Simplifying Business

Solution Dynamics

# Interim Report

**For the six months ended 31 December 2018**

# HIGHLIGHTS FOR SIX MONTHS TO 31 DECEMBER 2018

- Net profit after tax declines 77% to $192,000
  Decline of 42% adjusted for impact of acquisitions
- Software & technology revenues grow 29% to $3.8 million
- EBITDA declines 56% to $0.58 million
- Cash flow from operations declines $657,000 to $170,000
- Interim dividend of 2.0 cents per share (down 2.0 cents)
- December achieved first major win in US for Hybrid Mail / DéjarMail solution
- A decline of around 25% to 35% is forecast for FY2019 profit (NPAT)

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# CHAIRMAN'S & CHIEF EXECUTIVE OFFICER'S REPORT

## Result Introduction

The Company was expecting FY2019 to be a difficult year for three main reasons:

1. NZ Post postage price changes pushing customers into faster switching to digital communications, eroding gross margins in traditional print/mail side of the business;
2. Higher costs, particularly to support Software and international growth, coupled with the conclusion of NZTE cost support in the UK during FY2018; and
3. Net losses from acquisitions made in the second half of FY2018.

These factors have proved somewhat stronger than we initially estimated and consequently, SDL's result is not only well down on the prior year but also lagging internal budgets. To the above reasons can be added some unexpected client losses as several customers consolidated their printing into a single supplier (SDL was only a small portion of those customers' print activity).

Much of the earnings pressure emanates from SDL's domestic NZ operations. Clearly, the Company has been reactive to this greater local margin pressure and has significantly restructured NZ print and mail operations to reduce costs. However, cost cutting is a game with a finite number of moves and the ongoing trend of erosion to physical print and mail volumes will not abate.

Fortunately, the Company is continuing to see very strong growth with its international software and arguably has the strongest prospective pipeline in its history. Both DéjarMail and DTP's Jupiter platform are generating broad interest. But pipelines don't pay any bills and there is significant pressure to execute in closing sales over 2019. The negative domestic forces are proving stronger than the positive international software forces in FY2019, however, irrespective of whether SDL is successful with some of the larger sales opportunities currently in play, the level of software wins achieved to date, coupled with ongoing growth from existing software customers, means – subject to the risk of an unexpected major customer loss – the Directors are reasonably confident of a return to earnings growth in FY2020.

## Result Overview

Solution Dynamics Limited ("SDL" or "Company") produced an unaudited net profit after tax of $0.192 million for the half year (1H FY18 $0.832 million), a decline of 77%. This fall in profit stems from a variety of factors including the impact of losses from acquisitions, increased amortisation resulting from acquisitions, postage price increases causing a tougher domestic print and mailing market, and much higher UK costs. The effect of these factors is detailed more fully in the Financial Performance section, which highlights that even on a like-for-like basis, adjusting for the effect of acquisitions, earnings declined. Cash flow from operations was $0.170 million (1H FY18 $0.827 million) and the closing net cash position at 31 December was $1.39 million (1H FY18 $2.41 million). The Directors have declared an interim dividend of 2.0 cents per share (1H FY18 4.0 cents), fully imputed.

SDL typically has a seasonal earnings pattern that is stronger in the first half of the financial year. This is not expected to be the case in FY2019, given the timing of additional costs, acquisition losses from DTP skewed towards the first half, and new business revenue and pipeline strongly biased towards the second half.

## Operational Commentary

Operating revenue grew 12.7% to $12.73 million. As usual, there were revenue gains in low margin postage revenue and subcontracted printing in the UK where SDL earns low margins. NZ domestic print and mail volumes are under increasing pressure, with digital print and document handling revenue declining 10.9% year-on-year. The consequence of SDL's changing revenue mix – particularly the pressure on higher margin local print and mail volumes, more on that below – was a drop in the Company's gross margin percentage from 37.3% to 32.87% (although dollar gross margin largely held, down 0.8% to $4.18 million). Costs in general continue to be well managed, although Selling, General & Administration costs rose 24.5% with the increase coming from both the effect of acquisitions as well as SDL adding additional resource for Software development and support, particularly in the UK.

Software & Technology revenues continue to show gains, increasing by 28.5% to $3.78 million (1H FY18 $2.93 million), as the Company's UK revenues in particular continue to build. SDL's UK channel partners are increasingly gaining sales traction. The acquisition of DTP has opened a broad range of material sales opportunities in the US, with one medium sized new client added late in 2018.

As noted above, the traditional digital print and document handling services market revenue declined 10.9% year-on-year to $3.01 million (1H FY17 $3.38 million). Anecdotally, the pace of overall decline in market volumes has accelerated and SDL is not immune to this trend. The Company has historically gained market share at a faster pace than customers have been switching to electronic communications channels, however, the loss of several clients to integrated print providers saw this position reverse during the half (and the impact will be felt to a greater degree in the second half and fully in FY2019). The first half saw an ongoing increase in the rate at which customers switched to electronic communications, with mail lodgements down 14.4% and email volumes up 37.5%. While the gross margin percentage for handling emails is higher than print, the gross margin dollar value per email that SDL earns is lower and consequently this increase in switching is acting as a net drag on the Company's earnings.

As a result of this volume and margin pressure, the Company undertook a cost reduction restructuring exercise that started in late 2018 and has progressed through early 2019. This has regrettably affected a number of staff and placed some pressure on the organisation generally but is forced on SDL by external industry trends. The Directors particularly thank staff for their assistance and efforts during what is inevitably a difficult process. While we have reduced costs in the traditional part of the business, the growth in Software and Technology revenues and the requirement to support a broader range of customers and software solutions has meant additional staff have been added to support this growth.

The Company is seeing increasing interest in its software technology in the UK and Europe, particularly DéjarMail, and more recently DTP. Mail resellers are attracted to DéjarMail as a means of capturing desktop mail volumes, a fragmented sector of the mail market they have historically been unable to access. SDL now has two large mail resellers in the UK and is seeing solidly growing volumes through these channels. Additional sales pipeline interest is being generated by distributed print solutions (the technology SDL acquired through DTP) and also for scanning solutions (the technology acquired through Scantech) as a result of tighter European privacy regulations.

## Financial Performance

Earnings before interest, tax, depreciation and amortisation (EBITDA) declined by 56% to $0.58 million (1H HY18: $1.32 million) on sales revenue that rose 12.7%.

| **Summary Financial Performance** (all figures $000) | 1H FY19 | 1H FY18 | Yr-on-Yr $ Change | Yr-on-Yr % Change |
|---|---|---|---|---|
| **Total Revenue** | **12,726** | **11,292** | **1,434** | **12.7%** |
| Cost of Goods Sold | 8,547 | 7,080 | 1,467 | 20.7% |
| Gross Margin | 4,179 | 4,212 | (33) | -0.8% |
| Gross Margin (%) | 32.8% | 37.3% | | |
| Selling, General & Admin Costs | 3,597 | 2,888 | 709 | 24.5% |
| **EBITDA** | **582** | **1,324** | **(742)** | **-56.0%** |
| **EBITDA Margin (%)** | **4.6%** | **11.7%** | | |
| Depreciation | 109 | 102 | 7 | 6.9% |
| Amortisation | 173 | 53 | 120 | 226.4% |
| **EBIT** | **300** | **1,169** | **(869)** | **-74.3%** |
| Net Interest | (3) | (2) | (1) | n.a. |
| **Net Profit before Tax** | **303** | **1,171** | **(868)** | **-74.1%** |
| Taxation | 111 | 339 | (228) | -67.3% |
| **Net Profit after Tax** | **192** | **832** | **(640)** | **-76.9%** |

The EBITDA decline stems from two factors. The first is a broadly flat Gross Margin dollar result. This is partly a sales mix issue; the table below highlights that around two-thirds of revenue growth came in the very low margin Outsourced Services revenue line, which includes postage. Postage in New Zealand has always been low margin, however, aggressive price hikes by NZ Post from 1 July 2019 along with changes to qualifying rules for postage rebates to mail houses further eroded margins. Arguably the greater impact to SDL from NZ Post's price increases was to exacerbate the rate at which the Company's customers switched from physical print towards electronic communications. This mix change from physical to electronic in volumes, combined with the inherent operating leverage in SDL's print and physical mail operations caused margin pressure. The Company has responded with a cost reduction programme, however, the usual lags in implementation mean that the lower cost structure will only show benefit from early in the second half of the financial year.

The second cause of lower EBITDA is higher SG&A costs. This has been caused by three main factors: no further NZ Trade and Enterprise ("NZTE") reimbursement of part of the Company's UK market development costs (the NZTE support programme expired at the end of FY2018); additional sales and support personnel in the UK and Europe to support Software growth; and the addition of overheads in relation to acquisitions made during the second half of FY2018.

The acquisition of DTP has also had a negative financial effect although the Company expects this position will progressively abate during the second half of FY2019. However, until SDL can obtain traction with its US sales pipeline opportunities, North America is likely to remain a drag on EBITDA.

SDL's taxation rate in 1H FY2018 was 36.6% versus 28.9% in the prior period. The Company is paying tax at the full rate on both New Zealand and UK earnings but incurring losses in the US. These US losses are not able to be grouped for tax purposes so skew the reported tax rate above the NZ and UK statutory rates. This position will persist until the US becomes profitable.

| **Revenue Analysis** (all figures $000) | 1H FY19 | 1H FY18 | Yr-on-Yr $ Change | Yr-on-Yr % Change |
|---|---|---|---|---|
| Software & Technology | 3,770 | 2,933 | 837 | 28.5% |
| Digital Print & Document Handling | 3,012 | 3,381 | (369) | -10.9% |
| Outsourced Services | 5,944 | 4,978 | 966 | 19.4% |
| **Total Revenue** | **12,726** | **11,292** | **1,434** | **12.7%** |

The 28.5% growth rate for Software & Technology revenue streams in the first half was a pleasing acceleration in the rate of growth (growth for 1H FY18 was 21.0%). SDL's pipeline of opportunities and sales efforts in the UK, European and US markets are likely to ensure Software & Technology has a number of years of revenue growth ahead. The Company is still overly reliant on direct sales efforts by a couple of key staff and a small number of customers in the UK. SDL's small scale and geographic distance from our most important growth markets continues to place pressure on management resources. At some point SDL will require a step change in costs for both greater management and materially larger in-market sales presence in the UK and North America.

Digital print in 1H FY2019 was extremely problematic, largely as a result of NZ Post price increases and the resulting increased rate of switching to electronic communications noted above. The industry has excess digital print capacity and rationalisation will inevitably occur; the Company has held discussions with several market participants, however, to date we have found a general reluctance to be the first mover in structural industry change.

## Acquisitions Performance

The acquisitions of Scantech and DTP in late FY2018 were an aggregate net drag on profitability in the first half of FY2019, with a small Scantech gain being well offset by the DTP deficit. As the following table shows, they collectively incurred operating losses of $0.174 million (pre-amortisation) and a further $0.115 million in amortisation charge, for a total drag of $0.289 million to earnings.

| **Adjusted Profit (before Acquisitions)** (all figures $000) | 1H FY19 | 1H FY18 | Yr-on-Yr $ Change | Yr-on-Yr % Change |
|---|---|---|---|---|
| Reported Net Profit after Tax | 192 | 832 | (640) | -76.9% |
| Add back Acquisition costs | 0 | 0 | | |
| Add back Acquisition Losses (excl Amort) | 174 | 0 | | |
| Add back Acquisition Amortisation costs | 115 | 0 | | |
| **Net Profit before Acquisitions** | **481** | **832** | **(351)** | **-42.2%** |

Given the earnings losses to date, from DTP in particular, it is reasonable for investors to understand why the Company undertook the acquisition. Firstly, DTP was incurring losses when it was acquired by SDL and the extent of those losses was a factor in the amount SDL paid to acquire the business and the structure of the earn-out. SDL's directors and management were aware of the likely risk that the losses would continue for some time.

Secondly, the key asset SDL acquired was DTP's Jupiter platform. This is a software platform that links into a global network of printers and allows globally distributed print instead of home country printing and international mailing. This lowers the combined print and mail cost as well as shortening the time for communications to reach end customers; Jupiter appeared a complementary add on product to broaden SDL's existing suite of communication-enabling software. Thirdly, from discussions with various international users of SDL's existing software, there seemed to be genuine demand for a Jupiter-like service and there were not any obvious competing offerings. It seemed probable that the small size of DTP (a three person company) meant that even with a good product, DTP simply did not have broad sales or distribution channels to market. Lastly, it seemed probable that owning Jupiter would open incremental doors to a range of customers that SDL would not otherwise access.

Our view from the time of acquisition is broadly unchanged. While losses have been somewhat greater than we initially expected, the new opportunities that DTP is generating are, to date, proving far greater than we anticipated. The December 2018 announcement of a new contract with a US-based multinational provider of marketing communication services to SMEs was a direct result of having Jupiter as the integral part of an overall communications solution. The magnitude of DTP-related sales pipeline is exceptionally material in scale to SDL's prospects; the task ahead is to convert this pipeline into contracts.

## Balance Sheet, Liquidity and Debt

SDL closed the half year with net cash on hand of $1.39 million, down 43% on 1H FY2018 ($2.41 million). A bank overdraft facility of $0.2 million remains in placed but is unused. Capital expenditure was $0.23 million in the half, largely for upgrades to the Company's mailing equipment and financial reporting systems.

| **Selected Balance Sheet and Cashflow Figures** (all figures $000) | 1H FY19 | 1H FY18 | Yr-on-Yr $ Change | Yr-on-Yr % Change |
|---|---|---|---|---|
| Net Cash on Hand (net of debt) | 1,385 | 2,408 | (1,023) | -42.5% |
| Non-current Assets | 2,811 | 1,959 | 852 | 43.5% |
| Net Other Liabilities | (482) | (398) | (84) | 21.1% |
| **Net Assets** | **3,714** | **3,969** | **(255)** | **-6.4%** |
| Cashflow from Trading | 503 | 968 | (465) | -48.0% |
| Movement in Working Capital | (333) | (141) | (192) | 136.2% |
| **Cash Inflow from Operations** | **170** | **827** | **(657)** | **-79.4%** |

Book value (net assets) declined by 6.4% to $3.71 million, the result of lower earnings in the first half coupled with the accounting reduction to retained earnings from payment of the final FY2018 dividend. Working capital remains reasonably well managed although the negative movement in working capital was slightly higher than expected.

Given a focus on ensuring value is obtained from the two acquisitions made in the second half of FY2018, the Company is not currently examining any acquisition opportunities. SDL remains interested in opportunities that will inevitably result from domestic mail and print industry restructuring, however, there are only a small number of transactions that would make sense for the Company, and any deal would need to be value adding for shareholders.

## Dividend

SDL is declaring an interim dividend of 2.0 cents per share, a 50% reduction on the prior year.

| Earnings and Dividend per Share | 1H FY19 | 1H FY18 | Yr-on-Yr Change | Yr-on-Yr % Change |
|---|---|---|---|---|
| Shares on Issue (000) | 14,559.8 | 14,249.8 | 310.0 | 2.2% |
| **Earnings per share (cents)** | **2.51** | **6.21** | **(3.70)** | **-59.6%** |
| **Dividend per share (cents)** | **2.00** | **4.00** | **(2.00)** | **-50.0%** |
| Dividend proportion Imputed | 100.0% | 100.0% | n.a. | n.a. |
| Payout ratio | 79.8% | 64.4% | n.a. | n.a. |

The dividend is fully imputed and the amount represents a payout ratio of 79.8% of earnings per share. A new market development agreement with NZTE (details in FY2019 Outlook section below) will limit SDL to paying future dividends to a limit of 75% of NPATA (Net profit after tax but before amortisation) across any financial year.

## Migration to NZX Main Board Listing

The process of moving from the NZAX to the main board is well underway and the Directors have now approved the draft governance and policy documents and draft constitution. A further announcement on this process is expected shortly. The Directors remain conscious of the limited liquidity in trading of SDL shares and will review trading liquidity following the transfer to the NZX Main Board.

## FY 2019 Outlook

Two trends will influence the second half outlook and the relative timing and strength of these may cause actual results to vary from expectations to a greater degree than usual. The first is the loss of several domestic contracts that progressively occurs during 2H, partly offset by an internal restructuring to lower costs associated with print and mail operations. The second – more variable effect – is the growth of international Software and Technology revenue, where a number of new or trial contracts and development projects commence during 2H.

In February 2019, SDL was approved by NZTE for a further contract for market development costs to support for the Company's US expansion efforts. This will be a three year agreement that is similar in nature to SDL's prior NZTE agreement for UK market development. To ensure the Company retains adequate internal funding for US growth, the new NZTE agreement will also cap SDL's dividend payout ratio at 75%, although in recognition of the fact that acquisitions have added significantly to non-cash amortisation charges against profit, the payout ratio cap is now applied to net profit after tax but before amortisation (NPATA).

The acquisition of DTP has broadened SDL's pipeline of opportunities significantly, as noted above, both geographically into the US and in terms of the number of potential clients seeking a distributed print solution. The Directors note that, irrespective of how the 2H earnings volatility eventuates, should SDL succeed in closing some of the current larger prospects, particularly those related to DTP/ Jupiter, then FY2020 earnings growth may be very material.

SDL has previously provided FY2019 guidance for earnings decline of around 15%. Following the first half result, and considering cost and gross margin pressures, plus the Software pipeline, are revising the full year outlook down to an expected reported earnings decline of around 25% to 35%. The caveat to the full year forecast is that timing and success around the Software and Technology opportunities during 2H introduces a higher-than-usual degree of volatility (both upside and downside) to this outlook.

John McMahon.

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# CONSOLIDATED STATEMENT OF PROFIT OR LOSS (UNAUDITED)

**FOR THE SIX MONTHS ENDED 31 DECEMBER 2018**

| (NZ$ in thousands, except per share amounts) | 6 MONTHS ENDED 31 DEC 2018 | 6 MONTHS ENDED 31 DEC 2017 | AUDITED YEAR ENDED 30 JUN 2018 |
|---|---|---|---|
| Operating revenue | 12,600 | 11,095 | 22,383 |
| Grant income | 119 | 162 | 293 |
| Property rental | 7 | 35 | 56 |
| **Total income** | **12,726** | **11,292** | **22,732** |
| **Expenses** | | | |
| Employee costs | 3,070 | 2,711 | 5,630 |
| Rental and operating lease expenses | 406 | 352 | 715 |
| Research & development | 370 | 170 | 473 |
| Directors fees & salaries | 310 | 300 | 513 |
| Print & other outsource expenses | 5,311 | 4,469 | 8,826 |
| Other expenses | 2,677 | 1,966 | 4,302 |
| **Total Expenses** | **12,144** | **9,968** | **20,459** |
| **Earnings before interest, tax, depreciation & amortisation (EBITDA)** | **582** | **1,324** | **2,273** |
| Depreciation | 109 | 102 | 208 |
| Amortisation of intangible assets (software) | 173 | 53 | 161 |
| Net Interest (income) | (3) | (2) | (5) |
| **Profit before income tax** | **303** | **1,171** | **1,909** |
| Income tax | 111 | 339 | 577 |
| **Net profit after income tax** | **192** | **832** | **1,332** |
| | **Cents** | **Cents** | **Cents** |
| Basic earnings per share | 1.3 | 5.8 | 9.3 |
| Diluted earnings per share | 1.3 | 5.7 | 9.1 |

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (UNAUDITED)

## FOR THE SIX MONTHS ENDED 31 DECEMBER 2018

| (NZ$ in thousands, except per share amounts) | 6 MONTHS ENDED 31 DEC 2018 | 6 MONTHS ENDED 31 DEC 2017 | AUDITED YEAR ENDED 30 JUN 2018 |
|---|---|---|---|
| Net operating profit after income tax | 192 | 832 | 1,332 |
| Exchange differences on translation of foreign operations | 14 | (5) | (9) |
| **Other comprehensive income for the period, net of tax** | **14** | **(5)** | **(9)** |
| **Total comprehensive income for the year** | **206** | **827** | **1,323** |

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (UNAUDITED)

**FOR THE SIX MONTHS ENDED 31 DECEMBER 2018**

| (NZ$ in thousands) | SHARE CAPITAL | EMPLOYEE SHARE PLAN | CURRENCY TRANSLATION RESERVE | ACCUM-ULATED LOSSES | TOTAL EQUITY |
|---|---|---|---|---|---|
| Balance 1 July 2017 | 5,169 | 113 | 1 | (1,764) | 3,519 |
| Issue of shares to employees | - | 9 | | - | 9 |
| Exercise of employee options | 71 | (36) | - | 36 | 71 |
| **Transactions with owners** | **71** | **(27)** | **-** | **36** | **80** |
| Dividend | - | - | - | (457) | (457) |
| Profit for the year after tax | - | - | | 832 | 832 |
| Other comprehensive income | - | - | (5) | - | (5) |
| **Total comprehensive income** | **-** | **-** | **(5)** | **375** | **370** |
| **Balance 31 December 2017** | **5,240** | **86** | **(4)** | **(1,353)** | **3,969** |
| Issue of shares to employees | - | 14 | - | - | 14 |
| Exercise of employee options | 117 | (72) | - | 72 | 117 |
| **Transactions with owners** | **117** | **(58)** | **-** | **72** | **131** |
| Dividend | - | - | - | (585) | (585) |
| Profit for the year after tax | - | - | | 500 | 500 |
| Other comprehensive income | - | - | (4) | - | (4) |
| **Total comprehensive income** | **-** | **-** | **(4)** | **(85)** | **(89)** |
| **Balance 30 June 2018 (Audited)** | **5,357** | **28** | **(8)** | **(1,366)** | **4,011** |
| Issue of shares to employees | - | 8 | | - | 8 |
| Exercise of employee options | - | - | - | - | - |
| **Transactions with owners** | **-** | **8** | **-** | **-** | **8** |
| Dividend | - | - | - | (511) | (511) |
| Profit for the year after tax | - | - | | 192 | 192 |
| Other comprehensive income | - | - | 14 | - | 14 |
| **Total comprehensive income** | **-** | **-** | **14** | **(319)** | **(305)** |
| **Balance 31 December 2018** | **5,357** | **36** | **6** | **(1,685)** | **3,714** |

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION (UNAUDITED)

## AS AT 31 DECEMBER 2018

| (NZ$ in thousands) | AS AT 31 DEC 2018 | AS AT 31 DEC 2017 | AUDITED AS AT 30 JUN 2018 |
|---|---|---|---|
| **Current Assets** | | | |
| Cash and bank balances | 1,385 | 2,408 | 1,956 |
| Trade & other receivables | 2,634 | 2,214 | 2,902 |
| Inventories and work in progress | 270 | 156 | 183 |
| Prepayments | 251 | 182 | 131 |
| **Total Current Assets** | **4,540** | **4,960** | **5,172** |
| **Current Liabilities** | | | |
| Trade creditors | 1,885 | 1,517 | 1,871 |
| Other current liabilities | 826 | 625 | 1,245 |
| Other non-financial liabilities | 398 | 388 | 444 |
| Employee benefit Liabilities | 528 | 420 | 472 |
| **Total Current Liabilities** | **3,637** | **2,950** | **4,032** |
| **Working Capital** | **903** | **2,010** | **1,140** |
| **Non-Current Assets** | | | |
| Deferred tax asset | (10) | 99 | (24) |
| Capital works in progress | 116 | 4 | 61 |
| Property, plant & equipment | 648 | 603 | 594 |
| Intangible assets | 1,020 | 315 | 1,179 |
| Goodwill | 1,037 | 938 | 1,061 |
| **Total Non-Current Assets** | **2,811** | **1,959** | **2,871** |
| **Net Assets** | **3,714** | **3,969** | **4,011** |
| **Equity** | | | |
| Share capital | 5,357 | 5,240 | 5,357 |
| Employee share option plan | 36 | 86 | 28 |
| Foreign currency translation reserve | 6 | (4) | (8) |
| Accumulated losses | (1,685) | (1,353) | (1,366) |
| **Total Equity** | **3,714** | **3,969** | **4,011** |

For and on behalf of the Board

John McMahon.

**John McMahon** – Director (Chairman)
Date: x xxxxx 2019

**Nelson Siva** – Director

# CONSOLIDATED CASH FLOW STATEMENT

**(UNAUDITED)**

**FOR THE SIX MONTHS ENDED 31 DECEMBER 2018**

| (NZ$ in thousands) | 6 MONTHS TO 31 DEC 2018 | 6 MONTHS TO 31 DEC 2017 | AUDITED YEAR TO 30 JUN 2018 |
|---|---|---|---|
| **Cash Flow from Operating Activities** | | | |
| *Cash was provided from:* | | | |
| Receipts from sales | 14,744 | 12,766 | 25,041 |
| Other revenue | 119 | 162 | 293 |
| | **14,863** | **12,928** | **25,334** |
| *Cash was applied to:* | | | |
| Payments to suppliers | 9,960 | 8,254 | 15,830 |
| Payments to employees | 4,036 | 3,212 | 6,621 |
| GST paid to Inland Revenue | 697 | 635 | 1,261 |
| | **14,693** | **12,101** | **23712** |
| **Net Cash Inflow from Operating Activities** | **170** | **827** | **1,622** |
| **Cash Flow from Investing Activities** | | | |
| *Cash was applied to:* | | | |
| Purchase of property, plant & equipment & capital works in progress | 219 | 41 | 120 |
| Purchase of software | 14 | 74 | 68 |
| Payments for businesses acquired | - | - | 712 |
| | **233** | **115** | **900** |
| **Net Cash (Outflow) from Investing Activities** | **(233)** | **(115)** | **(900)** |
| **Cash Flow from Financing Activities** | | | |
| *Cash was provided from:* | | | |
| Exercise of employee share options | - | - | 188 |
| Interest received | 3 | 2 | 5 |
| Issue of shares through employee option plan | - | 71 | - |
| | **3** | **73** | **193** |
| *Cash was applied to:* | | | |
| Payment of dividends | 511 | 457 | 1,039 |
| Interest paid | - | - | - |
| Repayments for term loan & finance lease liabilities secured on equipment | - | - | - |
| | **511** | **457** | **1,039** |
| **Net Cash (Outflow) from Financing Activities** | **(508)** | **(384)** | **(846)** |
| Net change in cash and cash equivalents | (571) | 328 | (124) |
| Add cash & cash equivalents held at beginning of year | 1,956 | 2,080 | 2,080 |
| **Finance Facility and Cash Balance at End of Year** | **1,385** | **2,408** | **1,956** |

# CONSOLIDATED CASH FLOW STATEMENT CONTINUED (UNAUDITED)

**FOR THE SIX MONTHS ENDED 31 DECEMBER 2018**

| (NZ$ in thousands) | 6 MONTHS TO 31 DEC 2018 | 6 MONTHS TO 31 DEC 2017 | AUDITED YEAR TO 30 JUN 2018 |
|---|---|---|---|
| **Reconciliation of net deficit after income tax for the year with net cash inflow/ (outflow) from operating activities** | | | |
| Net (deficit)/surplus after income tax | 192 | 832 | 1,332 |
| Interest expense (reclassified as financing activity) | - | - | - |
| Interest income (reclassified as financing activity) | (3) | (2) | (5) |
| *Add non-cash items:* | | | |
| Depreciation & amortisation of assets | 283 | 155 | 369 |
| (Gain) / Loss on foreign exchange | (1) | (30) | (39) |
| Other non-cash items | 32 | 13 | 20 |
| **Cash Flow from Trading** | **503** | **968** | **1,677** |
| Add movements in Working Capital | (333) | (141) | (55) |
| **Net Cash Inflow from Operating Activities** | **170** | **827** | **1,622** |

# NOTES TO THE CONDENSED FINANCIAL STATEMENTS

For the six months ended 31 December 2018

## 1. GENERAL INFORMATION AND BASIS OF PREPARATION

The condensed interim consolidated financial statements (the interim financial statements) are for the six months ended 31 December 2018 and are presented in NZ$, which is the functional currency of the parent company. They have been prepared in accordance with New Zealand generally accepted accounting practice and comply with New Zealand Equivalent to International Accounting Standard 34 (NZIAS34) and IAS 34 “Interim Financial Reporting” (IAS34). They do not include all of the information required in annual financial statements in accordance with IFRS’s, and should be read in conjunction with the consolidated financial statements for the year ended 30 June 2018.

Solution Dynamics Limited is the Group’s ultimate parent company. It is a limited liability public company incorporated and domiciled in New Zealand and is listed with the New Zealand Stock Exchange on the NZAX. The address of its registered office and principal place of business is 18 Canaveral Drive, Auckland, New Zealand.

The Group comprises Solution Dynamics Limited and its wholly owned subsidiaries Solution Dynamics (International) Limited (based in the United Kingdom), Solution Dynamics Incorporated (based in the United States of America) and Déjar International Limited (non-trading).

The Group offers a range of integrated solutions encompassing data management, electronic digital printing, web presentment and archiving, fulfilment, traditional print services, scanning, data entry and document management.

The interim financial statements for the six months ended 31 December 2018 and the related comparative interim period, are unaudited. Due to seasonal variability financial information from the audited financial statements for the immediate preceding financial year ending 30 June 2018 have also been included.

The unaudited interim financial statements for the Group for the six months ended 31 December 2018 were authorised for issue on 28 February 2018 in accordance with a resolution of the directors of the Company.

## 2. SIGNIFICANT ACCOUNTING POLICIES

These interim financial statements have been prepared in accordance with the accounting policies adopted in the Group's most recent annual financial statements for the year ended 30 June 2018.

## 3. ESTIMATES

When preparing the interim financial statements, management undertakes a number of judgements, estimates and assumptions about recognition and measurement of assets, liabilities, income and expenses. The actual results may differ from the judgements, estimates and assumptions made by management, and will seldom equal the estimated results.

The judgements, estimates and assumptions applied in the interim financial statements, including the key sources of estimation uncertainty were the same as those applied in the Group's last annual financial statements for the year ended 30 June 2018. The only exception is the estimate of the provision for income taxes which is determined in the interim financial statements using the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

## 4. Segment Information

The Group operates in one business segment, the supply of customer communication solutions. These include a range of integrated document management products and services separated into four streams; outsource services, technology & development services, intelligent imaging and output services. Specific elements of these streams are as follows:

- **Software & Technology**, Solution Dynamics owns the intellectual property in five products;
    - » Déjar, an online digital archival and retrieval system sold stand-alone under licence agreements and also as a hosted service in New Zealand and Internationally.
    - » Bremy, Digital asset management, workflow and multichannel publishing software sold as a licenced product and also as a hosted service in New Zealand, Australia and the UK.

» Composer, "On-Demand" content creation software.

» DéjarMail, is a web browser-based desktop mail management solution which allows customers to route mail correspondence to SDL or any other service provider for printing and delivery.

» Jupiter is a hybrid mail application that was acquired through the purchase of the DigitalToPrint business. The application routes data received from clients for international distribution of communications to the destination country for print production and lodgement as local mail.

In addition to owning the intellectual property for the above products, Solution Dynamics provides programming, consulting and design services that help clients to distribute marketing and essential communications by mail and electronically. The provision of these services is covered under this category.

- **Digital Printing & Document Handling Services**, the printing of client's information digitally using high speed laser printers followed by the lodgement and distribution of those documents using a variety of machine and other processes.

- **Outsourced Services**, not all components of Solution Dynamics' solutions are produced internally. External elements such as post, freight, paper and envelopes are sourced from external suppliers and included in this service stream. Solution Dynamics has long term arrangements with a number of key suppliers such as NZ Post for the provision of these services.

An overhead structure including sales, marketing and administration departments provides services for all of the above revenue streams.

There are no reconciling items in this note due to the management information provided to the Chief Operating Decision Maker being compiled using the same standards and accounting policies as those used to prepare the financial statements.

| (NZ$ in thousands) | 6 months to December 2018 | | 6 months to December 2017 | | Year to June 2018 | |
|---|---|---|---|---|---|---|
| Software & Technology | 3,770 | 30% | 2,933 | 26% | 6,052 | 27% |
| Digital Printing & Document Handling Services | 3,012 | 24% | 3,381 | 30% | 6,773 | 30% |
| Outsourced services | 5,944 | 46% | 4,978 | 44% | 9,907 | 43% |
| **Total income** | **12,726** | **100%** | **11,292** | **100%** | **22,732** | **100%** |
| Less cost of sales | 8,547 | 67% | 7,080 | 63% | 14,315 | 63% |
| **Gross margin** | **4,179** | **33%** | **4,212** | **37%** | **8,417** | **37%** |
| Selling, general & administration | 3,597 | 28% | 2,888 | 26% | 6,144 | 27% |
| **Earnings before interest, tax, depreciation & amortisation** | **582** | **5%** | **1,324** | **11%** | **2,273** | **10%** |
| Depreciation | 109 | 1% | 102 | 1% | 208 | 1% |
| Amortisation | 173 | 1% | 53 | 0% | 161 | 1% |
| Interest | (3) | 0% | (2) | 0% | (5) | 0% |
| Income tax | 111 | 1% | 339 | 3% | 577 | 2% |
| **Operating Profit after income tax** | **192** | **2%** | **832** | **7%** | **1332** | **6%** |

### Segment Assets

Assets are not segmented between service streams

### Information about Major Customers

Included in revenues for Solution Dynamics of $12.726 million (2017: $11.292 million) are services revenues of $1.513 million (2017: $1.255 million) which arose from sales to the Company's largest customer.

### Geographical Information

The Group has customers in New Zealand, Australia and Europe.

| (NZ$ in thousands) | Revenue from external customers 6 months to 31 Dec 2018 | 6 months to 31 Dec 2017 | Year to 30 June 2018 | Non-current assets As at 31 Dec 2018 | As at 31 Dec 2017 | As at 30 June 2018 |
|---|---|---|---|---|---|---|
| New Zealand | 9,387 | 9,331 | 17,604 | 2,802 | 1,959 | 2,870 |
| Australia | 312 | 218 | 1,111 | - | - | - |
| United States of America | 401 | - | 62 | - | | |
| Europe | 2,626 | 1,743 | 3,955 | 9 | - | 1 |
| **Total** | **12,726** | **11,292** | **22,732** | **2,811** | **1,959** | **2,871** |

## 5. CASH & CASH EQUIVALENTS

| (NZ$ in thousands) | As at 31 Dec 2018 | As at 31 Dec 2017 | As at 30 Jun 2018 |
|---|---|---|---|
| Cash and cash equivalents | 1,385 | 2,408 | 1,956 |
| **Total Finance Facility and Cash** | **1,385** | **2,408** | **1,956** |

Solution Dynamics has an overdraft facility in place with the ANZ Bank at an interest rate of 12.35% p.a. (2017: 12.35%). This facility is to support the operational requirements of the Group, is interest only and is secured by first ranking debenture over the assets of the Group.

At period end, the ANZ Bank has imposed no financial covenants to secure the existing facilities. The Group maintains a $200,000 overdraft facility that was unused at the reporting date 2017: $200,000). The Group now holds a net cash position with no bank debt (2017: $Nil).

At the end of the reporting period the Bank provided commercial guarantees totalling $65,000 (2017: $65,000) to the Group's suppliers.

## 6. SHARE CAPITAL & SHARE-BASED PAYMENTS

Solution Dynamics Limited has 14,559,810 ordinary shares (2017 14,249,810 ordinary shares) each fully paid.

The Group operates equity-settled, share-based compensation plans, under which employees provide services in exchange for non-transferable options. The value of the employee services rendered for the grant of non-transferable options is recognised as an expense over the vesting period, and the amount is determined by reference to the fair value of the options granted.

| **Number of Shares**<br>(Shares in $000's) | **As at 31 Dec 2018** | **As at 31 Dec 2017** | **As at 30 Jun 2018** |
|---|---|---|---|
| Shares Issued and Fully Paid: | | | |
| - Beginning of the Period | 14,560 | 14,060 | 14,060 |
| - Share Issue (exercise of options) | - | 190 | 500 |
| **Shares Issued and Fully Paid** | **14,560** | **14,250** | **14,560** |
| Employee Share Option Plan: | | | |
| - Beginning of the Period | 80 | 580 | 580 |
| - Options issued | - | - | - |
| - Options exercised | - | (190) | (500) |
| - Options forfeited | - | - | - |
| **Shares Authorised for Share-based Payments** | **80** | **390** | **80** |
| **Total Shares Authorised at the end of the Period** | **14,640** | **14,640** | **14,640** |

The 80,000 options outstanding (2017: 390,000) were at a weighted average exercise price of $0.70 (2016: $0.44). 80,000 options are eligible to be exercised now with an expiry date of September 2019.

For the six months ended 31 December 2018

## 7. RELATED PARTIES

Transactions between related parties include payments to shareholders, directors and their companies and senior executives, also being shareholders.

Related party transactions from 1 July 2018 to 31 December 2018 were as follows:

- Key management were paid $424,216 (as employees of Solution Dynamics Limited) during the period (2017: $421,228) and were owed $68,176, including annual leave, at 31 December 2018 (2017: $46,301).
- Salaries paid to directors are disclosed in the Consolidated Statement of Comprehensive Income.

## 8. EVENTS AFTER THE BALANCE DATE

At the board meeting of 28 February 2019, the directors resolved to pay a fully imputed interim dividend of 2.0 cents per share, amounting to $291,196 (2017: the directors approved the payment of a fully imputed interim dividend of 4.0 cents per share, amounting to $569,992). There were no other significant events after balance date.

# COMPANY DIRECTORY

## Directors
John McMahon - Chairman
Julian Beavis
Elmar Toime
Indrajit Nelson Sivasubramaniam
(Nelson Siva)
– Chief Executive Officer

## Auditors
Grant Thornton New Zealand Audit Partnership
Grant Thornton House
152 Fanshawe Street
AUCKLAND

## Bankers
ANZ National Bank Limited
9-11 Corinthian Drive
Albany
AUCKLAND 0632

## Legal Representative
Stephen Layburn
Commercial Barrister
Level 3, 175 Queen Street
AUCKLAND

## Share Registry
Computershare Investor Services
Level 2, 159 Hurstmere Rd
Takapuna
AUCKLAND

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AUCKLAND 1142

## Registered Office and address for service
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## Solution Dynamics (International) Limited
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Tel +44 1489 668219

## Solution Dynamics Incorporated
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UNITED STATES OF AMERICA
Tel: +1 (917) 319 5625

## Déjar International Limited (non-trading)
18 Canaveral Drive
Albany
AUCKLAND

PO Box 301248
Albany
AUCKLAND 0752

## Stock Exchange

The Company's shares trade on the New Zealand Stock Exchange Alternative Market (NZAX).

NZAX Trading Code: SDL

Bremy

Déjar

Composer

Déjar Mail

## SOLUTION DYNAMICS ON THE WEB

www.solutiondynamics.com
www.dejar.com
www.bremy.com

Solution Dynamics