# Windflow Technology Limited
# Interim Report December 2013

# Contents

# Directors' Six-Month Review to 31 December 2013

Windflow Technology has continued to build value and prospects for a sustainable, profitable business. It has adhered to the 1-2-3 course of action which it has been following since early 2011 and continues to make positive, if slow, progress. Funding has been forthcoming through shareholder loans and equity, reflecting the strong commitment shareholders have to achieving Windflow's potential. These funds have been applied to investments in turbines for the UK, as well as meeting overhead and warranty commitments. With most revenues continuing to be internally generated, a Group loss of $2.8 million has been recorded.

The major milestones for the six-months were:

- July - Windflow and GD SATCOM entered into a formal warranty insurance agreement, pursuant to which GD SATCOM has in August issued the first warranty insurance certificate for a single turbine project in the Orkneys
- August – GD SATCOM confirmed approval of the final design of the Class 2A turbine, enabling the manufacture of the prototype to proceed (completion expected in May 2014) and a major milestone payment to Windflow
- September - independent report on the Westray turbine showed a considerable reduction in sound levels had been achieved, as expected. This will improve the marketability of the turbine for the UK
- December – availability at Te Rere Hau for calendar year 2013 was 95.0%.

Subsequent to balance date:

- January – a capital raising was completed of $2.9 million for the issue of preferential shares.
- January – a project of three turbines was confirmed for North Harris in the Outer Hebrides. Monan Wind Company Limited was formed as a 90% owned subsidiary for this project.
- March - NZ Windfarms advised that it will enter arbitration to resolve the matter of its December 2013 power curve warranty claim which the Company disputes.

Looking ahead to the rest of calendar year 2014:

- The prototype 60 Hz Class 2A turbine will be installed by GD SATCOM (with support from Windflow) at a site in West Texas by mid-year. Preliminary marketing has commenced and royalty payments to Windflow are expected to commence from GD SATCOM in the second half of 2014
- Windflow will complete the manufacture and installation at least five Class 1A turbines in Scotland, being the two confirmed in early 2013 and the three confirmed in late 2013
- Windflow expects to confirm further projects in the UK, including external sales, and including a demonstration 50 Hz Class 2A turbine
- Windflow expects that warranty payments to NZ Windfarms will reduce significantly as about 60 turbines complete their five-year warranty periods, although risks remain in terms of unforeseen and disputed warranty claims.
- Low wholesale power prices are likely to persist in New Zealand. They have been at 4-5 c/kWh for the last few years, which compares with more than 7.5 c/kWh being needed for long-term viability. Accordingly Windflow will continue its focus on overseas markets.
- Windflow expects to record a loss for the full-year to 30 June 2014 of $4.4 million.
- Windflow may need to raise further capital depending on progress in achieving external sales. This question will be reviewed as the year progresses.

For further details, we refer you to the Financial Statements and Notes.

# Directors' declaration

In the opinion of the directors of Windflow Technology Limited (the "Company"), the consolidated interim financial statements of Windflow Technology Limited for the six months ended 31 December 2013 and notes, on pages 4 to 13:

- comply with New Zealand generally accepted accounting practice and give a true and fair view of the financial position of the Company and the Group as at 31 December 2013 and the results of its operations and cash flows for the 6 months ended on that date.
- have been prepared using appropriate accounting policies, which have been consistently applied and supported by reasonable judgements and estimates.

The directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Company and facilitate compliance of the consolidated interim financial statements with the Financial Reporting Act 1993.

The directors consider that they have taken adequate steps to safeguard the assets of the Company and to prevent and detect fraud and other irregularities. Internal control procedures are also considered to be sufficient to provide a reasonable assurance as to the integrity and reliability of the consolidated interim financial statements.

For and on behalf of the Board of Directors:

D. M. Chick

Chairman
12 March 2014

Geoff Henderson

Director
12 March 2014

# Unaudited Consolidated Interim Statements of Financial Position

**As at 31 December 2013**

| | Note | Unaudited 31 December 2013 ($000's) | Audited 30 June 2013 ($000's) |
|---|---|---|---|
| **Current assets** | | | |
| Cash on hand and at bank | | 270 | 188 |
| Income earned not invoiced | | 73 | 199 |
| Trade and other receivables | | 1,293 | 1,589 |
| Prepayments | 7 | 696 | 216 |
| Retentions | | 167 | 167 |
| Inventory and w ork in progress | | 1,173 | 1,011 |
| Value added goods and services tax refund | | 75 | 185 |
| **Total current assets** | | **3,747** | **3,555** |
| **Non-current assets** | | | |
| Property, plant & equipment | | 2,582 | 2,287 |
| Intangible assets | | 1,768 | 1,872 |
| Retentions | | 250 | 250 |
| **Total non-current assets** | | **4,600** | **4,409** |
| **Total assets** | | **8,347** | **7,964** |
| **Equity** | | | |
| Contributed capital | | 37,927 | 37,927 |
| Foreign currency exchange gains / (losses) on net investments | | (30) | - |
| Accumulated losses | | (40,145) | (37,131) |
| Equity attributable to the ow ners of the Company | | | |
| **Total equity** | | **(2,248)** | **796** |
| **Current liabilities** | | | |
| Trade and other payables | | 3,366 | 2,504 |
| Provisions | 8 | 1,604 | 2,158 |
| **Total current liabilities** | | **4,970** | **4,662** |
| **Non-current liabilities** | | | |
| Loan from shareholder | 9 | 4,822 | 1,757 |
| Provisions | 8 | 803 | 749 |
| **Total non-current liabilities** | | **5,625** | **2,506** |
| **Total equity and liabilities** | | **8,347** | **7,964** |

The notes on pages 8 to 13 are an integral part of these financial statements.

For and on behalf of the Board of Directors who authorise these financial statements for issue on 12 March 2014.

D. M. Chick

Chairman

Geoff Henderson

Director

# Unaudited Consolidated Interim Statements of Comprehensive Income

**For the 6 months ended 31 December 2013**

| | Note | Unaudited 31 December 2013 ($000's) | Unaudited 31 December 2012 ($000's) |
|---|---|---|---|
| Operating revenue | 4 | 373 | 837 |
| Cost of sales | | 517 | 274 |
| **Gross profit / (loss)** | | **(144)** | **563** |
| Other revenue | | 96 | 71 |
| Licensing revenue | 4 | 641 | 168 |
| **Less:-** | | | |
| Depreciation | | (93) | (63) |
| Amortisation of licences and patents | | (129) | (129) |
| General and administration costs | | (973) | (644) |
| Engineering costs | | (635) | (733) |
| Research and development costs | | (39) | (25) |
| Marketing costs | | (465) | (91) |
| Wind farm development, operations & maintenance | | (1,044) | (1,002) |
| Operating loss before finance income and expenses | | **(2,785)** | **(1,885)** |
| Finance income | | | 3 |
| Finance expense | | - | - |
| **Loss before income tax** | | **(2,785)** | **(1,882)** |
| Income tax expense / (credit) | | **(3)** | **-** |
| **Loss for the period** | | **(2,788)** | **(1,882)** |
| Other comprehensive income: | | **-** | **-** |
| Exchange differences on translating foreign operations | | **(30)** | **-** |
| Cash flow hedging | | **-** | **-** |
| – reclassification to profit or loss | | **-** | **-** |
| **Total comprehensive loss for the period attributable to the shareholders of Windflow Technology Limited** | | **(2,818)** | **(1,882)** |
| Losses per share for loss attributable to the ordinary equity holders of the Company during the period: | | | |
| Basic Loss per Share | | **$(0.14)** | **$(0.10)** |
| Diluted Loss per Share | | **$(0.07)** | **$(0.09)** |

The notes on pages 8 to 13 are an integral part of these financial statements.

# Unaudited Consolidated Interim Statement of Changes in Equity

**For the 6 months ended 31 December 2013**

| | Note | Ordinary Share Capital ($000's) | Preference Share Capital ($000's) | Foreign Exchange Gains / Losses ($000's) | Retained Earnings ($000's) | Total Equity ($000's) |
|---|---|---|---|---|---|---|
| **Balance at 1 July 2012** | | **33,238** | **-** | | **(32,764)** | **474** |
| Total comprehensive loss | | - | - | | (1,882) | **(1,882)** |
| Ordinary shares issued | | 350 | - | | - | **350** |
| **Balance at 31 December 2012** | | **33,588** | **-** | **-** | **(34,646)** | **(1,058)** |
| | | | | | | |
| **Balance at 1 January 2013** | | **33,588** | **-** | | **(34,646)** | **(1,058)** |
| Total comprehensive loss | | - | | | (2,360) | **(2,360)** |
| Preferential dividends | | - | | | (125) | **(125)** |
| Redeemable Convertible Preference Shares | | - | 4,512 | | - | **4,512** |
| Issue costs of Preference Shares | | - | (173) | | - | **(173)** |
| **Balance at 30 June 2013** | | **33,588** | **4,339** | **-** | **(37,131)** | **796** |
| | | | | | | |
| **Balance at 1 July 2013** | | **33,588** | **4,339** | **-** | **(37,131)** | **796** |
| Total comprehensive loss | | - | - | (30) | (2,788) | (2,818) |
| Preferential dividends | 6 | - | - | | (226) | (226) |
| **Balance at 31 December 2013** | | **33,588** | **4,339** | **(30)** | **(40,145)** | **(2,248)** |

The notes on pages 8 to 13 are an integral part of these financial statements.

# Unaudited Consolidated Interim Statements of Cash Flows

**For the 6 months ended 31 December 2013**

| | Note | Unaudited 31 December 2013 ($000's) | Unaudited 31 December 2012 ($000's) |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash receipts from customers | | | |
| Sales of turbines and components | | 106 | - |
| Licensing revenue | | 830 | 168 |
| Other | | 10 | 69 |
| Interest received | | 3 | 3 |
| Cash paid to suppliers and employees | | | |
| Suppliers | | (2,589) | (463) |
| Employees | | (1,128) | (1,062) |
| Other | | (195) | (263) |
| **Net cash used in operating activities** | | **(2,963)** | **(1,548)** |
| **Cash flows from investing activities** | | | |
| Disposal of property plant and equipment | | - | - |
| Disposal of investment | | - | - |
| Acquisition of property plant, equipment and capital WIP | | (20) | (507) |
| **Net cash used in investing activities** | | **(20)** | **(507)** |
| **Cash flows from financing activities** | | | |
| Issue of shares | | - | 350 |
| Issue of redeemable convertible preference shares | | - | - |
| Loan from a shareholder | | 3,065 | 1,837 |
| Issue costs of equity | | - | (69) |
| **Net cash from financing activities** | | **3,065** | **2,118** |
| **Net increase (decrease) in cash and cash equivalents** | | **82** | **63** |
| Cash and cash equivalents at beginning of the period | | 188 | 40 |
| **Cash and cash equivalents at end of the period** | | **270** | **103** |

The notes on pages 8 to 13 are an integral part of these financial statements.

# Notes to the Financial Statements

## 1. General Information

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

| | Nature of business | Interest percentage | |
|---|---|---|---|
| | | **2013** | **2012** |
| Wind Blades Ltd | Construction of blades for Wind turbines | 100 | 100 |
| Windflow International Ltd | Non trading | 100 | 100 |
| Windflow UK Ltd | Trading | 100 | 100 |
| Windflow Hammer Ltd | Trading | 100 | 100 |
| Hammer Westray LLP | Trading | 100 | 100 |
| Our Wind Ltd | Non trading | 100 | 100 |
| Monan Wind Company Ltd | Trading | 90 | n/a |
| Windpower Otago Ltd | Non trading | 20 | 20 |

The Company is an issuer for the purpose of the Financial Reporting Act 1993. These Financial Statements have been prepared in accordance with the Financial Reporting Act 1993 and Companies Act 1993.

The Financial Statements comprise the Consolidated Interim Financial Statements of the Group. They do not include separate parent company accounts.

These consolidated interim financial statements were approved for issue by the Board of Directors on 12 March 2014.

The Company is profit oriented and undertakes wind turbine development and manufacture, and operates in New Zealand and the United Kingdom. The Group is not subject to impacts of seasonality or cyclicality.

## 2. Basis of Preparation of Half Year Report

The Group is a profit-oriented company and this condensed consolidated interim financial information for the six months ended 31 December 2013 has been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). These financial statements comply with NZ IAS 34 'Interim Financial Reporting' and with International Accounting Standard 34 (IAS 34).

The condensed consolidated interim financial information should be read in conjunction with the annual financial statements for the period ended 30 June 2013, which have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

## 3. Significant Accounting Policies

The accounting policies applied are consistent with those of the annual financial statements for the period ended 30 June 2013.

New accounting standards, or amendments to existing standards, came into effect for periods beginning on or after 1 January 2013. These were:

- NZ IFRS 10 Consolidated Financial Statements
- NZ IFRS 11 Joint Arrangements
- NZ IFRS 12 Disclosure of Interests in Other Entities
- NZ IFRS 13 Fair Value Measurement
- NZ IAS 1 Amendments Presentation of Items of Other Comprehensive Income
- NZ IAS 27 Separate Financial Statements
- NZ IAS 28 Investments in Associates and Joint Ventures

There was no material impact on the accounts when incorporating changes as a consequence of adopting the new standards.

## 4. Segmental Reporting

The Group operates in two separately reportable business segments; the Wind Turbines segment and the Licensing segment, which are reviewed by the chief operating decision maker. All other activities are aggregated as 'all other segments'. Transactions between reporting segments are accounted for on the accruals basis. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer.

**Wind Turbines Segment:** Represents manufacturing, installing, commissioning, operating and maintaining wind turbines. It is an aggregation of the activities in New Zealand and the United Kingdom.

**Licensing Segment:** Derives revenue from licensing agreements with other manufacturers of wind turbines. In these financial statements all such revenue was from engineering services provided to GD SATCOM Technologies Inc., USA.

**All Other Segments:** Represents the design and development of the Wind Turbine, general marketing and administration expenses; it includes the parent and subsidiary companies and their general central administration income and expenses that are not applicable to the Licensing Segment nor the Turbine Construction Segment.

## a) Business Segmental Analysis

| Revenue | Unaudited 31 December 2013 Wind Turbines ($000's) | Unaudited 31 December 2013 Licensing ($000's) | Unaudited 31 December 2013 All Other Segments ($000's) | Unaudited 31 December 2013 Total ($000's) | Unaudited 31 December 2012 Wind Turbines ($000's) | Unaudited 31 December 2012 Licensing ($000's) | Unaudited 31 December 2012 All Other Segments ($000's) | Unaudited 31 December 2012 Total ($000's) |
|---|---|---|---|---|---|---|---|---|
| From external customers | 72 | 641 | 301 | 1,014 | - | 168 | 911 | 1,079 |
| From other segments | - | - | - | - | - | - | - | - |
| Segment revenues | **72** | **641** | **301** | **1,014** | **-** | **168** | **911** | **1,079** |
| Less:- Operating expenses | 1,240 | - | 2,559 | 3,799 | - | - | 2,961 | 2,961 |
| **(Loss)/Profit before income tax** | **(1,168)** | **641** | **(2,258)** | **(2,785)** | **-** | **168** | **(2,050)** | **(1,882)** |

| Assets and Liabilities | Unaudited 31 December 2013 Wind Turbines ($000's) | Unaudited 31 December 2013 Licensing ($000's) | Unaudited 31 December 2013 All Other Segments ($000's) | Unaudited 31 December 2013 Total ($000's) | Audited 30 June 2013 Wind Turbines ($000's) | Audited 30 June 2013 Licensing ($000's) | Audited 30 June 2013 All Other Segments ($000's) | Audited 30 June 2013 Total ($000's) |
|---|---|---|---|---|---|---|---|---|
| Segment assets | 3,675 | - | 4,598 | 8,273 | 2,762 | - | 5202 | 7,964 |
| Segment liabilities | 7,668 | - | 2,853 | 10,521 | 2,478 | - | 4690 | 7,168 |
| **Total equity** | **(3,993)** | **-** | **1,745** | **(2,248)** | **284** | **-** | **512** | **796** |

## 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.

| | Unaudited 31 December 2013 Wind Turbines ($000's) | Unaudited 31 December 2013 Licensing ($000's) | Unaudited 31 December 2013 All Other Segments ($000's) | Unaudited 31 December 2013 Total ($000's) | Unaudited 31 December 2012 Wind Turbines ($000's) | Unaudited 31 December 2012 Licensing ($000's) | Unaudited 31 December 2012 All Other Segments ($000's) | Unaudited 31 December 2012 Total ($000's) |
|---|---|---|---|---|---|---|---|---|
| New Zealand | - | - | 257 | 257 | - | - | 911 | 911 |
| United Kingdom and Europe | 72 | - | - | 72 | - | - | - | - |
| North America | - | 641 | 44 | 685 | - | 168 | - | 168 |
| **Revenue** | **72** | **641** | **301** | **1,014** | **-** | **168** | **911** | **1,079** |

## c) Non-current Assets by Geographic Location

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

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

| | Unaudited 31 December 2013 Wind Turbines ($000's) | Unaudited 31 December 2013 Licensing ($000's) | Unaudited 31 December 2013 All Other Segments ($000's) | Unaudited 31 December 2013 Total ($000's) | Audited 30 June 2013 Wind Turbines ($000's) | Audited 30 June 2013 Licensing ($000's) | Audited 30 June 2013 All Other Segments ($000's) | Audited 30 June 2013 Total ($000's) |
|---|---|---|---|---|---|---|---|---|
| New Zealand | 250 | - | 2,094 | 2,344 | 250 | - | 2,323 | 2,573 |
| United Kingdom and Europe | 2,256 | - | - | 2,256 | 1,765 | - | 71 | 1,836 |
| North America | - | - | - | - | - | - | - | - |
| **Total non-current assets** | **2,506** | **-** | **2,094** | **4,600** | **2,015** | **-** | **2,394** | **4,409** |

## 5. Earnings Per Share

| | 31 December 2013 | 31 December 2012 |
|---|---|---|
| Weighted average number of shares on issue | 20,159,764 | 19,722,264 |
| Additional shares if all preference shares converted | 18,048,690 | - |
| Additional shares if all staff options converted | 1,334,688 | 761,407 |
| **Total potential shares** | **39,543,142** | **20,483,671** |
| | **($000's)** | **($000's)** |
| **Loss for the period** | **(2,818)** | **(1,882)** |
| Basic earnings/(loss) per share | $(0.14) | $(0.10) |
| Diluted earnings/(loss) per share | $(0.07) | $(0.09) |

## 6. Dividends

In March 2013 the Company allotted 9,024,345 Redeemable Convertible Preference Shares with a 10% per annum dividend rate and a five year term to maturity. The total capital raised amounted to $4,512,173. The preferential dividends are cumulative and payable quarterly. The Company declared and paid preferential dividends of $113,731 for each of the quarters ended 30 September and 31 December 2013 (2012: nil). The preferential dividends of $113,731 for the quarter ended 31 December 2013 were paid on 10 January 2014.

No ordinary dividend was declared or paid during the period (2012: nil).

## 7. Prepayments

Prepayments as at 31 December 2013 increased due to a $325,000 refundable deposit on a development project (see Note 14 b) and $141,000 of issue costs of the redeemable convertible preference shares allotted on 8 January 2014 (see Note 14 a).

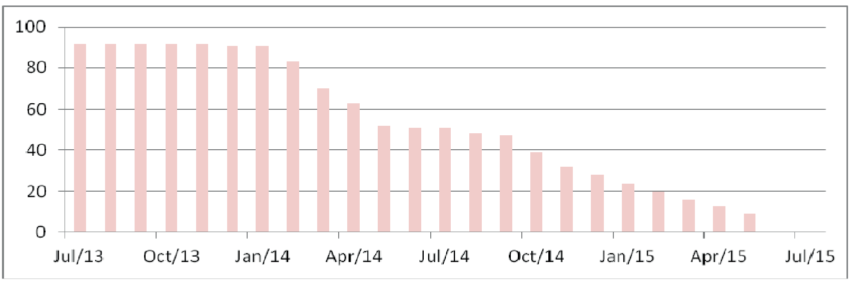
## 8. Provision for warranties

| | 6 months 31 December **2013** **($000's)** | 6 months 31 December **2012** **($000's)** | 12 months Audited 30 June 2013 **($000's)** |
|---|---|---|---|
| **Balance at beginning of period** | **2,907** | **4,612** | **4,612** |
| Amounts added to warranty provision | 1,376 | 130 | 273 |
| Amount released from warranty provision | (1,488) | (750) | (1,977) |
| Increase/(decrease) in discounted amount | (388) | - | (1) |
| **Balance at end of period** | **2,407** | **3,992** | **2,907** |
| Expected to be utilised within one year | 1,604 | 1,443 | 2,158 |
| Provision for remainder of warranty period | 803 | 2,549 | 749 |
| **Balance at end of period** | **2,407** | **3,992** | **2,907** |

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.

These warranties extend for 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 number of turbines under warranty as at 31 December 2013 was 91, falling to nil by 1 July 2015.

The following graph illustrates the number of turbines under warranty; all are at the Te Rere Hau wind farm.



The provision includes possible future failures of specific components, where there has historically been a higher than expected failure rate and an estimated 'miscellaneous' provision based on the historic general costs anticipated from a turbine through the warranty period to 1 July 2015.

During the 2010 financial year, 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 International Electrotechnical Commission 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 $417,000 from the turbine sale price retentions (being the estimated total maximum upgrade cost left from that of $966,200 calculated in 2010). 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 be undertaken or a report from an independent consultant provides 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, the Company will provide a 20 year warranty against failure of those particular components. The Company has provided against the expected cost of these obligations.

The Company has provided several other warranties to NZ Windfarms under the sale and purchase agreement for the turbines. These warranties apply to turbines for 5 years from their commissioning date.

a) The Company has provided a Sound Level Warranty in respect of two matters:
   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 later in this note.
   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 has been involved in an Environment Court hearing and High Court appeal with respect to certain declarations sought by the Palmerston North City Council relating to sound emissions from their wind farm. The High Court judgement of 20 June 2013 found in favour of NZ Windfarms that the Te Rere Hau wind farm complies with the specific noise conditions of its consent. Palmerston North City Council has been granted leave to appeal the High Court decision. NZ Windfarms has stated its intention to contest the appeal.

   No provision is considered necessary for this warranty as the turbines are believed to be well within the specific sound level conditions of the consent.

b) 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. The availability percentage for the wind farm has generally been comfortably above the 95% level, however, for the year ended 31 December 2013 the availability percentage was 94.96% incurring an accrued liability of $3,127. No future provision is considered necessary in respect of this item.

c) The Company has provided a warranty to NZ Windfarms for power curve performance of 95%. NZ Windfarms has expressed its intent to seek compensation, has submitted an invoice for approximately $40,000 for one turbine under this warranty and has also provided notification of a further four turbine claims. The Company disputes any liability for breach of the warranty and considers that any claim should be calculated when the last turbine exits its 5-year warranty period on 1 July 2015. Accordingly, at this point no provision has been made relating to this warranty. NZ Windfarms has advised they will enter arbitration to determine the methodology for calculating the power curve performance and the date on which a claim may be lodged, if applicable.

The provisions are 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.

## 9. 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), would undertake up to 3 wind turbine projects in Scotland (the "Projects").

In December 2013 this loan facility was increased to a maximum of £7,380,000 (NZ$14,841,180 as at 31 December 2013 exchange rate) to fund development projects in the UK for a total of 7 turbines, provided certain conditions set out in the loan documents are satisfied. The Company and WHL are covenantors and guarantors of WUK's obligations.

As at 31 December 2013 the aggregate liability under these loans was $4,822,173 with a security over the 'wind turbine' fixed asset $2.0 million and capital work in progress $0.2 million that are included in Property, Plant and Equipment. At the date of signing these financial statements the aggregate liability under these secured loans was $4.8 million and the turbine asset and capital work in progress $3.3 million.

The loan facilities incorporate 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 10% per annum compounding daily, equivalent to an annual percentage rate of 10.516% per annum. Repayments under the Term Loan Agreement are scheduled to commence on the date that is 3 years from the date of each loan agreement. No repayments are required before August 2015.
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).

## 10. Related Party Disclosures

**a) Transactions with key management personnel:**
Key management personnel are classified as any persons, including the Directors, who have the authority and responsibility for planning, directing and controlling the activities of the Group.

*i) Loans to Directors*
There were no loans to Directors issued during the period to 31 December 2013 (2012: nil).

*ii) Key management personnel compensation*
Other than their salaries and incentives, there were no other cash benefits to Directors or executive officers.

**b) Payments to directors**
Mr A Napier, Director, provided management services of $18,350 at normal commercial rates of which $4,275 was unpaid as at 31 December 2013.

## 11. Reconciliation Of Reported Deficit With Cash Flows From Operating Activities

| | 6 months 31 December **2013** **($000's)** | 6 months 31 December **2012** **($000's)** |
|---|---|---|
| **Net Deficit** | **(2,818)** | **(1,882)** |
| Less Non-cash items: | | |
| Amortisation of licences & patents | 129 | 129 |
| Depreciation | 93 | 63 |
| Loss on sale of fixed asset | - | - |
| Impairment provision | - | - |
| Other | - | - |
| | 222 | 192 |
| **Cash flow from operations before working capital changes** | **(2,596)** | **(1,690)** |
| Movements in w orking capital: | | |
| Movement in accounts payable excluding asset purchases | 381 | (983) |
| Increase in progress payments held | - | - |
| Movement in holiday pay | (8) | 90 |
| Decrease in accruals | (231) | 345 |
| Movement in provisions | (494) | (221) |
| (Increase)/Decrease in other assets | - | 163 |
| Movement in maintenance accrual | 126 | - |
| Movement in accounts receivable & interest accrued | (297) | 299 |
| Decrease in stock & WIP | (162) | 189 |
| Movement in prepayments | 553 | 75 |
| Movement in retentions | - | - |
| Movement in GST | (110) | 185 |
| Preferential dividends payable | (125) | - |
| Net movements | (367) | 142 |
| **Net cash flows from operating activities** | **(2,963)** | **(1,548)** |

## 12. Contingent Liabilities

a) **Component Defects/Failure:** As disclosed in Note 8, the Company has made specific and miscellaneous provisions for the cost of repair or replacement of turbine components which break down by reason of defective manufacture or material inside their 5 year warranty period.

b) **Sound Level performance:** As disclosed in Note 8, the Company has provided a Sound Level warranty in respect of the turbines.

c) **Power curve:** As discussed in Note 8, the Company has provided NZ Windfarms with a warranty for power curve performance of 95% which the Company considers to crystallise as the turbines exit their 5 year warranty period on 1 July 2015. The calculation of the power curve performance contains several adjustments, some of which remain to be agreed with NZ Windfarms. A programme has been in place to finalise the adjustments and to seek NZ Windfarms' agreement. NZ Windfarms has expressed its intent to seek compensation under this warranty as each turbine exits its warranty period, has submitted an invoice for approximately $40,000 for one turbine under this warranty and has also provided notification of a further four turbine claims. The Company disputes any liability. Accordingly, no provision has been made in these Financial Statements.

## 13. Capital Commitments

The Group had capital commitments amounting to $570,000 as at 31 December 2013 (2012:$187,729).

## 14. Significant Events After the Reporting Date

a) **Preference Share Allotment:** In January 2014 the Company allotted 5,840,579 Redeemable Convertible Preference Shares with a value of $2,920,289.50 from which was deducted legal costs and other costs of raising capital totalling $166,742. The Redeemable Convertible Preference Shares do not have voting rights except on matters affecting those shares. From the first anniversary of their issue date, they bear a 10% per annum preferential dividend which is payable quarterly. They may be redeemed by the Company at their issue price of $0.50 at any time from 30 months after their allotment date 8 January 2014, until their 5 year maturity date. They may be converted to ordinary shares by either the Company or the holder at any time and will be converted by the Company to ordinary shares if not redeemed by the 5 year maturity date. If converted by the holder they will convert to ordinary shares at 1:1. If converted by the Company they will convert into three ordinary shares for each preference share.

b) **Monan Wind Company Limited:** In January 2014 the Company formed a 90% owned subsidiary to commence a confirmed development project for installation of three turbines on the island of North Harris, Scotland, in 2014.

c) **Power Curve Warranty Claim to go to Arbitration:** In March 2014, NZ Windfarms advised that it will enter arbitration to resolve the matter of its claim which (as discussed in Note 8) the Company disputes.

## 15. Going Concern Assumption

As at 31 December 2013 the Group had negative equity of $2.2 million and restored positive equity by issuing $2.9 million of preference shares as outlined in Note 14.

These Financial Statements have been prepared using the going concern assumption. There is a significant element of uncertainty as to the Group's ability to remain a going concern, which is contingent on it being able to increase external revenue in its wind turbines and licensing segments as well as raise funds for any further development activities in the United Kingdom. In turn, this would enable the parent company to meet its ongoing overheads and warranty obligations.

The significant element of uncertainty arises because of ongoing delays with the commencement of orders in the budgeted financial performance. Orders from the United Kingdom planned for the year to 30 June 2013 are commencing in the current period to 30 June 2014, having been delayed primarily in resolving grid connection and planning consent issues.

The above lack of confirmed sales has set back the Group's programme for achieving profitability. To facilitate and expedite projects proceeding in its target market in the UK, the Group has in the interim focussed on development activities which are relatively capital intensive, but which are expected to be more profitable.

The Company estimates that it can make the transition to profitability in 2015 with projects proceeding at a rate of 1 turbine per month in the years to 30 June 2014 and 2015. While there have been ongoing delays to attaining confirmed sales, there has been good progress with a three turbine development project confirmed since balance date (see Note 14 (b)). There is a growing pipeline of prospects for external sales and development projects.

Depending on progress with growing revenue from its various activities (licensing, engineering services, turbine sales, project sales and electricity sales), the Directors may or may not carry out further capital raising in 2014 or 2015.

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

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

Windflow continues to build on the progress achieved in the year to 30 June 2013, despite the constraints imposed by the Scottish and Southern Energy moratorium on Orkney grid connections announced in September 2012.

In summary, based on the Group's generally positive progress in its 1-2-3 strategy, the Directors consider the going concern assumption to be a valid basis on which to prepare these Condensed Interim Financial Statements. This conclusion was reached giving due regard to circumstances likely to affect the Company over the coming 12 months, and to circumstances which may occur beyond that date which may affect the going concern assumption.

The Directors stress that there exists significant risk around making the transition to profitability based on a mix of sales and capital intensive development projects. Should this be unsuccessful, the Directors would have to re-consider the going concern assumption and take appropriate action. If that process results in the Directors concluding that the Group was no longer a going concern, the net assets of the Company and the Group would reduce significantly and this would result in significant negative equity.