Windflow Technology Limited

Interim Report December 2012

Contents

Directors’ Six-Month Review to 31 December 2012

Overview

The half-year to 31 December 2012 was a period of positive progress and important changes for Windflow. The first turbine for the UK was completed and exported, bound for Westray in the Orkney Islands. It was funded through a significant loan facility provided by a shareholder and approved by all shareholders in early July 2012. New directors, including a new chairman, have joined to help drive the Company forward to commercial success.

Since December 2012 two particularly significant events have occurred:

- A preference share issue was successful in raising $4.5 million of equity in mid-March. Combined with the shareholder loan facility, this leaves the Company well-placed to take advantage of the opportunities it has through its global licensing and UK project development activities.
- The first UK turbine has been installed and commissioned and has been running unattended since March 13. This has enabled the essential in-market demonstration phase of the Company’s UK market entry to commence.

This review will briefly describe these activities during the reporting period and Windflow’s plans under the familiar “1-2-3” action headings. The prospects that have previously been reported are now starting to materialise, and the directors are pleased to report that the Company’s perseverance is being vindicated. The Company intends to continue implementing this course of action for the foreseeable future, pressing forward immediately with an increased focus on realising the opportunities it provides for sales and revenue.

The Company’s 1-2-3 Course of Action

Since early 2011 the Company has been committed to the following course of action:

1. License its intellectual property (IP) internationally;
2. Continue to meet its maintenance and warranty obligations for Te Rere Hau wind farm (TRH);
3. Develop its market presence in the UK to achieve turbine sales.

Recently the Company has affirmed a UK market entry strategy which emphasises that achieving turbine sales includes a role as project developer. The Company can thereby strengthen its turbine sales prospects while realising three significant revenue streams:

- “turbine sales” – being essentially a basic sale to a UK landowner or developer (ex-factory plus customs, insurance and freight to UK), combined with an operating and maintenance (O&M) contract (typically for five-years) which provides an additional revenue stream designed to ensure the Company’s O&M and warranty commitments are at least self-funding.
- “project sales” – the Company obtains construction finance to cover the turbine purchase as well as all the initial site construction costs and then sells the commissioned turbine in situ. This provides the turbine sale and O&M revenue, plus a significant portion of the net present value of the turbine’s 20-year revenue from the sale of electricity.
- “FIT revenue” – the Company retains substantial long-term ownership of the installed turbine to benefit from the long-term revenue stream guaranteed by the UK government under the renewable Feed-in Tariff (FIT) scheme.

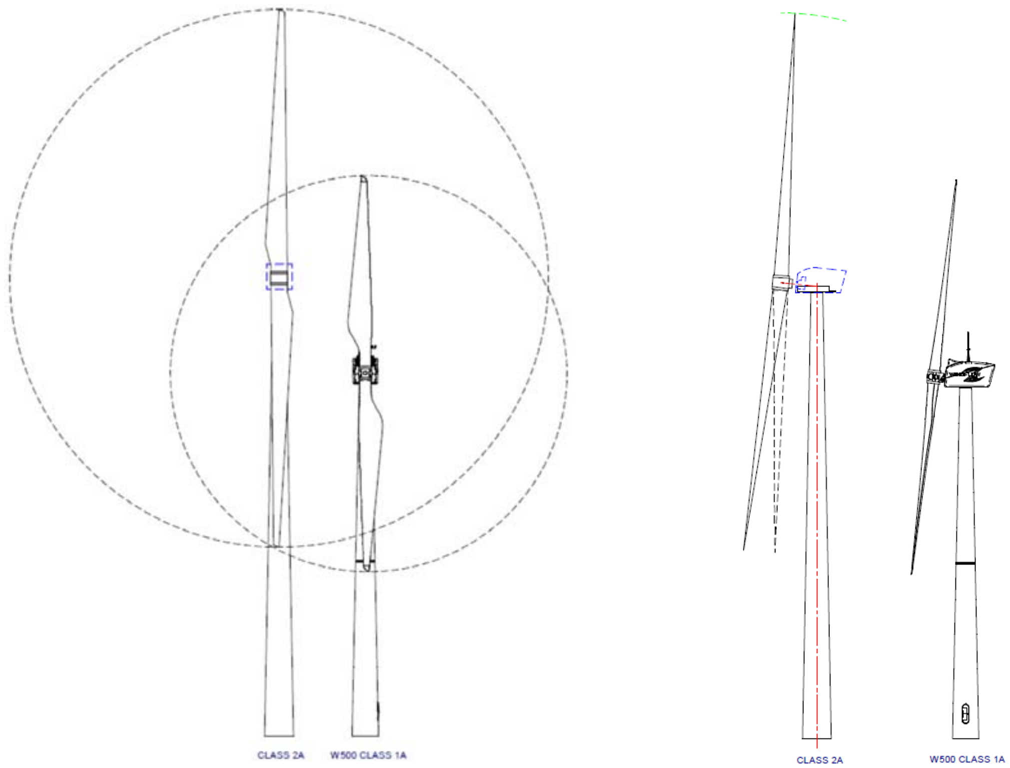
We report in more detail on the 1-2-3 course of action as follows.

1. Licensing of Windflow's IP – the GD SATCOM Relationship

In February 2012 General Dynamics SATCOM Technologies Inc (GD SATCOM)[1] signed a licence agreement for the Americas and Africa which includes co-funded development of a new turbine, the design of which will be owned by Windflow and licensed to GD SATCOM on the same basis as the existing turbine. The term of the agreement is ten years, with GD SATCOM having rights of termination after two years. GD SATCOM is contracted to make a number of payments to Windflow, both initially and over the term of the agreement. Some of these payments are contingent on design deliverables for product development over that two year period. These payments are covering some but not all of Windflow's planned operating expenses.

As well as the current 50 Hz design, Windflow has delivered design documents for a 60 Hz version of the existing high wind speed (Class 1A) turbine and continues to work with GD SATCOM on the new, lower wind speed, Class 2A turbine design. The Class 2A turbine has longer blades (45 metre rotor diameter compared to 33 metres for the Class 1A turbine – see drawings below) and is being promoted by GD SATCOM as the GD45-500. In late July, four Windflow engineers travelled for a week-long design review at their Texas offices and manufacturing facilities.

Since then Windflow has made steady progress on the detailed design of the Class 2A turbine and has released the major drawings for the rotor (including the blades) and gearbox to GD SATCOM for procurement. A further major design review meeting is scheduled for early May 2013, after which the Company expects GD SATCOM will confirm its timetable for construction of the Class 2A prototype.



[1] For more information about GD SATCOM and its entry into the wind turbine market see http://www.gdsatcom.com/email/3-8-12.htm and http://www.gdenergysolutions.com. It is appropriate to emphasize that this Review is on behalf of the Windflow directors, and is not intended to represent GD SATCOM's opinions. Neither GD SATCOM nor General Dynamics has endorsed this Review.

Windflow retains the rights for manufacture and sale of its turbine designs throughout Europe, Asia and Australasia, as well as worldwide rights in the application of its field-proven core technologies in, for example, multi-megawatt turbines.

Work to license the Company's intellectual property in other parts of the world has continued, albeit with less focus in the present reporting period than in the previous year to June 2012.

GD SATCOM has also contracted to offer warranty insurance, with the premiums to be determined on a case-by-case basis, for sales by Windflow in the UK, New Zealand and elsewhere. In September 2012 Windflow and GD SATCOM signed a Memorandum of Understanding covering early UK sales. The Directors believe that its provisions (outlined below) will significantly facilitate the availability of finance for our customers' projects, which will make Windflow 500s easier to buy and enhance sales prospects for the UK.

The GD SATCOM-Windflow Early Adopter UK Sales Memorandum of Understanding

Long-term warranty insurance and construction performance assurance

Windflow will offer a very comprehensive form of full service O&M contract for the UK FIT context that effectively guarantees minimum annual revenue in return for a share of that revenue sufficient to meet foreseeable O&M costs.

This full service O&M contract will cover operations, maintenance and an availability warranty, for 5 or 10 years. It will be funded by an ongoing fee paid to Windflow by the turbine owner on a p/kWh basis, so that the more energy that is generated, the higher the annual O&M fee payable to Windflow.

For a small percentage of the sale price of the turbine, GD SATCOM will provide insurance to the turbine owner to cover the risk that Windflow may cease to trade or become insolvent during the O&M contract period.

In addition, on request from Windflow, GD SATCOM will offer certain assurances around the delivery and commissioning of the turbine in accordance with the sale and purchase agreement for the turbine.

Security

To ensure GD SATCOM can provide the continuity of support to UK customers required by either of the above forms of support in the event of Windflow ceasing to trade or becoming insolvent, GD SATCOM will need securities over certain Windflow assets to be put in place. These securities and the legal agreements embodying their terms have yet to be put in place and will be set up so as not to conflict with existing securities over Windflow assets.

Term

The Memorandum of Understanding will apply for three years or until its provisions have been applied to a certain number of turbines sold into the UK market.

The two companies have also been working to realise further benefits of the licensing relationship by:

- joint marketing in both Windflow's and GD SATCOM's territories to increase revenue opportunities, for example a joint presentation in October to a conference in South Africa; and
- joint supply chain development and management to decrease component costs. For example Windflow and GD SATCOM have in recent months been collaborating to identify the most cost-effective international suppliers for certain key components of the Class 1 and 2 turbines.

2. TRH Performance and O&M Arrangements

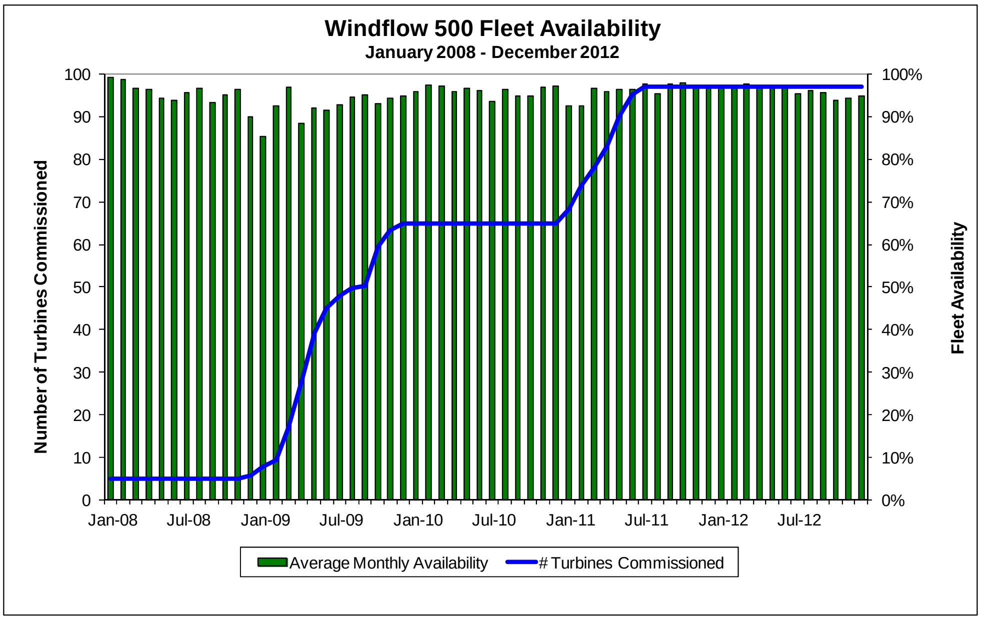
The relationship with NZ Windfarms has focused primarily on matters associated with the Company's warranty obligations. Please refer to Notes 10 and 16 to the Financial Statements which detail these warranty obligations and the provisions remaining. While there remain outstanding issues flowing from warranty matters, the two companies are working to resolve these in a constructive way.

As detailed in the Annual Report to June 2012, since NZ Windfarms exercised its option to take over TRH Services Ltd (on 20 October 2011), the two companies have worked to resolve a range of transitional and commercial issues. One of these issues, the method used to calculate the part period maintenance costs due to the Company, has not been agreed and is expected to be determined through arbitration. Another concerns the release of retentions under the Settlement Agreement of March 2010. For a number of months Windflow offset its warranty expenditure against anticipated sums payable by NZ Windfarms. In recent months these offsets reached their reasonable limit, at which point Windflow reverted to paying for agreed warranty claims normally.

Windflow successfully developed and demonstrated to NZ Windfarms a work platform allowing some work which had previously required a turbine nacelle to be lowered to the ground to be performed on a nacelle in situ. This allowed for reduced anticipated warranty expenditure and was a basis of the offset referred to above.

As set out in previous Reports, there are a number of significant component issues which Windflow has been handling as part of its warranty obligations. The most expensive of these components (pitch bearings) continue to need replacing at a rate of about one per month. Pleasingly, there have been no further failures in cases where new pitch bearings were installed with an initial fill of the new grease which was selected after rigorous research and testing in Christchurch.

Warranted turbine availability across the wind farm must be > 95% averaged over each calendar year of the warranty period, otherwise Windflow needs to make good the lost revenue up to the 95%. For the calendar year 2012, the wind farm achieved 96.0% availability. The graph below shows the accumulated track record at TRH in terms of numbers of turbines installed and overall availability.



3. Windflow's UK Market Entry

The Feed-Tariff review

The UK government released its decisions on the Feed-in Tariff (FIT) in July 2012, after a review which commenced in February 2011. It was subsequently ratified by the Westminster parliament during late 2012. The decisions confirmed the availability of the FIT at a rate of 17.5 p/kWh. This rate applies for projects commissioned from 1 December 2012 through to 31 March 2014 or, for projects pre-accredited by 31 December 2013, through to 31 December 2014. Minimum annual reductions in the rate thereafter will be either 5%, 10% or 20% depending on new generation installed in response to the FIT incentive. It is expected the reduction will be at least 10%.

Combined with a minimum export value of 4.5 p/kWh, the revenue from the FIT means that 500 kW turbines installed in 2013 and 2014 can now be expected to earn about 22 p/kWh on a 20-year government contract with annual inflation adjustment. Windflow has until the end of 2013 to confirm as many as possible of the projects in its pipeline for them to benefit from the 17.5 p/kWh FIT rate.

First Turbine Installation

A significant loan facility to fund the first three turbines in the UK has been provided by a shareholder and was approved by all shareholders in early July 2012. Subsequently the first turbine for the UK was completed and exported in October, bound for Westray in the Orkney Islands. It was installed and commissioned on Hammer Farm, Westray during the northern winter and has been running unattended since March 13. This has enabled the essential in-market demonstration phase of the Company's UK market entry to commence. Windflow is working on the proposed sale of the Westray project.

Next Two Turbine Projects

During December 2012, the next two UK turbine projects received funding approval. Both of these will be on the main island of Orkney. Procurement work is currently taking place for the nacelles to be assembled in Christchurch later in 2013.

Progress on Further Turbine Projects

During 2012, Windflow UK and its dealers made good progress promoting the Windflow 500 as an option for landowners to put into the planning process. As a result more than a dozen turbines have received planning permission, each of which represents an investment of several thousand pounds by the landowner. Most of these are on the Orkneys, but there are some on other Scottish islands, and a few on mainland Scotland and elsewhere in the British Isles.

It has proved more difficult to obtain grid connections. The Class 1 sites which suit the Windflow 500 tend to have weak grids and a significant amount of embedded wind power already. Fewer than a dozen turbines have grid connection offers. On Orkney the network operator Scottish and Southern Energy, (SSE) has used a variety of innovations to free up grid capacity under a scheme called Active Network Management (ANM) which became active in 2009. The ANM is operated on a last on, first off basis. If a part of the grid is faced with grid constraints, the last generator on must curtail generation, and if necessary, turn off completely.

In September 2012, SSE announced what was effectively a moratorium on new connection offers on the Orkneys while it investigates the need for grid reinforcement or further innovative smart network management solutions to enable more wind power to be installed. Results of these investigations are expected to be announced by June 2013 and may or may not enable the several projects on the Orkneys which have planning permission for the Windflow 500 to proceed. Note that this does not affect the first three projects except to the extent they face curtailment under the existing ANM system.

Accordingly Windflow and its dealers have shifted focus since September away from the Orkneys and are progressing planning and grid applications for sites on mainland Scotland.

Increased Sales Drive

The Company has an immediate window (through to the end of 2013) within which to maximise projects which will benefit from the current level of the FIT. Beyond then the FIT will still remain very attractive for the next year or two. Having made its market entry, installed its first turbine, confirmed two more and had a successful capital raising, the Company is currently well-placed to firmly establish its presence in the UK so that it can participate in ongoing UK wind opportunities in whatever form they may take during subsequent years.

It is important to note that Scotland alone has a population the same as New Zealand's as well as access to the much larger electricity markets of England, Wales and (through sub sea interconnects) Ireland and continental Europe. It also has the best wind resource in Europe and a strong political commitment to renewable energy both from Edinburgh and Westminster. Major grid upgrades are underway so that Scotland can become a major producer of renewable power (wind, hydro, wave and tidal).

Since early 2011, Windflow UK (http://www.windflow.co.uk/) has had two staff in Great Britain, working with three dealers to promote the Windflow 500. During most of that time the market has been very uncertain because of the FIT review. Windflow UK now has three staff and a fourth dealer. In addition the Company is recruiting a Deputy CEO who will be based in Scotland for the next six months, supporting the Windflow UK team in an increased sales drive. It takes significant effort and a wide range of skills to progress each wind turbine project towards financial close and then take it through to construction and commissioning. The four Windflow staff based in Great Britain are now better resourced and have the relevant sales, project management, wind power and engineering experience between them for the various phases:

- Preliminary site assessment and selling the concept to the land-owner
- Planning and grid applications
- Financial modelling and contract completion
- Site civil and electrical construction management.

In recent months GD SATCOM and Windflow have been developing the details of legal agreements, initially as regards warranty insurance, to give effect to the Early Adopter UK Sales Memorandum of Understanding. The Directors believe that this will significantly facilitate the availability of finance for our customers' projects, which will make Windflow 500s easier to buy and enhance sales prospects for the UK.

Windflow UK's staff have been liaising with the banking community since 2010 to inform that sector about the Windflow 500's track record and its suitability for many sites in Great Britain. As a result, the Windflow 500 is pre-approved for secured lending by a number of major UK lenders, including: AMC Finance, Barclays, HSBC, RBS/NatWest and Peregrine Finance. To date, the banks have taken a risk-averse approach to the provision of unsecured lending (non-recourse except for project assets) for single turbine FIT projects in general. The Company will continue to liaise with them in the expectation that time and UK track record will enable them to qualify the Windflow 500 for this type of lending.

Windflow will also continue to market directly to developers, with a view to achieving both turbine sales and project sales (of commissioned turbines).

The Company is tracking and progressing over 100 potential projects on its customer database, and its dealers have their own substantial pipelines independent of this. While aspects of the process remain challenging, in particular obtaining grid connection offers, the Directors remain of the view that orders in at least modest volumes will be forthcoming from the Scottish market in particular.

Financial Results

The consolidated six-month results show Windflow made a gross profit of $0.563 million ($0.333 million 2011). Operating revenue was $0.837 million ($1.983 million) and the overall net loss was $1.882 million ($2.366 million).

At 31 December 2012, total equity (net assets) stood at -$1.058 million ($2.327 million last year). Since balance date a capital raising of $4.5 million has restored the Company's positive equity position.

Windflow is expecting a net loss for the Group in the year to 30 June 2013 of about $3.6 million.

The outlook for the coming year includes ongoing revenue from GD SATCOM as the Company moves towards completion of the Class 2A design, along with a mix of UK revenue including turbine sales, project sales and electricity sales, including FIT revenue.

The main outgoings of the Company are now the costs of maintaining an engineering core of expertise for research and development, meeting its warranty obligations and sales and marketing in the UK.

Staffing

Overall staff numbers now stand at 22 (excluding part-time contractors):

- 12 in the engineering/R&D team
- 2 in production/procurement
- 4 in sales and marketing (UK-based)
- 4 in administration.

Directors

Two new directors joined the board in October and November 2012 respectively:

- Michael Chick joined as director and chairman. He has some 40 years of experience in medium and high technology companies focused on international growth since qualifying in electrical engineering in Wales. Until 2009 he was CEO of Tait Limited, a Christchurch based high growth radio equipment manufacturer with revenue in excess of $200 million and close to 1,000 staff. He remains a Director of Tait Limited and a trustee of its controlling shareholder as well as being chairman of some smaller electronic companies. Michael is also director and chairman of Windflow UK Limited and Windflow Hammer Limited. He joined the Company to assist it to successfully build upon its strong engineering base to become a company with equally strong commercial capability.
- Angus Napier joined as director and chairman of the Audit and Risk Committee. He qualified as a Chartered Accountant and was for many years a member of the Institute of Chartered Accountants in England and Wales and in New Zealand. Prior to April 2000 Angus held a variety of full-time employment positions, most recently as Senior Advisor, State-Owned Enterprises, to the Crown Company Monitoring Advisory Unit within the Treasury. Earlier positions included Internal Audit Manager, Standard Chartered Bank, Hong Kong; and financial management consultancy and external audit roles with KPMG Peat Marwick, in New Zealand, Hong Kong and England. Since 2000 his focus has been as an Independent Management Consultant. Angus is also a director of Windflow UK Limited and Windflow Hammer Limited.

The directors wish to acknowledge the substantial and dedicated contributions of Simon Young and Keith McConnell, outgoing directors who retired at the November 2012 Annual Meeting.

Prospective New Zealand Projects

There has been no significant progress on New Zealand projects. The New Zealand wind industry is quite stagnant currently due to the combined effect of:

- Oversupply in the generation sector
- Depressed demand growth due to the Christchurch earthquakes, the global financial crisis and the high New Zealand dollar causing a contraction in the manufacturing sector
- Uncertainty caused by ongoing restructuring of the electricity industry as three large generators are expected to be partially privatised, the transmission pricing methodology debate drags on, and Rio Tinto is proposing to close the Bluff aluminium smelter in 3-5 years time
- Lack of a long-term market for generation output
- Lack of a consistent emissions trading system, combined with taxpayer subsidies of emissions and geologic exploration costs, have depressed the value of emissions-free electricity relative to fossil-fired and geothermal power.

As a result no wind farms are expected to be built for a few years, once the already committed Mill Creek is completed in 2014.

With an eye to the future, Windflow retains its interest in a number of sites around New Zealand for possible longer-term development. However its focus is firmly on its export activities.

Summary

In summary the six months to 31 December 2012 was a period of positive progress and important changes for Windflow. The first turbine for the UK was completed and exported, bound for Westray in the Orkney Islands, where it has recently been commissioned. It was funded through a significant loan facility provided by a shareholder and approved by all shareholders in early July 2012. New directors, including a new chairman, have joined to help drive the Company forward to commercial success.

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In mid-March a preference share issue was successful in raising $4.5 million of equity. Combined with the shareholder loan facility, this leaves the Company well-placed to take advantage of the opportunities it has through its global licensing and UK project development activities.

Consolidated Balance Sheet

As at 31 December 2012 (unaudited)

	Note	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Current assets				
Cash on hand and at bank	11	103	591	40
Accruals		126	489	126
Trade and other receivables		732	386	1,031
Prepayments and deposits		199	9	124
Retentions		1,036	2,432	1,036
Stock and work in progress	9	1,524	1,150	1,335
Sales tax refunds		249	59	64
Total current assets		**3,969**	**5,116**	**3,756**
Non-current assets				
Property, capital work-in-progress, plant & equipment		853	510	405
Intangible assets		2,000	2,248	2,119
Total non-current assets		**2,853**	**2,758**	**2,524**
Total Assets		**6,822**	**7,874**	**6,280**
Equity				
Contributed share capital	8	33,588	33,236	33,238
Retained deficit		(34,646)	(30,909)	(32,764)
Total equity		**(1,058)**	**2,327**	**474**
Current liabilities				
Trade and other payables		1,903	700	1,030
Provision for staff entitlements		148	203	164
Provision for warranty	10	1,443	929	2,696
Long Term Liabilities				
Provision for warranty	10	2,549	3,715	1,916
Shareholder loans	12	1,837	-	-
Total liabilities		**7,880**	**5,547**	**5,806**
Total equity and liabilities		**6,822**	**7,874**	**6,280**

The notes on pages 13 to 20 are an integral part of these financial statements.

For and on behalf of the Board of Directors:

Angus Napier

Director
18 April 2013

Geoffrey Henderson

Director
18 April 2013

Consolidated Income Statement

For the six months ended 31 December 2012 (unaudited)

	Note	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Operating revenue	4	837	1,983	3,662
Cost of sales		(274)	(1,650)	(3,224)
Gross profit		**563**	**333**	**438**
Other revenue	4	71	203	237
Licensing revenue	4	168	-	937
Less:-				
Depreciation		(63)	(83)	(172)
Amortisation of licences and patents		(129)	(129)	(258)
General and administration costs		(644)	(993)	(1,719)
Engineering costs		(733)	(600)	(1,116)
Research and development costs		(25)	(74)	(196)
Marketing costs		(91)	(408)	(559)
Wind farm development, operations & maintenance		(1,002)	(625)	(1,691)
Loss from operating activities	5	**(1,885)**	**(2,376)**	**(4,099)**
Finance income	4	3	10	16
Loss before income tax		**(1,882)**	**(2,366)**	**(4,083)**
Income tax	7	-	-	-
Loss for the period attributable to the equity holders of the Company		**(1,882)**	**(2,366)**	**(4,083)**
Basic earnings per share	6	**$(0.09)**	**$(0.11)**	**$(0.21)**
Diluted earnings per share	6	**$(0.08)**	**$(0.11)**	**$(0.20)**

Consolidated Statement of Comprehensive Income

For the six months ended 31 December 2012 (unaudited)

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Loss for the year	**(1,882)**	**(2,366)**	**(4,083)**
Changes to the value of investments	-	-	-
Total comprehensive loss for the year, net of tax	**(1,882)**	**(2,366)**	**(4,083)**

Consolidated Statement of Changes in Equity

For the six months ended 31 December 2012 (unaudited)

	Share Capital ($000's)	Retained Earnings ($000's)	Total Equity ($000's)
Balance at 30 June 2012	**33,238**	**(32,764)**	**474**
Total recognised income and expenses	-	(1,882)	(1,882)
Contributions from owners	350	-	350
Balance at 31 December 2012	**33,588**	**(34,646)**	**(1,058)**

The notes on pages 13 to 20 are an integral part of these financial statements.

Consolidated Statement of Cash Flows

For the six months ended 31 December 2012 (unaudited)

	Note	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Cash flows from operating activities				
Cash receipts from customers				
Consulting fees		-	25	48
Sales of turbines and components		-	1,289	2,949
Licensing revenue		168	-	520
Other		69	119	168
Interest received		3	10	16
Cash paid to suppliers and employees				
Suppliers		(463)	(2,240)	(3,720)
Employees		(1,062)	(1,120)	(2,044)
Other		(263)	(298)	(619)
Net cash used in operating activities	14	**(1,548)**	**(2,215)**	**(2,682)**
Cash flows from investing activities				
Disposal of investment		-	48	-
Disposal of property plant and equipment		-	(17)	34
Sale of listed investments		-	-	48
Acquisition of property plant and equipment		507	-	(144)
Net cash used in investing activities		**(507)**	**31**	**(62)**
Cash flows from financing activities				
Issue of shares	8	350	2,000	2,002
Issue costs of equity to be issued March 2013		(69)	(62)	(62)
Shareholder loans		1,837	-	-
Other		-	(7)	-
Net cash from financing activities		**2,118**	**1,931**	**1,940**
Net increase (decrease) in cash and cash equivalents		**63**	**(253)**	**(804)**
Cash and cash equivalents at beginning of period		40	844	844
Cash and cash equivalents at end of period	11	**103**	**591**	**40**

The notes on pages 13 to 20 are an integral part of these financial statements.

Notes to the Financial Statements

1. GENERAL INFORMATION

Windflow Technology Ltd (the "Company" or the "Parent") is a company incorporated and domiciled in New Zealand. The Company, its subsidiaries and associates comprise the Windflow Technology Group (the "Group").

Subsidiaries within the Group include Wind Blades Limited, Windflow UK Limited, Windflow Hammer Limited, Hammer Westray LLP, Wind Power Otago Limited (non-trading), Windflow International Limited (non-trading), Our Wind Limited (non-trading).

The Company is an issuer for the purpose of the Financial Reporting Act 1993.

These statements were approved by the Board of Directors on the 18 April 2013.

The Company is profit oriented and undertakes wind turbine development and manufacture and operates within New Zealand, North America and the United Kingdom.

2. SUMMARY OF ACCOUNTING POLICIES

The Financial Statements of the Group have been prepared in accordance with NZ IAS 34 Interim Financial Statement and are in respect of the Group only. These interim financial statements do not include all notes normally included in annual financial statements. The accounting policies and methods of computation described in the most recent annual financial statements are applied in the interim financial statements.

Disclosures in respect of dates titled 31 December relate to either the 6 months ended on that date or the balance as at that date, as the context requires. Disclosures in respect of dates titled 30 June relate to either the 12 months ended on that date or the balance as at that date, as the context requires.

3. SEGMENTAL REPORTING

The Group operates in two business segments, these being the Corporate Segment and the Licensing Segment.

Corporate Segment: The Corporate Segment involves the development, manufacture and sale of wind turbines and spares for wind turbines. The Corporate Segment includes the parent company and other central administration expenses that are not applicable to the Licensing Segment.

Licensing Segment: Licensing Segment derives revenue from licensing agreements with other manufacturers of wind turbines.

a) Business Segmental Analysis

	Licensing	Corporate	Total	Licensing	Corporate	Total
	31 December 2012 ($000's)	31 December 2012 ($000's)	31 December 2012 ($000's)	Audited 30 June 2012 ($000's)	Audited 30 June 2012 ($000's)	Audited 30 June 2012 ($000's)
GROUP REVENUE						
Total revenue : Sales to customers	168	911	**1,079**	937	3,915	**4,852**
Less:- Operating expenses	-	2,961	**2,961**	-	8,935	**8,935**
Profit/(Loss) before income tax	**168**	**(2,050)**	**(1,882)**	**937**	**(5,020)**	**(4,083)**
ASSETS AND LIABILITIES						
Segment assets	-	6,753	**6,753**	-	6,280	**6,280**
Segment liabilities	-	(7,880)	**(7,880)**	-	(5,806)	**(5,806)**
Total equity	-	(1,127)	**(1,127)**	-	474	**474**
CASH FLOW						
Cash receipts from customers						
Consulting fees	-	-	**-**	-	48	**48**
Sales of turbines and components	-	-	**-**	-	2,949	**2,949**
Licensing revenue	168	-	**168**	520	-	**520**
Other	-	69	**69**	-	168	**168**
Interest received	-	3	**3**	-	16	**16**
Cash paid to suppliers and employees						
Suppliers	-	463	**463**	-	(3,720)	**(3,720)**
Employees	-	1,062	**1,062**	-	(2,044)	**(2,044)**
Other	-	263	**263**	-	(619)	**(619)**
Net cash used in operating activities	**168**	**(1,716)**	**(1,548)**	**520**	**(3,202)**	**(2,682)**

b) Geographic Revenue

Revenue from external customers by geographic locations is detailed below. Revenue is attributed to each geographic location based on the location of the customer. Differences in foreign currency transactions can impact funds received.

	Licensing 31 December 2012 ($000's)	Corporate 31 December 2012 ($000's)	Total 31 December 2012 ($000's)	Licensing Audited 30 June 2012 ($000's)	Corporate Audited 30 June 2012 ($000's)	Total Audited 30 June 2012 ($000's)
New Zealand	-	911	**911**	-	3,915	**3,915**
North America	168	-	**168**	937	-	**937**
United Kingdom	-	-	**-**	-	-	**-**
Total revenue	**168**	**911**	**1,079**	**937**	**3,915**	**4,852**

c) Non-current Assets by Geographic Location

The non-current segment assets are scheduled by the geographic location where each asset is held.

The non-current assets, which include property, plant and equipment, goodwill, intangible assets and advances for each geographical location, are as follows:

	Licensing 31 December 2012 ($000's)	Corporate 31 December 2012 ($000's)	Total 31 December 2012 ($000's)	Licensing Audited 30 June 2012 ($000's)	Corporate Audited 30 June 2012 ($000's)	Total Audited 30 June 2012 ($000's)
New Zealand	-	2,853	**2,853**	-	2,524	**2,524**
North America	-	-	**-**	-	-	**-**
United Kingdom	-	-	**-**	-	-	**-**
Total non-current assets	**-**	**2,853**	**2,853**	**-**	**2,524**	**2,524**

d) Long Term Liabilities by Geographic Location

The non-current segment liabilities are scheduled by the geographic location where each liability is held.

The non-current liabilities, which include warranty provisions (note 10) and shareholder loans (note 12), are as follows:

	Licensing 31 December 2012 ($000's)	Corporate 31 December 2012 ($000's)	Total 31 December 2012 ($000's)	Licensing Audited 30 June 2012 ($000's)	Corporate Audited 30 June 2012 ($000's)	Total Audited 30 June 2012 ($000's)
New Zealand	-	2,549	**2,549**	-	1,916	**1,916**
North America	-	-	**-**	-	-	**-**
United Kingdom	-	1,837	**1,837**	-	-	**-**
Total long term liabilities	**-**	**4,386**	**4,386**	**-**	**1,916**	**1,916**

No comparative figures are provided for 31 December 2011 as during that year the Company and Group had no segmental activities.

4. GROUP REVENUE

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Operating revenue:			
Sale of turbines	-	(147)	76
Maintenance fees	-	160	160
Warranty provision released	750	768	1,859
Sale of turbine components	71	1,195	1,737
Other	16	7	(170)
	837	1,983	3,662
Other revenue:			
Consultancy fees	1	25	19
Fixed asset disposal	-	(18)	(39)
Sale of Subsidiary Company – Te Rere Hau Services Ltd	-	48	48
New Zealand Trade and Enterprise grant	-	36	36
Sundry income	70	112	173
	71	203	237
Licensing revenue	168	-	937
Interest received	3	10	16
Total revenue	**1,079**	**2,196**	**4,852**

5. GROUP OPERATING EXPENSES

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Operating expenses include:			
Amortisation of licences and patents	129	129	258
Depreciation	63	83	172
Research and development	25	74	196
Audit fees	30	17	24
Directors' fees	63	86	153
Rent and leases	100	228	369
Loss on sale of fixed assets	-	-	46
Employee benefit expense:			
Wages and salaries	982	1,148	1,856
Defined contribution & superannuation	18	26	65

6. GROUP EARNINGS PER SHARE

	31 December 2012	31 December 2011	Audited 30 June 2012
Weighted average number of shares on issue	20,597,264	19,718,264	19,722,264
Additional shares if all options converted	528,756	528,756	761,407
Total potential shares	**21,126,020**	**20,247,020**	**20,483,671**
Basic earnings per share	**$(0.09)**	**$(0.11)**	**$(0.21)**
Diluted earnings per share	**$(0.08)**	**$(0.11)**	**$(0.20)**

7. GROUP TAXATION

The Group has $8,300,000 deferred tax benefit which has not been recognised in the accounts based on the lack of certainty that such benefits will be able to be utilised by the company.

8. GROUP CONTRIBUTED CAPITAL

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Balance at beginning of year	33,238	31,298	31,298
Ordinary shares issued	350	1,938	1,940
Balance at end of period	**33,588**	**33,236**	**33,238**

	Number of ordinary shares		
	31 December 2012	31 December 2011	Audited 30 June 2012
Balance at beginning of year	19,722,264	15,718,264	15,718,264
Placements	875,000	4,000,000	4,004,000
Balance at end of period	**20,597,264**	**19,718,264**	**19,722,264**

All Ordinary Shares have equal voting rights and share equally in dividends and surplus on winding up. The shares have no par value.

9. GROUP STOCK AND WORK IN PROGRESS

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Stock on hand	1,524	1,144	1,334
Work in progress	-	6	1
Stock and work in progress at end of period	**1,524**	**1,150**	**1,335**

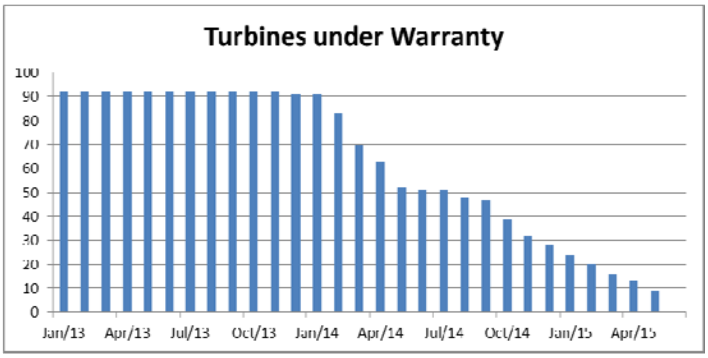
10. GROUP PROVISION FOR WARRANTY

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Balance at beginning of period	**4,612**	**5,386**	**5,386**
Amounts added to warranty provision	130	-	1,211
Amount deducted from warranty provision for warranty provisions elapsed	(750)	(742)	(1,985)
Balance at end of period	**3,992**	**4,644**	**4,612**
Expected to be utilised within 1 year	1,443	929	2,696
Provision for period of 1 to 5 years	2,549	3,715	1,916
Balance at end of period	**3,992**	**4,644**	**4,612**

Warranty provisions are an estimate of the future costs to fulfil the obligations the Company has in respect of product warranty for turbines sold. The actual liability could be higher or lower than the warranty provision.

This warranty extends for up to 5 years from the date of commissioning, plus such recurring 2 year time periods as are required for a warranty repair to last for 2 years following the date of that repair. The estimated general warranty costs per turbine per month are $890. The number of turbines currently under warranty is 92, falling to nil by June 2015.

During previous financial years 5 turbines have reached the end of their warranty period. This graph illustrates the number of turbines still under warranty.



A future estimated general provision totalling $1,865,000 has been provided against the general costs anticipated from each turbine through the warranty period.

In addition to the above provision, the Company has provided $1,565,000 in respect of possible future failures of specific components where there has historically been a higher than expected failure rate. The majority of the provision relates to possible future pitch bearing, sprag clutch and gearbox failures.

During the 2010 financial period, the Company and NZ Windfarms Ltd ("NZ Windfarms") reached agreement on a monitoring programme with respect to some components in the early turbines at Te Rere Hau which were subsequently modified as part of the Company's IEC Certification (IEC) process because they did not meet IEC requirements for a 20 year life. Under this agreement, NZ Windfarms is entitled to retain a sum of $966,200 (being the estimated total maximum upgrade cost calculated in 2010) from the proceeds of the retentions. This sum will be released to the Company if and when the Company discharges certain obligations during the 5 year warranty period, outlined as follows. Upgrade works may either be undertaken or a report obtained from an independent consultant providing an opinion that the affected components are expected to achieve a 20 year life and accordingly do not need to be upgraded. In the absence of such a report or completion of the upgrade works, the Company will provide a 20 year warranty against defects for those particular components. The Company has provided $562,000 against the expected cost of these obligations.

The Company has provided a turbine availability warranty wherein the turbine availability across the wind farm must be greater than 95% for the year. The penalty for non-compliance is a make-good calculation for the lost revenue up to the 95% availability. To date, the availability percentage for the wind farm is above the 95% level. No provision is considered necessary in respect of this item.

The Company has provided several other warranties to NZ Windfarms under the sale and purchase agreement for the turbines. These warranties are explained in note 16(a) and (b) below.

The provision for warranty is based on estimates made by the engineering staff of the Company from historical warranty data. In determining these estimates, the Company has undertaken rigorous analysis of all material warranty issues, including a probabilistic assessment of the likely recovery from suppliers.

11. GROUP CASH ON HAND AND AT BANK

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Trading accounts balances	82	570	19
Deposits held as security	21	21	21
Balance at end of period	**103**	**591**	**40**

The Company has $15,000 and $6,000 deposited as security with a financial institution. These serve as security in respect of the NZAX and for the company credit cards respectively. The Company earns interest at a rate between 4% - 5% depending on the length of term the funds are deposited.

12. SHAREHOLDER LOAN

In July 2012, a construction financing agreement (Shareholder Loan Facility) was reached with a shareholder, David Iles, wherein the Company, together with its wholly-owned subsidiaries Windflow UK Limited (WUK) and Windflow Hammer Limited (WHL), will undertake up to 3 wind turbine projects in Scotland (the "Projects"), please refer to note 19(b).

The Shareholder Loan Facility provided for advances up to £2,830,000 to WUK to fund the Projects, provided certain conditions set out in the loan documents were satisfied. As set out in note 19(b) the Shareholder Loan Facility has since been increased to £3,380,000. The Company and WHL are covenantors and guarantors of WUK's obligations.

The Shareholder Loan Facility incorporates the following documents:

i) Term Loan Agreement wherein interest will accrue on the amounts advanced to WUK from the date of draw down at a rate of 20% per annum compounding daily, equivalent to an annual percentage rate of 22.134% per annum. Repayments under the Term Loan Agreement are scheduled to commence on the date that is 3 years from the date of the loan agreement;
ii) General Security Agreement (in respect of parts and assemblies of the turbines owned by the Company);
iii) Guarantee and Indemnity wherein the Company and WHL jointly and severally guarantee WUK's obligations to the lender under the Term Loan Agreement;
iv) Debenture over the assets of WUK granting a general and floating charge over all the assets and undertakings of WUK securing its obligations under the loan (English law);
v) Debenture over the assets of WHL granting a general and floating charge over the assets and undertakings of WHL, securing WHL's obligations as guarantor of WUK's obligations under the loan (English law);
vi) Floating Charge over assets of WHL granting a general and floating charge over project equipment owned by WUK and the Company securing WUK's obligations under the loan (as the borrower under the Term Loan Agreement) and the Company's obligations as guarantor of WUK's obligations to the lender (Scottish Law).

13. RELATED PARTY DISCLOSURES

(a) Loans to Directors

There were no loans to Directors issued during the period or outstanding as 31 December 2012 (December 2011: nil, June 2012: nil).

(b) Key management personnel compensation

Other than their salaries and remuneration, there were no other cash benefits to Directors or executive officers.

(c) Payments to Directors

Interest was payable to Mr G. Henderson under a $102,000 bridging finance provided prior to the March 2013 capital raising. This bridging finance was lent at an interest rate of 15% pa. The loan and interest was repaid in full to Mr G. Henderson on the 21st March 2013.

Prior to his retirement on 31 October 2012, Mr K. McConnell, provided management services of $4,000. Mr H Kelly, Director provided management services of $1,410. Both of these were at normal commercial rates and were not outstanding at 31 December 2012.

14. RECONCILIATION OF REPORTED DEFICIT WITH CASH FLOWS FROM OPERATING ACTIVITIES

	31 December 2012 ($000's)	31 December 2011 ($000's)	Audited 30 June 2012 ($000's)
Net Deficit	**(1,882)**	**(2,366)**	**(4,083)**
Less Non-cash items:			
Amortisation of licences & patents	129	129	258
Depreciation	63	83	173
Loss on sale of fixed assets	-	(18)	46
Other	-	-	11
	192	**194**	**488**
Cash flow from operations before working capital changes	**(1,690)**	**(2,172)**	**(3,595)**
Movements in working capital:			
Movement in accounts payable excluding asset purchases	(983)	(31)	46
Movement in accounts payable asset purchases	-	30	-
Movement in holiday pay	90	(107)	(138)
Movement in accruals	345	201	(9)
Movement in provisions	(221)	(712)	(763)
Movement in maintenance accrual	-	(106)	258
Movement in other assets	163	-	37
Movement in accounts receivable & interest accrued	299	(7)	(404)
Movement in stock & WIP	189	705	514
Movement in prepayments	75	47	48
Movement in retentions	-	(76)	1,320
Movement in tax asset	-	6	4
Movement in GST	185	7	-
Net cash flows from operating activities	**(1,548)**	**(2,215)**	**(2,682)**

15. SEASONALITY OR CYCLICALITY OF INTERIM OPERATIONS

Revenue for the six months under review is comprised mainly of the release of warranty provisions and the licensing revenue from General Dynamics Satcom Technologies Inc (GD SATCOM).

16. CONTINGENT LIABILITIES

a) **Sound Level performance:** The Company has provided NZ Windfarms a Sound Level warranty in respect of the turbines:
   i) A turbine must operate within its Resource Consent for 5 years from the commissioning date. The consequence of failure to comply with this warranty is that the turbine may be required to be shut down which in turn would affect the availability warranty referred to in note 10.
   ii) The turbine must achieve a sound power level less than 104 dBA. The consequence of non compliance with this warranty is that such failure is deemed a defect under the General Warranty against Defects requiring remediation.

   NZ Windfarms is party to an Environment Court hearing. In July 2012, NZ Windfarms received a determination by the Environment Court which enabled the Palmerston North City Council to review the conditions of the NZ Windfarms consent under which its wind farm operates. NZ Windfarms has lodged an appeal and is also in discussions with the Council and affected neighbours to find a mutually acceptable solution. Should NZ Windfarms lose its appeal and be unable to reach some compromise with affected neighbours, this could give rise to liabilities for the Company under its Sound Level warranty provided to NZ Windfarms.

   Presently, it is not possible to estimate the probability or costs associated with this possible warranty risk and accordingly, no provision has been established in respect of this risk.

b) **Power curve:** The Company has provided NZ Windfarms with a warranty for power curve performance of 95% which crystallises as the turbines exit their 5 year warranty period in July 2015. The calculation of the power curve performance contains several adjustments, some of which remain to be agreed with NZ Windfarms. It is possible that once these calculations are finalised a warranty claim could arise. A programme has been put in place to finalise the adjustments and obtain NZ Windfarms agreement.

   Because of the uncertainty of quantifying the amount and whether it will even arise, no provision has been made in these Financial Statements.

c) **Leading edge tape:** Leading edge tape on turbine blades is a wearing item and the question has arisen at TRH as to what is an acceptable wear rate. The Company believes the wear rate on most sites is acceptable and that any accelerated wear is due primarily to environmental factors on the TRH extension. NZ Windfarms does not share this view. There are a number of factors involved which the companies are investigating with a view to finding a reasonable commercial resolution as well as an improved technical solution. The cost (if any) to the Company is not known at the time of this report.

The Group has no other contingent liabilities as at 31 December (December 2011: nil, June 2012: as disclosed in those accounts).

17. COMMITMENTS

The Group has a $184,729 capital commitment as at 31 December 2012, this being a commitment to Scottish and Southern Energy Power Distribution. The deposit already made is refundable should the project be cancelled (December 2011: nil, June 2012: $45,000).

18. GOING CONCERN ASSUMPTIONS

These Financial Statements have been prepared using the going concern assumption.

In March the company completed a successful capital raising which resulted in issuing $4.5 million worth of redeemable convertible preference shares.

The continued viability of the Company is dependent on the following underlying factors in forming a judgement on the going concern assumption.

a) Release of certain retentions held by NZ Windfarms in accordance with the existing contractual arrangements. These retentions now total $403,000 plus GST.

   The Company has offset some of its warranty liabilities to NZ Windfarms against the release of this retention.

b) Release of part period maintenance charges to NZ Windfarms in accordance with the provisions of the existing contractual arrangements. The Company has entered into arbitration to determine the liability of NZ Windfarms under this agreement. At the date of this report, based on legal advice received, Directors are of the view that the Company will obtain a successful outcome from arbitration. Based on this view, the Company has offset its warranty liability to NZ Windfarms to the extent of $366,000 plus GST.

c) Receipt of funds from GD SATCOM in respect of license payments and the sale of engineering resources. The Company is confident that these funds will be received as scheduled and in our dealings with GD SATCOM to date their payments have been received on their due date.

d) Deposits received in respect of turbine orders from the United Kingdom. At the date of this report, the Company has 3 contracted turbine sites in the United Kingdom. These sites will be developed internally and upon commissioning will either be retained as an investment or sold (depending upon the liquidity requirements of the Company). Prior to their sale or retention, these sites have been funded within the Shareholder Loan Facility.

   The Company expects to receive one order per month from July 2013. There are a number of factors that will influence the ability of the Company to secure these orders. These factors include:
   i) Entering into formal agreements with GD SATCOM which give effect to a Memorandum of Understanding which was signed with that company in September 2012 (the GD MoU), which provides warranty insurance to customers of our Company. These formal agreements are now at an advanced stage of negotiation. The budget assumptions include provision of construction performance assurance as well as warranty insurance under the GD MoU for all sales excluding those funded through the Shareholder Loan Facility.
   ii) The ability of certain purchasers to secure development finance for their purchase of the turbines or Windflow UK being capitalised sufficiently to be able to provide it.
   iii) No amendments or delays to the Feed In Tariff decisions announced in July 2012.
   iv) A stock of turbine spares being available to support UK sales.

Funding from sources a) to d) above is forecast to enable the Company to maintain positive shareholders funds and meet its obligations. There are significant quantum and timing risks associated with each of the above assumptions.

In summary, based on the Company's:

- cash flow forecasts using the above assumptions,
- forecast warranty liabilities, and
- forecast level of shareholder's funds within the Company using the above assumptions;

the Directors consider the going concern assumption to be a valid basis on which to prepare the Financial Statements. This conclusion was reached giving due regard to circumstances likely to affect the company within the next 12 month period.

19. SIGNIFICANT EVENTS AFTER BALANCE DATE

a) **Offer Document:** On the 12th February 2013, an Offer Document was issued wherein the Company sought to raise share capital of between $2 million and $5.1 million. This capital raising closed on the 14 March 2013, raising $4.5 million of equity for which 9 million redeemable convertible preference shares at $0.50 each were issued**.**

b) **Shareholder Loan Facility extension:** At a special meeting held on the 7th March 2013, shareholders approved that the Company and its subsidiaries could increase the existing Shareholder Loan Facility of £2,830,000 by a further £550,000 (so that the total Shareholder Loan Facility is £3,380,000). This increase is to cover the possibility that intended (but not committed) part-funding of the New Holland project is not forthcoming from the land-owners and also to cover immaterial increases in the Project budgets which have occurred since July 2012.

c) **Commissioning of the Westray turbine:** The turbine has been installed and commissioning was substantially completed on February 27th 2013. Successful first synchronisation with the national grid occurred that day and unattended operation commenced on March 13th 2013, once a current imbalance issue had been investigated and identified as being due to local network load imbalances.