

ESR HALF-YEARLY REPORT

for the six months ended 31 December 2014



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Dr Keith Bedford *General Manager, Forensic*
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Registered office

Kenepuru Science Centre
34 Kenepuru Drive
Porirua 5022
PO Box 50348
Porirua 5240
T: +64 4 914 0700
F: +64 4 914 0770
www.esr.cri.nz

Auditor

Chris Barber of PricewaterhouseCoopers on behalf of the Auditor-General

Banker

The ANZ Bank New Zealand Limited

Solicitor

Buddle Findlay

ESR (The Institute of Environmental Science and Research Limited) is a Government-owned Crown research institute that delivers world-class knowledge, research and laboratory services to help New Zealand get the most out of its investment in science and innovation.

Chairperson's report

The financial result for the six months ending December 2014 is a profit of \$483k after tax. This is \$77k greater than budget and a significant \$1.1m improvement from the same period last year. Revenue is \$672k above last year and \$980k below budget. Revenues from both the Ministry of Health (MOH) and Police contracts are ahead of budgets due to additional services provided under the MOH contract, and increased DNA analytical services to the Police. Cash flow is \$4.6m ahead of budget due to lower capital expenditure (\$2.2m), coupled with a better opening cash balance in July (\$1.8m).

Client relationships continued to be strengthened with a variation to the MOH agreement being signed, which includes additional services to the value of \$2.8m. Negotiations are also underway on a new service level agreement with New Zealand Police. A new contract with the Ministry for Primary Industries (MPI) was signed for the provision of food safety research and science services. ESR is also a key participant in the New Zealand Food Safety and Science Research Centre (NZFSSRC) that has been established as part of the Government's response to the whey protein contamination issue. During the period, ESR's Health Intelligence Team was crucial in MPI's response to the outbreak of *Yersinia pseudotuberculosis*.

A broad suite of initiatives was identified as part of ESR's Strategic Refresh undertaken in the second half of the 2014 financial year. These initiatives focus on strengthening the core, driving growth initiatives and achieving step change. During the first half of the year we made good progress towards delivery of these initiatives. Workplace Drug Testing has been repositioned to function on a more commercial footing. The future of the Pharmaceuticals Programme is more secure following the variation to the MOH agreement. The commercialisation activities identified as part of the Strategic Refresh continue to develop. The recognition of STRmix™ as a valuable forensic tool for determining DNA profiles from complex mixtures is increasing. As a result, revenue from sales of the STRmix™ software is growing. A commercial pathway for the Rapid Pointcloud Viewer (RPV) software has been greatly enhanced by additional funding from Kiwinet and specialist advice from The Icehouse business incubator. In addition, ESR continues to grow links with other organisations involved in technology transfer (eg Investment Incubators and Kiwinet). In response to our growing activities in this area and the potential for entering overseas markets, ESR is seeking to expand its relationship with New Zealand Trade and Enterprise (NZTE).

The implementation of the new forensic laboratory information system began. This project involves a significant change in business processes within the Forensic business group, as well as a new IT system. It is expected to deliver significant cost improvements across the group when it goes live late in the second half of this financial year. Currently this project is tracking within budget and on time.

Working alongside the University of Canterbury's Te Awatea Violence Research team, the Social Science Group contributed two papers to assist the Glenn Inquiry into child abuse and family violence in New Zealand.

A forward screening laboratory was opened at Auckland Airport as the result of close cooperation and a strong working relationship between ESR and New Zealand Customs Service.

In November and December, the Four-Year Rolling Review Panel met with the Board, senior staff, stakeholders and scientists. Following Board/panel discussions, ESR has put together an action plan and that has been submitted to MBIE.

In July, Dr Keith McLea formally joined ESR as Chief Executive after a number of months as Interim Chief Executive. Dr McLea is currently building a senior team and positioning ESR to meet the challenges identified as part of the Strategic Refresh and to build on the platform established by the first-half result.

The expectation is that full-year NPAT will be \$1.65m (FY14 – \$0.6m) and \$0.3m below budget. Forecast revenue of \$65.7m is \$0.6m over budget and expenses are forecast to be \$63.5m.



Dr Susan Macken (Chair)

Key financial performance measures

	6 months ended 31 December 2014 actual	Year ended 30 June 2015 plan	Year ended 30 June 2014 actual	Year ended 30 June 2013 actual
Revenue, \$m	30.9	65.1	61.8	62.1
Operating margin, %	11.0	13.1	8.1	11.7
Return (NPAT**) on equity, %	1.2	4.8	-1.4	3.3
Return (EBIT*) on assets, %	1.1	3.5	-1.3	2.9
Acid test, ratio	1.2	1.0	1.3	1.4
Equity ratio, %	67.5	73.3	67.8	66.4
Gearing, %	0.4	–	0.7	1.4
Interest cover	–	–	–	–
Annualised operating margin per FTE	18,495	22,336	13,235	19,073

* Earnings (annualised surplus) before taxation and interest

** Net profit (annualised surplus) after taxation

Statement of profit or loss and other comprehensive income

for the six months ended 31 December 2014

	Group unaudited 6 months ended 31 December 2014 \$'000s	Group audited 12 months ended 30 June 2014 \$'000s	Group unaudited 6 months ended 31 December 2013 \$'000s
Operating revenue			
Revenue from rendering of services	27,946	54,042	26,943
Core funding	2,980	7,723	3,311
	30,926	61,765	30,254
Operating expenses			
Scientific materials	(2,948)	(5,798)	(3,011)
Subcontracting expense	(2,832)	(5,954)	(2,672)
Employee benefit expense	(16,417)	(32,488)	(16,672)
Depreciation and amortisation expense	(2,771)	(5,741)	(2,875)
Other expenses	(5,328)	(12,524)	(5,908)
	(30,296)	(62,505)	(31,138)
Operating profit / (loss)	630	(740)	(884)
Finance income – interest income	73	86	50
Finance expense	(3)	(13)	(7)
Net finance income / (expense)	70	73	43
(Loss) / profit before income tax expense	700	(667)	(841)
Income tax expense	(217)	114	192
(Loss) / profit for the period attributable to the institute's shareholder	483	(553)	(649)
Other comprehensive income	–	–	–
Total profit or loss and other comprehensive income for the period attributable to the institute's shareholder	483	(553)	(649)

The accompanying notes form an integral part of these financial statements.

Statement of changes in equity

for the six months ended 31 December 2014

	Share capital	Retained earnings	Total
	\$'000s	\$'000s	\$'000s
Balance at 1 July 2013	8,494	30,624	39,118
Loss for the period		(649)	(649)
Other comprehensive income	–	–	–
Total comprehensive income	–	(649)	(649)
Transactions with owners:			
Dividend	–	–	–
Balance at 31 December 2013	8,494	29,975	38,469

Balance at 1 July 2014	8,494	30,071	38,565
Profit for the period		483	483
Other comprehensive income	–	–	–
Total comprehensive income	–	483	483
Transactions with owners:			
Dividend	–	–	–
Balance at 31 December 2014	8,494	30,554	39,048

The accompanying notes form an integral part of these financial statements.

Statement of financial position

as at 31 December 2014

	Group unaudited 6 months ended 31 December 2014 \$'000s	Group audited 12 months ended 30 June 2014 \$'000s	Group unaudited 6 months ended 31 December 2013 \$'000s
Non-current assets			
Property, plant and equipment	32,659	31,900	32,868
Investment	–	30	–
Intangible assets	7,631	8,979	8,856
	40,290	40,909	41,724
Current assets			
Cash and cash equivalents	4,744	1,897	1,284
Trade and other receivables	11,572	13,304	9,530
Derivative financial instruments	92	142	92
Income tax receivable	236	432	388
Inventories	908	1,027	1,200
	17,552	16,802	12,494
Current liabilities			
Trade and other payables	11,554	11,884	8,092
Employee benefits	2,691	2,571	2,892
Finance lease liabilities	79	223	276
	14,324	14,678	11,260
Net current assets / (liabilities)	3,228	2,124	1,234
Non-current liabilities			
Employee benefits	902	910	921
Finance lease liabilities	62	62	120
Deferred taxation	3,506	3,496	3,448
	4,470	4,468	4,489
Net assets	39,048	38,565	38,469
Equity			
Share capital	8,494	8,494	8,494
Retained earnings	30,554	30,071	29,975
Total equity	39,048	38,565	38,469

Dr Susan Macken (Chair)

Marion Cowden (Deputy Chair)

The accompanying notes form an integral part of these financial statements.

Statement of cash flows

for the six months ended 31 December 2014

Note	Group unaudited 6 months ended 31 December 2014 \$'000s	Group audited 12 months ended 30 June 2014 \$'000s	Group unaudited 6 months ended 31 December 2013 \$'000s
Cash flows from / (used in) operating activities			
<i>Cash was provided from:</i>			
	32,712	61,515	33,081
Customers			
	73	86	50
Interest received			
	32,785	61,601	33,131
<i>Cash was applied to:</i>			
	(27,630)	(56,792)	(31,169)
Suppliers and employees			
	(3)	(14)	(7)
Interest paid			
	(10)	(239)	(176)
Income tax paid			
	(27,643)	(57,045)	(31,352)
Net cash inflow from operating activities	5,142	4,556	1,779
2			
Cash flows from / (used in) investing activities			
<i>Cash was provided from:</i>			
	–	84	–
Proceeds from sale of property, plant and equipment			
	–	84	–
<i>Cash was applied to:</i>			
	(449)	(2,345)	(1,169)
Purchase of property, plant and equipment			
	(1,702)	(2,188)	(1,312)
Purchase of intangible assets			
	–	(30)	–
Acquisition of business			
	(2,151)	(4,563)	(2,481)
Net cash outflow from investing activities	(2,151)	(4,479)	(2,481)
Cash flows from / (used in) financing activities			
<i>Cash was provided from / (applied to):</i>			
	–	–	–
Dividends paid			
	(144)	(316)	(150)
Repayment of finance lease liabilities			
Net cash (outflow) / inflow from financing activities	(144)	(316)	(150)
Net (decrease) / increase in cash held	2,847	(239)	(852)
Cash and cash equivalents at the beginning of the period	1,897	2,136	2,136
Cash and cash equivalents at the end of the period	4,744	1,897	1,284

The accompanying notes form an integral part of these financial statements.

Notes to the financial statements

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

Reporting entity

These financial statements of the Institute of Environmental Science and Research Limited and its subsidiaries ("ESR" and the "Group") are for the six months ended 31 December 2014.

ESR is a Crown entity incorporated and domiciled in New Zealand. The address of its registered office is 34 Kenepuru Drive, Porirua.

ESR is a Crown research institute that provides specialist scientific services and research, particularly to the health and justice sectors. Its purpose is to deliver enhanced scientific and research services to the public health, food safety, security and justice systems, and the environmental sector to improve the safety and contribute to the economic, environmental and social well-being of people and communities in New Zealand.

Basis of preparation

The interim financial statements are Parent (ESR) and Group financial statements. The two subsidiaries of ESR are dormant non-trading entities; consequently there is no difference between the financial statements of the Group and those of the Parent.

These interim financial statements are prepared on the basis of historical cost as modified by the revaluation of derivative financial instruments.

These interim financial statements should be read in conjunction with the financial statements and related notes included in ESR's annual report for the year ended 30 June 2014 (2014 Annual Report).

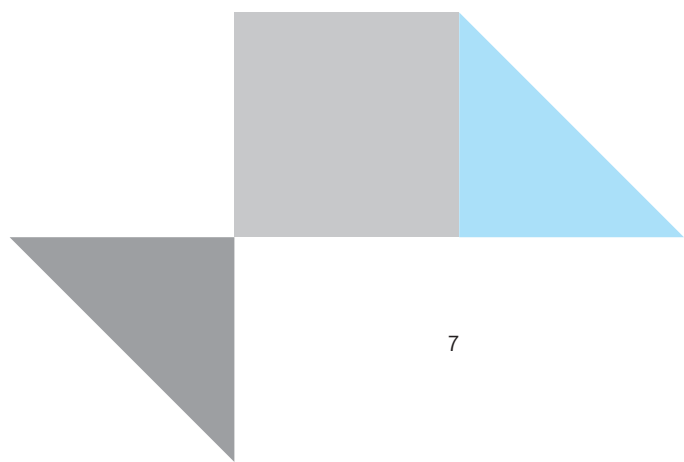
The interim financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (\$000).

The accounting policies set out in the 2014 Annual Report have been applied consistently to all the periods in these interim financial statements. There have been no changes in accounting policies from those applied in ESR's 2014 Annual Report. Where necessary, comparative figures have been reclassified for consistency with current year disclosures.

Statement of compliance

These interim financial statements for the six months ended 31 December 2014 have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting, the New Zealand equivalent to International Accounting Standard 34 Interim Financial Reporting issued by the New Zealand Institute of Chartered Accountants, and other applicable financial reporting standards, as appropriate for profit-oriented entities.

The financial statements have also been prepared in accordance with the requirements of the Crown Entities Act 2004, the Crown Research Institutes Act 1992, the Companies Act 1993 and the Financial Reporting Act 1993.



2. RECONCILIATION OF PROFIT / (LOSS) AFTER TAXATION TO CASH FLOWS FROM OPERATING ACTIVITIES

	Group unaudited 6 months ended 31 December 2014 \$'000s	Group audited 12 months ended 30 June 2014 \$'000s	Group unaudited 6 months ended 31 December 2013 \$'000s
Profit / (loss) for the period	483	(553)	(649)
Non-cash items:			
Depreciation and amortisation	2,771	5,741	2,875
Provisions	–	480	–
Bad debts written off	3	3	–
Increase / (decrease) in deferred taxation liability	–	58	10
Foreign exchange (gain) / loss	135	(5)	(64)
Fair value (gain) / loss on derivatives	(4)	(142)	(92)
	2,905	6,135	2,729
Impact of changes in investing activities:			
Loss / (gain) on sale of assets	–	(84)	–
	–	(84)	–
Financing			
Finance charge on leases	9	9	7
	9	9	7
Changes in working capital:			
Decrease / (increase) in trade and other receivables	1,803	(1,647)	2,233
(Increase) / decrease in income tax receivable	185	(412)	(368)
(Increase) / decrease in inventories	117	(302)	(475)
(Decrease) / increase in employment benefits	112	(370)	(38)
(Decrease) / increase in financial liabilities	(144)	(261)	–
(Decrease) / increase in trade and other payables	(328)	2,041	(1,660)
	1,745	(951)	(308)
Net cash inflow / (outflow) from operating activities	5,142	4,556	1,779

The accompanying notes form an integral part of these financial statements.

3. CAPITAL COMMITMENTS

The following amounts have been committed to by ESR, but have not been recognised in the financial statements:

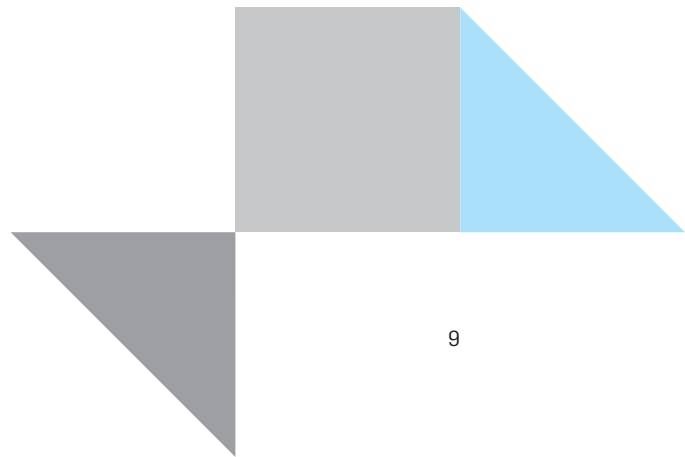
	Group unaudited 6 months ended 31 December 2014 \$'000s	Group audited 12 months ended 30 June 2014 \$'000s	Group unaudited 6 months ended 31 December 2013 \$'000s
Property, plant and equipment	704	80	218
Intangibles – software	1,176	1,266	386
Total capital commitments	1,880	1,346	604

4. CONTINGENT LIABILITIES

There are no known material contingent liabilities at 31 December 2014 (2013: nil).

5. EVENTS SUBSEQUENT TO BALANCE DATE

There were no events subsequent to reporting date that require disclosure in the financial statements.



Kenepuru Science Centre

34 Kenepuru Drive, Kenepuru, Porirua 5022
PO Box 50348, Porirua 5240
New Zealand
T: +64 4 914 0700 F: +64 4 914 0770

Mt Albert Science Centre

120 Mt Albert Road, Sandringham, Auckland 1025
Private Bag 92021, Auckland 1142
New Zealand
T: +64 9 815 3670 F: +64 9 849 6046

NCBID – Wallaceville

66 Ward Street, Wallaceville, Upper Hutt 5018
PO Box 40158, Upper Hutt 5140
New Zealand
T: +64 4 529 0600 F: +64 4 529 0601

Christchurch Science Centre

27 Creyke Road, Ilam, Christchurch 8041
PO Box 29181, Christchurch 8540
New Zealand
T: +64 3 351 6019 F: +64 3 351 0010

www.esr.cri.nz