

Summary: Wellington 2004 Full Year Result

Overview

The year has seen good progress in establishing Wellington as a reliable supplier of electronic motors and associated components, and as a reliable provider of customised motor solutions for licensees. However, it has also been a year of delays which have adversely affected our financial results.

It is satisfying to report that our products are being delivered in moderate quantities to Europe, our main European licensees are progressing well, and sales enquiries, requests for samples and requests for quotations are rising. Discussions with several potential new licensees are progressing. Overall, Wellington is meeting the requirements of demanding customers.

As reported in March, changes to the scope and timing of supply contracts and development programmes earlier this year delayed revenue receipts. Though now rectified, "teething" problems during the start-up of production of new motors and controllers resulted in some unwelcome and unexpected costs. Consequently, the financial results do not yet reflect the progress the Company has made.

Delays are disappointing. Nevertheless, as predicted in March, volume deliveries of motors and controllers began in June and have continued steadily since then. Our projects with European licensees are nearing completion. We have invested in infrastructure, product development and intellectual property, and have established production, selling and distribution capabilities. Flexible contract manufacturing capacity is being established in Asia to allow for the rapid and sustained increase in sales that is expected and to optimize production costs and stock holdings. Overall, the company is becoming well positioned to achieve the strong revenue growth that we are expecting.

Background Note

Wellington produces and sells electronically-commutated electric motors for domestic and industrial appliances. We also offer licenses to companies that want to build our designs into their own end products, or make motors for sale, and we provide engineering support services to assist them. Our motors are usually called "EC" or "electronic", because electronic controllers and software are major components within the motors. EC motors have high energy efficiency compared to familiar electric motors, and this is a major reason for demand today, particularly in our target markets in Europe and the United States, where electricity is generated from expensive oil and gas. Using electronic motors saves energy.

Wellington electronic motors are efficient and save energy. Compared to other EC motors, our products are usually quieter and vibrate less. Our motors can be made in standard and, just as importantly, non-standard shapes more cost effectively than most other types of motors. These factors are important for many types of domestic appliance, giving cost savings and offering better industrial design options. They are the major reasons why a Wellington motor will be chosen over a competitor's product.



Financial Review

The consolidated loss before tax and before unusual items was \$2.9 million, compared to the loss of \$2.3 million in the year ended 30 June 2003. Revenues from product sales were greater than the previous year, in spite of the delays reported in March. Revenues from engineering projects were also greater than the previous year.

At the same time the infrastructure necessary to supply products to customers and licensees has been put in place. This has required the Company to invest in further product development, in-market sales and marketing, distribution, production and stock. Costs were higher than last year reflecting these actions (UK distribution centre costs up \$73,000 and overseas sales representation and exhibition costs up \$177,000, engineering costs up \$113,000 and depreciation up \$81,000).

Stock on hand at year end was \$746,000, an increase on the previous year's (\$285,000), as we began to produce larger numbers of motors and controllers. Fixed assets increased from the previous year. The increases were again associated mainly with starting production of new motor and controller types and completion of the development of new products launched late last year.

Our financial results are still strongly linked to timing issues. Our target market is mature, conservative companies with long lead times for new product introductions and for changes in suppliers. In most cases, starting to use Wellington motors is the first major change that our customers have made for many years. The change process has taken longer than we expected, and it has also taken longer than customers and licensees themselves expected. This has affected the timing of our revenue receipts, although working through, and overcoming, the detail problems that have arisen has strengthened our relationships with our customers and licensees.

Operational Review

Product Sales and Deliveries

The successful delivery of initial orders to high-profile European clients has seen reorders for larger numbers. There has been an increase in the level of enquiry stemming partly from the visible fact that more motors in finished products are being sold to consumers.

Deliveries of trial quantities of Wellington motors and controllers to European customers, under the Supply Agreements announced last year, began in December 2003. A variety of detail changes were made to electronics and software earlier this year (as advised in March) to account for changes requested by customers as a result of their test programmes. Volume deliveries began in June, approximately four months later than planned, have been on-going since then and are expected to continue and steadily grow. Sales growth is mainly limited by available production capacity and logistics issues. We have several actions planned for the next few months that will lift capacity substantially, and reduce delivery times.

Market demand for appliances with increasing sophistication, coupled with a greater emphasis on energy efficiency in OECD markets, has created conditions where improved electric motors are in demand, provided that the price asked is commercially acceptable. Because of this general market movement, together with our on-going marketing and growing delivery record, an increasing number of enquiries are being received. Sample motor products are being supplied to prospects on an on-going basis.



Production and Supply Chain

Several new products were launched in October 2003, and some minor problems occurred during the start-up of full production. Most known problems have been eliminated, and all will be removed as production volumes increase further.

Stock levels are higher than planned. Shipping times for consolidated sea freight (applicable to Wellington's present small production levels) have been longer in practice than offered by shipping agents, so that additional stocks have been required to ensure timely deliveries to customers. These effects will reduce over the coming months as production levels grow and further improvements are made to the supply chain.

Wellington is increasing its Asian contract manufacturing capability with a partner based in Singapore. This will expand our supply capabilities to meet the expected future increase in product sales volumes, and reduce product delivery lead times, relative stock levels and production costs. Electronic controllers have been built in Asia for Wellington by our Singapore-based partner for more than two years. Construction of motor components will begin there soon. The direct effects on product costs are significant. Shipping times to customers in Europe and the United States are also much shorter than from New Zealand. This will reduce the stock level required, and is also important in providing for increased sales.

The Singapore arrangement being put in place now is appropriate for millions of units annually, and can be expanded to these levels in stages as sales increase. Because Wellington motor production does not require the same complexity of equipment needed for most other motor types, some avenues for flexible production can be used that are not available to the established motor manufacturing industry.

The Company is planning to expand its Distribution Centre in the United Kingdom to support continuing order growth.

Licensing Programmes

Wellington's development programmes with Aweco GmbH (Germany) and Arçelik Ş. A. (Turkey) are progressing well and nearing completion. Each is on target for a launch into production during the 2005 financial year. A further European licensee is also making progress with a confidential new product that they expect to introduce before the end of the 2005 financial year.

All of these programmes involve integration of a Wellington motor, electronics and software with the end appliance. Integration reduces overall product component count, and costs, while improving performance and industrial design flexibility. Wellington plans to apply a "Total Integration" trademark to products of this type.

A license to manufacture and sell some specific Wellington motors was granted to A O Smith Electrical Products Company Inc. (AOS) in October 2003. AOS launched Wellington motors at the ASHRAE Exhibition, Los Angeles, California in January, 2004. There have been some delays in AOS' internal decisions following the resignation of the President of AOS (Mr Don Heinrich) in March 2004.

Seeley International Pty. Ltd (Australia) began selling (in December 2003) an evaporative cooling air conditioner (the "Breezeair Icon Series, www.seeley.com.au) which uses a Wellington motor built under license. The product is promoted by Seeley as the world's most energy efficient evaporative air conditioner and has enjoyed good sales so far.



Several negotiations are in progress to partner or license in specific markets. One is with a European company that is considered the world leader in its market. We are planning to expand Wellington's presence in the important North American market by partnering there, and discussions are progressing with a number of substantial companies in the United States.

Enquiries from North America have increased substantially. In response, we recently appointed a US based executive and are beginning to offer a wider range of products and services in North America.

Outlook

Due to the progress in establishing Wellington as a reliable supplier of electronic motors and customised motor solutions for licensees, Wellington's outlook remains strongly positive.

Wellington has established a record of successful delivery to demanding customers and our products are gaining increasing visibility in major markets. Establishment of the infrastructure for a substantial increase in production levels and sales is well-advanced. Wellington-based products are being launched under license by several of the largest, and most respected, companies in their segments of the European appliance industry.

Several external drivers are also helping cause an increasing level of enquiries and requests for quotations. The energy saving benefits of Wellington motors are a major factor in all of our present business. The high prices for oil are focusing authorities and consumers on energy efficiency to a greater extent than at any previous time. Market demand for electric motors with good energy efficiency, like Wellington's, is growing. Energy saving incentives and regulations are being put in place in an increasing number of national and regional jurisdictions.

Consequently, the Company's internal medium term financial plan is based on strong revenue growth over the current financial year and beyond. The medium term plan anticipates good levels of profitability being achieved.

Although it involves achieving rapid revenue growth over the short and medium term (which is difficult to predict), meeting the plan would represent the achievement by Wellington of only a modest penetration of the premium appliance motor market, valued at an estimated NZ\$6 billion annually, that is the initial target. It does not assume any penetration of the mass appliance motor market, which is over five times larger. Over time, with rising production volumes, the development path to achieve competitive prices in this mass market is clear, and Wellington's engineering team has begun work on designs that are targeted to be price competitive in mass market applications.

Based on the expected strong growth in revenues this financial year, Wellington is budgeting for a small profit for the year ending 30 June 2005. It should be noted that the range of realistic outcomes is still relatively large and it remains difficult to predict the Company's revenues and profitability with certainty. Several options to raise capital are currently being worked through, with the most likely outcome being a private placement of new shares. Directors believe it in shareholders' best interests to raise additional capital to help accelerate and better secure the profitable commercialisation of the Company's technologies and to more visibly secure the Company's financial position.