



Good Health **Healthy Future**

ANNUAL REPORT

FOR THE YEAR ENDED 31 DECEMBER 2018

2018

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2 Company Directory

Company Number	CH/1168773
Issued Capital	218,769,344 Ordinary Shares
Registered Office	3 Desi Place Hillsborough, 8022 Christchurch
Shareholders	Listed on the USX (Unlisted Securities Exchange)
Directors	Dr M G Shepherd Mr K W Fergus Dr W L Burt Mr P W Dobbs
Accountants	Graeme Burnett Accountants Limited Rangiora
Bankers	Bank of New Zealand Limited Christchurch
Solicitors	Wynn Williams and Co. Christchurch
Auditors	Deloitte Limited Christchurch

3 Directors' Report

Statement of affairs

For the 12 months ending 31 December 2018, PharmaZen Limited is reporting a post-tax surplus of \$1,280,463 on a turnover of \$12,572,559. This compares with a post-tax deficit of \$285,704 on a turnover of \$7,304,115 for the previous year. The pre-tax surplus increased from a deficit of \$351,809 in 2017 to \$1,791,571 in 2018.

The capital raise undertaken late 2017 provided the funds required to accelerate the completion of all major capital expansion projects within the first six months of 2018. In total \$7.55 million of capital projects were completed in 2018 and it is worth revisiting the major achievements now operational:

- Freeze drying capacity increased 75% with the installation of the largest batch freeze dryer in Australasia.
- Fully operational specialised solvent extraction facility capable of extracting oils and other biological fractions from animal, marine and botanical raw materials.
- GMP (Good Manufacturing Practice) certification – Approved to manufacture an "Active Pharmaceutical Ingredient" under a "Licence to Manufacture Medicines" authorised by Medsafe (New Zealand Medicines and Medical Devices Safety Authority).
- Licensed to produce consumer ready products including softgel and hard-shell capsules.
- Issued US patent for "High Osteocalcin Microcrystalline Hydroxyapatite for Calcium Supplement".
- Completed commissioning of an additional 1,000 sqm of production facilities.

The management team, aware of the challenges in final commissioning and validation, had taken an appropriately cautious approach to pre-selling the increase in capacity and new products. The level of demand for both new and existing products once capabilities were in place has been exceptionally pleasing and well exceeded expectations.

The investment decisions of the last five years have been strongly endorsed by a \$2.1 million improvement in profit before tax and revenue growth of 72%.

3 Directors' Report (Cont.)

Outlook

The growth in turnover has created additional opportunities as well as a number of positive challenges.

The second half of 2018 saw sales of just over \$7 million dollars; marginally lower than the full year 2017 result of \$7.3m.

The business growth has reached the point where we are able to separate key parts of the process into semi-autonomous facilities;

- Original factory – which is now effectively animal only with wet processing, vacuum drying, evaporation and freeze-drying processes.
- Extraction facility – solvent extraction of assorted materials.
- Dry Powder processing – specialist blending, milling and packing of powder.
- Marine processing facility – stand-alone processing from incoming raw material to finished product.

This separation reduces challenges around compliance, minimises downtime for cleaning between species changes and improves overall efficiency.

Growth of the level experienced stretched resources considerably and we moved quickly to strengthen the management team with some exceptional senior level appointments.

Ben Alberts, Chief Operating Officer, was part of a global search and comes to us from South Africa's largest sports nutrition manufacturer, Globepak, where he was Chief Executive Officer. Gary Monk, Chief Technical Officer, a newly created role, was the General Manager at Gelita and brings a wealth of industry experience to the Company.

The strengthening of the management team although driven by current growth requirements is indicative of the Company's future aspirations as we head into 2019 with continuing high levels of demand.

Future growth will continue to be supported by capital and marketing investment as appropriate opportunities present.

One example is the blackcurrant plant project, which was not originally scheduled until 2020, is being bought forward.

The original intention was that we would run botanical and marine products through the same facility until demand supported a separation of facilities.

This situation has come rather earlier than anticipated and we have purchased a specialist production line that will be dedicated to blackcurrants and other botanical products.

This state of the art plant incorporates Macroporous Resin Columns at the centre of the system. The plant will be capable of processing more than 1,000 mt of blackcurrants per annum while opening additional processing opportunities.

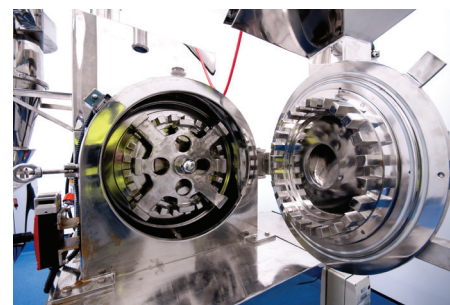
Another significant new initiative is the addition of a range of specialised finished products – consumer ready, retail packaged nutritional supplements.

While the Company continues to see itself as an ingredient supplier, it has become more and more apparent that product traceability and provenance for ingredient suppliers is a challenge in some markets.

Provenance being – knowing not only who you purchased your product from, but who manufactured it. Where it was manufactured and grown, along with traceability, are critical drivers of the global food and supplement industry.

While the issue is a global one, it is in fast developing economies such as China, where it is of greatest focus. In very simple terms, ingredients converted to finished products in market are treated on par with domestic raw material based products.

The New Zealand domestic nutraceutical market by contrast is dominated by New Zealand manufactured products made from imported ingredients. We therefore foresee a significant opportunity for a 100% New Zealand made and New Zealand sourced product range.



3 Directors' Report (Cont.)

This has resulted in the Company creating two unique product ranges, the first of which will be launched in June 2019 and branded AiOra™.

AiOra™ encompasses an extensive range of animal, marine and botanical ingredients targeting health issues ranging from digestive and cognitive function through to bone and joint health.



AiOra™ is our own range of premium, consumer ready supplements.

The second range, The 5th Quarter, will be launched late 2019. We are extremely pleased with the response to early sales presentations.



The 5th Quarter™ is our own range of glandular nutritional therapies.

It is important to note that these products will be available only in selected Asia Pacific markets. They will not be available in markets where we have significant existing presence such as North America.

The Company sees this as a long-term project and has very realistic expectations as to the rate of growth and is well aware of the required investment for success.

The current growth momentum makes for exciting times as there is no shortage of opportunities to pursue. The vastly improved resources, both capital and human combined with the jump in performance, allows us to accelerate and pursue said opportunities.

Most importantly the Company is starting to demonstrate with results the potential the Board and management have long understood.

The Board records its appreciation for the staff effort and commitment throughout the year and in particular, the contributions of our Chief Executive Officer, Craig McIntosh.

Message from the Chairman

I have indicated to the Board I will be retiring as Chairman and Director at the 2019 AGM. I have been Chairman since the Company floated in November 2001.

It is with great pride that I look back at what has been achieved across those 18 years, and the challenges surmounted along the way. From the closure of the Dunedin operations, through global financial crises, record exchange rates and of course devastating earthquakes, we have built a globally significant business with unparalleled capabilities in New Zealand.

The timing of my departure coincides not only with the most exciting times for the Company, but at a stage when the Company is best resourced with a strong and experienced Board and management team who will no doubt take the business to new levels.

I am immensely grateful for the support and efforts of my fellow Directors; past and present, as well as the dedication from management and staff.

M. G. Shepherd



3 Directors' Report (Cont.)

Principal Activity

The Company manufactures and sells advanced human and animal nutritional ingredients.

Dividend

No dividend was declared or paid during the period.

Directors' Interests

Directors' Remuneration

Remuneration and other benefits paid or due to the Directors of the Company and receivable during the year, were \$55,001 (2017:\$55,001).

Directors' Loans

There were no loans by the Company to Directors.

Share Dealing

The table below records the PharmaZen Limited ordinary shares in which each Director had a relevant interest as at 31 December 2018 and 31 December 2017.

Director	Number of Ordinary Shares Beneficial		Number of Ordinary Shares Non-Beneficial	
	2017	2018	2017	2018
Dr M G Shepherd	35,377,333	36,392,204	–	–
Dr W L Burt	29,299,190	32,000,000	–	–
Mr K W Fergus	8,308,000	9,000,000	6,042,710	6,756,996
Mr P W Dobbs	1,393,655	1,978,674	–	–

Substantial Security Holders

The Companies register of substantial security holders at 31 December 2018.

Name	Number of voting securities
Downie Stewart Trustee Limited – Rutherglen Account	36,092,204
Citibank Nominees New Zealand Limited	32,000,000
JB Were (NZ) Nominees Limited	20,556,000
Custodial Services Limited	19,114,068
Lee Patterson Family Trust Co. Limited	11,557,312

Employee Remuneration

Four employees received remuneration or benefits in excess of \$100,000 as follows:

\$100,001 – \$110,000	2 employees
\$120,001 – \$130,000	1 employee
\$290,001 – \$300,000	1 employee

4 Directors' Responsibility Statement

The Directors are pleased to present to shareholders the financial statements for PharmaZen Limited for the year ended 31 December 2018. The financial statements presented are signed for, and on behalf of the Board, authorised for issue on the date below.

The Directors are responsible for presenting financial statements in accordance with New Zealand law and generally accepted accounting practice, which materially reflect the financial position of the Company as at 31 December 2018 and the results of its operations and cash flows for the year ended on that date.

The Directors consider the financial statements of the Company have been prepared using accounting policies which have been consistently applied and supported by reasonable judgements and estimates and that all relevant financial reporting and accounting standards have been followed.

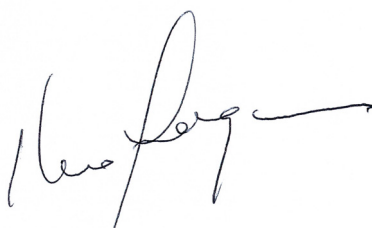
The Directors believe that proper accounting records have been kept which enable with reasonable accuracy, the determination of the financial position of the Company and facilitate compliance of the financial statements with the Financial Reporting Act 2013 and Financial Markets Conduct Act 2013.

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 financial statements.

The financial statements are signed on behalf of the Board by:



Director



Director

26 March 2019

5 Income Statement

	Notes	2018 \$	2017 \$
Revenue			
Sales	3a	12,572,559	7,304,115
Cost of sales		<u>7,561,492</u>	<u>4,987,492</u>
Gross profit		5,011,067	2,316,623
Other income	3b	30,678	101,534
Expenses			
Marketing		625,842	415,515
Occupancy		180,019	166,516
Administrative		695,388	556,176
Consultancy		66,297	200,087
Research and Development		228,740	209,238
Finance Costs	3c	215,772	203,475
Depreciation	11	734,122	591,691
Loss/(Gain) on disposal of property, plant and equipment		—	1,843
Insurance		324,408	272,604
Other		<u>179,586</u>	<u>152,821</u>
		<u>3,250,174</u>	<u>2,769,966</u>
Net Surplus/(Deficit) Before Taxation from Continuing Activities			
	3d	1,791,571	(351,809)
Taxation expense/(credit)	4a	<u>511,108</u>	<u>(66,105)</u>
Net surplus/(deficit) for the year		<u>1,280,463</u>	<u>(285,704)</u>
Earnings Per Share			
Basic (cents per share)	13	0.62	(0.18)
Diluted (cents per share)	13	0.62	(0.18)

Calculated on a weighted average basis of the number of shares outstanding.

6 Statement of Comprehensive Income

	Notes	2018 \$	2017 \$
Net surplus/(deficit) for the year		1,280,463	(285,704)
Total Comprehensive Income/(Loss)		1,280,463	(285,704)

7 Statement of Changes in Equity

	Notes	Fully paid ordinary shares	Treasury Stock	Retained Earnings	Total
		\$	\$	\$	\$
Balance at 1 January 2017		8,001,000	–	371,272	8,372,272
Net deficit for the year		–	–	(285,704)	(285,704)
Contributions of Equity net of Transaction Costs and Tax	13	2,438,134	–	–	2,438,134
Reductions in Equity including Transaction Costs and Tax		–	–	–	–
Other comprehensive income		–	–	–	–
Balance at 31 December 2017		10,439,134	–	85,568	10,524,702
Balance at 1 January 2018		10,439,134	–	85,568	10,524,702
Net surplus for the year		–	–	1,280,463	1,280,463
Contributions of Equity net of Transaction Costs and Tax	13	1,669,122	–	–	1,669,122
Reductions in Equity including Transaction Costs and Tax	13	–	(44,451)	–	(44,451)
Other comprehensive income		–	–	–	–
Balance at 31 December 2018		12,108,256	(44,451)	1,366,031	13,429,836

8 Balance Sheet

	Notes	2018 \$	2017 \$
Assets			
Cash and cash equivalents		229,813	770,148
Accounts receivable	7	2,027,286	1,626,453
Prepayments		321,628	256,345
Inventories	8	1,470,599	1,076,154
Current tax refundable	4c	–	32,923
Total current assets		4,049,326	3,762,023
Non-current assets			
Property, plant and equipment	11	19,110,532	16,508,209
Intangible assets	12	138,205	–
Total non-current assets		19,248,737	16,508,209
Total assets		23,298,063	20,270,232
Liabilities			
Current liabilities			
Bank overdraft	10	–	1,200,000
Accounts payable and accruals	9	1,328,358	1,213,972
Current tax liabilities	4c	168,599	–
Borrowings	10	852,733	1,647,533
Total current liabilities		2,349,690	4,061,505
Non-current liabilities			
Borrowings	10	6,928,950	5,228,640
Deferred tax liability	4d	589,587	455,385
Total non-current liabilities		7,518,537	5,684,025
Total liabilities		9,868,227	9,745,530
Owners Equity			
Share capital	13	12,108,256	10,439,134
Treasury stock	13	(44,451)	–
Retained earnings	14	1,366,031	85,568
Total equity		13,429,836	10,524,702
Total liabilities and Owners Equity		23,298,063	20,270,232

9 Cash Flow Statement

	Notes	2018 \$	2017 \$
Cash Flows from Operating Activities			
Cash was provided from (applied to):			
Receipts from customers		12,196,162	7,418,065
Interest received		1,080	866
Taxation refund received/(paid) – net		(175,384)	(80,652)
Payments to suppliers and employees		(10,153,133)	(6,692,455)
Payment of interest		(387,678)	(203,475)
Net cash inflow from operating activities	20	1,481,047	442,349
Cash Flows from Investing Activities			
Cash was provided from (applied to):			
Payment for property, plant and equipment		(3,213,357)	(4,095,947)
Payment for intangible assets		(138,205)	–
Net cash outflow applied to investing activities		(3,351,562)	(4,095,947)
Cash Flows from Financing Activities			
Cash was provided from (applied to):			
Proceeds from borrowings		1,538,115	2,853,830
Repayment of loans		(1,832,606)	(278,411)
Net proceeds from issues of shares	13	1,669,122	2,438,134
Shares repurchased	13	(44,451)	–
Net cash inflow from financing activities		1,330,180	5,013,553
Net increase/(decrease) in cash and cash equivalents		(540,335)	1,359,955
Cash and cash equivalents at the beginning of the year		770,148	(589,807)
Cash and short term deposits at the end of the year		229,813	770,148
Comprised of:			
Cash and short term deposits		229,813	770,148
Bank Overdraft		–	–
Net Cash		229,813	770,148

10 Notes to the Financial Statements

1) Summary of Accounting Policies

Reporting entity

PharmaZen Limited ("PharmaZen" or "Company") is a profit-oriented entity incorporated and domiciled in New Zealand.

The principal activity of the Company is formulating, manufacturing and marketing specialised animal and human health products based on immune protective bioactive components and other novel bioactive ingredients.

As an issuer, the Directors have determined that the Company is a FMC reporting entity.

These financial statements comply with the Financial Reporting Act 2013 and the Financial Markets Conduct Act 2013.

Statement of compliance

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand ("NZ GAAP"). For the purposes of complying with NZ GAAP, the Company is a for-profit entity. They comply with the New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable financial reporting standards as appropriate for profit-oriented entities.

The financial statements also comply with International Financial Reporting Standards ("IFRS").

Basis of preparation

The financial statements have been prepared on the basis of historical cost. Cost is based on the fair values of the consideration given in exchange for assets.

The financial statements have been prepared on the basis that the Company is a going concern (refer Note 2).

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

The financial statements are presented in New Zealand dollars.

Critical judgements and estimates in applying accounting policies

In the application of NZ IFRS, management is required to make judgements, estimates and assumptions about carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstance, the results of which form the basis of making the judgements. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements made by management in the application of NZ IFRS that have significant effects on the financial statements and estimates with a significant risk of material adjustments to the carrying amount of assets and liabilities in the next year are disclosed, where applicable, in the relevant notes to the financial statements. The key areas where judgement is required are:

- Revenue recognition (refer Note 3)
- Property, plant and equipment impairment

Summary of significant accounting policies

The principal accounting policies applied in the preparation and presentation of the financial statements are set out below. These policies have been consistently applied unless otherwise stated.

Property, plant and equipment

All items of property, plant and equipment are stated at cost less accumulated depreciation and impairment. Cost includes expenditure that is directly attributable to the acquisition of the item. In the event that settlement of all or part of a purchase is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of acquisition.

Depreciation is provided on property, plant and equipment, other than land.

Depreciation is calculated on a straight line basis so as to write off the net cost of the asset over its expected useful life to its estimated residual value. The following estimates of useful lives are used in the calculation of depreciation:

- Buildings 6 – 50 yrs
- Furniture, fixtures and fittings 1 – 15 yrs
- Motor vehicles 7 yrs
- Plant and machinery 2 – 44 yrs

Assets in the course of construction for use in the production or supply of goods, or administrative purposes are carried at cost, less any recognised impairment loss. Cost includes professional fees and for qualifying assets, borrowing costs capitalised in accordance with the Company's accounting policy. Such assets are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation of these assets, on the same basis as other assets, commences when the assets are ready for their intended use.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in profit or loss.

Impairment of assets

At each balance sheet date, the Company reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a

10 Notes to the Financial Statements (Cont.)

pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit or loss immediately.

Intangible assets

Intangible assets relate to expenditure on patents, trademarks and licenses that is expected to have an enduring benefit to the Company. Intangible assets are stated at their accumulated historical cost until such time as confirmation has been received that the patent, trademark or licence to which the expenditure relates has been approved. From that time the cost is amortised on a straight-line basis over the expected useful life of the asset for intangible assets with a finite useful life. For intangible assets with an indefinite useful life there is no amortisation of cost. Where an application is declined, and management decides not to take the matter further, the accumulated expenditure is expensed in the year that decision is taken. Management assesses all intangible assets for impairment on an annual basis and any necessary adjustments are made to carrying values.

Revenue recognition

Sale of Goods

PharmaZen sells human and animal and nutritional products to customers in Asia, Australia, Europe, New Zealand and the United States.

Revenue is recognised by the Company when it passes control of the goods, which occurs at the time a customer's order has

been fulfilled in all aspects, including the physical specifications (based on lab testing results), and it is invoiced. This represents the point in time at which the right to consideration becomes unconditional, as only the passage of time is required before payment is made.

Processing services

PharmaZen provides contract processing services to external customers in New Zealand. Revenue is recognised by the Company over time as these services are being performed. There are no other obligations to perform services under such contracts that will impact the revenue being recognised as services are performed.

Other income

Other income is recognised to the extent that it is probable that the economic benefits will flow to the Company and the income can be reliably measured, regardless of when the payment is received. Other income is measured at the fair value of the consideration received or receivable.

Grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the related costs, for which it is intended to compensate, are expensed. When the grant relates to an asset, it is recognised as income in equal amounts over the expected useful life of the related asset.

Interest revenue

Interest revenue is accrued on a time basis, by reference to the principal outstanding and the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of these assets, until such time as the assets are

substantially ready for their intended use or sale. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

Taxation

Current tax

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent it is unpaid (or refundable).

Deferred tax

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax bases of those items.

In principle, deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that sufficient taxable amounts will be available against which deductible temporary differences or unused tax losses and tax offsets can be utilised. However, deferred tax assets and liabilities are not recognised if the temporary differences giving rise to them arise from the initial recognition of assets and liabilities (other than as a result of a business combination) which affects neither taxable income nor accounting profit.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised based on tax rates that have been enacted or substantively enacted at reporting date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited to other comprehensive income or directly to equity, in which case the deferred tax is also dealt with in other comprehensive income or equity respectively.

Inventories

Inventories are valued at the lower of

10 Notes to the Financial Statements (Cont.)

cost and net realisable value. Costs, including an appropriate portion of fixed and variable overhead expenses, are assigned to inventory on hand on a first in, first out basis. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

Goods and Services Tax (GST)

All items in the balance sheet are stated exclusive of GST, with the exception of receivables and payables, which include GST. All items in the income statement are stated exclusive of GST.

Financial instruments

Financial assets and financial liabilities are recognised on the Company's balance sheet when the Company becomes a party to the contractual provisions of the instrument.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, demand deposits, other short-term highly liquid investments (with a maturity less than three months) that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Accounts receivable

Accounts receivable are measured at initial recognition at fair value and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in profit or loss at an amount equal to lifetime expected credit losses.

Expected credit losses on these financial assets are estimated using a provision matrix based on the Company's historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date, including time value of money where appropriate.

Equity instruments

Equity instruments issued by the Company are recorded as the proceeds received net of direct issue costs. Direct issue costs include registration and

other regulatory fees, amounts paid to legal, accounting and other professional advisers and printing and distribution costs.

Accounts payable

Trade payables and other accounts payable are recognised when the Company becomes obliged to make future payments resulting from the purchase of goods and services.

Borrowings

Borrowings are initially recorded at fair value, plus transaction costs and subsequently at amortised cost using the effective interest rate method.

Employee benefits

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

Provision made in respect of employee benefits expected to be settled within 12 months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within 12 months are measured at the present value of the estimated future cash outflows to be made by the Company in respect of services provided by employees up to reporting date.

Financial assets

The Company's financial assets held in order to collect contractual cash flows that are solely payments of principal and interest on the principal outstanding are measured at amortised cost. Cash and cash equivalents and accounts receivable are classified in this category.

The Company recognises a loss allowance for lifetime expected credit losses ("ECL") on accounts receivable (see Note 21(g)). For all other financial instruments, the Company recognises lifetime ECL when there has been a significant increase in credit risk since initial recognition. However, if the credit risk on the financial instrument has not increased significantly since initial recognition, the Company

measures the loss allowance for that financial instrument at an amount equal to 12-month ECL.

For financial assets, the expected credit loss is estimated as the difference between all contractual cash flows that are due to the Company in accordance with the contract and all the cash flows that the Company expects to receive, discounted at the original effective interest rate.

Foreign currency transactions

All foreign currency transactions during the financial year are brought to account using the exchange rate in effect at the date of the transaction. Foreign currency monetary items at reporting date are translated at the exchange rate existing at reporting date.

Exchange differences are recognised in profit or loss in the period in which they arise.

Leased asset

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Entity as lessee

Operating lease payments are recognised as an expense on a straight line basis over the lease term, except where another systematic basis is more representative of the time pattern in which the economic benefits from the leased asset are consumed.

Cash flow statement

The cash flow statement is prepared exclusive of GST, which is consistent with the method used in the income statement.

Definition of terms used in the cash flow statement

Operating activities include all transactions and other events that are not investing or financing activities.

Investing activities are those activities relating to the acquisition and disposal of current and non-current investments and any other non-current assets.

10 Notes to the Financial Statements (Cont.)

Financing activities are those activities relating to changes in the equity and debt capital structure of the Company and those activities relating to the cost of servicing the Company's equity.

Adoption of new revised standards and interpretation

Standards and interpretations effective in current year

Application of NZ IFRS 9 (2014) Financial Instruments

Following the application of NZ IFRS 9 (2014), Financial Instruments which became effective on 1 January 2018; the impairment of financial assets has transitioned to an expected credit loss model, as opposed to an incurred credit loss model under NZ IAS 39. The expected credit loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

Impairment

Financial assets measured at amortised cost being cash and cash equivalents, trade receivables and employee loans are subject to the impairment provisions of NZ IFRS 9 (2014).

PharmaZen applies the simplified approach to recognise lifetime expected credit losses for the above financial assets as required or permitted by NZ IFRS 9 (2014). In general, the application of the expected credit loss model of NZ IFRS 9 (2014) results in earlier recognition of credit losses and increases the amount of loss allowance recognised for those items. There has been no material impact as a result of adopting this approach.

Application of NZ IFRS 15 Revenue from Contracts from Customers

Revenue is measured based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. PharmaZen recognises revenue when it transfers control of a product or service to a customer. PharmaZen has applied the

modified approach on transitioning to NZ IFRS 15 and has applied the standard on initial application beginning 1 January 2018. There has been no material impact as a result of adopting this standard.

Standards and interpretations effective in issue not yet adopted

The Company has not applied the following new and revised NZ IFRS that have been issued but are not yet effective:

- NZ IFRS 16 Leases – effective 1 January 2019.

Other standards, interpretations and amendments on issue but not yet effective, are not expected to have a material impact on the Company.

NZ IFRS 16 leases

NZ IFRS 16 will supersede the current lease guidance including NZ IAS 17 Leases and the related interpretations when it becomes effective for PharmaZen in the 2019 financial year.

NZ IFRS 16 distinguishes leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions of operating leases (off balance sheet) and finance leases (on balance sheet) are removed for lessee accounting and is replaced by a model where a right-of-use asset and a corresponding liability have to be recognised for all leases by lessees (i.e. all on balance sheet), except for short-term leases and leases of low value assets.

The right-of-use asset is initially measured at cost and subsequently measured at cost (subject to certain exceptions), less accumulated depreciation and impairment losses, adjusted for any remeasurement of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at that date. Subsequently, the lease liability is adjusted for interest and lease payments, as well as the impact of lease modifications.

Furthermore, the classification of cash flows will also be affected as operating lease payments under NZ IAS 17 are presented as operating cash flows; whereas under the NZ IFRS 16 model, the lease payments will be split into a principal and an interest portion which

will be presented as financing and operating cash flows respectively.

The new requirement to recognise a right-of-use asset and a related lease liability is expected to have a significant impact on the amount recognised in the financial statements and the Directors are currently assessing its potential impact. It is not practicable to provide a reasonable estimate of the financial effect until the Directors complete their review. (Refer Note 16 for existing lease commitments).

2) Going Concern

After reviewing internal management financial reports and budgets, the Directors believe the Company will continue to be a going concern in the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

10 Notes to the Financial Statements (Cont.)

3) Surplus from Operations

	2018 \$	2017 \$
(a) Revenue		
Trading revenue consisted of the following items:		
Sales of goods and services	12,572,559	7,304,115
	12,572,559	7,304,115

Judgement – Sale of goods

The Company concluded that control of the goods passes to the customer upon invoicing at the point the customer's order requirements including detailed product specification have been fully complied. At that point in time the Company concluded that the customer is considered to have accepted the goods and that the actual acceptance of the customer is a formality that would not affect the Company's determination of when the customer has obtained control of the goods.

Judgement – Processing Services

The Company concluded that the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date. The Company determined that the output method is the best method in measuring progress of the processing services (based on the quantity of goods processed), because there is a direct relationship between the Company's effort and the transfer of service to the customer.

(b) Other income

Other income from operations consisted of the following items:

Grants received	23,677	94,330
Interest	1,080	866
Miscellaneous income	5,921	6,338
	30,678	101,534

(c) Finance costs

Interest on borrowings	387,678	362,240
Less capitalised interest	(171,906)	(158,765)
	215,772	203,475

Interest costs that are directly attributable to the acquisition of property, plant and equipment have been capitalised at an average interest rate of 4.76% (2017:4.72%).

(d) Other expense disclosures

Net surplus before taxation includes the following specific expenses:

Directors' fees	55,001	55,001
Operating lease	204,836	190,496
Inventory written off	2,998	2,393
Employee benefits expensed	2,015,933	1,676,241
KiwiSaver employer contributions	53,407	41,686

10 Notes to the Financial Statements (Cont.)

4) Income Taxes

(a) Income tax recognised in profit or loss

The prima facie income tax expense on pre-tax accounting profit reconciles to the income tax expense in the financial statements as follows:

	2018 \$	2017 \$
Surplus/(Deficit) before taxation	1,791,571	(351,809)
Income tax expense calculated at 28% (2017 : 28%)	501,639	(98,506)
Non-deductible expenses	30,361	33,321
Prior period adjustments	(15,641)	4
Other	(5,251)	(924)
Tax expense	<u>511,108</u>	<u>(66,105)</u>
Recognised as:		
Current tax	376,906	4
Deferred tax	<u>134,202</u>	<u>(66,109)</u>
	<u>511,108</u>	<u>(66,105)</u>

(b) Income tax recognised in other comprehensive income or directly in equity

There was no current or deferred tax charged/(credited) directly to other comprehensive income or equity during the period.

(c) Current tax assets and liabilities

	2018 \$	2017 \$
Current tax assets:		
Income tax refundable – current year	–	81,076
Income tax payable – prior years	<u>–</u>	<u>(48,153)</u>
	<u>–</u>	<u>32,923</u>
Current tax liabilities:		
Income tax payable – current year	<u>168,599</u>	<u>–</u>
	<u>168,599</u>	<u>–</u>

10 Notes to the Financial Statements (Cont.)

(d) Deferred tax balances

Deferred tax assets/(liabilities) arise from the following:

2018	Opening Balance \$	Charged to Income \$	Closing Balance \$
Property, plant and equipment	(606,161)	(66,125)	(672,286)
Losses carried forward	97,719	(97,719)	–
Employee entitlements	51,459	12,191	63,650
Provisions	1,598	17,451	19,049
	<u>(455,385)</u>	<u>(134,202)</u>	<u>(589,587)</u>
2017	Opening Balance \$	Charged to Income \$	Closing Balance \$
Property, plant and equipment	(561,773)	(44,388)	(606,161)
Losses carried forward	–	97,719	97,719
Employee entitlements	38,490	12,969	51,459
Provisions	1,789	(191)	1,598
	<u>(521,494)</u>	<u>66,109</u>	<u>(455,385)</u>

A deferred tax asset has been recognised on losses incurred in the year ended 31 December 2017 on the basis that it is probable that sufficient taxable profit will be derived in future years against which the unused tax losses could be utilised.

(e) Imputation credit account balances	2018 \$	2017 \$
Balance at beginning of the year	1,037,189	957,569
Income tax paid	144,638	81,076
Income tax payable – current year	168,598	–
Income tax payable – prior year	–	–
Other adjustments	–	(1,456)
	<u>1,350,425</u>	<u>1,037,189</u>

10 Notes to the Financial Statements (Cont.)

5) Remuneration of Auditors

	2018 \$	2017 \$
Audit of the financial statements	30,600	27,000
Other advisory services	–	3,000
	<u>30,600</u>	<u>30,000</u>

6) Key Management Personnel Compensation

	2018 \$	2017 \$
Short-term employee benefits	306,800	251,352
Directors' fees	55,001	55,001
	<u>361,801</u>	<u>306,353</u>

There were no long term benefits, post employment benefits, termination benefits or share based payments.

Key management personnel include Chief Operating Officer and the Board of Directors.

7) Accounts Receivable

	2018 \$	2017 \$
Trade receivables (i)	1,933,398	1,529,755
Other receivables	2,353	–
Goods and Services Tax (GST) receivable	91,535	96,698
	<u>2,027,286</u>	<u>1,626,453</u>

(i) The average credit period on sales of goods is 30 days from delivery. There are balances totalling \$221,447 included in the Company's accounts receivable balance for debtors which are past due at the reporting date for which the Company has not provided as there has not been a significant change in credit quality and the Company believes that the amounts are still recoverable based on past experience (2017:\$189,645).

The average age of these receivables at 31 December 2018 is 45 days (2017:70 days). There are no receivables that would otherwise have been past due or impaired whose terms have been re-negotiated. There was no allowance account for expected credit losses during the period as none was considered necessary (2017:\$Nil).

8) Inventories

	2018 \$	2017 \$
Raw materials	687,849	428,986
Work in progress	268,623	183,042
Finished goods	514,127	464,126
	<u>1,470,599</u>	<u>1,076,154</u>

10 Notes to the Financial Statements (Cont.)

9) Accounts Payable and Accruals

	2018 \$	2017 \$
Accounts payable	719,791	693,755
Other payables and accruals	241,227	197,348
Employee entitlements	351,937	315,028
Revenue in advance	15,403	7,841
Total accounts payable	1,328,358	1,213,972

10) Borrowings

	2018 \$	2017 \$
Total borrowings at beginning of period	8,076,173	5,500,754
Proceeds from borrowings during the year	1,538,116	2,853,830
Loans repaid during the year	(1,832,606)	(278,411)
Total borrowings at end of period	7,781,683	8,076,173

Borrowing repayable within one year At amortised cost

Bank overdraft	–	1,200,000
Secured borrowings	308,163	1,002,140
Secured export trade finance	544,570	645,393
	852,733	2,847,533

Borrowing repayable after one year At amortised cost

Secured borrowings	6,928,950	5,228,640
	6,928,950	5,228,640

The secured borrowings mature between 11 October 2019 and 18 November 2021, bear interest at a weighted average rate of 4.76% (2017:4.72%) and are secured by a mortgage over the Company's land and buildings at Port Hills Road and Nuttall Drive, Christchurch and all present and after acquired property.

The Company entered into an Export Trade Finance facility on 4 June 2015. This is a revolving credit facility allowing the Company to fund up to \$1,200,000 of its total debt in foreign currencies where favourable interest rates are available. The weighted average interest rate applying to this facility at 31 December 2018 is 3.86% (2017:2.83%) The debt is matched to specific sales invoices providing an economic hedge against currency movements and is secured by a mortgage over the Company's land and buildings at Port Hills Road and Nuttall Drive, Christchurch and all present and after acquired property. Repayments under this facility are due at the earlier of the due date for the sales invoice plus 14 days, or 90 days from drawdown.

Cash flow movements relating to this facility have been included on a net basis within the Cash Flow Statement.

Letters of Credit

The Company has a Letter of Credit facility securing the payment of wages and salaries to a maximum of \$55,000 per pay period (2017:\$55,000).

Other Borrowings

The Company has a bank overdraft facility with BNZ with a limit of \$750,000 (2017:\$1,950,000). At balance date the Company had not drawn down on that facility (2017:\$1,200,000). Cash and cash equivalents are entitled to be set off against the bank overdraft as required.

All overdraft facilities drawn down as at 31 December 2017 related to the development of property, plant and equipment and thus were considered as part of total borrowings at that date.

The Company operates credit card accounts, mainly for travelling expenses, with a combined credit limit of \$59,500.

10 Notes to the Financial Statements (Cont.)

11) Property, Plant and Equipment

2018	1 Jan. 2018	Cost	Additions	Transfers from work in progress	Disposals	Cost	Accumulated depreciation	Depreciation expense	Accumulated depreciation reversed on disposal	Accumulated depreciation	Book value
	\$	\$	\$	\$	\$	31 Dec. 2018	1 Jan. 2018	\$	\$	31 Dec. 2018	31 Dec. 2018
Land	1,911,004	-	-	-	-	1,911,004	-	-	-	-	1,911,004
Buildings	4,593,662	776,512	-	3,015,842	-	8,386,016	(588,682)	(171,885)	-	(760,567)	7,625,449
Plant and machinery	8,769,408	1,375,151	-	2,365,040	-	12,509,599	(3,615,690)	(549,003)	-	(4,164,693)	8,344,906
Motor vehicles	7,817	-	-	-	-	7,817	(1,383)	(1,118)	-	(2,501)	5,316
Furniture, fixtures, fittings	144,440	21,227	-	-	-	165,667	(114,457)	(12,116)	-	(126,573)	39,094
Construction in progress	5,402,090	1,163,555	-	(5,380,882)	-	1,184,763	-	-	-	-	1,184,763
Total property, plant and equipment	20,828,421	3,336,445	-	-	-	24,164,866	(4,320,212)	(734,122)	-	(5,054,334)	19,110,532
2017	1 Jan. 2017	Cost	Additions	Transfers from work in progress	Disposals	Cost	Accumulated depreciation	Depreciation expense	Accumulated depreciation reversed on disposal	Accumulated depreciation	Book value
	\$	\$	\$	\$	\$	31 Dec. 2017	1 Jan. 2017	\$	\$	31 Dec. 2017	31 Dec. 2017
Land	1,911,004	-	-	-	-	1,911,004	-	-	-	-	1,911,004
Buildings	4,038,152	-	-	555,510	-	4,593,662	(470,919)	(117,763)	-	(588,682)	4,004,980
Plant and machinery	7,671,547	250,578	-	856,723	(9,440)	8,769,408	(3,160,271)	(464,610)	9,191	(3,615,690)	5,153,718
Motor vehicles	5,652	2,165	-	-	-	7,817	(471)	(912)	-	(1,383)	6,434
Furniture, fixtures, fittings	283,299	17,916	-	-	(156,775)	144,440	(261,232)	(8,406)	155,181	(114,457)	29,983
Construction in progress	2,928,647	3,885,676	-	(1,412,233)	-	5,402,090	-	-	-	-	5,402,090
Total property, plant and equipment	16,838,301	4,156,335	-	(166,215)	(166,215)	20,828,421	(3,892,893)	(591,691)	164,372	(4,320,212)	16,508,209

No impairment losses were recorded in 2018 or 2017.

10 Notes to the Financial Statements (Cont.)

12) Intangible Assets

Patents and Licences. At 31 December 2018 all such expenditure incurred related to projects that were still in progress at that date. Management is reasonably certain that all projects will receive appropriate approval and future economic benefits will be generated and flow to the Company.

Cost	Progress costs for Patents with finite useful life \$	Progress costs for Trademarks and Licences \$	Total \$
Balance at beginning of the year	–	–	–
Additions – internally developed	5,285	132,920	138,205
Balance at end of the year	5,285	132,920	138,205
Amortisation and impairment			
Balance at beginning of the year	–	–	–
Amortisation	–	–	–
Impairment	–	–	–
Balance at end of the year	–	–	–

13) Share Capital

	2018 No. of Shares	2018 \$	2017 No. of Shares	2017 \$
Balance at beginning of the year	195,422,324	10,439,134	160,000,000	8,001,000
Contributions of Equity net of Transaction Costs and Tax	23,939,711	1,669,122	35,422,324	2,438,134
Shares Repurchased	(592,691)	(44,451)	–	–
Balance at end of the year	218,769,344	12,063,805	195,422,324	10,439,134

All shares are fully paid ordinary shares and carry equal voting rights. All shares participate equally in any dividend.

During the year ended 31 December 2018 the Company issued a further 23,939,711 shares at an average of \$0.07 per share. There were no additional costs incurred in raising this new capital. In December 2017, the Company issued 35,422,324 shares at \$0.07 per share with associated costs of \$41,429.

The Company also repurchased a total of 592,691 shares from minority shareholders during the year at an average of \$0.075 per share. This was part of a programme to rationalise the Company's shareholding structure.

	2018 Cents/Share	2017 Cents/Share
Basic and diluted earnings per share	0.62	(0.18)

The earnings and weighted average number of ordinary shares used in the calculation of basic and diluted earnings per share are as follows:

	2018 \$	2017 \$
Net surplus/(deficit) after tax	1,280,463	(285,704)
Weighted average number of ordinary shares for the purposes of basic and diluted earnings per share:	207,281,147	160,000,000

The shares issued in December 2017 (35,422,324), were not taken into account in calculating the basic or diluted earnings per share for the year ended 31 December 2017, as those share issues had almost no impact on the Company's earnings for that year.

10 Notes to the Financial Statements (Cont.)

14) Retained Earnings

	2018 \$	2017 \$
Balance at beginning of the year	85,568	371,272
Total comprehensive income/(loss) for the year	1,280,463	(285,704)
	<u>1,366,031</u>	<u>85,568</u>

15) Related Party Transactions

There were no related parties, including Directors, that have a significant influence which provided and or received services and or supplies to or from the Company during the period, other than the Directors' remuneration and other key management personnel compensation set out in Note 6.

16) Commitments for Expenditure

(a) Capital expenditure commitments

The Company has committed to construction contracts as part of its programme for broadening and expanding its production capacity. The expenditure committed to, but not yet incurred, as at 31 December 2018 is \$20,000 (2017: \$250,000).

(b) Operating lease commitments

The Company leases office and production premises, a motor vehicle and office equipment in the normal course of business. There were no restrictions imposed by lease arrangements for those assets. There are no sub-lease payments expected to be received at the end of the reporting period.

	2018 \$	2017 \$
Not later than one year	170,325	149,985
Later than one year but not later than two years	146,932	146,932
Later than two years but not later than five years	54,897	199,117
Later than five years	–	2,712
	<u>372,154</u>	<u>498,746</u>

17) Contingent Assets and Liabilities

There are no contingent liabilities as at 31 December 2018 (2017: \$Nil).

18) Subsequent Events

There have been no material events requiring reporting since balance date.

10 Notes to the Financial Statements (Cont.)

19) Segment Information

Products and services from which reportable segments derive their revenues.

The Company operates in one industry, being the manufacture and sale of advanced human and animal nutritional ingredients from New Zealand. Raw materials may be of animal, marine or, increasingly, plant origin but the manufacturing process is largely the same with the same plant and equipment being used irrespective of the origin of the raw materials.

The regulatory environment for the Company's products varies in different markets. The Company generally manufactures to specifications and standards that meet the most stringent regulations in order to obtain the greatest flexibility in terms of the market for the product. Although the Company sells to overseas markets in Europe, Asia, United States, Australia and Japan, as well as to the domestic market, no geographical or product information is available and the cost to develop this is excessive. Marketing initiatives target the global market without specific focus on location.

Segment revenues and results

As there is only one reportable segment for the Company the segment profit or loss represents profit or loss earned for the Company after all costs including administration costs, Directors' salaries, investment revenue, finance costs and income tax expenses. This is the measure reported to the chief operating decision maker for the purpose of resource allocation and assessment of segment performance.

Information about major customers

Included in total revenue are revenues which arose from sales to the Company's largest customers as follows;

31 December 2018

There were four customers that individually comprised 10 per cent or more of the total revenue with total sales of \$6,815,667.

31 December 2017

There was one customer that comprised 10 per cent or more of the total revenue with sales of \$1,275,037.

10 Notes to the Financial Statements (Cont.)

20) Notes to the Cash Flow Statement

	2018 \$	2017 \$
Reconciliation of net surplus/(deficit) after taxation with net cash flows from operating activities		
Net surplus/(deficit) for the year	1,280,463	(285,704)
Adjustments for non-cash items:		
Loss (Gain) on disposal of property, plant and equipment	–	1,843
Depreciation on property, plant and equipment	734,122	591,691
Movement in deferred taxation	134,202	(66,109)
	868,324	527,425
Items classified as investing activities:		
Interest capitalised	(171,906)	–
Movements in working capital:		
Accounts receivable and prepayments	(466,114)	151
Inventories	(394,445)	(92,496)
Employee entitlements	36,909	60,108
Current tax payable (refundable)	201,522	(80,652)
Accounts payable and accruals	175,112	373,902
Movements related to capital expenditure financing	(48,818)	(60,385)
	(495,834)	200,628
Net cash inflow (outflow) from operating activities:	1,481,047	442,349

21) Financial Instruments

All of the Company's financial assets are measured at amortised cost.

All of the Company's financial liabilities are measured at amortised cost.

(a) Financial risk management objectives

Exposure to credit, interest rate, foreign currency and liquidity risks arises in the normal course of the Company's business. The Company will from time to time enter into derivative financial instruments to economically hedge an exposure to foreign currency risk. The use of derivatives is governed/overseen by the Directors.

The Company does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes. Specific risk management objectives and policies are set out below.

(b) Capital risk management

The Company manages its capital to ensure that the Company will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Company consists of debt (Note 10), cash, cash equivalents and equity; comprising issued capital and retained earnings as disclosed in Notes 13 and 14 respectively.

10 Notes to the Financial Statements (Cont.)

The Company's Board of Directors reviews the capital structure on a regular basis.

The Company is in compliance with all externally imposed capital requirements in the form of covenant requirements on external borrowings. These covenants relate to tangible asset ratios and earnings before interest and tax cover ratios.

The Company's overall strategy remains unchanged from 2017.

(c) Market risk

Market risk is the potential for change in the value of balance sheet positions caused by a change in the value, volatility or relationship between market risks and prices. Market risk arises from the mismatch between assets and liabilities. The Company's activities expose it primarily to market risk associated with changes in foreign currency rates and interest rates as set out below. The mechanisms to manage these risks are set out below. There have been no changes during the year to the Company's exposure to risk or the manner in which the risks are measured and managed.

(d) Interest rate risk

The Company is exposed to interest rate risk as from time to time it borrows funds at floating interest rates and also invests cash in short term deposits at fixed interest rates.

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. Investments at fixed interest rates expose the Company to fair value interest rate risk. The Company does not hedge this risk.

Cash flow interest rate risk is the risk that the cash flows from a financial instrument will fluctuate because of changes in market interest rates. Borrowings issued at variable interest rates expose the Company to cash flow interest rate risk. The Company does not hedge this risk.

The Company's exposure to interest rates on financial assets and financial liabilities is detailed in the liquidity risk management section of this note.

(e) Foreign exchange risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

In the course of normal trading activities, the Company undertakes transactions denominated in foreign currencies, hence exposures to exchange rate fluctuations arise.

There were no foreign currency hedge instruments in place for this purpose at 31 December 2018 (2017: \$Nil) however, the Export Trade Finance facility referred to in Note 10 provides a partial economic hedge against currency movements for the specific sales to which the facility relates.

The carrying amount of the Company's foreign currency denominated monetary assets and monetary liabilities at the balance date are as follows:

	Liabilities		Assets	
	2018	2017	2018	2017
	\$	\$	\$	\$
Euro	149,006	281,356	358,571	514,625
United States Dollar	395,564	339,437	1,199,341	792,328
Australian Dollar	–	–	–	35,906
Japanese Yen	–	–	94,832	50,604

The table expresses the foreign currency amounts in New Zealand dollar equivalents using the exchange rate at 31 December 2018 and 31 December 2017.

10 Notes to the Financial Statements (Cont.)

(f) Other price risk

The Company is not exposed to substantial other price risk arising from financial instruments.

(g) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Company. Financial instruments which potentially subject the Company to credit risk principally consist of bank balances and accounts receivable. The Company has adopted a policy which is used to manage this exposure to credit risk. As part of this policy, limits on exposures with counterparties are monitored on a regular basis.

The Company does not have any significant credit risk exposure to any single counterparty or group of counterparties having similar characteristics, except that all cash deposit balances are held with the BNZ, and that in 2018 the Company's four largest customers accounted for 52% of total revenue (2017: 40%) and 59% of total accounts receivable (2017:50%).

The maximum exposures to credit risk at balance date are:

	2018 \$	2017 \$
Cash and short term deposits	229,813	770,148
Accounts receivable	2,027,286	1,626,453
	<u>2,257,099</u>	<u>2,396,601</u>

In assessing the Company's exposure to credit risk it has applied the NZ IFRS 9 simplified approach to measuring expected credit losses. This requires an assessment of the risk characteristics applying to all trade receivables and where applicable, grouping them based on those characteristics and the days past due.

The nature of the Company's business, the markets in which it operates and its credit policies means that credit losses are irregular, however, could be significant if they occur. For that reason the Company carries insurance against credit losses in its export markets.

Based on past experience and consideration of the macro economic conditions in the markets in which it operates, the Company has assessed the probability of default at 0.005% of overdue trade receivables. The loss given default for customers located within New Zealand is calculated at 100% of the exposure at default. For export customers the loss given default is 15% of the exposure at default with the other 85% being covered by insurance.

	Total	New Zealand		Export	
		Current	Overdue	Current	Overdue
Expected Loss Rate %		0%	0.00500%	0%	0.00075%
Trade receivables as at 31 December 2018	\$1,933,398	\$303,869	\$2,895	\$1,409,008	\$217,626
Loss allowance	2	0	0	0	2

10 Notes to the Financial Statements (Cont.)

(h) Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Board of Directors, who have built an appropriate liquidity risk management framework for the management of the Company's short, medium and long-term funding and liquidity management requirements. The Company manages liquidity risk by maintaining adequate reserves, banking facilities and reserve borrowing facilities, by monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities using interest rates applying at year end.

The maturity profiles of the Company's interest bearing investments and borrowings are disclosed later in this note.

Liquidity and interest risk tables

The following tables detail the Company's remaining contractual maturity for its non-derivative financial assets and financial liabilities. The tables have been drawn up based on the undiscounted contractual maturities of the financial assets and financial liabilities including interest that will accrue to those assets or liabilities.

2018	Weighted Average Effective Interest Rate %	Less than 1 Year \$	1-2 Years \$	3-5 Years \$	Later than 5 years \$	Total \$
Financial assets:						
Cash and short term deposits	–	229,813	–	–	–	229,813
Accounts receivable	–	1,935,752	–	–	–	1,935,752
Financial liabilities:						
Accounts payable	–	976,422	–	–	–	976,422
Secured borrowings (including interest)	4.74%	641,527	750,705	2,898,058	4,375,563	8,665,853
Secured export trade finance	3.86%	544,570	–	–	–	544,570
2017	Weighted Average Effective Interest Rate %	Less than 1 Year \$	1-2 Years \$	3-5 Years \$	Later than 5 years \$	Total \$
Financial assets:						
Cash and short term deposits	–	770,148	–	–	–	770,148
Accounts receivable	–	1,529,755	–	–	–	1,529,755
Financial liabilities:						
Bank overdraft	5.50%	1,200,000	–	–	–	1,200,000
Accounts payable	–	898,940	–	–	–	898,940
Secured borrowings (including interest)	4.72%	1,271,865	1,006,910	4,776,461	–	7,055,236
Secured export trade finance	2.83%	645,393	–	–	–	645,393

10 Notes to the Financial Statements (Cont.)

(i) Sensitivity

The Company is exposed to foreign currency risk arising from transactions denominated in currencies other than the Company's functional currency, arising from normal trading activities.

The majority of foreign currency related exposure relates to accounts receivable, mitigated for some foreign receivables by amounts owing under the Export Trade Finance facility. For any foreign receivables financed by the Export Trade Finance facility any unfavourable movements in foreign exchange rates will be offset by a favourable movement in amounts repayable under that facility. The Company is mainly exposed to the Euro, United States Dollar, Japanese Yen and Australian Dollar.

The exchange rates adopted in converting foreign currency denominated assets and liabilities at 31 December 2018 were as follows:

	2018	2017
Euro	0.5900	0.5900
United States Dollar	0.6800	0.7100
Australian Dollar	0.9400	0.9000
Japanese Yen	76.0000	78.0000

Foreign currency exchange rate sensitivity is calculated at balance date assuming that the bank balances and accounts receivable balances denominated in foreign currencies had been converted to New Zealand dollars at rates above or below those adopted as set out above.

If exchange rates had been 10% higher/lower at balance date and all other variables held constant, the Company's:

- Net profit after tax for the 2018 year would decrease/increase by \$79,788 (2017: Loss increase/decrease by \$55,632);
- Equity for the 2018 year would decrease/increase by \$79,788 (2017: Equity decrease/increase by \$55,632).

The Company is exposed to interest rate risk arising from unhedged floating rate liabilities at balance date. The sensitivity analysis below has been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the reporting date. For floating rate liabilities, the analysis is prepared assuming the amount of liability outstanding at reporting date was outstanding for the whole year. A 1% increase or decrease is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates. Impact on net profit after tax, and equity, assumes that none of the floating interest rate borrowings were hedged.

	2018		2017	
	1%	-1%	1%	-1%
Impact on net profit after tax, and equity	-56,029	56,029	-58,149	58,149

(j) Fair Value of Financial Instruments

The Directors consider that the carrying amount of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values.

11 Statement of Corporate Governance

For the Year Ended 31 December 2018

The Directors are responsible for the Corporate Governance of the Company. The Corporate Governance processes set out in this statement outline the governance policies and practices followed by the Company.

Financial statements

The Directors are responsible for ensuring the financial statements materially reflect the financial position of the Company as at 31 December 2018 and its financial performance and cash flows for the year ended on that date. The external auditors are responsible for expressing an opinion on the financial statements, based on their assessment of the conclusions drawn from evidence obtained during the course of the audit.

The Directors consider that the financial statements of the Company have been prepared using appropriate accounting policies, consistently applied and supported by reasonable judgements and estimates and that all relevant financial reporting and accounting standards have been followed.

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 financial statements with the Financial Reporting Act 1993 and the Financial Markets Conduct Act 2013.

After reviewing internal management financial reports and budgets, the Directors believe that the Company will continue to be a going concern in the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Board of Directors

The Board of Directors of PharmaZen Limited is elected by the shareholders to supervise the management of the Company. The Board establishes the Company's objectives, strategies for achieving these objectives, the overall policy framework within which the business of the Company is conducted, monitors management's performance and ensures that procedures are in place to provide effective internal financial control. The day-to-day management responsibilities of the Company have been delegated to the Chief Executive Officer.

The Directors have a diverse range of expertise and experience, and are committed to use this to benefit the Company.

The primary responsibilities of the board include:

- The approval of the annual financial report;
- The establishment of the long term goals of the Company and strategic plans to achieve those goals;
- Succession planning for the Chief Executive Officer and the Board;
- The review and adoption of annual budgets for the financial performance of the Company and monitoring the results on a regular basis;
- Monitoring environmental, social and economical performance;

- Ensuring that the Company has implemented adequate systems of internal controls including internal financial controls together with appropriate monitoring of compliance activities;
- Ensuring legislative compliance;
- Monitoring executive management;
- Communicating with stakeholders.

Board membership

The Board currently comprises four non-executive Directors including the Chairman. Four formal Board meetings and monthly operational meetings were held during the financial year.

Code of conduct

As part of the Board's commitment to the highest standard of conduct, the Company adopts a code of conduct as part of a Directors' Operations Manual to guide Directors and management in carrying out their duties and responsibilities.

The Directors' Operations Manual covers such matters as:

- Corporate governance matters;
- Role of the Board and composition of the Board;
- Director responsibilities;
- Appointment of, responsibilities of and remuneration of a Chief Executive Officer;
- Confidentiality and the safeguarding of Company information;
- Compliance with laws and regulations;
- Shareholder participation.

Newly elected Directors are required to familiarise themselves with and comply with the Directors' Operations Manual.

Training is also provided to new and existing Directors, where this is required, to enable Directors to fulfil their responsibilities.

Conflicts of interest

All Directors must disclose any specific and general interests which could be in conflict with their obligations to PharmaZen Limited.

Sub committees

Given the size of the Board, there are no sub committees. Rather, the full Board is involved in the Director nomination process, liaison with the Company's external auditors and other corporate financial matters.

The Directors' Operations Manual sets out a written charter in relation to:

- Appointment of external auditors;
- Monitoring the external audit of the Company's affairs;
- Reviewing the annual financial statements;
- Reviewing the Company's internal controls and systems.

The Board receives reports from the external auditors concerning any matters which arise in connection with the performance of their role. The full Board also monitors the independence of the external auditors and reviews and approves any services provided by the auditors other than in their statutory role.



Independent Auditor's Report

To the Shareholders of PharmaZen Limited

Opinion

We have audited the financial statements of PharmaZen Limited (the 'Company'), which comprise the balance sheet as at 31 December 2018, and the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements, on pages 8 to 29, present fairly, in all material respects, the financial position of the Company as at date, and its financial performance and cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS').

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing ('ISAs') and International Standards on Auditing (New Zealand) ('ISAs (NZ)'). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

We are independent of the Company in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Other than in our capacity as auditor, we have no relationship with or interests in the Company, except that partners and employees of our firm deal with the Company on normal terms within the ordinary course of trading activities of the business of the Company.

Audit materiality

We consider materiality primarily in terms of the magnitude of misstatement in the financial statements of the Company that in our judgement would make it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced (the 'quantitative' materiality). In addition, we also assess whether other matters that come to our attention during the audit would in our judgement change or influence the decisions of such a person (the 'qualitative' materiality). We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

We determined materiality for the Company's financial statements as a whole to be \$320,000.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Adoption of NZ IFRS 15 *Revenue from Contracts with Customers*

How our audit addressed the key audit matter

In the year ended 31 December 2018 the Company has adopted NZ IFRS 15 *Revenue from Contracts with Customers*. The standard was applied using the modified retrospective basis. The Company has noted that there were no material changes arising from the comparative period.

Note 1 *Summary of Accounting Policies* and Note 3a *Revenue* provides information on the accounting policies applied to revenue under NZ IFRS 15. In assessing the impact of NZ IFRS 15, the Company prepared an analysis of revenue transactions. The Company has exercised judgement in order to:

- Determine if a contract with the customer exists;
- Identify the performance obligation in each contract; and
- Determine the appropriate timing for revenue to be recognised.

Given the size of the revenue, and the change in the revenue recognition criteria in the current year, we have considered this a key audit matter.

We assessed the Company's revenue recognition policy for compliance with NZ IFRS 15 and its impact on PharmaZen's business. In doing so we have obtained an understanding of the sales process for all material revenue transactions and the assumptions applied by management.

Our audit procedures included the following:

- We assessed management's analysis of material revenue transactions.
- We assessed management's impact analysis with reference to historical practice and supporting documentation;
- We assessed the criteria for revenue to be recognised at a point in time or over time. We selected a sample of revenue transactions and agreed the point of recognition to management's assessment; and
- We considered the appropriateness of management's disclosures in relation to the adoption of NZ IFRS 15.

Other information

The directors are responsible on behalf of the Company for the other information. The other information comprises the information in the Annual Report that accompanies the financial statements and the audit report.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and consider whether it is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If so, we are required to report that fact. We have nothing to report in this regard.

Directors' responsibilities for the financial statements

The directors are responsible on behalf of the Company for the preparation and fair presentation of the financial statements in accordance with NZ IFRS and IFRS, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible on behalf of the Company for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and ISAs (NZ) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the External Reporting Board's website at:

<https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-2>

This description forms part of our auditor's report.

Restriction on use

This report is made solely to the Company's shareholders, as a body. Our audit has been undertaken so that we might state to the Company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

The logo for Deloitte Limited, featuring the company name in a stylized, cursive script.

Mike Hoshek, Partner
for Deloitte Limited
Christchurch, New Zealand
26 March 2019



Good Health Healthy Future

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