Mercer Group Limited
NZX Release **29 August 2018**

2018 Audited Financial Results

Mercer Group Limited (MGL) is announcing a net loss before tax of $7.8m, having taken significant asset write downs and intangible asset impairments.

The key points to note from the financial year are as follows:

1. Revenue growth of 8.2% to $29m resulting in an EBITDA loss of $1.4m.
2. A good performance from Mercer Stainless, which generated EBITDA of $1m.
3. A weaker sales performance than forecast from Haden & Custance (H&C) resulting in an EBITDA loss of $1.6m.
4. A decision to write down the value of the Titan assets, including goodwill, inventory and other receivables by $3.2m.
5. $1.9m of tax assets have been derecognised due to requirements of accounting standards. We note that the tax assets themselves have not been lost, and can be utilised in future to offset taxable profits.

figures 000's	30 June 2018		30 June 2017	
	Total sales of goods and contract revenue	Segment result (EBITDA)	Total sales of goods and contract revenue	Segment result (EBITDA)
Stainless Fabrication	**18,514**	**1,055**	21,570	(298)
Haden & Custance	**12,503**	**(1,595)**	8,222	(1,626)
Mercer Technologies	**6**	**5**	65	28
Corporate	**-**	**(887)**	-	(1,576)
Intersegment eliminations	**(2,204)**		(3,235)	
Total sales, EBITDA.	**28,819**	**(1,422)**	**26,622**	**(3,472)**
Depreciation and amortisation	**-**	**(410)**	-	(459)
Finance costs	**-**	**(490)**	-	(723)
Inventory Adjustment	**-**	**(1,938)**	-	-
Impairment of Intangible Assets	**-**	**(822)**	-	-
Impairment of Tangible Assets	**-**	**(857)**	-	-
Income tax credit (charge)	**-**	**(1,901)**	-	(2,308)
Total Group sales, profit (loss) after tax.	**28,819**	**(7,841)**	**26,622**	**(6,962)**

Despite this result, we look forward with a degree of confidence. While the H&C result fell short of expectations, we remain committed to the stated strategy to shift MGL to become a technology led, export focused business. H&C provides us the platform to do this and the changes made during the year and current trajectory of the business are all positive.

The S-Clave continues to progress through final development and testing. We are still targeting commencing hospital trials by the end of 2018.

Financial Performance

Operating revenue of $29m was 8.2% up on prior year. This revenue growth was driven by a full year of H&C (the prior year included only seven months of H&C). Revenue at Mercer Stainless was down 14% to $18.5m, but EBITDA was up at $1.1m (from a $300k EBITDA loss in the previous year), as we generated stronger margins and reduced costs in the business. H&C's revenue at $12.5m was disappointing and a reflection of a concentrated sales pipeline that saw some delays. This lower sales revenue coupled with increased costs on the business resulted in an EBITDA loss of $1. 6m for the financial year.

Corporate costs reduced from $1.6m to $889k during the year. This saw a group EBITDA loss of $1.4m which, while disappointing, was an improvement on the $3.5m EBITDA loss for the prior year.

Cash from Operations improved significantly from an outflow of $4.7m in the 2017 financial year to an outflow of $591k in the 2018 financial year.

During the year the Company repaid $1.4m in debt, reducing total borrowings to $6.3m at year end, and raised $2.97m in new equity. This resulted in financing costs reducing from $723k to $490k in the 2018 financial year. The Company has renewed banking facilities with BNZ through to September 2019.

The Company made the decision to write down the value of a number of other balance sheet items, mostly Titan related, which resulted in a $1.9m provision for inventory, a $822k impairment of intangible assets and a $555k impairment of tangible assets. The key items included inventory of Titan Slicers (where, as previously advised, we retain a number of slicers returned in 2014 and 2015 of which we have impaired the value), goodwill (reduced to nil on Titan) and the write down of some other Titan related receivables. While again this is disappointing, it is a fair reflection of the performance of Titan since MGL acquired the business.

Haden & Custance

H&C did not reach expectations in the 2018 financial year and generated an EBITDA loss of $1.6m on revenue of $12.5m. This was due to the following:

1. A number of large projects in the US being delayed which saw the business miss revenue targets.
2. The sales strategy being too concentrated on a small number of US based cheese convertors.
3. An increase in the cost base in the US as we continue to invest in that market and corporate overhead allocations.

Despite this performance, we note that H&C successfully completed the installation of a number of large systems in the US and retained its gross margins. This capability to deliver large systems on time and on budget remains a key success factor for the business and provides a solid reputational base from which to build the business.

Having recognised there were issues with the sales strategy, we instigated the following strategic and operational changes:

1. USA: Broadening our automation offering to existing US cheese customers (the business has previously been focused on the depalletization, de-box and de-bag systems only) and have begun

marketing the specialist solutions to the red meat industry. In this regard, we recruited a senior, experienced, US domiciled sales person to lead the US business. We expect to sell the first H&C system into the red meat sector in calendar 2018 which will be a significant milestone and should provide the platform for further growth.

2. NZ/AU: Re-entered the NZ/AU markets with a broader automation offering. We are gaining good traction, particularly in the horticulture sector which increasingly requires automation in its plants and pack houses as it grows.

3. Other: The General Manager left the business which allowed for a reset of the cost base and the operating structure.

The current workflows at H&C are good and the pipeline is stronger and more diverse that it has been since we acquired the business. H&C has a broad capability set in automation and robotics that it has not fully marketed in the past. This provides us an opportunity to grow the business in its existing food production sectors, but also in other sectors such as warehousing and logistics.

We remain excited about the opportunity H&C represents for MGL as we transition to being an export led technology company. We believe the 2019 financial year will be profitable for H&C. We would encourage shareholders to look at H&C's website (www.hadencustance.com) to get a sense of the breadth of offering and capability the company provides. We want to stress that H&C is an established business with a strong, loyal customer base, excellent reputation and true growth opportunities with its proven technology. The underperformance in the 2018 financial year was due to focus on too fewer customers coupled with increased costs. The refreshed, broader strategy is underway and the pipeline looks healthy with more breadth.

S-Clave

The S-Clave continues to progress through final development. We were frustrated by a three month delay in the tool making which was out of our control, but since the tooling was received in May, the testing has been successful. We are currently working through options for sealing the container and lid, after which the product should be ready for hospital trials.

We continue to work closely with our Australian partner Atherton's both on our working relationship and the market entry strategy. Feedback from the hospitals and medical centres we have shown the S-Clave to, continues to be positive and we remain of the view that the market potential for the product is significant.

We are focused on having the S-Clave in a hospital by the end of the 2018 calendar year, subject to the pace at which final testing can be completed.

Mercer Stainless

Mercer Stainless had a good year, generating $1.1m of EBITDA off a slightly lower revenue base, having recorded a $300k EBITDA loss in the previous year. This was a result of a reduced cost base and a higher margin work mix.

The business operates in a competitive, price driven sector. As such, we continue to seek to diversify the business away from a reliance on the dairy industry. We have had some success in the wine sector, but margins are tight and there is a strong, established competitor in the sector. We are therefore focused on quoting only to levels where our business can be sustainable and looking to continue the diversification strategy.

Mercer Stainless continues to work through the Edendale process, as previously disclosed to the market. We are hoping this will be concluded within the next two to three months.

Outlook

We remain committed to the strategy of change at MGL. We were disappointed with the performance of H&C in the 2018 year but believe that the changes we have made to the business position us well for the future.

Current workflows in both Mercer Stainless and H&C are good, and the Company generated an EBITDA profit in July, which was pleasing. We are looking to continue this momentum and have the workflows and operating structures to do so.

H&C's outlook for the medium term is good with increasing demand for automation in NZ/AU and a specialist, niche technology in depalletizing and de-boxing that has global opportunity. While our current focus is selling a system into the red meat industry in US, we believe the technology has far broader application in the warehousing and logistics sectors.

The medium term outlook for Mercer Stainless is only adequate, with a pullback in dairy investment currently underway. As outlined above, this is driving our diversification strategy.

We also continue to review other growth opportunities to provide us more scale. We have reviewed and continue to review a number of potential acquisition opportunities that align with our stated strategy of becoming a technology led, export focused company.

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