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2018 Annual Meeting: Chairman's Address

FY2018 Financial Result

FY2018 saw a reported net profit after tax of $1.33 million a 1.7% increase from the prior financial year. Revenue was up 13.7% to $22.7 million for the year. While much of this growth was from lower margin outsourced services and postage revenue, Software and Technology revenue grew 19.5% and now represents over a quarter of the Company's revenue. Revenues in the UK and Europe are continuing to ramp up and gained 34% to $4.0 million.

The 1.7% rise in reported net profit was constrained by two acquisitions late in the financial year. These incurred acquisition costs and one, DigitalToPrint ("DTP"), is losing money. The net profit growth of SDL's core business, excluding the effect of these acquisitions, was around 19%.

Solution Dynamics' net cash on hand dropped slightly, from $2.08 million the prior year to $1.96 million at balance date. This net cash balance is after SDL paid just over $0.7 million for the two acquisitions in the year. Shareholders should keep in mind that much of our printing and related equipment is financed under operating leases and consequently the Company carries more financial leverage than is apparent from the balance sheet.

The switch from print to electronic communications accelerated during the FY2018, up from a historic rate of around 5% each year, to 8.6%. The Company has historically gained some market share, normally more than sufficient to offset this erosion, however, this is proving increasingly difficult, partly because of limited resources and our increased focus on international sales. Shareholders should expect this decline in domestic mail volumes to worsen in FY2019.

Solution Dynamics' FY2018 dividends totalled 7.5 cents per share (fully imputed), up 0.75 cents or about 11% on the prior year. The Board reiterates its policy to pay dividends of around 70-75% of earnings, subject to no abnormal internal requirements for unusual capital expenditure items or acquisitions, as well as being able to fully impute any dividend.

Strategy

The Company's strategy is predominantly based around building the Software and Technology business internationally. This is where much of the management effort and the Managing Director's time are now spent. It is proving successful, although the difficulties of developing sales channels and selling into large organisations on the other side of the world should not be underestimated. Sales cycles for software to large enterprise customers are typically long. We have added further sales and support resources in the UK and, with the acquisition of DTP, have now opened a beachhead in the US. We expect further progress in the current financial year, although gains are likely to be sporadic and lumpy and we are incurring up-front costs ahead of expected revenue gains.

New Zealand mail volumes are expected to be negatively affected by NZ Post's decision to materially hike mail prices from 1 July 2018. Other material changes to the Access Partner agreement will also have an impact on the already very slim margins for the resale of postage services. This is likely to see faster volume erosion over the coming year and is likely to result in industry consolidation. SDL is examining industry change opportunities and will look to engage in transactions if there is potential to improve the Company's strategic position and increase shareholder value.

Acquisitions

The Company made two acquisitions during FY2018. The first was Scantech, which provides document scanning services domestically, and also has developed software to manage the scanning process workflow. We think the workflow software has broader applications and are already pitching this to clients in the UK, where we do expect to see some take up, especially given the European GDPR privacy rules that require companies to keep track of information and documents they hold about individuals.

The second is DTP, where the purchase price is effectively the combination of the upfront payment plus the need to fund what we expect to be short term losses. The attraction of this business was its Jupiter software platform, which gives the ability to manage and globally distribute print across a network over 300 printers in more than 60 countries. SDL was aware of existing demand for this functionality from existing UK clients and a solid pipeline of prospects has already been achieved.

FY2019 Outlook

In terms of Solution Dynamics' outlook for FY2019, we have previously provided guidance for an expected decline in reported net profit of 5-10%. This includes losses from DTP and the accounting requirement to begin amortising much of the purchase price of the acquisitions made in FY2018. The amortisation charge alone is around $0.2 million after tax and is driven by the fact that much of the acquisition cost is represented by intangible assets.

Trading for the early part of FY2019 has positives and negatives. On the downside, DTP revenue and losses are running at a much worse level than we had forecast and this had dragged year-to-date results well below our budget. In combination with some additional costs, this means SDL's first half result will be significantly lower than the prior year. As an additional negative, the Company has lost a couple of medium sized accounts. It is unusual for SDL to lose customers, so some explanation is in order. In both cases, the business was with larger corporate customers and SDL was providing only a small component of their overall print needs. Both tendered their entire print business, the bulk of which was offset print in each case. SDL was not capable of tendering for the entirety of the business and partnering opportunities were not available; these changes will have an impact in the second half of the year.

On the positive side of the ledger, mail volumes are thus far holding at a steady rate of erosion rather than the more rapid drop off we expected from NZ Post's price changes, although it would be naive to expect that faster volume decline will not eventuate at some stage. While DTP results are worse than expected, the pipeline of sales prospects for DTP's Jupiter platform and international distributed print is proving to be much larger and more probable than expected. There are four large prospects in the northern hemisphere, with whom we are in various stages of negotiations, although these are complex sales and there is no certainty any contracts will be won. Each of these prospects would be material additions to SDL's revenue and earnings on an annualised basis, although the potential contribution in the second half of the current financial year is difficult to assess.

The net of these factors is that the Directors are maintaining current full year guidance with an expectation that some new business, coupled with a review of domestic costs, will offset the higher DTP losses and second half customer loss. However, we caution that there is the potential for greater volatility than usual around eventual results versus our guidance.

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