Mercer Group Limited
NZX Release **29 August 2017**

2017 Audited Financial Results

Overview:

Mercer Group Limited (MGL) is announcing a net before tax loss of $4.65m for the full year to 30 June 2017. As forecast at the half year MGL generated positive EBITDA, albeit minimal, for the second half of the year being reported, signalling the start of the long awaited turnaround.

While the annual result is not where we need or want it to be, the efforts of the past year have been focused on fundamental change to our operations and strategy:

1. Improved H&S, resulting in tertiary qualification from ACC
2. Successful rights issue undertaken in November 2016
3. Acquisition of Haden & Custance in December 2016
4. The completion of significant restructuring across the group
5. Positive normalised EBITDA for the second half of the financial year

We now consider MGL as a holding company with three separate business units, operating independently of each other:

1. Haden & Custance ('H&C') – the design and supply of automated and robotic bulk materials handling equipment and systems for the bulk cheese, butter and online fulfilment sectors. This also includes the Titan, AiCo and Beta ranges (previously within Mercer Stainless).
2. S-Clave – the disruptive medical sterilisation technology that is in the final stages of commercialisation.
3. Mercer Stainless – fabricator of stainless steel equipment for the dairy, wine and food sectors, predominantly in New Zealand.

Financial Performance

Operating revenue of $26.6m was 14% up on prior year. The revenue contribution from H&C for the machines business was 30%, this included seven months trading for H&C. Revenue for the stainless fabrication business was $21.6m down 12% from prior year. Post the restructure of the fabrication business it is now operating off a smaller cost base due to downsizing our New Plymouth site.

Group Revenue - figures 000's

	Jun 17	Jun 16
Stainless Fabrication	21,570	24,548
Machines (H&C) *	8,222	2,820
Mercer Technologies	65	71
Corporate		
Intersegment eliminations	(3,235)	(4,131)
Total Revenue	26,622	23,308

Footnote:

* *FY16 is Titan only, FY17 is H&C and Titan.*

Reported EBITDA was a loss of $3.5m vs prior year loss $3.2m. However, normalised EBITDA was loss a $0.56m for FY17 vs $3.46m for prior year, and as noted above, was positive for the second half of the financial year.

Group EBITDA - figures 000's

	Jun 17	Jun 16
Stainless Fabrication	(298)	(2,204)
Machines	(1,626)	(1,351)
Mercer Technologies	28	(64)
Corporate	(1,576)	455
Reported EBITDA	(3,472)	(3,164)
Insurance settlement		(2,608)
Asset Impairment & Restructuring costs[1]	2,244	2,306
Capital raising[2]	392	
Other[2]	280	
Normalised EBITDA	(556)	(3,466)

footnote

[1] *Includes items catergorised in cost of sales & salaries.*

[2] *Includes items categorised in other expenses.*

The past year has seen the completion of the restructuring announced twelve months ago and saw wages and salaries reduced by over $1.9m year on year (given timing of staff reductions, this figure is more when annualised). The acquisition and integration of H&C into the MGL's operations brought about short term additional cost and disruption to the businesses. However, H&C has resulted in estimated annual cost savings of $1.2m most of which are staff related and more importantly H&C has improved efficiency in our operating platforms for the future.

Titan costs and operational issues have been stabilised with a complete restructuring of resources supporting the brand. The impairment of Titan inventory of $1.16m was necessary after an assessment and the transfer of all Titan stock to H&C. There was also a $250k impairment of Titan goodwill to reflect the lower value of future revenues.

MGL borrowings reduced by $2.3m during the year. Banking facilities have been rolled over with core bank debt increasing by $1.1m due to the acquisition of Haden & Custance (note, Gresham Finance was repaid $3.5m). MGL also utilised a $1.5m temporary overdraft facility with a limit step down of $0.5m by 31 October and the balance of the limit expiring by 31 March 2018. MGL has a financial banking covenant based on achieving a level of EBITDA, the covenant is tested at 31 December. Covenant compliance depends on H&C achieving forecast sales, which it is currently on track to do.

The reported after-tax loss of $6.9m includes a $2.1m expense for deferred tax adjustments, which is the result of derecognising tax loss assets that resulted from shareholder continuity changes at the time of the rights issue. MGL retains an off balance sheet future tax benefit of $2.85m that can be recognised in future years when expected taxable profits are available to offset them against.

The balance sheet position has improved although we note that the deferred tax adjustment in 'Non-Current Assets' lines masks this. As explained above the off balance sheet tax asset can be capitalised in the future periods when expected taxable profits are available.

Group Balance Sheet - figures 000's

debit / (credit)	Jun 17		Jun 16	
Capital		Debt/ Equity		Debt/ Equity
Net Debt*	(7,919)	45%	(10,526)	56%
Equity	(9,510)	55%	(8,337)	44%
Total Capital Employed	(17,429)		(18,863)	
Funding Other Net Assets				
Current Assets	8,469		7,424	
Current Liabilities	(5,686)		(5,871)	
Non-Current Assets	14,646		17,310	
Total Other Net Assets (ToNA)	17,429		18,863	
Net Tangible Assets	16,811		15,445	

footnote

* Net debt includes; cash, overdraft and borrowings.

Haden & Custance

Haden & Custance (www.hadencustance.com) specialises in the design and supply of automated robotic material handling systems that prepare bulk cheese and butter for processing.

H&C's principal focus is the US where it has an established customer base of tier one cheese and butter companies, an installed base of systems and a reputation for delivering high quality solutions on time, that work. There is a significant growth opportunity in H&C's core business as the industry fundamentals are strong (cheese production increasing in the US by c.3% per annum), companies strategically want more automation in their plants given acute labour shortages in the US, the installed base provides a positive references, and the ROI of H&C systems is compelling.

In addition to the core sectors, H&C are currently working with a large global online retailer to design an automated system for their fulfilment centres. If this is successful, it will be a material short term growth opportunity that will require investment in our support services in the US market. We will keep the market updated on this exciting development.

The Mercer machines (Titan, AiCo and Beta) has now been transferred to H&C and have a better platform from which to improve and grow. This is based on; (i) the core capability set of the H&C team being mechanical, electrical and controls design, an area where Mercer Stainless did not have the appropriate resource or skill set; and (ii) an outsourced business model that is leading to build cost savings.

As reported at the half year, given the poor performance of Titan over a long period, we have undertaken a full review of the technology. This was driven by John Kelsey, our new Titan product manager who joined H&C from a large global slicing company. While we are still of the view that the Titan technology is good and the sectors it sells into are growing, the legacy of the previous installations, many of which resulted in returned machines, remain. Given the new team and operating structure we remain committed to Titan and the long term opportunity it represents but note that growth will be more moderate than previously forecast in the short term.

More encouragingly, the AiCo line of packaging equipment has a strong pipeline of opportunities in both the red meat and horticultural sectors. Both the AiCo and Beta range of equipment have benefited from the move to H&C with reduced build costs.

In the year ahead H&C are focused on execution of their existing sales pipeline, developing the online fulfilment systems and building the presence in the US. H&C currently has one person based in Green Bay, Wisconsin but are planning on increasing this number and increasing the presence of our NZ based team in the US. While the opportunity for H&C is strong, the business is a capital equipment business that is susceptible to delays in orders which is difficult from a working capital perspective. Subject to adequately resourcing the H&C team, it is our belief that H&C can grow to $50m revenue in the next two to three years.

S-Clave

We continue to make solid progress with the S-Clave. As announced at the half year, we considered capital raising options for the S-Clave, but ultimately made the decision that we should further develop the technology before revisiting capital structures.

Key to the final development to a commercialised product is our partnership with our Australian sterilisation company Atherton's, who have proved to be a highly credible and positive influence on the development. Critically, working with Atherton's has meant that we will now be able to sell the S-Clave as a retro-fit to existing Atherton's autoclaves, which reduces the upfront cost to customers, and simplifies the approval process. We are now finalising the sealing process of the container with testing of prototypes being undertaken currently. This has been slower than we would like due to the complexities of the process and time taken to manufacture the prototypes (they need to be 3D printed out of high temperature resistant plastics). We expect the final testing to be complete within the next three months after which we will invest in the required tooling with a view to launching the S-Clave in the calendar year 2018.

Mercer and Atherton's have recently presented the S-Clave to a number of hospitals and medical clinics in Australia. The feedback has been very positive and we have four major hospitals and one private hospital group that have requested to be included in the initial roll out of the S-Clave. We are currently looking to recruit a senior Australian based commercialisation officer to work with Atherton's to drive the roll out of the S-Clave.

We have agreed in principal terms with Atherton's for the roll out of the S-Clave in Australia. We will update the market on these terms once finalised and documented.

While the development process for the S-Clave has been slower than we would have envisaged, we have not seen anything to date that changes our view that the S-Clave represents a significant opportunity for MGL. The market feedback has been strong and we have the right partner in Atherton's for an initial launch in Australia. We still have a relationship with the large US based sterilisation company, who now have a non-exclusive license rather than exclusive, which provides us with more flexibility in our international market strategy.

Mercer Stainless

The Mercer Stainless fabrication business had a strong second half of the financial year. The acquisition of H&C and subsequent moving of the Mercer machines out of the business has allowed the business to focus on its core strengths – the fabrication of stainless steel equipment for the dairy, wine and food sectors.

The Marlborough earthquake in late 2016 opened up the opportunity to enter the wine sector. The wine sector has grown significantly over the past 20 years with exports reaching $1.6bln in the year to March 2017 and the industry has a goal of reaching $2bln of exports by 2020. We have now undertaken work for a number of the top wine companies including Penrod Ricard and Villa Maria and plan on continuing to build our presence in the sector. It provides much needed diversity to the dairy sector which Mercer Stainless was too reliant.

While that diversification is essential for a business like Mercer Stainless, dairy remains a significant sector for us. Investment in dairy this year has increased, which has seen good workflows through both our Christchurch and New Plymouth facilities, and the medium term outlook for the sector is strong.

As outlined above, we are continuing to seek to diversify the Mercer Stainless business away from an over reliance on dairy, which is cyclical. We will be improving the front end sales function in the business with cultural change and a more market focused approach. The key to the success of Mercer Stainless is full workshops and while we have started the new financial year well with good workloads, we have to originate more work for the remainder of the financial year.

We were pleased to win the contract to build the replacement 500m3 silo for Fonterra at Edendale which was delivered in August 2017. We continue to work closely with Fonterra and the industry on new designs and codes for the manufacture of tanks for the dairy industry. There is nothing further to update as regards insurance claims from the Edendale collapse at this point.

Outlook

We are forecasting a continuation of the improved operating performance for the 2018 financial year. H&C has a strong pipeline, but it is subject to order timing delays so the focus is on executing on the opportunities in front of it and building momentum in the market. We are focused on launching the S-Clave in Australia this financial year which will be a significant milestone for the group. Mercer Stainless is currently busy and has a decent outlook for the current financial year.

At a strategic level, we are comfortable with the businesses. Robotics and automation (H&C) and medical technology (S-Clave) are highly relevant in today's world and we now have a settled structure and platform from which to grow in both of these spaces.

Execution of the growth plans may well require further capital, which we are constantly reviewing. In addition, while each of the three businesses has opportunities as described, we will also remain open to further possible and relevant acquisitions and partnerships.

We would like to thank our customers, shareholders and bankers for their continued support of MGL.

John Dennehy
Chairman

Richard Rookes
CEO

For further information contact
Richard Rookes, 021 414 016