

# Windflow Technology Limited

## Independent Adviser's Report

### In Respect of the Increase in Control of Voting Rights Held by David Iles

*June 2014*

#### Statement of Independence

Simmons Corporate Finance Limited confirms that it:

- has no conflict of interest that could affect its ability to provide an unbiased report
- has no direct or indirect pecuniary or other interest in the proposed transactions considered in this report, including any success or contingency fee or remuneration, other than to receive the cash fee for providing this report.

Simmons Corporate Finance Limited has satisfied the Takeovers Panel, on the basis of the material provided to the Takeovers Panel, that it is independent under the Takeovers Code for the purposes of preparing this Independent Adviser's Report.

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## 1. Introduction

### 1.1 Background

Windflow Technology Limited (**Windflow Technology** or the **Company**) was incorporated on 13 October 2000 as Windflow Engineering Limited. It changed its name to Windflow Technology Limited on 24 November 2000.

The Company designs, manufactures, assembles, commissions and services wind turbines. Its assembly factory is located at Riccarton, Christchurch.

The first prototype *Windflow 500* wind turbine was installed in 2003. The *Windflow 500* is a 2 bladed wind turbine rated at 500 kW. The turbine incorporates technology making it particularly well suited for high wind and gusty sites. It is designed to minimise transmitted fatigue loads, enabling a relatively small and lightweight wind turbine to provide durable service.

5 *Windflow 500* turbines have been in commercial operation since 2006 at the Te Rere Hau wind farm, near Palmerston North. During 2009, the number of turbines in commercial operation at Te Rere Hau grew from 5 to 65. There are now 97 turbines at Te Rere Hau.

The *Windflow 500* has been a technical success and the Company has established platforms for joint marketing and development with General Dynamics SATCOM Technologies, Inc. (**GD SATCOM**) and for its UK market activities.

The Company listed its shares on the alternative market (**NZAX**) operated by NZX Limited (**NZX**) in December 2003. Its market capitalisation was \$1.4 million as at 9 June 2014 and its unaudited total equity was negative \$0.9 million as at 31 March 2014.

### 1.2 David Iles

David Iles is the largest shareholder in Windflow Technology. He currently holds 3,222,901 ordinary shares in the Company (15.65% of the total ordinary shares on issue) and 11,522,683 redeemable convertible preference shares (**RCPS**) (77.52% of the total RCPS on issue).

#### **Ordinary Shares**

Mr Iles has held ordinary shares in the Company since June 2006. His most recent acquisition of ordinary shares was on 6 December 2012 by way of a placement of 875,000 new ordinary shares to him by the Company at an issue price of \$0.40 per share.

#### **RCPS**

Mr Iles acquired his 11,522,683 RCPS through 2 right issues undertaken by the Company in March 2013 and December 2013.

#### **March 2013 Rights Issue**

Mr Iles acquired 6,522,683 RCPS in March 2013 when the Company undertook a pro rata renounceable rights issue to eligible shareholders to subscribe for one new RCPS for every 2 existing ordinary shares held by them at \$0.50 per RCPS (the **March 2013 RCPS**).

Mr Iles took up his entitlements for 2,522,683 March 2013 RCPS and the Company subsequently made a placement of 4,000,000 March 2013 RCPS to him.

The March 2013 rights issue resulted in the issue of 9,024,345 RCPS, raising \$4.5 million of capital.

The March 2013 RCPS have the following rights:

- an entitlement to a 10.0% per annum dividend, paid quarterly
- in the event of liquidation of the Company, payment of the issue price and any outstanding dividend ranks behind secured and unsecured creditors and before the rights of ordinary shareholders
- the RCPS do not carry votes other than in respect of resolutions which directly or adversely varies the rights of the RCPS
- the Company has the right to redeem the RCPS for cash at any time between 18 months and 5 years of their allotment
- the Company and the shareholder each have the right at any time prior to 5 years of the RCPS's allotment to convert the RCPS into ordinary shares:
  - the holder conversion rate is one for one
  - the Company conversion rate is 2 ordinary shares for one RCPS
- any RCPS not redeemed or converted within 5 years of their allotment shall be redeemed by the Company at that date for their issue price of \$0.50.

#### *December 2013 Rights Issue*

Mr Iles acquired 5,000,000 RCPS in January 2014 when the Company undertook a pro rata renounceable rights issue to eligible shareholders to subscribe for one new RCPS for every 3 existing ordinary shares held by them at \$0.50 per RCPS (the **December 2013 RCPS**).

The Company entered into a Shortfall Placement Agreement dated 6 November 2013 with Mr Iles, under which Mr Iles agreed to purchase any shortfall of December 2013 RCPS not subscribed for under the December 2013 rights issue up to a maximum value of \$2.5 million (5,000,000 RCPS).

The December 2013 rights issue resulted in the issue of 5,840,579 RCPS, raising \$2.9 million of capital.

The December 2013 RCPS have the same terms and rights as the March 2013 RCPS, other than:

- dividends are not payable in the first year
- the Company has the right to redeem the RCPS for cash at any time between 30 months and 5 years of their allotment (as opposed to 18 months and 5 years for the March 2013 RCPS)
- if the Company elects to convert the new RCPS into ordinary shares prior to 5 years of their allotment, the conversion rate will be 3 ordinary shares for one December 2013 RCPS (as opposed to 2 ordinary shares for one March 2013 RCPS).

### ***Iles Loan Facility***

Mr Iles has also provided a loan facility of up to £7.38 million (approximately \$14.56 million at the current exchange rate) to the Company (the **Iles Loan Facility**) to fund development projects in the UK for a total of 7 turbines. Interest on the loans is charged at the rate of 10% per annum compounding daily (equivalent to an annual percentage rate of 10.516% per annum). As at May 2014, the aggregate liability under the Iles Loan Facility was £2.79 million (\$5.50 million).

Included in the Iles Loan Facility is a loan of £0.54 million (approximately \$1.06 million) in respect of the Ludenhill approved project (the **Ludenhill Loan**).

### ***2013 Special Meeting***

The Company's shareholders other than Mr Iles (the **Non-associated Shareholders**) approved an ordinary resolution at a special meeting on 4 December 2013 (the **2013 Special Meeting**) permitting Mr Iles to increase his control of voting rights in the Company to up to 58.29% through the conversion of all of the March 2013 RCPS and December 2013 RCPS that he holds.

Based on the actual number of December 2013 RCPS that was allotted to Mr Iles under the Shortfall Placement Agreement, the conversion of all of the March 2013 RCPS and December 2013 RCPS held by Mr Iles and the Non-associated Shareholders will result in Mr Iles holding between 41.58% and 55.67% of the voting rights in the Company (depending on whether the Company or the shareholders convert the RCPS and assuming there are no other changes to the Company's current capital structure).

## **1.3 Allotment of Further RCPS to Mr Iles**

### ***Deed Placement***

The Company entered into a Conditional Preference Share Deed with Mr Iles on 9 April 2014 (the **RCPS Deed**) whereby Mr Iles will subscribe for 2,000,000 RCPS in the Company, conditional on obtaining shareholder approval (the **Deed Placement**).

The RCPS subscribed for by Mr Iles under the Deed Placement will be subscribed at \$0.50 per RCPS and the RCPS shall be issued on the same terms as the December 2013 RCPS.

The payment for the allotment of the 2,000,000 RCPS shall be \$1.0 million, credited towards the Ludenhill Loan.

In the event that the Non-associated Shareholders do not approve the Deed Placement, Mr Iles has agreed to release the Company absolutely from the debt (up to \$1.0 million) under the Ludenhill Loan and to forgive the debt absolutely.

### ***Further Placements***

Windflow also proposes to allot over the next 12 months up to 10,000,000 RCPS to Mr Iles in addition to the Deed Placement, in the event that Mr Iles agrees to subscribe for further RCPS (the **Further Placements**).

Any RCPS subscribed for by Mr Iles under the Further Placements will be subscribed at \$0.50 per RCPS and the RCPS shall be issued on the same terms as the December 2013 RCPS.

We refer to the Deed Placement and the Further Placements collectively as the **Iles Placements**.

### ***Iles RCPS Conversion***

The RCPS may be converted into ordinary shares by either the RCPS holder or by the Company at any time from the date of issue until 5 years following the date of issue, at which point if the RCPS have not been converted, they will be redeemed by the Company.

If some or all of Mr Iles' RCPS are converted into ordinary shares during this period (the **Iles RCPS Conversion**), it is likely that Mr Iles' control of the voting rights in Windflow will increase beyond 20% to potentially up to 72.98%.

Following shareholder approval at the 2013 Special Meeting, Mr Iles already has the ability to increase his level of control of voting rights in the Company through the conversion of all of the March 2013 RCPS and the December 2013 RCPS that he holds. However, he will require shareholder approval in order to further increase his level of control of voting rights in the Company through the conversion of the RCPS issued under the Iles Placements.

## **1.4 2014 Special Meeting of Shareholders**

The Non-associated Shareholders will vote on 3 ordinary resolutions at the Company's special meeting of shareholders on 25 June 2014 (the **2014 Special Meeting**) in respect of:

- the Deed Placement (resolution 1)
- the Further Placements (resolution 2)
- the Iles RCPS Conversion (resolution 3) (the **Iles RCPS Conversion Resolution**).

Mr Iles and his associated parties / associates are not permitted to vote on the resolutions.

## **1.5 Mr Iles' Potential Shareholding Levels**

If the Iles RCPS Conversion does not occur (ie Mr Iles' RCPS are not converted into ordinary shares), then his control over the voting rights in the Company will remain at the current level of 15.65% (assuming that Mr Iles does not acquire or dispose of any ordinary shares and there is no change to the number of ordinary shares on issue).

The number of ordinary shares that Mr Iles will hold if the Iles RCPS Conversion occurs will depend upon:

- the number of RCPS subscribed for by Mr Iles under the Iles Placements and
- the number of RCPS held by Mr Iles that are converted into ordinary shares by either Mr Iles or the Company.

Following the Iles RCPS Conversion, the level of voting rights controlled by Mr Iles will also be dependent upon the number of RCPS held by the Non-associated Shareholders that are converted into ordinary shares by either the Non-associated Shareholders or the Company.

These various factors mean that there are a wide range of possible outcomes as to the level of voting rights that Mr Iles will control following the Iles RCPS Conversion. Depending on the assumptions regarding the conversion of the RCPS, Mr Iles will control between 44.70% and 72.98% of the voting rights in the Company following the Iles RCPS Conversion.

### Maximum Shareholding Level Under the Iles RCPS Conversion

The effect of passing the Iles RCPS Conversion Resolution is that Mr Iles will be permitted to increase his shareholding of ordinary shares in the Company up to a maximum of 67,268,267 ordinary shares through the allotment of a maximum of 64,045,366 ordinary shares under the Iles RCPS Conversion.

Maximum Number of Ordinary Shares That May Be Held by Mr Iles		
	RCPS	Ordinary Shares
Ordinary shares currently held		3,222,901
Existing March 2013 RCPS	6,522,683	13,045,366 <sup>1</sup>
Existing December 2013 RCPS	5,000,000	15,000,000 <sup>2</sup>
New RCPS from the Iles Placements	12,000,000 <sup>3</sup>	36,000,000 <sup>4</sup>
Total RCPS prior to the Iles RCPS Conversion	<u>23,522,683</u>	
Maximum ordinary shares held following the Iles RCPS Conversion		<u>67,268,267</u>

<sup>1</sup> Assumes the 6,522,683 March 2013 RCPS are converted by the Company on a 2:1 basis  
<sup>2</sup> Assumes the 5,000,000 December 2013 RCPS are converted by the Company on a 3:1 basis  
<sup>3</sup> Assumes the maximum number of RCPS are issued under the Further Placements  
<sup>4</sup> Assumes the new RCPS are converted by the Company on a 3:1 basis

The maximum level of voting rights that Mr Iles can hold following the Iles RCPS Conversion will be 72.98%. This assumes:

- Mr Iles subscribes for 10,000,000 RCPS under the Further Placements in addition to 2,000,000 RCPS under the Deed Placement
- the Company then converts all RCPS into ordinary shares:
  - the 23,522,683 RCPS held by Mr Iles convert into 64,045,366 ordinary shares
  - the 3,342,241 RCPS held by the Non-associated Shareholders convert into 7,525,061 ordinary shares.

There will be 92,167,691 ordinary shares on issue in total.

### Minimum Shareholding Level Under the Iles RCPS Conversion

At the other end of the spectrum, the minimum level of voting rights that Mr Iles can hold following the Iles RCPS Conversion will be 44.70% under the following assumptions:

- Mr Iles subscribes for 2,000,000 RCPS under the Deed Placement and no RCPS under the Further Placements
- Mr Iles and all the Non-associated Shareholders convert all of their RCPS into ordinary shares on a one-for-one basis:
  - the 13,522,683 RCPS held by Mr Iles convert into 13,522,683 ordinary shares

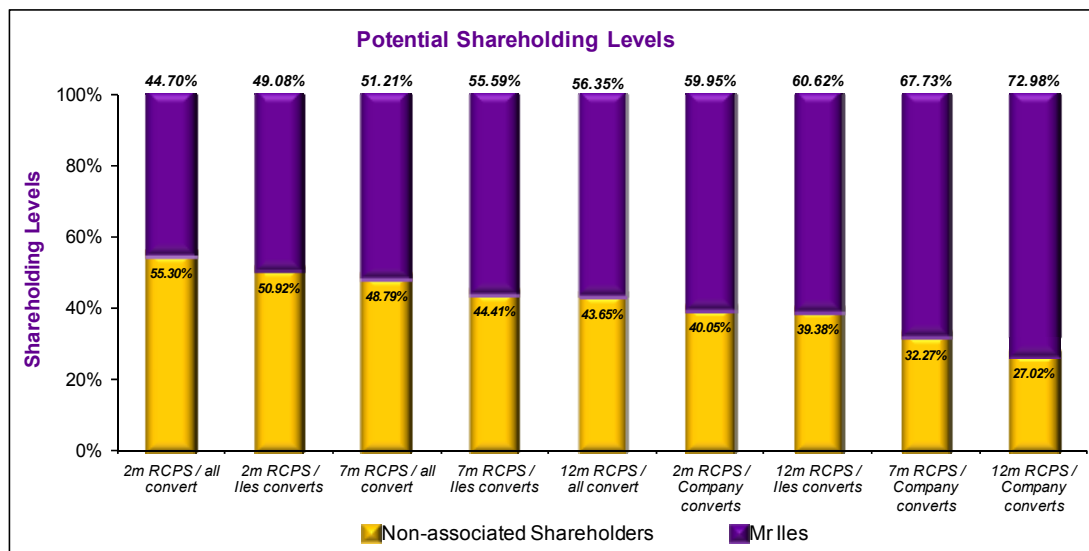
- the 3,342,241 RCPS held by the Non-associated Shareholders convert into 3,342,241 ordinary shares.

There will be 37,462,188 ordinary shares on issue in total.

### Potential Shareholding Levels Under the Iles RCPS Conversion

The graph below shows the potential shareholding levels for Mr Iles varying from 44.70% to 72.98% following the Iles RCPS Conversion, depending on:

- whether Mr Iles subscribes for 2,000,000, 7,000,000 (by way of example) or 12,000,000 RCPS under the Iles Placements
- whether the Company converts all of the RCPS
- whether only Mr Iles converts all of his RCPS
- whether both Mr Iles and the Non-associated Shareholders convert all of their RCPS.



We note that under the approval provided at the 2013 Special Meeting, Mr Iles is already permitted to convert into ordinary shares the 6,522,683 March 2013 RCPS and the 5,000,000 December 2013 RCPS that he holds. Even if the Iles RCPS Conversion Resolution is not approved at the 2014 Special Meeting, Mr Iles will still be able to convert these RCPS and thereby increase his control of voting rights in the Company to between 41.58% and 55.67%.

## 1.6 Regulatory Requirements

Rule 6 of the Code prohibits:

- a person who holds or controls less than 20% of the voting rights in a code company from increasing their holding or control of voting rights (together with its associates) beyond 20%
- a person holding or controlling 20% or more of the voting rights in a code company from increasing their holding or control of voting rights

unless the person and that person's associates comply with exceptions to this fundamental rule.



One of the exceptions, set out in Rule 7(d) of the Code, enables a person and their associates to increase their holding or control of voting rights by an allotment of shares if the allotment is approved by an ordinary resolution of the code company.

Accordingly, the Non-associated Shareholders will vote at the 2014 Special Meeting on an ordinary resolution in respect of Mr Iles increasing his holding or control of voting rights in the Company arising from the Iles RCPS Conversion in accordance with the Code.

Rule 18 of the Code requires the directors of a code company to obtain an Independent Adviser's Report on the merits of an allotment under Rule 7(d).

This Independent Adviser's Report is to be included in the notice of meeting pursuant to Rule 16(h).

### 1.7 Purpose of the Report

The Company's board of directors (the **Board**) has engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Independent Adviser's Report on the merits of the allotment of shares to Mr Iles under the Iles RCPS Conversion in accordance with Rule 18 of the Code.

Simmons Corporate Finance was approved by the Takeovers Panel on 29 April 2014 to prepare the Independent Adviser's Report.

Simmons Corporate Finance issues this Independent Adviser's Report to the Board for the benefit of the Non-associated Shareholders and to assist them in forming their own opinion on voting on the Iles RCPS Conversion Resolution.

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the merits of Mr Iles increasing his control of voting rights as a result of the allotment of shares under the Iles RCPS Conversion in relation to each shareholder. Our advice and opinions are necessarily general in nature.

This Independent Adviser's Report is not to be used for any other purpose without our prior written consent.

Any references to \$ are references to New Zealand dollars. References to foreign currencies are appropriately denoted.

## 2. Evaluation of the Merits of the Allotment of Shares to Mr Iles under the Iles RCPS Conversion

### 2.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the allotment of shares to Mr Iles under the Iles RCPS Conversion.

There is no legal definition of the term *merits* in New Zealand in either the Code or in any statute dealing with securities or commercial law.

In the absence of an explicit definition of *merits*, guidance can be taken from:

- the Takeovers Panel *Guidance Note on Independent Advisers and the Takeovers Code* dated May 2014
- definitions designed to address similar issues within New Zealand regulations which are relevant to the proposed transactions
- overseas precedents
- the ordinary meaning of the term *merits*.

We are of the view that an assessment of the merits of the allotment of shares to Mr Iles under the Iles RCPS Conversion should focus on:

- the requirement for the Iles Placements
- the alternatives to the Iles Placements
- the prospects for Windflow Technology without the Iles Placements
- the terms and conditions of the Iles Placements
- the impact of the Iles Placements on the Company's financial position
- the impact of the Iles RCPS Conversion on the control of the Company
- the impact of the Iles RCPS Conversion on Windflow Technology's share price
- other benefits and disadvantages to Mr Iles of the Iles RCPS Conversion
- the benefits and disadvantages for the Non-associated Shareholders of the Iles RCPS Conversion
- the implications if the Iles RCPS Conversion Resolution is not approved.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.

## 2.2 Summary of the Evaluation of the Merits of the Allotment of Shares to Mr Iles under the Iles RCPS Conversion

**In our opinion, after having regard to all relevant factors, the positive aspects of the allotment of shares to Mr Iles under the Iles RCPS Conversion outweigh the negative aspects from the perspective of the Non-associated Shareholders.**

Our evaluation of the merits of the allotment of shares to Mr Iles under the Iles RCPS Conversion is set out in detail in sections 2.3 to 2.15. In summary, the key factors leading to our opinion are:

- the rationale for the Iles Placements is sound. The Iles Placements will raise further equity for the Company, allowing it to meet its short term financing requirements and to respond to opportunities for building turbines for the United Kingdom market
- alternative capital raising options are not as viable at this point in time
- the structure of the Iles Placements is reasonable. The RCPS are being issued on the same terms as the December 2013 RCPS, which all shareholders (at the time of the December 2013 rights issue) had the opportunity to subscribe for
- the Iles Placements will have a positive impact on the Company's financial position, increasing equity by between \$1.0 million and \$6.0 million (before costs)
- the Iles RCPS Conversion could significantly increase Mr Iles' ability to influence the outcome of shareholding voting as it would result in Mr Iles controlling between 44.70% and 72.98% of the voting rights in the Company. This is the main negative aspect of the Iles RCPS Conversion
- the Iles RCPS Conversion is not expected to increase Mr Iles' influence over the Board or the Company's operations. However, Mr Iles may be in a position to singlehandedly pass an ordinary resolution to appoint or remove directors
- Non-associated Shareholders may see their shareholding interests diluted by between 34% and 68% following the Iles RCPS Conversion, depending on the number of RCPS allotted to Mr Iles under the Further Placements and whether Mr Iles or the Company elects to convert the RCPS
- trading in the Company's shares is very thin. The Iles Placements and the Iles RCPS Conversion are unlikely to have any material impact on the Company's share price or the liquidity of its shares
- the Iles RCPS Conversion may reduce the attraction of Windflow Technology as a takeover target to Mr Iles
- following the 2013 Special Meeting, Mr Iles is permitted to convert all of the March 2013 RCPS and December 2013 RCPS that he holds, which would increase his control of voting rights in the Company to between 41.58% and 55.67%. The implications of the Iles RCPS Conversion Resolution not being approved are that any future conversion of the RCPS issued under the Iles Placements that increases Mr Iles' control of voting rights in the Company beyond 55.67% will potentially result in a breach of the Code, thereby requiring remedial steps to be undertaken. The possibility of this occurring may reduce Mr Iles' desire to subscribe for RCPS under the Further Placements.

## 2.3 The Requirement for the Iles Placements

Windflow Technology had negative equity of \$0.9 million as at 31 March 2014. It incurred a loss of \$2.8 million in the 6 months ended 31 December 2013 and is forecasting a loss of \$4.4 million for the full 2014 financial year. The Company used \$3.0 million of cash in its operating activities in the first half of the 2014 financial year, while drawing down a further \$3.1 million on the Iles Loan Facility.

The Deed Placement will convert \$1.0 million of the Iles Loan Facility to equity and the Further Placements may raise up to a further \$5.0 million of equity.

Mr Iles has signalled that he is prepared to support the Company as opportunities arise during the coming year for building turbines for the United Kingdom market and elsewhere as well as other revenue-generating activities such as technology licensing. Issuing RCPS to Mr Iles, which in most cases will be swapped for debt already owing to Mr Iles under the Iles Loan Facility, will provide flexibility for the Company to meet the short term financing requirements of responding to these opportunities.

## 2.4 Alternatives to the Iles Placements

Windflow Technology could pursue alternative forms of raising capital including:

- a pro rata rights issue
- seeking alternate debt funding
- seeking another strategic investor
- making a series of share placements
- asset sales.

We consider that these alternative capital raising options are not as attractive as the Iles Placements:

- the Company recently undertook 2 pro rata rights issues in March 2013 and December 2013. Of the \$7.44 million raised from the 2 rights issues, Mr Iles contributed 77.5% (\$5.76 million) and the Non-associated Shareholders contributed 22.5% (\$1.68 million). While the Non-associated Shareholders contributed 27.7% of the capital raised in the March 2013 rights issue, they only contributed 14.4% of the capital raised in the December 2013 rights issue, suggesting a diminishing appetite on their part to invest in the Company. Accordingly, the likelihood of raising a significant level of capital from another pro rata rights issue at this point in time is not high without it being underwritten by a party such as Mr Iles
- the Company has £7.38 million of debt facilities through the Iles Loan Facility. Given the Company's current financial position and near term prospects, it is unlikely that it could raise additional debt from other sources (such as trading banks) at this point in time
- given the Company's current financial position, we consider it unlikely that Windflow Technology could make any significant placements of equity to one or more new or existing investors (other than Mr Iles) on terms close to or in line with the Iles Placements
- the Company has minimal uncharged assets available for sale as most of its assets have been provided as security for the Iles Loan Facility.

## 2.5 The Prospects for the Company Without the Iles Placements

The prospects for Windflow Technology continuing as a going concern without the additional capital from the Iles Placements are limited. The Company is forecasting a loss of \$4.4 million for the full 2014 financial year. It had equity of negative \$0.9 million as at 31 March 2014 along with \$5.1 million owing under the Iles Loan Facility.

Windflow Technology requires the capital from the Iles Placements to fund its short to medium term operations. In the absence of this capital, the Company would most likely need to cease operating.

## 2.6 Structure of the Iles Placements

The key terms of the Iles Placements are:

- the issue of between 2,000,000 and 12,000,000 RCPS
- an issue price of \$0.50 per new RCPS
- new RCPS will rank equally in all respects with the December 2013 RCPS.

We are advised by the Board that the maximum amount of \$6.0 million of equity to be raised under the Iles Placements was based on its estimate of the amount of capital required to meet the Company's cash flow needs over the next 12 months or so, thereby averting the possible need to revert to shareholders for approval of further capital raising initiatives.

We are advised by the Board that it set the price of \$0.50 per new RCPS to ensure consistency with the price set for the March 2013 RCPS and the December 2013 RCPS. Furthermore, the other terms of the RCPS to be issued under the Iles Placements are identical to the terms of the December 2013 RCPS.

## 2.7 Impact on Financial Position

Windflow Technology's unaudited total equity as at 31 March 2014 was negative \$0.9 million, equating to negative \$0.02 per share on a fully diluted basis. The Company's net tangible assets (NTA) at that date were approximately negative \$2.6 million, equating to negative \$0.05 per share.

The Iles Placements will potentially raise \$5.96 million (net of costs). For illustrative purposes, if the full net proceeds were to have been received on 31 March 2014, Windflow Technology's equity would increase to \$5.1 million, equity per share would increase to \$0.06 and NTA per share would increase to \$0.04.

Illustrative Effect of the Iles Placements (Fully Diluted Basis)				
	Equity (\$000)	No. of Shares (000)	Equity / Share (\$)	NTA / Share (\$)
31 March 2014	(861)	56,168 <sup>2</sup>	(\$0.02)	(\$0.05)
Iles Placements net proceeds	5,960 <sup>1</sup>	36,000 <sup>3</sup>	\$0.17	\$0.17
Post the Iles Placements	<u>5,099</u>	<u>92,168</u>	<u>\$0.06</u>	<u>\$0.04</u>

<sup>1</sup> Assumes the maximum number of RCPS are issued under the Further Placements  
<sup>2</sup> Based on the current 14,864,924 RCPS converting to 35,570,427 ordinary shares  
<sup>3</sup> Based on the new 12,000,000 RCPS converting to ordinary shares on a 3:1 basis

## 2.8 Impact on Control

### Capital Structure and Shareholders

#### Ordinary Shares

Windflow Technology currently has 20,597,264 ordinary fully paid shares on issue held by 894 shareholders.

The names, number of ordinary shares and percentage holding of the 10 largest shareholders as at 9 June 2014 are set out below.

Windflow Technology's 10 Largest Ordinary Shareholders		
Shareholder	No. of Shares Held	%
David Iles	3,222,901	15.65%
Mighty River Power Limited	2,382,496	11.57%
Delane Wycoff	1,100,000	5.34%
New Zealand Central Securities Depository Limited (NZCSD)	890,859	4.33%
Geoff Henderson	702,564	3.41%
Jennifer Henderson	550,000	2.67%
Reda Holdings Limited	241,000	1.17%
FNZ Custodians Limited	213,953	1.04%
Jeanette Fitzsimons	211,513	1.03%
Sheila Kolstad	165,000	0.80%
Subtotal	9,680,286	47.00%
Others (884 shareholders)	10,916,978	53.00%
<b>Total</b>	<b>20,597,264</b>	<b>100.00%</b>

Source: NZX Data

#### Redeemable Convertible Preference Shares

Windflow Technology currently has 14,864,924 RCPS on issue held by 200 shareholders.

The names, number of RCPS and percentage holding of the 10 largest shareholders as at 8 May 2014 are set out below.

Windflow Technology's 10 Largest RCPS Shareholders		
Shareholder	No. of Shares Held	%
David Iles	11,522,683	77.52%
NZCSD	420,772	2.83%
Michael Chick	182,500	1.23%
Geoff Henderson	141,250	0.95%
Health Consultants Limited	140,000	0.94%
Sheila Kolstad	122,500	0.82%
Ian Shearer & Mary Newman	105,757	0.71%
Jennifer Henderson	100,000	0.67%
Angus Napier & Emma Napier	99,750	0.67%
Brett Whiston	96,408	0.65%
Subtotal	12,931,620	86.99%
Others (190 RCPS holders)	1,933,304	13.01%
<b>Total</b>	<b>14,864,924</b>	<b>100.00%</b>

Source: Windflow Technology

### **Shareholder Voting**

The Iles RCPS Conversion would enable Mr Iles to increase his control of voting rights in Windflow Technology without having to make a formal offer to all shareholders in accordance with Rules 7(a) or 7(b) of the Code. This is the principal reason why the Non-associated Shareholders have the opportunity to vote for or against the resolution in respect of the Iles RCPS Conversion.

As set out in section 1.5, there are a wide range of possible outcomes with respect to Mr Iles' eventual shareholding following the Iles RCPS Conversion. Mr Iles' shareholding level will be between 44.70% and 72.98%.

Currently, Mr Iles does not hold any significant ability to influence the outcome of shareholder voting. He cannot singlehandedly pass or block special resolutions (which require the approval of 75% of the votes cast by shareholders) or pass or block ordinary resolutions (which require the approval of more than 50% of the votes cast by shareholders).

Following the Iles RCPS Conversion, Mr Iles' ability to influence the outcome of shareholder voting would change significantly.

The minimum shareholding level of 44.70% would enable Mr Iles to singlehandedly block special resolutions but not singlehandedly pass special resolutions. While technically a 44.70% shareholding cannot block or pass ordinary resolutions, in reality, it most likely can in a listed company with more than 800 shareholders (as Windflow Technology has). This is because some shareholders in listed companies tend not to vote on resolutions and hence the relative weight of the 44.70% shareholding increases.

The maximum shareholding level of 72.98% would enable Mr Iles to singlehandedly pass or block ordinary resolutions and block special resolutions. He would also most likely be able to singlehandedly pass special resolutions.

The ability for any shareholder to influence the outcome of voting on the Company's ordinary resolutions or special resolutions may be reduced by external factors such as the NZAX Listing Rules, the Company's constitution and the Companies Act 1993.

Given the above, we are of the view that the allotment of ordinary shares to Mr Iles under the Iles RCPS Conversion will significantly increase Mr Iles' ability to exert shareholder voting control over Windflow Technology. However, following the 2013 Special Meeting, Mr Iles already has the right to convert all of the March 2013 RCPS and December 2013 RCPS that he holds into ordinary shares, which would result in Mr Iles holding between 41.58% and 55.67% of the voting rights in the Company.

### **Board Control**

The Board consists of:

- Michael Chick, independent director, chair
- Geoff Henderson, executive director and chief executive officer
- Heugh Kelly, independent director
- Angus Napier, independent director.

None of the directors are deemed to be associated with Mr Iles.

Mr Iles does not currently have any Board representation. We are advised by the Board that there have been no discussions with Mr Iles regarding any Board representation by Mr Iles as a result of the Iles Placements or the Iles RCPS Conversion. However, we note that if Mr Iles has the ability to singlehandedly pass an ordinary resolution, then he will have the ability to pass an ordinary resolution to appoint or remove directors.

### Operations

We are advised by the Board that it does not envisage that Mr Iles' ability to exert control over the Company's operations would change as a result of the Iles Placements or the Iles RCPS Conversion.

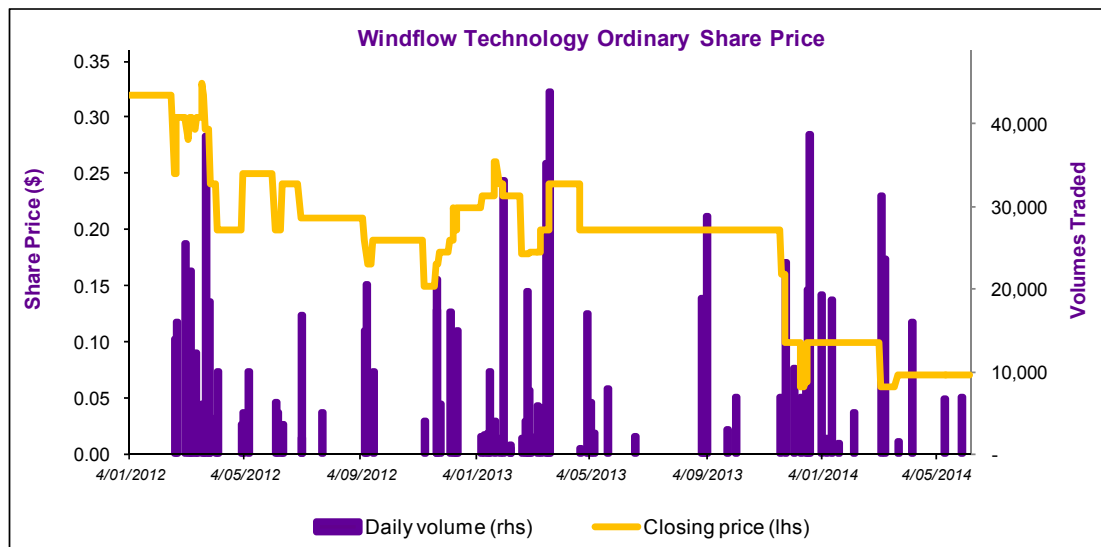
## 2.9 Dilutionary Impact

The Iles Placements and the Iles RCPS Conversion would result in the Non-associated Shareholders' proportionate shareholdings in the Company being diluted, depending on the number of RCPS allotted to Mr Iles under the Further Placements and whether Mr Iles or the Company elects to convert the RCPS:

- if Mr Iles' shareholding level increases to 44.70%, then each Non-associated Shareholder's proportionate interest in the Company will be diluted by 34.4%
- if Mr Iles' shareholding level increases to 72.98%, then each Non-associated Shareholder's proportionate interest in the Company will be diluted by 68.0%.

## 2.10 Impact on Ordinary Share Price and Liquidity

Set out below is a summary of Windflow Technology's daily closing ordinary share price and daily volumes of ordinary shares traded from 4 January 2012 to 9 June 2014.



Source: NZX Data

During the period, Windflow Technology's ordinary shares have traded between \$0.06 and \$0.33 at a volume weighted average share price (VWAP) of \$0.19.



Trading in the Company's ordinary shares is extremely thin. An analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of shares outstanding) is set out below.

Share Trading					
Period	Low <sup>1</sup> (\$)	High <sup>1</sup> (\$)	VWAP <sup>1</sup> (\$)	Volume <sup>1</sup> Traded (000)	Liquidity <sup>1</sup>
1 month	0.07	0.07	0.07	14	0.1%
3 months	0.06	0.07	0.07	55	0.3%
6 months	0.06	0.10	0.08	208	1.0%
12 months	0.06	0.20	0.11	311	1.5%

<sup>1</sup> Up to 9 June 2014  
Source: NZX Data

The shares have traded on only 24 days in the past year.

All of the RCPS are priced at \$0.50 each. Their conversion terms differ if they are to be converted by the Company:

- the March 2013 RCPS convert into 2 ordinary shares
- the December 2013 and the Iles Placements RCPS convert into 3 ordinary shares.

In theory, the conversion of (a maximum possible) 26,864,924 \$0.50 RCPS to (a maximum possible) 71,570,427 ordinary shares could have an impact on the Company's share price. However, based on the current share price of \$0.07, and taking into account the very thin trading in the Company's shares, we are of the view that the Iles RCPS Conversion would have little effect on the Company's share price. Given that the number of shares held by the Non-associated Shareholders would not necessarily change under the Iles RCPS Conversion, we do not consider the liquidity of the Company's shares would be impacted to any great extent.

## 2.11 Benefits to Mr Iles

The Iles RCPS Conversion provides Mr Iles with the opportunity to convert his RCPS to ordinary shares and thereby significantly increase his shareholding of ordinary shares and his level of shareholder voting control in Windflow Technology.

Mr Iles would hold between 44.70% and 72.98% of the Company's shares following the Iles RCPS Conversion. However, the actual shareholding level that Mr Iles would hold would depend upon:

- the extent to which Mr Iles subscribes for RCPS under the Further Placements
- the extent to which Mr Iles' RCPS are converted into ordinary shares by either himself or the Company and
- the extent to which the Non-associated Shareholders' RCPS are converted into ordinary shares by either themselves or the Company.

Rule 7(e) of the Code enables persons that hold or control between 50% and 90% of the voting rights in a code company to increase their holding or control of voting rights by a further 5% per annum (the **Creep Provisions**).

If, following the Iles RCPS Conversion, Mr Iles holds 50% or more of the voting rights in the Company, he will be able to utilise the Creep Provisions to increase his shareholding level.

## **2.12 Disadvantages to Mr Iles**

### ***Increased Exposure to the Risks of Windflow Technology***

As Mr Iles' ownership in Windflow Technology increases, so does his exposure to the key issues and risks that are likely to impact upon the business operations of Windflow Technology.

### ***Significant Financial Commitment***

Mr Iles may invest up to \$6.0 million for RCPS under the Iles Placements, some of which may be credited against the liability under the Iles Loan Facility. This represents a significant financial commitment and represents over 300% of the Company's current market capitalisation.

## **2.13 Benefits for the Non-associated Shareholders**

### ***Benefits to Windflow Technology of Mr Iles as a Cornerstone Shareholder***

Mr Iles is an important cornerstone investor in the Company. He is currently the largest shareholder in the Company, holding 15.65% of the ordinary shares and 77.52% of the RCPS. In addition, he has provided the £7.38 million Iles Loan Facility to finance 7 wind turbine projects in the UK.

Subject to shareholder approval, Mr Iles will provide further financial support to Windflow Technology through subscribing for up to \$6.0 million of RCPS through the Iles Placements (which may involve the conversion of the Iles Loan Facility to equity).

The provision of financial assistance will enhance Mr Iles' position as an important cornerstone investor in the Company.

### ***Non-associated Shareholder Approval is Required***

Pursuant to Rule 7(d) of the Code, the Non-associated Shareholders must approve by ordinary resolution the allotment of shares to Mr Iles under the Iles RCPS Conversion.

Neither Mr Iles nor the Company will be able to convert the Iles Placements RCPS into ordinary shares to increase Mr Iles' control of voting rights in the Company unless the Non-associated Shareholders approve the Iles RCPS Conversion Resolution.

However, irrespective of the voting on the Iles RCPS Conversion Resolution, Mr Iles will be able to convert all of the March 2013 RCPS and December 2013 RCPS that he holds as these are subject to the approval received at the 2013 Special Meeting.

## 2.14 Disadvantages to the Non-associated Shareholders

### *Dilutionary Impact*

Following the Iles RCPS Conversion, the Non-associated Shareholders proportionate interests in the Company could reduce by between 34% and 68%.

### *Likelihood of a Takeover Offer from Mr Iles may Reduce*

If, following the Iles RCPS Conversion, Mr Iles holds less than 50% of the voting rights, he will only be able to acquire more shares in the Company if:

- he makes a full or partial takeover offer or
- the acquisition is approved by way of an ordinary resolution of the Non-associated Shareholders or
- the Company makes an allotment of shares which is approved by way of an ordinary resolution of the Non-associated Shareholders or
- the Company undertakes a share buyback that is approved by the Non-associated Shareholders and Mr Iles does not accept the offer of the buyback.

If Mr Iles holds 50% or more of the voting rights, then he could increase his shareholding by up to 5% per annum utilising the Creep Provisions.

An increase in Mr Iles' control of voting rights to between 44.70% to 72.98% could reduce the likelihood of a takeover offer for the Company from Mr Iles as he may consider that he has sufficient control over the Company.

It is possible that if Mr Iles did make a takeover offer for further shares in the Company, he may offer a control premium that is lower than would otherwise be expected as he may value his offer on the basis that he already has significant control of the Company and hence does not need to pay a control premium of any significance.

### *Likelihood of Other Takeover Offers does not Change Significantly*

In our view, the increase in Mr Iles' shareholding from 15.65% to between 44.70% and 72.98% under the Iles RCPS Conversion would not have a material impact on the attraction of Windflow Technology as a takeover target to other parties.

Any bidder looking to fully take over the Company would need to ensure that Mr Iles would accept its offer. However, a bidder may be slightly less inclined to make a partial takeover offer for (say) 50.1% of the Company unless it was certain that Mr Iles would accept the offer.

## 2.15 Implications of the Resolution not being Approved

Shareholders approved the conversion into ordinary shares of the March 2013 RCPS and December 2013 RCPS held by Mr Iles at the 2013 Special Meeting. This permits Mr Iles to increase his control of voting rights in the Company to between 41.58% and 55.67%.

If the Iles RCPS Conversion Resolution is not passed, then any future conversion of the RCPS issued to Mr Iles under the Iles Placements that increases Mr Iles' control of voting rights in the Company beyond 55.67% will potentially result in a breach of the Code, thereby requiring remedial steps to be undertaken.

If Mr Iles considers this to be a potential issue, then he may be less inclined to subscribe for additional RCPS under the Further Placements. As stated in section 2.5, the prospects of the Company continuing as a going concern without the proceeds from the Iles Placements would be limited.

If the Iles Placements proceed but neither Mr Iles nor the Company convert some of the RCPS held by Mr Iles, then Windflow Technology will be obliged to redeem these RCPS on the fifth anniversary of their allotment. The redemption will require the Company to pay Mr Iles cash of \$0.50 per RCPS. This may require a significant cash outlay on the Company's part. Windflow Technology would need to look to alternative capital raising options to raise sufficient capital to redeem Mr Iles' RCPS. There is no guarantee that the alternative capital raising options will deliver the level of capital sought or provide capital within the desired timeframes.

We note that if the Deed Placement is not approved, Mr Iles has agreed to release the Company absolutely from the payment of the debt (up to \$1.0 million) under the Ludenhill Loan and to forgive the debt absolutely.

## 2.16 Voting For or Against the Resolution

Voting for or against the Iles RCPS Conversion Resolution is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

### **3. Sources of Information, Reliance on Information, Disclaimer and Indemnity**

#### **3.1 Sources of Information**

The statements and opinions expressed in this report are based on the following main sources of information:

- the draft notice of 2014 Special Meeting
- the RCPS Deed
- the December 2013 rights issue short-form prospectus and investment statement dated 26 November 2013 and amendments
- the March 2013 rights issue prospectus and investment statement dated 12 February 2013
- the Windflow Technology annual reports for the years ended 30 June, 2011 to 2013
- the Windflow Technology preliminary interim report dated December 2013
- the Windflow Technology management accounts for the 9 months ended 31 March 2014
- data in respect of Windflow Technology from NZX Data and Capital IQ.

During the course of preparing this report, we have had discussions with and / or received information from the Board and Windflow Technology's legal advisers.

The Board has confirmed that we have been provided for the purpose of this Independent Adviser's Report with all information relevant to the Iles Placements and the Iles RCPS Conversion that is known to them and that all the information is true and accurate in all material aspects and is not misleading by reason of omission or otherwise.

Including this confirmation, we have obtained all the information that we believe is desirable for the purpose of preparing this Independent Adviser's Report.

In our opinion, the information to be provided by Windflow Technology to the Non-associated Shareholders is sufficient to enable the Board and the Non-associated Shareholders to understand all the relevant factors and to make an informed decision in respect of the Iles RCPS Conversion.

#### **3.2 Reliance on Information**

In preparing this report we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was available from public sources and all information that was furnished to us by Windflow Technology and its advisers.

We have evaluated that information through analysis, enquiry and examination for the purposes of preparing this report but we have not verified the accuracy or completeness of any such information or conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of Windflow Technology. We do not warrant that our enquiries would reveal any matter which an audit, due diligence review or extensive examination might disclose.

### **3.3 Disclaimer**

We have prepared this report with care and diligence and the statements in the report are given in good faith and in the belief, on reasonable grounds, that such statements are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial position of Windflow Technology will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of Windflow Technology and its directors and management. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.

We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of the report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the report or assumptions reasonably taken as implicit.

Our evaluation has been arrived at based on economic, exchange rate, market and other conditions prevailing at the date of this report. Such conditions may change significantly over relatively short periods of time. We have no obligation or undertaking to advise any person of any change in circumstances which comes to our attention after the date of this report or to review, revise or update our report.

We have had no involvement in the preparation of the notice of 2014 Special Meeting issued by Windflow Technology and have not verified or approved the contents of the notice of 2014 Special Meeting. We do not accept any responsibility for the contents of the notice of 2014 Special Meeting except for this report.

### **3.4 Indemnity**

Windflow Technology has agreed that, to the extent permitted by law, it will indemnify Simmons Corporate Finance and its directors and employees in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity does not apply in respect of any negligence, wilful misconduct or breach of law. Windflow Technology has also agreed to indemnify Simmons Corporate Finance and its directors and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where Simmons Corporate Finance or its directors and employees are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, Simmons Corporate Finance shall reimburse such costs.

## **4. Qualifications and Expertise, Independence, Declarations and Consents**

### **4.1 Qualifications and Expertise**

Simmons Corporate Finance is a New Zealand owned specialist corporate finance advisory practice. It advises on mergers and acquisitions, prepares independent expert's reports and provides valuation advice.

The person in the company responsible for issuing this report is Peter Simmons, B.Com, DipBus (Finance), INFINZ (Cert).

Simmons Corporate Finance and Mr Simmons have significant experience in the independent investigation of transactions and issuing opinions on the merits and fairness of the terms and financial conditions of the transactions.

### **4.2 Independence**

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with Windflow Technology or Mr Iles or any conflicts of interest that could affect our ability to provide an unbiased opinion in relation to the Iles RCPS Conversion.

Simmons Corporate Finance has not had any part in the formulation of the Iles Placements or the Iles RCPS Conversion or any aspects thereof. Our sole involvement has been the preparation of this report.

Simmons Corporate Finance will receive a fixed fee for the preparation of this report. This fee is not contingent on the conclusions of this report or the outcome of the voting in respect of the Iles RCPS Conversion. We will receive no other benefit from the preparation of this report.

### **4.3 Declarations**

An advance draft of this report was provided to the Board for its comments as to the factual accuracy of the contents of the report. Changes made to the report as a result of the circulation of the draft have not changed the methodology or our conclusions.

Our terms of reference for this engagement did not contain any term which materially restricted the scope of the report.

### **4.4 Consents**

We consent to the issuing of this report in the form and context in which it is to be included in the notice of 2014 Special Meeting to be sent to Windflow Technology's shareholders. Neither the whole nor any part of this report, nor any reference thereto may be included in any other document without our prior written consent as to the form and context in which it appears.



Peter Simmons  
Director

**Simmons Corporate Finance Limited**  
9 June 2014