The New Zealand Merino Company Limited’s Prospective Financial Information, a reconciliation of non-GAAP to GAAP information and supplementary financial information

A. About this Document

The information contained in this document should be read in conjunction with the Product Disclosure Statement dated 23 October 2020 ("the PDS") prepared by The New Zealand Merino Company Limited ("NZM") and other information presented on the Offer Register.

Capitalised terms in this document have the same meaning as the terms defined in the PDS. This document contains the following information:

- Prospective financial information for NZM, including important assumptions that have been made in preparing that prospective financial information.
- A reconciliation between the GAAP financial information and non-GAAP financial information presented in the Table of Selected Financial Information in Section 7 (NZM's financial information) of the PDS.

B. Prospective Financial Information

Prospective consolidated financial statements for the years ending 30 June 2021 and 30 June 2022.

1. Introduction

The prospective consolidated financial statements of NZM comprise the following Prospective Financial Information ("PFI"):

- Prospective consolidated statement of comprehensive income;
- Prospective consolidated statement of financial position;
- Prospective consolidated statement of changes in equity;
- Prospective consolidated statement of cash flows;
- Basis of preparation and significant accounting policies;
- A description of the general and specific assumptions that support the PFI; and
- An analysis of the sensitivity of the PFI to changes in specific key assumptions.

The information contained in this document should be read in conjunction with the PDS and other information presented on the Offer Register.

2. Basis of Preparation

The PFI has been prepared in accordance with the requirements of Financial Reporting Standard 42: *Prospective Financial Statements*, as required by Clause 53(1)(c) of Schedule 3 to the Financial Markets Conduct Regulations 2014, specifically for the purpose of the offer of shares in NZM (the "Offer") and may not be suitable for any other purpose.

The PFI, including the assumptions underlying it, has been prepared by NZM's management and approved by the Board. It is based on the Board's assessment of events and conditions existing at the date of this PDS, the accounting policies and best estimate assumptions set out in Sections 3 and 5 below.

PFI by its nature involves risks and uncertainties, many of which are beyond the control of NZM. The Board believes that the PFI has been prepared with due care and attention, and consider the best estimate assumptions, when taken as a whole, to be reasonable at the time of preparing this PFI. Actual results are likely to vary from the information presented as anticipated events and results may not occur as expected, and the variations may be material. Accordingly, neither the Directors nor any other person can provide any assurance that the PFI will be achieved and investors are cautioned not to place undue reliance on the PFI.

The prospective consolidated statements of comprehensive income, prospective consolidated statements of changes in equity and prospective consolidated statements of cash flows cover the periods comprising the 12 months ending 30 June 2021 ("FY2021F") and 30 June 2022 ("FY2022F") (collectively the "**Prospective Period**"). The prospective consolidated statements of financial position are presented as at 30 June 2021 and 30 June 2022.

The FY2021F PFI includes actual results for July and 11 months of forecast information. While the forecast does not include the actual trading results for August and September, the operating results for this period are known and were materially consistent with the forecasts.

The Directors are responsible for and have authorised the issue of the PFI on 23 October 2020. There is no present intention to update the PFI or to publish PFI in the future, other than as required by regulations. NZM will present a comparison of the PFI with actual financial results in its FY2021F and FY2022F annual reports, as required by Regulation 64 of the Financial Markets Conduct Regulations 2014.

The PFI is presented in New Zealand dollars, unless otherwise specified, and is rounded to the nearest thousand dollars.

3. Significant Accounting Policies

The significant accounting policies applied in preparing the PFI are the same as the accounting policies as set out in the audited financial statements for the year ended 30 June 2020 for NZM (which are included on the Offer Register), and remain consistent through the Prospective Period.

Currently there are no anticipated changes to accounting standards under GAAP that are expected to materially affect NZM during the Prospective Period. However, any further changes to GAAP could necessitate changes in the accounting policies currently adopted and any new or amended accounting standards, or interpretation, may affect the actual financial results or financial position.

4. Prospective Financial Statements

4.1 Prospective consolidated statements of comprehensive income

$'000	FY2021F	FY2022F
Revenue	119,263	140,104
Cost of sales	(106,259)	(123,547)
Gross profit	**13,004**	**16,557**
Other income	4,793	4,129
Income from investments in other entities	0	0
Other income	**4,793**	**4,129**
Net finance costs	(373)	(343)
Depreciation and amortisation expense	(444)	(480)
Procurement and selling expenses	(4,494)	(4,802)
Marketing expenses	(3,468)	(3,860)
Innovation expenses	(3,337)	(3,327)
Administrative expenses	(4,287)	(4,388)
Share based arrangements	169	(24)
Other expenses	(20)	(21)
Expenses	**(16,254)**	**(17,245)**
Profit before income tax	**1,543**	**3,441**
Income tax expense	(432)	(963)
Profit / (loss) after tax	**1,111**	**2,478**
Other comprehensive income / (loss)		
Items that may be reclassified subsequently to profit or loss	0	0
Gains / (losses) from cash flow hedges		
Income tax relating to other comprehensive income	0	0
	0	0
Total comprehensive income	**1,111**	**2,478**

Calculation of prospective EBIT		
Profit / (loss) after tax	**1,111**	**2,478**
Income tax expense	432	963
Net finance costs	373	343
Earnings before interest and tax ("EBIT")	**1,916**	**3,784**

The prospective consolidated statements should be read in conjunction with the notes to the prospective consolidated financial statements in Sections 1, 2, 3 above and Sections 5 and 6 below.

4.2 Prospective consolidated statements of financial position

($'000)	FY2021F	FY2022F
ASSETS		
Current assets		
Cash and cash equivalents	6,846	9,965
Trade and other receivables	11,216	7,041
Inventories	12,162	12,155
Total current assets	**30,224**	**29,161**
Non-current assets		
Property, plant and equipment	2,021	1,744
Investments in other entities	15	15
Deferred tax	182	182
Intangible assets and goodwill	5,826	5,719
Right-of-use assets	4,828	4,245
Total non-current assets	**12,872**	**11,905**
Total assets	**43,096**	**41,066**
LIABILITIES		
Current liabilities		
Current portion of share-based arrangements provision	605	613
Current portion of income in advance	36	36
Trade and other payables	7,672	4,002
Lease liabilities	448	487
Total current liabilities	**8,761**	**5,138**
Non-current liabilities		
Long term incentive provision	114	332
Non-current portion of income in advance	381	345
Share based arrangements provision	1,011	1,026
Lease liabilities	4,676	4,150
Total non-current liabilities	**6,182**	**5,853**
Total liabilities	**14,943**	**10,991**
Net assets	**28,153**	**30,075**
EQUITY		
Share capital	11,071	11,071
Retained earnings	17,082	19,004
Total equity	**28,153**	**30,075**

The prospective consolidated statements should be read in conjunction with the notes to the prospective consolidated financial statements in Sections 1, 2, 3 above and Sections 5 and 6 below.

4.3 Prospective consolidated statements of changes in equity

($'000)	Share Capital	Retained Earnings	Cash Flow Hedge Reserve	Total Equity
Balance at 1 July 2020	1,471	15,971	(1,093)	16,349
Profit for the year	-	1,111	-	1,111
Other comprehensive income	-	-	1,093	1,093
Share based arrangement	-	-	-	-
Dividend	-	-	-	-
Capital raising	9,600	-	-	9,600
Balance at 30 June 2021	**11,071**	**17,082**	**-**	**28,153**
Balance at 1 July 2021	**11,071**	**17,082**	**-**	**28,153**
Profit for the year	-	2,478	-	2,478
Other comprehensive income	-	-	-	-
Dividend	-	(556)	-	(556)
Balance at 30 June 2022	**11,071**	**19,004**	**-**	**30,075**
Carry amounts				
At 1 July 2020	1,471	15,971	(1,093)	16,349
At 30 June 2021	11,071	17,082	-	28,153
At 30 June 2022	**11,071**	**19,004**	**-**	**30,075**

The prospective consolidated statements should be read in conjunction with the notes to the prospective consolidated financial statements in Sections 1, 2, 3 above and Sections 5 and 6 below.

4.4 Prospective consolidated statements of cash flows

$'000	FY2021F	FY2022F
Net cash from / (used in) operating activities		
Cash provided from:		
Receipts from customers	128,267	159,014
Interest income received	12	79
	128,279	159,093
Cash applied to:		
Payments to suppliers and employees	(129,485)	(153,509)
Income tax paid	(644)	(904)
Interest paid	(103)	(160)
Interest paid on leases	(282)	(262)
	(130,514)	(154,835)
Net operating cash flows	**(2,235)**	**4,258**
Net cash from / (used in) investing activities		
Cash applied to:		
Acquisition of intangibles	(192)	(30)
Purchase of property, plant and equipment	(154)	(66)
	(346)	(96)
Net investing cash flows	**(346)**	**(96)**
Net cash from / (used in) financing activities		
Cash provided from:		
Issue of Shares	12,600	-
	12,600	-
Cash applied to:		
Dividend	-	(556)
Capital raising costs paid	(500)	-
Buyback of Shares	(2,500)	-
Payments for leases	(448)	(487)
	(3,448)	(1,043)
Net financing cash flows	**9,152**	**(1,043)**
Net increase / (decrease) in cash balances	**6,571**	**3,119**
Cash balances at beginning of year	275	6,846
Cash balances / (bank overdraft) at the end of year	**6,846**	**9,965**

The prospective consolidated statements should be read in conjunction with the notes to the prospective consolidated financial statements in Sections 1, 2, 3 above and Sections 5 and 6 below.

5. General and Specific Assumptions

The following general and specific assumptions have been adopted in preparing the PFI. The general and specific assumptions contained in this section should be read in conjunction with Section 8 (Risks to NZM's business and plans) of the PDS.

5.1 General Assumptions in Respect of the PFI

- **COVID-19** – there will be no material disruption to NZM's wool season as a result of COVID-19 or any lock-down measures which may limit the ability to obtain wool. There will be no material additional disruption to NZM's operations, Growers, Value Chain Partners or its Brand Partners above what has already been experienced or incorporated in this PFI.

- **General economic environment** – there will be no material changes in the economic outlook for the New Zealand and international markets in which NZM sells products, beyond normal market movements in wool prices.

- **Political, legislative and regulatory environment** – there will be no material change to the political, legal or regulatory environments in which NZM acquires its inputs, sells its products or otherwise operates, including in relation to biosecurity controls and restrictions on the importation of wool into the offshore markets in which NZM sells or intends to sell its products.

- **Biosecurity** – there will not be any disease incursion or other biosecurity events impacting NZM, other New Zealand wool producers, sheep farmers, or New Zealand agriculture products.

- **Competitive environment** – there will be no material change in the competitive dynamics of the markets in which NZM operates or sells its products, including any material change in competitor activity or competing ethical wool brands. It is assumed that no new entrants will materially change the competitive environment in which NZM operates.

- **Industry conditions** – there will be no material change in the general industry structure, third party relationships, trends in seasonal demand or general employment conditions.

- **Key suppliers and customers** – there will be no change in key Grower suppliers, Value Chain Partners or Brand Partners and existing contractual, business and operational arrangements will remain in place. While NZM has witnessed impacts from COVID-19, Grower supply, Value Chain Partner and Brand Partner terms are expected to return to contractual terms in FY2022F after delivery and payment delays in FY2021F. Should any Grower suppliers, Value Chain Partner or Brand Partner customers be lost, it is assumed they are replaced on materially similar terms. Key Grower suppliers, Value Chain Partner and Brand Partner customers will comply with their contractual obligations.

- **Disruption to operations** – there will be no material disruption to operations, including through disruption to the New Zealand wool shearing season, natural disasters, environmental conditions, accidents, fires, product supply or quality issues or through normal hazards associated with activities (including disruptions to or affecting any of NZM's key Growers or Brand Partners). There will also be no disruption to NZM's Value Chain Partners which impact on the distribution of NZM's products.

- **Operating environment** – there will be no material costs incurred through either industrial or contractual disputes.

- **Business acquisitions or disposals** – there will be no material business acquisitions or disposals by NZM.

- **Management of NZM** – no key personnel will leave NZM, and management resources will be sufficient for NZM's requirements.

- **New Zealand and international tax laws** – there will be no material change to the tax rates or laws (including income tax, excise tax, import duties or goods and services tax) in New Zealand or the offshore markets in which NZM operates.

- **Financial Reporting Standards** – there will be no change in financial reporting standards or accounting interpretations which would have a material effect on NZM.

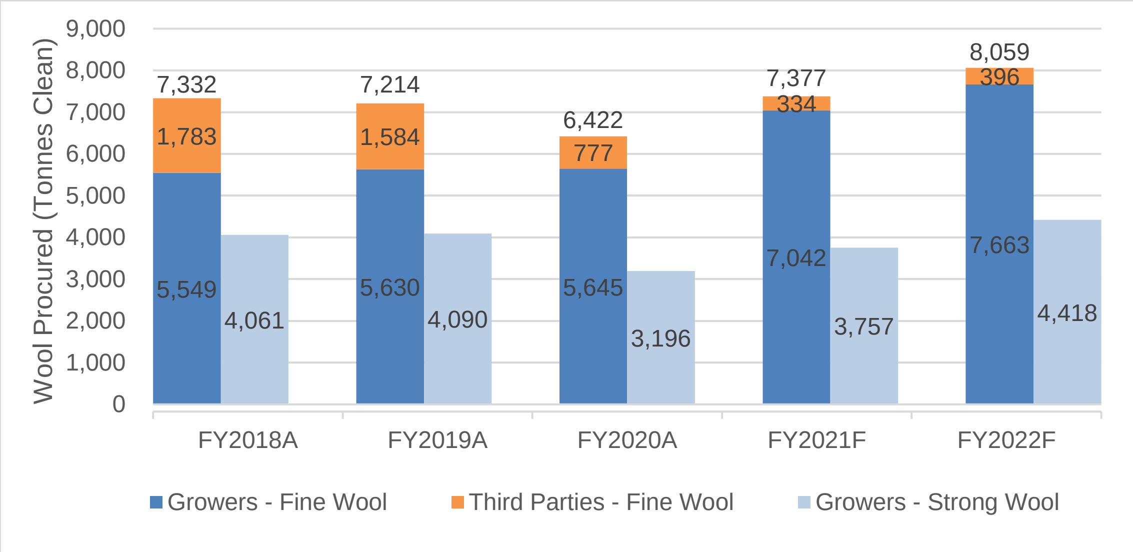
5.2 Specific Assumptions

5.2.1 Wool volumes

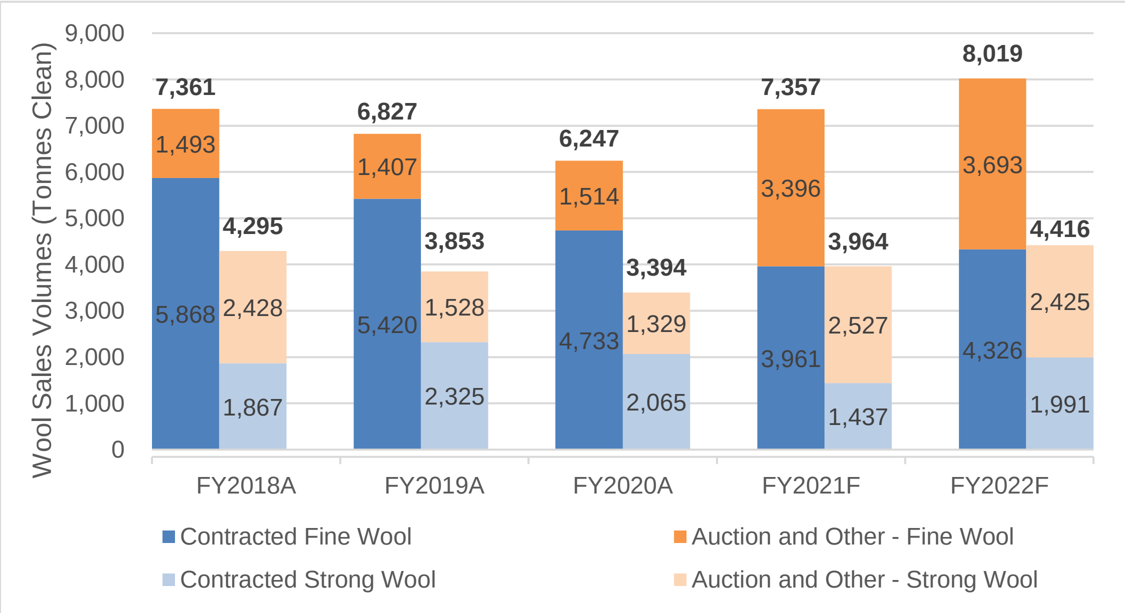
NZM's financial performance is strongly influenced by the wool volumes transacted with Growers and sold to Brand

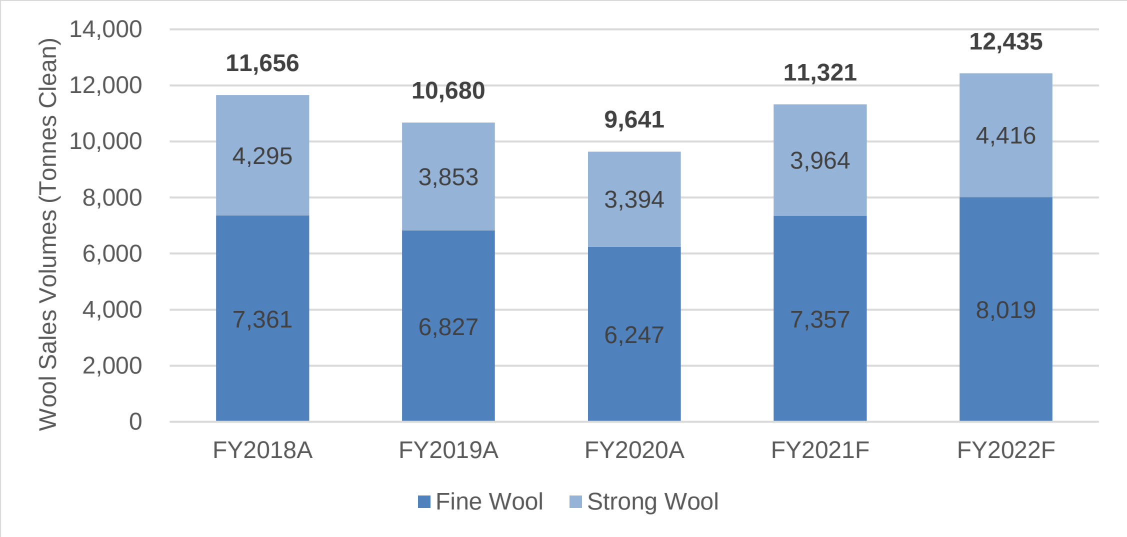
Partners. NZM's margin is also impacted by the level of contracted purchase volumes from Growers and contracted short term sales volumes with Brand Partners or Value Chain Partners as well as the amount of fine wool volumes and strong wool volumes.

The chart below illustrates the actual and forecasted bales procured by NZM for fine and strong wool, split into bales procured from Growers, and for fine wool bales procured from third-parties which are used to manage the difference between demand and supply in any given year. This demonstrates that procured wool volumes are expected to increase in both FY2021F and FY2022F, after a reduction in FY2020 primarily due to reduced third-party fine wool bales and reduced strong wool bales following the impact of COVID-19 in that year. Increased procured wool volumes in FY2021F and FY2022F are due to the expected impact of NZM's ZQRX initiative, some Brand Partner growth and forecast increased market-share in mid micron and strong wools. In FY2021F and FY2022F a larger percentage of procured wool is also expected to be sold through auction reflecting an expected decline in short term contract opportunities given the expected COVID-19 impact, and also specific initiatives to target more accredited mid-micron wool being sold at auction in Melbourne.



The charts below illustrate actual and forecast contracted and auction wool sales volumes as well as the split of sales between Fine Wool and Strong Wool. The chart reflects the increased bale volumes procured expectations described above.





Volumes procured from Growers and third parties are closely aligned with sales volumes. Any volumes unsold in each period are taken into inventory for sale in subsequent periods (see Section 5.2.6 on working capital).

5.2.2 Revenue

Revenue

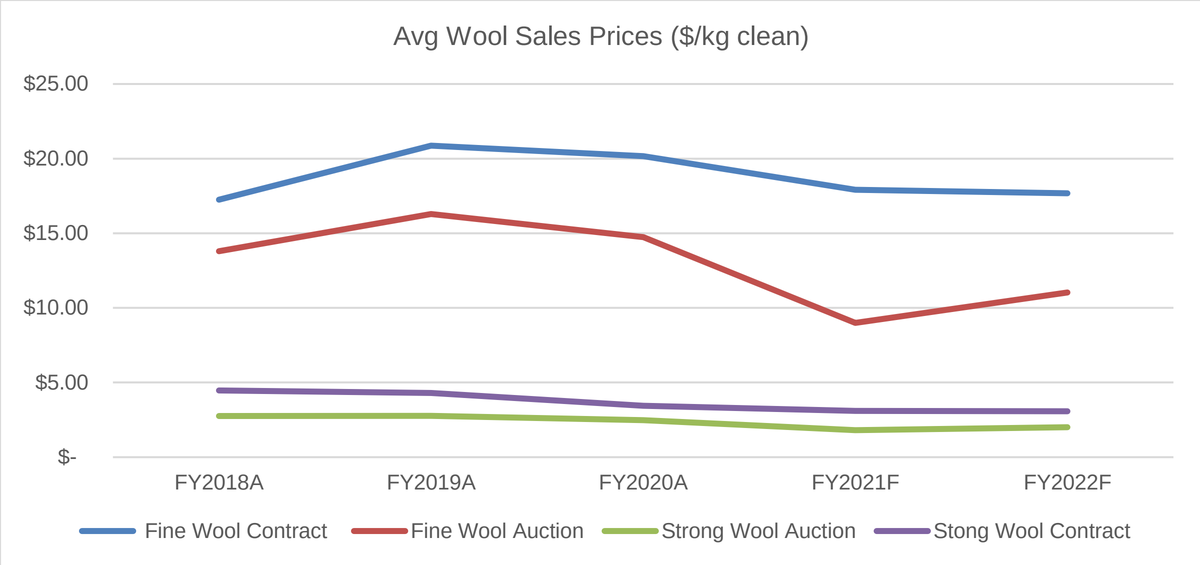
NZM primarily derives its revenue from three key sources:

1. Contract and Auction Wool Sales;
2. Wool Fees and Charges; and
3. Other Income.

Income Sources					
$'000	**FY2018**	**FY2019**	**FY2020**	**FY2021F**	**FY2022F**
Wool Sales	136,866	150,009	128,007	108,738	128,041
Fees and Charges	9,732	10,117	9,774	10,525	12,063
Total Revenue	**146,598**	**160,126**	**137,781**	**119,263**	**140,104**
Other Income	4,436	5,048	4,209	4,793	4,129
Total Income	**151,034**	**165,174**	**141,990**	**124,056**	**144,233**

Wool Sales Revenue

Wool sales revenue is driven by the volume of wool sold, the average price per kg of wool achieved and where applicable the foreign exchange rates used to convert sales to New Zealand dollars. The pricing for wool also demonstrates significant variability between wool varieties depending on the grade and micron of the wool, and whether the wool is ZQ or RWS certified. Pricing also varies depending on contract terms with Brand Partners (and relevant Value Chain Partners) while auction pricing may vary over the course of a financial year depending on prevailing market prices. The chart below illustrates historic and Prospective Period forecasts for average pricing across Fine Wool and Strong Wool blends for both contracted and auction volumes. While pricing may vary significantly across wool blends, microns and contracts, the pricing has been simplified as an average in order to demonstrate the underlying trend and relative contribution to NZM earnings.



The relative pricing achieved over the last three years demonstrates that NZM has generated Premiums for contracted wool volumes, underpinned by ZQ, over their equivalent auction volumes. This outcome is anticipated to continue over the Prospective Period. Auction prices are based on management's estimate of future wool prices in the current environment. While wool prices may vary and be significantly higher or lower, NZM's contract business model and back-to-back sales arrangements for contract and auction volumes means that while Wool Sales Revenue may vary significantly, it will have less of an impact on NZM's trading margins (see Wool trading margins below)

Fees and Charges

NZM charges its growers a number of fees and charges that are common to all wool brokers, as well as a number that are unique to its supply base. The main fees are the Marketing and Innovation Fee and a Consolidated Charge. The Marketing and Innovation Fee is currently 4% of the total wool sales value to cover market development, differentiation and innovation work. The Marketing and Innovation Fee is anticipated to remain constant over the Prospective Period.

The Consolidated Charge is a cents per kilogram fee on all wool sold and is in the range of $0.18/kg (Greasy) to $0.30/kg (Greasy) depending on the sales channel.

NZM also charges all New Zealand Fine Wool growers a Production Science Fee of $0.0525 per kg Greasy to support on-farm initiatives for Fine Wool growers. The Production Science Fee is anticipated to remain constant over the Prospective Period and applied to forecast fine wool volumes.

Fees and Charges income increases over the PFI period on the back of expected increased bale volumes.

Other Income

Other Income is forecast to increase 13.9% in FY2021F in line with currently budgeted external funding from the W3 'Wool Unleashed' Primary Growth Partnership (PGP) programme with the Ministry for Primary Industries for the New Zealand strong wool sector. Other Income is then forecast to decrease 13.9% in FY2022 due to the agreed PGP funding in that year being lower. Other items of Other Income are expected to be largely constant over the prospective period.

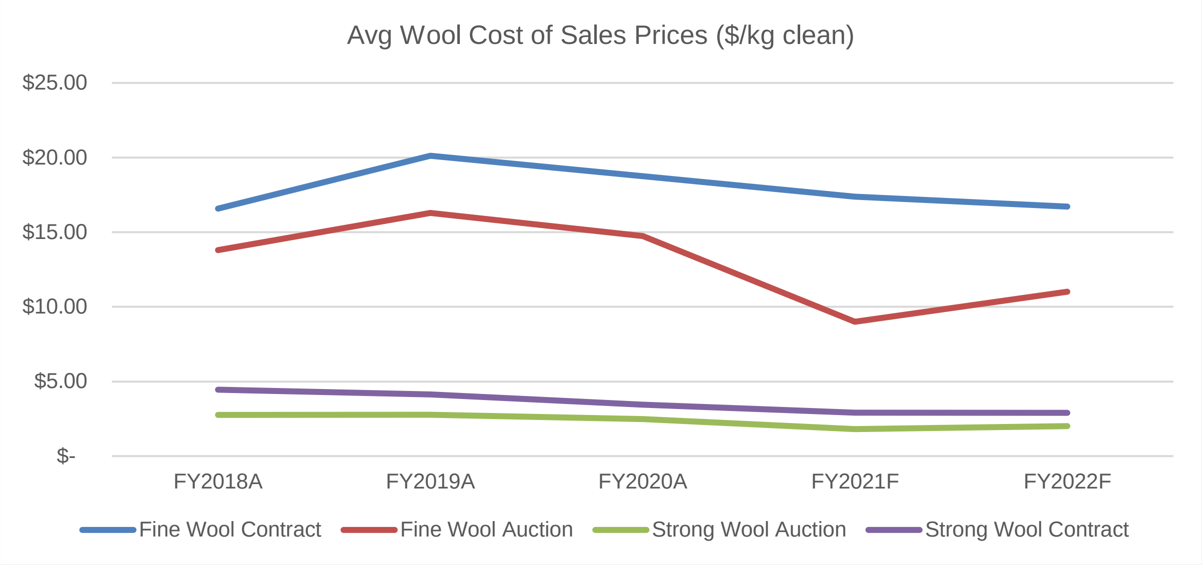
Foreign Exchange Rates

NZM has some foreign exchange exposure as a result of sales transactions denominated in foreign currencies. However, NZM's contracts with Growers, Value Chain Partners and Brand Partners are predominantly in NZD with any foreign currency exposure immediately hedged in NZD. The forecasts assume all contract pricing is in NZD with NZM not exposed to movements in foreign currency rates.

5.2.3 Cost of sales and trading margin

Cost of Sales

Cost of sales predominantly include wool purchase costs from Growers through contract or auction, and from Value Chain Partners. As for wool sales revenue, cost of sales is impacted by the volume contracted with Growers, the cost for contracted and auction volumes, the grade and micron of the wool, and the ZQ or RWS accreditation. The chart below illustrates historic and Prospective Period forecasts for average cost of sales across Fine Wool and Strong Wool blends for both contracted and auction volumes. As for the average wool sales prices, the cost of sales has been simplified as an average in order to demonstrate the underlying trend and relative impact on NZM earnings.



The cost of sales movements through time show a similar pattern to the wool sales prices. This reflects the contract nature of NZM's business and highlights that NZM does not make a trading margin on auction volumes which are purchased and sold in back-to-back arrangements. Consequently, trading margins on short term contracted sales volumes and open market trading opportunities provide a better determinant of NZM profitability than sales revenue (see below).

The cost of sales for the Prospective Period are based on current forward contract pricing and management's estimates of future wool prices in the current environment.

Wool Trading Margin

NZM's wool sales, in particular its contract model, is fundamental to its ability to create trading margins. NZM is able to create a trading margin from short-term opportunities. Brand Partners and Value Chain Partners commonly place orders that were not forecasted or contracted with an expedited delivery date. In such cases, NZM sources suitable wool from the most available and cost-effective sources, that could be the auction system or wool held in inventory. This provides NZM with an opportunity to generate a trading margin. Trading margins are also created from wool that is bought and sold on the open market.

The volatility of the wool commodity market means the variation in trading opportunities is high. However, NZM has consistently demonstrated an ability to create trading opportunities, which has the greatest impact of all revenue streams on net profit before tax.

As shown in the table below, NZM's wool trading margin increased over the historical period but is forecast to decline significantly in FY2021F due to the impacts of COVID-19 before recovering in FY2022F. The trading margin is largely influenced by the sales price for short term opportunities relative to the cost of wool purchased.

Trading Margin					
($'000)	**FY2018A**	**FY2019A**	**FY2020A**	**FY2021F**	**FY2022F**
Wool Sales	136,866	150,009	128,007	108,738	128,041
Cost of Sales	(132,879)	(145,509)	(121,311)	(106,259)	(123,547)
Trading Margin	**3,987**	**4,500**	**6,696**	**2,479**	**4,494**

The table demonstrates that NZM has made a trading margin of between $4.0 and $6.7 million over the historic period. Trading margins are forecast to reduce to $2.5 million in FY2021F before recovering to $4.5 million in FY2022F. The key factors influencing the forecast trading margins in FY2021F are the direct result of COVID-19: a reduction in Brand Partner requirements means that NZM needs to clear excess stock. NZM's expectation is that trading margins should be closer to pre-COVID-19 levels in FY2022F.

5.2.4 Other direct costs and operating expenses

Procurement and selling expenses

Procurement and selling expenses primarily reflect the personnel costs of the NZM procurement and sales teams, and the costs of logistics and storage of wool. These expenses have been forecast based on expected staff levels and the volumes of wool sold, with per unit logistics costs at a fixed and constant price per bale.

Marketing and innovation expenses

Marketing and innovation expenses primarily include the personnel costs of the NZM marketing and innovation teams and the in-market and differentiation activities undertaken with Brand Partners and Value Chain Partners.

Marketing and innovation expenses have been forecast to decrease in FY2021F due to significantly reduced international travel and reduced direct Brand Partner activity as a result of COVID-19 travel restrictions.

Administration and other expenses

Administration and other expenses primarily relate to selling, general and administrative costs. Administration expenses are forecast to increase in both FY2021F and FY2022F, primarily as a result of increased occupancy costs for the NZM premises.

5.2.5 Depreciation, amortisation and capital expenditure

NZM does not have any significant fixed assets or intangible assets other than goodwill. Depreciation and amortisation in the PFI is based on the existing rates of depreciation and amortisation adjusted for planned capital expenditure and are not material.

5.2.6 Working Capital

Working Capital ($'000)	FY2018	FY2019	FY2020	FY2021F	FY2022F
Trade and other receivables	6,118	7,332	5,582	11,216	7,041
Inventories[1]	5,116	11,834	11,931	12,162	12,155
Trade and other payables	(4,257)	(6,212)	(5,055)	(7,672)	(4,002)
Net Working Capital	**6,977**	**12,954**	**12,458**	**15,706**	**15,194**

1. *Wool inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business. Cost is based on actual cost for all wool purchased and includes expenditure incurred in acquiring the inventories and bringing them to their existing condition.*

NZM's FY2021F working capital balances have been forecast as follows:

- Given the impacts of COVID-19 on Brand Partners, NZM has agreed a payment deferral with Growers that have contracts with NZM. The amended terms are for 25% of net sale proceeds to be paid on the contractual due date with the balance to be paid within 90 days of the contractual due date.

FY2022F working capital has been forecast based on a return to normal grower payment terms based upon contractual due dates.

NZM's operations have a large seasonal component to them. Costs are incurred procuring wool from Growers ahead of sales to Brand Partners or Value Chain Partners, at times many months in advance due to New Zealand Merino wool only being available to purchase for a short period of time while Brand Partner demand is constant across the year. This gives rise to seasonal peak funding requirements during the wool shearing season and beyond, typically peaking around December as wool inventories increase. In FY2021F some of this inventory is funded through deferred payment to Growers but a significant portion is funded through NZM's seasonal bank funding facility. In FY2022F all of the inventory build-up is expected to be funded through NZM's seasonal bank funding facility.

Trade and other receivables peak around January as the large inventory levels held over the peak summer season are subsequently sold.

5.2.7 Financing

NZM has an overdraft facility with ASB Bank Limited for up to $3 million and a seasonal funding facility of up to $22 million. As of 12 October 2020, $15 million of the seasonal funding facility was drawn down. The facilities are secured by a General Security Agreement over the assets and undertakings of NZM.

Facility	Facility Size	Expiry Date
Seasonal funding facility	$25 million	30 June 2021

The table below highlights that NZM's net indebtedness is relatively low at the end of the financial year for each year in both the historical period and Prospective Period. However, this is not illustrative of intra-year movements, with drawn borrowings typically peaking in December due to NZM's seasonal working capital requirements as described in Section 5.2.6. The table therefore also includes peak debt witnessed over the relevant financial year in order to illustrate the seasonality.

Bank Debt ($'000)	FY2018	FY2019	FY2020	FY2021F	FY2022F
Seasonal / overdraft facility	0	2,657	0	0	0
(Net cash)	(2,708)	0	(275)	(6,846)	(9,965)
Net External Indebtedness / (Cash)	**(2,708)**	**2,657**	**(275)**	**(6,846)**	**(9,965)**
Peak facility drawn over financial year	**11,898**	**17,050**	**22,754**	**20,497**	**19,840**

Over the course of FY2021F, NZM's seasonal funding requirements are expected to peak at approximately $30 million in the absence of the Offer. Proceeds from the Offer will be immediately applied, as detailed in 5.2.8 below, against NZM's forecast seasonal funding facilities in order to reduce reliance on these facilities and provide further financial flexibility for growth.

Interest expense on drawn seasonal funding facilities is forecast at an average rate of 2.28% for FY2021F and 2.78% for FY2022F based on interest rate agreements currently in place and forecast interest rates and current margins under the banking facilities.

NZM's banking facilities include the following financial covenants:

- Shareholders' funds (measured as tangible assets less total liabilities) must not be less than $8.0 million, tested at the end of each financial year;
- Inventory and trade receivables must be greater than 1.2x drawn debt under the facilities, tested monthly; and
- Earnings (EBITDA) must be greater than 1.5x interest funding costs until 30 June 2021 and then 2.5x thereafter.

NZM is not forecast to breach banking covenants over the Prospective Period as shown in the table below.

Financial Covenants ($'000)	FY2021F	FY2022F
Shareholders' funds (>$8,000)	17,302	19,914
Inventory and receivables / seasonal funding facility (>1.2x)	NA	NA
Earnings / interest (>2.5x)	6.3x	12.4x

5.2.8 Offer proceeds and Buy-back

The forecasts assume that NZM raises the full $12.6 million under the Offer at an Offer Price of $3.80 as described in Section 3 (Purpose of the Offer) of the PDS. The Offer proceeds are forecast to be utilised as follows:

- $9.6 million primarily towards NZM's banking facilities to strengthen NZM's balance sheet or retained as cash to provide future working capital flexibility or to support growth strategies;
- $2.5 million is used to fund the proposed Buy-back. Such shares purchased under the Buy-back are assumed to be cancelled; and
- $0.5 million for costs associated with the Offer.

The net impact of the above is that NZM issues a further 2,644,078 shares (net of the Buy-back).

5.2.9 Taxation

The forecasts assume an effective income tax rate of 28% in both FY2021F and FY2022F, consistent with the current New Zealand corporate tax rate.

5.2.10 Dividends

Dividends are made at the Board's discretion and depend on NZM's financial performance. The payment of dividends is not guaranteed, and NZM's dividend policy may change over time. In declaring dividends, NZM must comply with the solvency test under the Companies Act and the covenants under NZM's banking facilities.

The current dividend policy is a targeted dividend pay-out ratio of 50% of NPAT provided the board considers there is no better use of the funds. However, NZM has decided to suspend the FY2020 dividend due to the current market uncertainty caused by COVID-19 and the Offer. A dividend for each of FY2021F and FY2022F is forecast to be declared at 50% of forecast distributable profit being, $556,000 in FY2021F and $1,239,000 in FY2022F. While the dividend in respect of FY2021F is forecast to be paid in FY2022F, the dividend for FY2022F is forecast to be paid outside of the Prospective Period. NZM anticipates that dividends will be fully imputed.

6. Group Sensitivity Analysis

PFI is subject to uncertainty. Actual results are therefore likely to vary from PFI and this variation could be material. We refer you to Section 8 of the PDS (Risks to NZM Group's business and plans) and the document on the Offer Register called "Other Material Information relating to the Offering of Ordinary Shares in The New Zealand Merino Company Limited", for information on the risks faced by NZM Group, which includes potential ongoing impact of COVID-19 which is highly uncertain. The PFI is sensitive to a number of variations in certain assumptions used in its preparation. A summary of the likely effect that variations to certain assumptions may have on the PFI is detailed below. The sensitivities for each assumption are not intended to be indicative or predictive of the possible range of outcomes but are for information purposes to allow potential investors to gain an understanding of potential sensitivities of financial outcomes to changes in key assumptions.

Care should be taken in interpreting the sensitivity information set out below. Each movement in an assumption is treated in isolation from possible movements in other assumptions, which is not likely to be the case. Movements in one assumption may have offsetting effects or compounding effects on other variables, the impact of which is not reflected in the PFI. In addition, it is possible that more than one assumption may move at any point in time, giving rise to cumulative effects which are not reflected in the PFI. We note that the potential ongoing impact of COVID-19 is highly uncertain and may have a cumulative impact on the drivers of NZM's future financial performance (including volumes, prices, trading margins and costs), including in combination with any of the other risks noted in Section 8 of the PDS and the Offer Register materialising.

Key assumptions that are considered to have a significant potential impact on NZM's forecast financial performance are described below. These assumptions focus on wool volumes and prices, also being amongst the factors which NZM expects to be most significantly impacted by COVID-19 (see Section 8 of the PDS for details of the risks associated with COVID-19) and which would likely have the most impact on the drivers of NZM's returns, particularly NZM's trading margin (see Section 1.6 (Key drivers of return) and Section 2.5 (Our Operations)).

- **Volumes**
  - The majority of NZM's sales volumes are contracted with Brand Partners and Value Chain Partners, or as open market contracts under which NZM typically earns a trading margin. The remaining sales volumes are sold through auction.
  - Should forecast auction sales volumes vary, NZM will likely achieve lower or higher auction revenues. This will impact on the Fees and Charges it receives. This sensitivity simplistically assumes that a change in volume only impacts on NZM's Fees and Charges and variable costs such as logistics while operating costs are assumed to be fixed.
- **Price (impact on fees and charges)**
  - The impact of spot market price variations is similarly limited to auction sales impacting fees and charges earnt by NZM.
- **Auction sales prices (impact on trading margin)**
  - A significant portion of NZM's earnings are through trading opportunities on sales orders that were not anticipated or contracted. In these instances, NZM sources wool from its available stock or purchased on the auction market. However, the trading margin on such opportunities may decrease or increase depending on the pricing for auction sales.
  - This sensitivity assumes that sales prices for auction sales increase or decrease with no offsetting countermeasures by NZM.

The table below illustrates the impact on NZM's EBITDA of various movements in these assumptions used in the Prospective Period. These sensitivities do not take into account any mitigating measures NZM may take if the actual value for each key parameter is different from the assumed value.

Sensitivities	Sensitivity Range	Impact on EBITDA ($'000)
Volumes		
FY2021F	+ / - 10%	$317 to ($317)
FY2022F	+ / - 10%	$385 to ($385)
Price		
FY2021F	+ / - 10%	$146 to ($146)
FY2022F	+ / - 10%	$191 to ($191)
Non-contracted sales prices		
FY2021F	+ / - 10%	$786 to ($786)
FY2022F	+ / - 10%	$2,044 to ($2,044)

C. Reconciliation of Non-GAAP to GAAP Information

$'000	FY2016A	FY2017A	FY2018A	FY2019A	FY2020A	FY2021F	FY2022F
Profit / (loss) after tax	**2,712**	**2,769**	**3,226**	**2,169**	**2,839**	**1,111**	**2,478**
Income tax expense (income)	(351)	144	407	971	1,172	432	963
Net finance costs	199	109	111	276	648	373	343
EBIT	**2,560**	**3,022**	**3,744**	**3,416**	**4,659**	**1,916**	**3,784**
Depreciation and amortisation expense			189	263	357	444	480
EBITDA			**3,933**	**3,679**	**5,016**	**2,360**	**4,264**
Indirect expense			**10,581**	**12,165**	**11,698**	**10,943**	**11,620**
CONTRIBUTION MARGIN			**14,514**	**15,844**	**16,714**	**13,303**	**15,884**