagging systems for the cheese industry globally (www.hadencustance.com). It is located in Hastings, but importantly has an office in Green Bay, Wisconsin, the "cheese capital" of the USA and an area that we expect to continue to invest in and grow. Demand for H&C's products is driven by a demand for automation in customers' production facilities in the growing worldwide market for prepared (shredded and sliced) cheese. H&C's customers are large, well-funded and growing. The challenge for H&C is to achieve profitable growth leveraging off a strong reputation, skill set and industry dynamics.

Given H&C's expertise in automation and controls, we have moved our AiCo, Titan and Beta ranges of products to H&C. This not only provides those products with greater focus and resource, it has also allowed us to rationalise resources that has resulted in immediate costs savings in the order of $1.25m annually.

During the six months to December we ceased our relationship with our US based distributor for Titan, Nu-Meat. As a result we are undertaking a comprehensive review of Titan's market strategy. While we believe Titan represents a credible market offering, Mercer lacked the necessary skills to execute. The H&C base in Wisconsin could provide a platform from which we build out our own Titan resource in market.

Fabrication

We still have our two fabrication workshops in Christchurch and New Plymouth. During the half year we continued to see underutilisation of the workshops, particularly in New Plymouth. However, the outlook for the following six months has been notably improved with good workflows enhanced by both orders for wine tanks following the Blenheim earthquake, and an increase in dairy related capex.

The fabrication business is currently focusing on improving its operational performance and filling its workshop capacity.

The collapse of the silo at Fonterra's Edendale site in September has had some impact on this business. However, we continue to work with all the parties involved to understand the cause of the collapse and ensure that such failures cannot reoccur. As previously mentioned, we have no other updates to report on Edendale.

Outlook

In the past six months we were focused on the rights issue, further refining our strategies and the acquisition of H&C. We are now focused on organic growth initiatives, improved operating performance and the commercialisation of the S-Clave. The contract nature of both the H&C and fabrication businesses makes them susceptible to periods of underutilisation between contracts and therefore we are focused on building scale and ensuring we are operationally flexible to reduce this risk.

Given the different growth opportunities, capital requirements and organisational structures of the three business units we will be assessing how each one moves forward separately.

John Dennehy, Chairman

Richard Rookes, CEO

Group Statement of Comprehensive Income

For the half year ended 31 December 2016

	Notes	Unaudited December 2016 $000	Unaudited December 2015 $000
Continuing Operations			
Revenue			
Sale of goods and contract revenue		**7,878**	9,700
Other income		**18**	105
Total income		**7,896**	9,805
Expenses			
Changes in inventories of finished goods and work in progress		**(3,411)**	(2,842)
Salaries and wages		**(4,352)**	(6,331)
Rental and operating leases		**(132)**	(261)
Other expenses		**(1,478)**	(2,142)
Depreciation		**(216)**	(286)
Amortisation		**(29)**	(46)
Restructuring costs	8	**(475)**	(1,439)
Development Costs		**-**	-
Continuing Operations Deficit before finance costs		**(2,197)**	(3,542)
Finance costs		**(382)**	(420)
Continuing operations Deficit before taxation		**(2,579)**	(3,962)
Income tax credit (expense)	7	**(25)**	760
Continuing operations Deficit after taxation		**(2,604)**	(3,202)
Discontinued operations			
Deficit from discontinued operations		**-**	(1,526)
Discontinued operations deficit after taxation		**(2,604)**	(4,728)
Deficit after taxation			
Attributable to:			
- Owners of the parent		**(2,604)**	(4,467)
- Non-controlling interest		**-**	(261)
		(2,604)	(4,728)
Other comprehensive (loss) income			
Items that may be subsequently charged or credited to profit and loss			
Currency translation differences		**14**	46
Items that will not be subsequently charged or credited to profit and loss			
Asset revaluation (devaluation) reserve movement		**-**	-
Other comprehensive (loss) income for the year, net of tax		**14**	46
Total comprehensive (Loss) income for the period		**(2,590)**	(4,682)
Options are conditional on the holder being in service on the vesting date.			
- Owners of the parent		**(2,590)**	(4,421)
- Non-controlling interest		**-**	(261)
Total		**(2,590)**	(4,682)
The Financial statements have been prepared using the going concern			
Deficit per share attributable to shareholders of the company (cents)	10	**(0.22)**	(1.43)
Fully diluted earnings per share:			
Deficit per share attributable to shareholders of the company (cents)	10	**(0.22)**	(1.43)

The above Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

Group Statement of Financial Position

As at 31 December 2016

	Notes	Unaudited 31 December 2016 $000	Audited 30 June 2016 $000
ASSETS			
Current assets			
Cash and bank balances		**848**	13
Accounts receivable		**3,895**	2,311
Other debtors and prepayments		**745**	868
Inventories		**2,729**	4,245
Total current assets		**8,217**	7,437
Non current assets			
Other debtors and prepayments		**1,117**	1,211
Property, plant and equipment		**6,806**	6,781
Intangible assets	9	**5,150**	4,548
Deferred tax asset	7	**4,728**	4,754
Investment in associate		**16**	16
Total non current assets		**17,817**	17,310
Total assets		**26,034**	24,747
LIABILITIES			
Current liabilities			
Bank overdraft		**1,030**	492
Trade and other payables		**4,239**	5,069
Employee entitlements		**1,238**	802
Borrowings		**3,591**	4,200
Total current liabilities		**10,098**	10,563
Non current liabilities			
Borrowings		**1,790**	5,847
Total liabilities		**11,888**	16,410
Net assets		**14,146**	8,337
EQUITY			
Share capital	4	**41,874**	33,475
Other reserves		**2,980**	2,981
Options are conditional on the holder being in service on the vestin		**(30,708)**	(28,119)
		14,146	8,337
Non-controlling interest		**-**	-
Total equity		**14,146**	8,337

The Financial statements have been prepared using the going concern assumption. For the half year ended 31 December 2016 the Group recorded a net loss of $2,604,000, which included several non-recurring costs for

Group Statement of Movements in Equity

For the half year ended 31 December 2016

	Notes	Attributable to the owners of the Group							
		Share capital	Retained earnings	Share based payments reserve	Foreign currency translation reserve	Asset revaluation reserve	Total equity	Non-controlling interest	Total equity
		$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Balance at 1 July 2015		33,475	(21,063)	10	(298)	2,814	14,938	(328)	14,610
Foreign currency translation reserve movement		-	-	-	46	-	46	-	46
Asset revaluation reserve movement		-	-	-	-	-	-	-	-
Deficit for the year		-	(4,467)	-	-	-	(4,467)	(261)	(4,728)
Total comprehensive income for the half year		-	(4,467)	-	46	-	(4,421)	(261)	(4,682)
Value of employee services	4	-	-	30	-	-	30	-	30
Issue of new shares		-	-	-	-	-	-	-	-
Balance at 31 December 2015		**33,475**	**(25,530)**	**40**	**(252)**	**2,814**	**10,547**	**(589)**	**9,958**
Balance at 1 July 2016		33,475	(28,119)	110	-	2,871	8,337	-	8,337
Foreign currency translation reserve movement		-	-	-	14	-	14	-	14
Deficit for the year		-	(2,604)	-	-	-	(2,604)	-	(2,604)
Total comprehensive income for the half		**-**	**(2,604)**	**-**	**14**	**-**	**(2,590)**	**-**	**(2,590)**
Value of employee services	4		15	(15)			-		-
Issue of New Shares	4	8,399	-	-	-	-	8,399	-	8,399
Balance at 31 December 2016		**41,874**	**(30,708)**	**95**	**14**	**2,871**	**14,146**	**-**	**14,146**

The above Statement of Movements in Equity should be read in conjunction with the accompanying notes.

Group Statement of Cash Flow
For the half year ended 31 December 2016

	Notes	Unaudited 31 December 2016 $000	Unaudited 31 December 2015 $000
Operating activities			
Deficit after tax		**(2,604)**	(4,728)
Income tax recognised in Statement of Comprehensive Income		**25**	(760)
Finance costs		**382**	420
Depreciation and amortisation		**245**	506
Provision for Restructuring continuing operations		**350**	1,129
Provision for closing discontinuing operations		**-**	1,056
Other non-cash items		**14**	62
Changes in working capital		**(622)**	1,002
Cash inflow (outflow) from operations		**(2,210)**	(1,313)
Interest paid		**(382)**	(420)
Net cash inflow (outflow) by operating activities		**(2,592)**	(1,733)
Cash was provided (to) from :			
Purchase of property, plant and equipment		**18**	(331)
Purchase of patents and development activities		**(291)**	(371)
Purchase of Haden & Custance	9	**(2,250)**	-
Cash from Haden & Custance	9	**1,679**	-
Proceeds from sale of Medical division		**-**	2,033
Net cash inflow (outflow) from investing activities		**(844)**	1,331
Financing activities			
Cash was provided from (to):			
New borrowings		**1,500**	1,000
Issue of new shares	4	**8,399**	-
Repayment of borrowings		**(6,166)**	(665)
Net cash inflow from financing activities		**3,733**	335
Net (decrease) increase in cash held		**297**	(67)
Cash (overdraft) at beginning of the period		**(479)**	(2,628)
Effect of exchange rate changes		**-**	46
Cash (overdraft) and bank balances at the end of the year		(182)	(2,649)

The above Statement of Cash Flow should be read in conjunction with the accompanying notes.

The Statement of Cash Flow is exclusive of GST.

1. General information

Statutory base

Mercer Group Limited is a limited liability company which is incorporated and domiciled in New Zealand. The address of its registered office is 53 Lunns Road, Middleton, Christchurch. It is registered under the Companies Act 1993 and is an FMC reporting entity under the Financial Markets Conduct Act 2013.

Mercer Group Limited is a public company registered under the Companies Act 1993 and is listed with the New Zealand Stock Exchange (NZX).

The Group comprises Mercer Group Limited and its wholly and majority owned subsidiaries. The core activities of Mercer Group are:

- **Stainless Fabrication:** This division includes workshops in Christchurch and New Plymouth operated by Mercer Stainless Limited, the primary business is the design and manufacture of propreitary equipment mainly for dairy sector. It has also operated the groups food processing and packaging brands.
- **Haden & Custance:** This division design and manufacture automated handling systems which prepare bulk cheese and butter for further processing. This division was acquired in December 2016 (see Acquisition note 9) .
- **Mercer Technologies:** The division manages the research and development of the Mercer Group. Currently focused on commercialing the S-Clave.

The Group is designated as a profit oriented entity for financial reporting purposes.

The financial statements have been approved for issue by the Board of Directors on 27 February 2017.

2. Summary of significant accounting policies

(a) Basis of preparation

The principal accounting policies adopted in the preparation of the financial report are set out in the 30 June 2016 Annual Report. These policies have been consistently applied to all the periods presented, unless otherwise stated.

The condensed consolidated interim financial information for the six months ended 31 December 2016 has been prepared in accordance with New Zealand equivalent to International Accounting standards NZ IAS34 and IAS 34, "Interim Financial Reporting". The condensed consolidated interim financial information should be read in conjunction with the Annual Financial Statements for the year ended 30 June 2016, which were prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP) and New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS). They also comply with International Financial Reporting standards (IFRS), and other applicable New Zealand Financial Reporting Standards, as appropriate for profit-oriented entities.

(b) Changes in accounting polices

There have been no significant changes in accounting policies from those applied by the Group in the financial statements as at 30 June 2016. Those accounting policies are set out in the Mercer Group Limited 2016 Annual Report.

(c) New standards and amendments

New standards and amendments to standards which are effective for the first time for the financial year beginning 1 July 2016 and which are relevant to the Group are set out in the Annual Report. These amendments have not resulted in material accounting or disclosure changes for the Group.

Standards and interpretations of relevance to the Group which were in issued but not yet effective and had not been early adopted are also set out in the Annual Report. The directors anticipate that the adoption of those Standards and Interpretations in future periods will have no material impact on the financial statements of the Group other than disclosures.

3. Segment information

The Group is organised into the following reportable segments by product and services type:

Stainless Fabrication: This division includes workshops in Christchurch and New Plymouth operated by Mercer Stainless Limited, the primary business is the design and manufacture of propreitary equipment mainly for dairy sector. It has also operated the groups food processing and packaging brands.

Haden & Custance: This division design and manufacture automated handling systems which prepare bulk cheese and butter for further processing. This division was acquired in December 2016 (see Acquisition note 9).

Mercer Technologies: The division manages the research and development of the Mercer Group. Currently focused on commercialing the S-Clave.

Corporate: This division includes Mercer Group Limited, the Parent Company and the head office activities within Mercer Stainless Limited. The segment result includes rental received from other segments in respect of properties owned and occupied by Mercer Stainless Limited. Goodwill previously included in Corporate has been allocated to the relevant reportable segment.

The segment results for the previous year does not include the discontinued operations of Interiors and Medical, which were discontinued in the 2016 financial year.

The table below shows the sales revenue, earnings before interest, tax, depreciation, amortisation and impairments (EBITDA) and assets by segment.

	31 December 2016 (Unaudited)			31 December 2015 (Unaudited)		
	Total sales of goods and contract revenue $000	Segment result (EBITDA) $000	Segment assets $000	Total sales of goods and contract revenue $000	Segment result (EBITDA) $000	Segment assets $000
Stainless Fabrication	**7,842**	**(953)**	**10,147**	9,670	(930)	13,239
Haden & Custance	**-**	**-**	**2,438**	-	-	-
Mercer Technologies	**36**	**(6)**	**2,220**	30	(13)	1,743
Corporate	**-**	**(518)**	**11,229**	-	(828)	12,611
Intersegment eliminations	**-**	**-**	**-**	-	-	-
Total sales, EBITDA, assets	**7,878**	**(1,477)**	**26,034**	**9,700**	**(1,771)**	**27,593**
Depreciation and amortisation	**-**	**(245)**	**-**	-	(332)	-
Provision for Restructure	**-**	**(475)**	**-**	-	(1,439)	-
Finance costs	**-**	**(382)**	**-**	-	(420)	-
Income tax credit (charge)	**-**	**(25)**	**-**	-	760	-
Share of profits (losses) of associate	**-**	**-**	**-**	-	-	-
Total Group sales, profit (loss) after tax, assets	**7,878**	**(2,604)**	**26,034**	**9,700**	**(3,202)**	**27,593**

Transactions between segments are accounted for using the same accounting policies as set out in these financial statements.

4. Related party transactions

(a) Directors

The names of persons who were directors of the company at any time during the period are as follows: J F Dennehy, HJD Rolleston, R Rookes and P Smart.

(b) Options

In November 2015 Mr J Dennehy, Director and Board Chair, was issued share options as follows:
a) to subscribe for 4,000,000 ordinary shares in the capital of the Company at an exercise price of $0.05 per share exercisable in August 2016, (These options have now expired); and
b) to subscribe for 3,571,429 ordinary shares in the capital of the Company at an exercise price of $0.07 per share exercisable in August 2017.

In November 2015 Mr R Rookes, CEO , was issued options as follows:
a) to subscribe for 5,500,000 ordinary shares in the capital of the Company exercisable at $0.05 per share exercisable in August 2017; and
b) to subscribe for 5,357,143 ordinary shares in the capital of the Company at an exercise price of $0.07 per share exercisable on in August 2018.

Options are conditional on the holder being in service on the vesting date. The vesting date can be brought forward if agreed to by the Shareholders at a Special General Meeting.

(c) Capital raise and share placement

The

In November 2016 a $7,019,335 renounceable rights issue was completed, a portion of which was taken up by management and Humphry Rolleston. This was fully underwritten by Humphry Rolleston a former director and shareholder of Mercer Group Limited. The proceeds were used to repay debt of $3,500,000 to Gresham Finance which is wholly owned by Humphry Rolleston, the repayment of a $1,500,000 temporary overdraft to the BNZ with the remaining balance applied to working capital. In December 2016 a share placement of $1,380,000 settled with the proceeds used to part fund the acquisition of Haden & Custance. This placement was partially taken up by Directors and members of management.

5. Dividends

During the six months ended 31 December 2016, Mercer Group paid no dividends (six months ended 31 December 2015: $Nil).

6. Commitments

The Group had no commitments for future capital expenditure as at 31 December 2016 (June 2016: $Nil).

7. Taxation

As a result of the November 2016 underwritten rights issue Humphry Rolleston's shareholding in Mercer Group Limited increased to 67.38%. The increase breached the IRD’s continuity rules of 49%, this resulted in the forfeiture of $9,119,028 of capitalised tax losses prior to 2010. This amount represented a tax expense of $2,553,328 (post the share placement Mr Rolleston’s shareholding reduced to 59.3%).
In June 2016 Mercer Group Limited chose not to recognised $6,665,000 of tax losses with a tax benefit of $1,866,000 due to the lack of probable future taxable benefits to utilise the available tax losses. Due to the acquisition of Haden & Custance Limited Mercer Group considers it is probable that future taxable amounts will be available to utilise the losses and has capitalised $1,866,000 as a deferred tax asset.

8. Restructuring costs

Following the acquisition of Haden & Custance the company is undergoing further restructuring of the remaining divisions which will result in the machine division moving to Hastings and the reduction in headcount. A restructure provision of $350,000 has been created to cover these costs.

9. Acquisition

a) Business acquired

Entity	Principal Activity	Date of Acquisition	Voting Equity interests	Consideration Transferred
Haden & Custance Limited	Machine Manufacturing	1/12/2016	100%	2,250,000

The business and assets of Haden & Custance Limited were acquired so as to continue the expansion and recognition of the Group activities in machine manufacturing.

b) Assets Acquired and Liabilities recognised at the date of acquisition

	Unaudited 30 November 2016 $'000
Current Assets	
Cash and bank balances	**1,679**
Accounts receivable	**1,464**
Other debtors and prepayments	**397**
Inventories	**355**
	3,895
Non Current Assets	
Property, plant and equipment	**258**
	258
Current Liabilities	
Trade and Other payables	**1,615**
employee entitlements	**628**
	2,243
Fair value of assets and liabilities acquired (provisional)	1,910
Consideration transferred in cash	2,250
Goodwill arising on acquisition	340

In December 2016 the company acquired the assets of Haden & Custance Limited to provide a strategic platform and promote the groups machine brands, which include Aico, Beta range and Titan. The initial accounting for the acquisition of Haden & Custance Limited has been provisionally determined at the end of December 2016. For valuation purposes, the acquisition value of Haden & Custance assets and liabilities are required to be at fair value. At the date of finalisation of these consolidated financial statements, the necessary fair value valuations and other calculations had not been finalised and they have therefore only been provisionally determined based on the directors' best estimate of the likely fair values.

c) Impact of acquisition on the result of the Group.

As at 31 December Haden & Custance had no atributable value for earnings in the reported Group loss. Had Haden & Custance been acquired on the 1st July 2016, the revenue of the group from continuing operations would have been $19,530,000 and the loss for the period would have been $2,350,000. The directors consider these pro-forma numbers to represent an approximate measure of the performance of the combined group on an periodic basis and to provide a reference point for comparison in future periods.

10. Earnings per share

Basic and diluted

Basic earnings per share are calculated by dividing the profit/(loss) attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during period.

Diluted earnings per share are calculated by dividing the profit/(loss) attributable to the equity holders of the Company by the weighted average number of ordinary shares in issue during the period adjusted to assume conversion of the dilutive potential of ordinary shares as a result of warrants on issue, and the exercise of share options where the weighted average market price of ordinary shares during the period exceeds the exercise price of the option / warrant.

	Unaudited 31 December 2016 # of shares	**Unaudited 31 December 2015 # of shares**
Weighted average number of ordinary shares in issue:		
Basic	**1,151,903,950**	311,970,446
Warrants	**-**	
Options	**14,428,572**	20,214,286
Total	**1,166,332,522**	**332,184,732**
Deficit attributable to the shareholders of the Company ($000)	**(2,604)**	(4,467)
Basic earnings (loss) per share	**(0.22) cents**	(1.43) cents
Diluted earnings (loss) per share	**(0.22) cents**	(1.43) cents

Given the deficit in 2015 and 2016 the instruments above are anti-dilutive. Accordingly the number of shares used in the diluted earnings per share calculation in 2015 is 311,970,446, and in 2016 is 1,151,903,950.

11. Going Concern

The Financial statements have been prepared using the going concern assumption. For the half year ended 31 December 2016 the Group recorded a net loss of $2,604,000, which included several non-recurring costs for restructuring and capital raising. The group had renegotiated its banking facilities at 30 June 2016 with the new covenants becoming applicable on 30 June 2017. With the banking facilities in place and forecast profit for the second half of the current financial year the Directors believe the going concern assumption remains valid.
If the Group was unable to continue in operational existence, and pay debts as and when they became due and payable, adjustments would have to be made to reflect the situation that assets may need to be realised and liabilities extinguished, other than in the normal course of business and at amounts which could differ significantly from the amounts at which they are currently recorded in the statement of financial position.

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