

ESR HALF-YEARLY REPORT

for the six months ended 31 December 2015



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Auditor

Chris Ussher of PricewaterhouseCoopers on behalf of the Auditor-General

Banker

ANZ Bank New Zealand Limited

Solicitor

Buddle Findlay

The Institute of Environmental Science and Research Limited (ESR) is a Crown research institute. It was incorporated in July 1992 and is wholly owned by the New Zealand Government. The two shareholding Ministers appoint a Board of Directors to govern the organisation. ESR has science facilities in Auckland, Wellington (Porirua and Wallaceville) and Christchurch.

Chair's report

FINANCIAL RESULTS

Continuing on from the favourable 2015 financial result, ESR has made a strong start to the 2016 financial year. Net profit after tax (NPAT) of \$1.7m for the six months is above budget by \$0.9m primarily due to higher Police submissions and strong sales of ESR's STRmix™ product.

The outlook for the full financial year is that the budgeted NPAT of \$2.3m will be achieved (a 5.5% return on equity), taking into account the cost of migrating IT to Infrastructure as a Service and revenue coming back in line with budget.

ESR STRATEGY

ESR made good progress on implementing the strategic initiatives aligned to ESR's three strategic themes: strengthen the core, drive growth and achieve step-change in science.

ESR continued to explore opportunities for growing international revenue in the Pacific, China, the US and Europe.

ESR's innovative forensic software STRmix™ continued to perform strongly. Sales for the half year were ahead of budget and the pipeline for the remainder of the year looks strong. STRmix™ was admitted as evidence in a court case in Michigan, which is a significant milestone in the adoption of STRmix™ across the USA.

Improving the financial sustainability of contracts with major government customers continues to be the focus. The existing Service Level Agreement (SLA) for forensic services was extended to June 2016, while ESR works with Police on the renewal of the SLA on more sustainable terms.

ESR's new forensic laboratory information system went live in November. This investment will enable ESR to better meet the casework requirements of criminal investigations through greater traceability of evidence and improved capability to interface directly with customer systems.

A recently purchased massively parallel DNA sequencer has provided ESR with the technology to conduct Whole Genome Sequencing. The sequencer is now being used by ESR's Health group for the genomic analysis and identification of bacterial and viral pathogens.

The ESR Board reviewed whether there are alternative organisational forms that would enable ESR to perform better. A briefing on the Board's findings is being prepared for the Minister of Science and Innovation.

ESR's vision, goals and values were refreshed to drive ESR's high value contribution for New Zealand in the areas of personal and community safety, health and prosperity.

OUTCOMES

We continued to provide independent scientific advice and services that are behind the decisions that safeguard people's health, provide the justice sector with expert forensic science, protect our food-based economy and improve the safety of our water resources.

To safeguard people's health, ESR conducted a number of investigations of pathogenic organisms and outbreaks to inform the responses of the Ministry of Health (MoH), District Health Boards (DHBs) and public health units. This included surveillance of notifiable diseases and outbreaks, reports on Sexually Transmitted Infections and Severe Acute Respiratory Infections, a Rheumatic Fever collaboration, Legionella outbreak advice and support, and surveillance and reporting for influenza and enteric pathogens.

To support justice outcomes, ESR's forensic scientists continued to identify and interpret evidence from crime scenes, provide analytical expertise in DNA, trace evidence, toxicology and drugs, and provide expert evidence in court. The very successful joint Customs/ESR Screening Laboratory, based at Auckland Airport, completed its first year of operations. One third of the 1,781 submissions processed by the laboratory were found to contain controlled drugs and were stopped from entering New Zealand.

To improve food safety, ESR supported the response from Ministry for Primary Industries and Ministry of Health to an outbreak of hepatitis A associated with frozen berries. ESR provided laboratory testing of berry samples for the virus and advice on epidemiology. The 18th International Campylobacter, Helicobacter and Related Organisms (CHRO) Conference organised by ESR was held in Rotorua in November 2015. The conference was a success with 260 delegates attending and several presentations provided by ESR scientists to the international audience.

ESR produced the Annual Report on Drinking Water Quality for the Ministry of Health. The report describes drinking-water quality, and progress towards meeting the requirements of the Health Act 1956 and the Drinking-Water Standards for New Zealand. ESR is a key collaborator in the AgResearch-led Our Land and Water National Science Challenge approved by MBIE's Science Board in December 2015. ESR will lead one of the Challenge sub-themes.

ESR completed the first part of a multi-year project for the Gisborne District Council on the redesign of their wastewater treatment system. ESR also completed a research contract with MFAT in Kiribati investigating the potential for coral beach sands to be used for disposing of septic tank material. ESR is also collaborating with the Building Research Association of New Zealand (BRANZ) to carry out research into the safe use of grey water and rainwater.



Denise Church QSO (Chair)

Key financial performance measures

	6 months ended 31 December 2015 Actual	Year ended 30 June 2016 Plan	Year ended 30 June 2015 Actual	Year ended 30 June 2014 Actual
Revenue, \$m	33.6	68.2	65.0	61.8
Operating margin, %	15.2	13.6	13.9	8.1
Return (NPAT**) on equity, %	8.4	5.5	6.5	(1.4)
Return (EBIT*) on assets, %	8.1	4.8	6.0	(1.3)
Acid test, ratio	1.8	1.0	1.5	1.3
Equity ratio, %	72.6	66.8	67.3	67.8
Gearing, %	1.3	0.4	0.8	0.7
Interest cover	–	–	–	–
Annualised Operating margin per FTE	29,141	24,546	25,646	13,235

* 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 2015

	Group unaudited 6 months ended 31 December 2015 \$'000s	Group audited 12 months ended 30 June 2015 \$'000s	Group unaudited 6 months ended 31 December 2014 \$'000s
Operating revenue			
Revenue from rendering of services	30,939	57,286	27,946
Core funding	2,700	7,723	2,980
	33,639	65,009	30,926
Operating expenses			
Scientific materials	(2,777)	(6,213)	(2,948)
Subcontracting expense	(3,240)	(6,698)	(2,832)
Employee benefit expense	(16,387)	(31,980)	(16,417)
Depreciation and amortisation expense	(2,757)	(5,465)	(2,771)
Other expenses	(6,110)	(11,112)	(5,328)
	(31,271)	(61,468)	(30,296)
Operating profit	2,368	3,541	630
Finance income – interest income	96	179	73
Finance expense	(7)	(9)	(3)
Net finance income	89	170	70
Profit before income tax expense	2,457	3,711	700
Income tax expense	(745)	(1,128)	(217)
Profit for the period attributable to the institute's shareholder	1,712	2,583	483
Other comprehensive income	–	–	–
Total profit and other comprehensive income for the period attributable to the institute's shareholder	1,712	2,583	483

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

Statement of changes in equity

for the six months ended 31 December 2015

	Share capital	Retained earnings	Total
	\$'000s	\$'000s	\$'000s
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

Balance at 1 July 2015	8,494	32,654	41,148
Profit for the period		1,712	1,712
Other comprehensive income	–	–	–
Total comprehensive income	–	1,712	1,712
Transactions with owners:			
Dividend	–	–	–
Balance at 31 December 2015	8,494	34,366	42,860

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

Statement of financial position

as at 31 December 2015

	Group unaudited 6 months ended 31 December 2015 \$'000s	Group audited 12 months ended 30 June 2015 \$'000s	Group unaudited 6 months ended 31 December 2014 \$'000s
Non-current assets			
Property, plant and equipment	30,052	30,248	32,659
Investment	30	30	–
Intangible assets	11,350	11,407	7,631
	41,432	41,685	40,290
Current assets			
Cash and cash equivalents	11,358	7,702	4,744
Trade and other receivables	5,366	10,780	11,572
Derivative financial instruments	82	–	92
Income tax receivable	–	–	236
Inventories	804	628	908
	17,610	19,110	17,552
Current liabilities			
Trade and other payables	8,104	11,806	11,554
Employee benefits	2,863	2,663	2,691
Finance lease liabilities	386	153	79
Derivative financial instruments	–	161	–
Income tax payable	313	359	–
	11,666	15,142	14,324
Net current assets / (liabilities)	5,944	3,968	3,228
Non-current liabilities			
Employee benefits	765	763	902
Finance lease liabilities	168	168	62
Deferred taxation	3,583	3,574	3,506
	4,516	4,505	4,470
Net assets	42,860	41,148	39,048
Equity			
Share capital	8,494	8,494	8,494
Retained earnings	34,366	32,654	30,554
Total equity	42,860	41,148	39,048



Denise Church QSO (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 2015

Note	Group unaudited 6 months ended 31 December 2015 \$'000s	Group audited 12 months ended 30 June 2015 \$'000s	Group unaudited 6 months ended 31 December 2014 \$'000s
Cash flows from / (used in) operating activities			
<i>Cash was provided from:</i>			
	39,798	64,339	32,712
Customers			
	96	179	73
Interest received			
	39,894	64,518	32,785
<i>Cash was applied to:</i>			
	(33,120)	(52,239)	(27,630)
Suppliers and employees			
	(7)	(9)	(3)
Interest paid			
	(780)	(260)	(10)
Income tax paid			
	(33,907)	(52,508)	(27,643)
Net cash inflow from operating activities	5,987	12,010	5,142
2			
Cash flows from / (used in) investing activities			
<i>Cash was provided from:</i>			
	1	–	–
Proceeds from sale of property, plant and equipment			
	1	–	–
<i>Cash was applied to:</i>			
	(2,186)	(2,108)	(449)
Purchase of property, plant and equipment			
	(54)	(3,859)	(1,702)
Purchase of intangible assets			
	(2,240)	(5,967)	(2,151)
Net cash outflow from investing activities	(2,239)	(5,967)	(2,151)
Cash flows from / (used in) financing activities			
<i>Cash was provided from / (applied to):</i>			
	–	–	–
Dividends paid			
	(92)	(238)	(144)
Repayment of finance lease liabilities			
Net cash outflow from financing activities	(92)	(238)	(144)
Net increase in cash held	3,656	5,805	2,847
Cash and cash equivalents at the beginning of the period	7,702	1,897	1,897
Cash and cash equivalents at the end of the period	11,358	7,702	4,744

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 2015.

ESR is a Crown Entity incorporated and based in New Zealand. Its registered office is at 34 Kenepuru Drive, Porirua.

ESR is a Crown research institute that provides specialist scientific services and research to the public health, food safety, security and justice systems, and the environmental sector.

Basis of preparation

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

The interim financial statements have 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.

The financial statements have been prepared on the basis of historical cost as modified by the revaluation of derivative financial instruments.

The 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 2015 (2015 Annual Report).

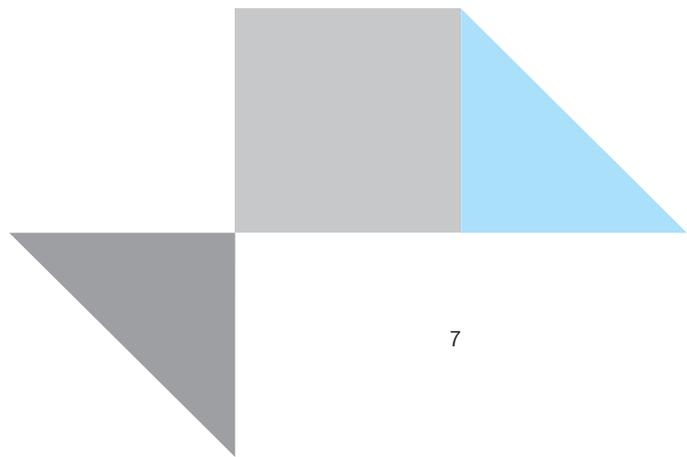
The financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (\$'000).

Changes in accounting policies

The accounting policies set out in the 2015 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 2015 Annual Report. Where necessary, comparative figures have been reclassified for consistency with current year disclosures.

Statement of compliance

These financial statements 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, and other applicable financial reporting standards as appropriate for profit oriented entities.



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

	Group unaudited 6 months ended 31 December 2015 \$'000s	Group audited 12 months ended 30 June 2015 \$'000s	Group unaudited 6 months ended 31 December 2014 \$'000s
Profit for the period	1,712	2,583	483
Non-cash items:			
Depreciation and amortisation	2,757	5,465	2,771
Impairment of property, plant and equipment	58	–	–
Provisions	–	303	–
Impairment of receivables	–	17	–
Bad debts written off	–	26	3
Increase / (decrease) in deferred taxation liability	–	5	–
Foreign exchange (gain) / loss	13	(17)	135
Fair value (gain) / loss on derivatives	(82)	161	(4)
	2,746	5,926	2,905
Items classified as investing and financing activities:			
Loss on sale of assets	4	10	–
Finance charge on leases	7	9	9
	11	19	9
Changes in working capital:			
(Increase) / decrease in trade and other receivables	5,401	2,515	1,803
(Increase) / decrease in income tax receivable	–	432	185
Increase / (decrease) in income tax payable	(46)	359	–
(Increase) / decrease in inventories	(176)	399	117
Increase / (decrease) in employment benefits	202	92	112
Increase / (decrease) in financial liabilities	–	(70)	(144)
Increase / (Decrease) in trade and other payables	(3,863)	(245)	(328)
	1,518	3,482	1,745
Net cash inflow / (outflow) from operating activities	5,987	12,010	5,142

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:

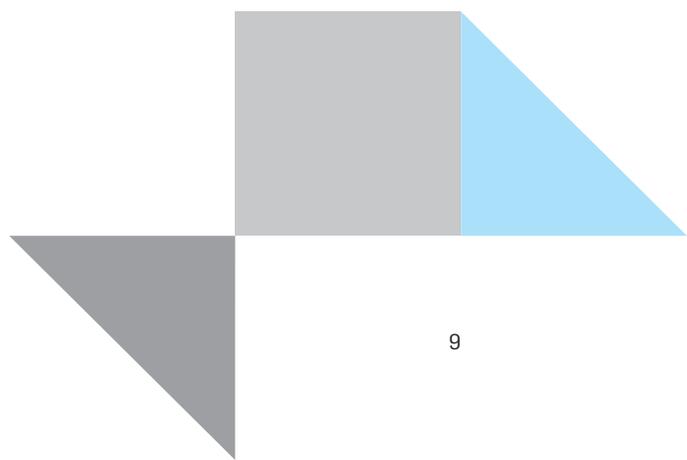
	Group unaudited 6 months ended 31 December 2015 \$'000s	Group audited 12 months ended 30 June 2015 \$'000s	Group unaudited 6 months ended 31 December 2014 \$'000s
Property, plant and equipment	943	357	704
Intangibles – software	28	284	1,176
Total capital commitments	971	641	1,880

4. CONTINGENT LIABILITIES

There are no known material contingent liabilities at 31 December 2015 (2014: nil).

5. EVENTS SUBSEQUENT TO BALANCE DATE

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



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