CHAIRMAN'S & CHIEF EXECUTIVE OFFICER'S REPORT

Result Overview

Solution Dynamics Limited ("SDL" or "Company") produced an unaudited net profit after tax of $1.45 million for the half year (1H FY2020 $0.47 million), a year-on-year increase of 209%.

This gain in profit stems largely from significant new revenue and gross margin from rollouts of SDL's global print and software solution for two major global organisations. This was offset by ongoing decline in domestic NZ print and mail services and a further increase in Selling, General & Administration (SG&A) costs to support UK operations and development of the US market opportunity.

Cash flow from operations was $2.16 million (1H FY2020 $1.29 million). The closing net cash position at 31 December was $6.06 million (1H FY2020 $2.20 million), noting that approximately a quarter of this cash represents pre-payments by customers of postage. The Directors have declared an interim dividend of 7.0 cents per share (1H FY2020 3.0 cents), fully imputed.

Operational Commentary

Operating revenue grew 17.3% to $18.52 million with strong international gains offset by declines in New Zealand operations. Software & Technology revenue (almost wholly international) increased 39.9% on the back of rollouts of two major contracts the company announced details of at the annual meeting in October 2020. Gains here were constrained by significant volume weakness in the UK where a major customer in the dental sector and a downstream mail access provider were affected by COVID. The overall New Zealand market remains in structural decline and industry rationalisation seems inevitable at some point.

SG&A costs continue to rise, up 6.2% year-on-year (on top of a 25.7% increase in the prior year first half). International expansion has seen a greater need for in-market customer support for account management, applications and DevOps, along with increased New Zealand and international staffing for software development and IT infrastructure such as cybersecurity. Additional sales staff have been added in the US and Europe, partly the result of COVID restrictions curtailing travel of New Zealand-based staff but also to attack new market opportunities.

The Company's traditional digital print and document handling services market revenue in New Zealand declined 23.9% year-on-year to $2.07 million (1H FY2020 $2.71 million). The first half saw an ongoing increase in the rate at which customers switched to electronic communications, with mail lodgements down 16.7% and email volumes up a disappointing 3.3%. The industry has excess digital print capacity and rationalisation will inevitably occur; the Company has held discussions with several market participants, however, there seems broad resistance to be the first mover in implementing structural change.

SDL's existing print equipment contract concluded during the first half. The Company has renewed with the same supplier and upgraded equipment although "click" charges for throughput have increased modestly on average. The extent of the overall increase will be partly dependant on the mix of equipment utilisation SDL is able to achieve.

SDL has maintained its COVID-related work practices around health monitoring, segregated teams and controlled facility access. This has helped ensure no staff member has been infected to date. The effects of COVID on revenue have mainly been seen in SDL's UK business as noted above, along with some constraints to certain operations by a number of international clients which lowered preliminary FY21 revenue growth expectations.

While there have been modest cost savings (notably travel) the net effect from COVID on gross margin and net profit has been moderately negative in the half year and little respite seems likely until sometime in FY2022, subject to the effectiveness of various vaccine rollouts underway.

The Company continues to see interest in its post-on-demand (POD) and distributed print solutions and is currently trialling POD sales activity in the US small-to-medium-business (SMB) market. This SMB market is currently served largely by hardware solutions so SDL's software-based solution should be competitive, although potential customers typically lease (on fixed terms) much of the hardware, meaning the Company will face longer sales cycles to grow market penetration.

Financial Performance

Earnings before interest, tax, depreciation and amortisation (EBITDA) approximately doubled to $2.85 million (1H HY2020 $1.42 million) on sales revenue that rose 17.3%.

Summary Financial Performance (all figures $000)	**1H FY21**	**1H FY20**	**Yr-on-Yr $ Change**	**Yr-on-Yr % Change**
Total Revenue	**18,522**	**15,785**	**2,737**	**17.3%**
Cost of Goods Sold	11,214	10,168	1,046	10.3%
Gross Margin	**7,308**	**5,617**	**1,691**	**30.1%**
Gross Margin (%)	39.5%	35.6%		
Selling, General & Admin Costs	4,463	4,201	262	6.2%
EBITDA	**2,845**	**1,416**	**1,429**	**100.9%**
EBITDA Margin (%)	15.4%	9.0%		
Depreciation	612	581	31	5.3%
Amortisation	150	176	-26	-15.0%
EBIT	**2,083**	**659**	**1,424**	**216.1%**
Net Interest	27	64	-37	-57.0%
Net Profit before Tax	**2,056**	**595**	**1,461**	**245.5%**
Taxation	607	126	481	381.7%
Net Profit after Tax	**1,449**	**469**	**980**	**208.9%**

The EBITDA improvement is partly a reversal of the prior year decline and mostly stems from better sales mix improving the Gross Margin, partly offset by higher SG&A costs. The Company has obtained NZ Trade & Enterprise ("NZTE") support for its US expansion activities and this helped offset some of the cost expansion in that market. The interim result included a net gain of $0.34

million (pre-tax) from realised foreign exchange currency hedges that were protecting part of SDL's offshore Gross Margin.

SDL's taxation rate in 1H FY20 was 29.5% versus 21.2% in the prior period. The Company is incurring losses in the UK as a result of COVID revenue declines there, and these are not able to be grouped against profits in other jurisdictions.

Revenue Analysis (all figures $000)	**1H FY21**	**1H FY20**	**Yr-on-Yr** **$ Change**	**Yr-on-Yr** **% Change**
Software & Technology	13,099	9,365	3,734	39.9%
Digital Print & Document Handling	2,065	2,713	-648	-23.9%
Outsourced Services	3,358	3,707	-349	-9.4%
Total Revenue	**18,522**	**15,785**	**2,737**	**17.3%**

SDL's pipeline of opportunities and sales efforts in the UK, European and US markets is likely to ensure Software & Technology has several years of revenue growth ahead, although COVID constraints place uncertainty around this expectation.

Balance Sheet, Liquidity and Debt

SDL closed the half year with net cash on hand of $6.06 million, up 175% on 1H FY2020 ($2.20 million) although around a quarter of this represents customer balances the Company is holding as prepayment for postage (and customers can ask for this to be returned). A bank overdraft facility of $0.2 million remains in place but is unused. Capital expenditure was $0.05 million in the half, largely for minor items of computer equipment.

Selected Balance Sheet and Cashflow Figures (all figures $000)	**1H FY21**	**1H FY20**	**Yr-on-Yr** **$ Change**	**Yr-on-Yr** **% Change**
Net Cash on Hand (net of debt)	6,063	2,203	3,860	175.2%
Non-current Assets (excl Right of Use)	2,048	2,554	-506	-19.8%
Right of Use Assets	900	2,361	-1,461	-61.9%
Net Other Liabilities (excl Right of Use)	-2,606	-611	-1,995	326.5%
Right of Use Liabilities	-1,036	-2,489	1,453	-58.4%
Net Assets	**5,369**	**4,018**	**1,351**	**33.6%**
Cashflow from Trading	1,887	1,288	599	46.5%
Movement in Working Capital	651	689	--38	-.5.5%
Cash Inflow from Operations	**2,538**	**1,977**	**561**	**28.4%**

Book value (net assets) increased 33.6% to $5.37 million, mainly the effect of higher first half earnings. Working capital remains reasonably well managed and SDL has not seen any bad or doubtful debt issues arising as a result of COVID.

Dividend

SDL has declared an interim dividend of 7.0 cents per share, a 133% on the prior year.

Earnings and Dividend per Share	1H FY21	1H FY20	Yr-on-Yr Change	Yr-on-Yr % Change
Shares on Issue (000)	14,639.8	14,639.8	0	0.0%
Earnings per share (cents)	9.89	3.20	6.69	208.9%
Earnings per share (cents) on NPATA (a)	10.92	4.41	6.51	147.8%
Dividend per share (cents)	7.00	3.00	4.00	133.3%
Dividend proportion Imputed	100.0%	100.0%	n.a.	n.a.
Payout ratio (on NPATA)	64.1%	68.1%	n.a.	n.a.

(a) NPATA is Net Profit After Tax plus Amortisation (i.e. adding back Amortisation to net profit). This is non-GAAP measure of earnings agreed with NZTE for maximum dividend payout ratio purposes.

The dividend is fully imputed and the amount represents a payout ratio of 70.7% of earnings per share (and 64.1% of NPATA). The new agreement with NZTE for US market development support continues to limit SDL to a dividend payout ratio of 75% of NPATA.

FY 2021 Outlook

As expected, the key factor contributing to SDL's expected FY2021 outlook has been the progressive onboarding and ramp up of new client wins for the Company's Software & Technology services and products internationally. The scale of various phases of onboarding and projects for a number of these clients has introduced a degree of lumpiness into revenue and earnings, which has been further affected by COVID-related delays and uncertainty.

SDL's New Zealand business continues to suffer the industry-wide pressure of declining physical volumes, partially offset by modest new business gains. The Company's international Software & Technology platforms are continuing to expand, particularly in North America. Activity levels at SDL's UK customers remains well down on the prior year although is around budget. Additional costs are currently being incurred as SDL is increasing its investment globally in both in sales channel development and customer support infrastructure (including developers, DevOps and cybersecurity) to maintain growth momentum and deliver expanded software functionality requirements that clients are requesting.

SDL reiterates its prior guidance of full year FY2021 net profit after tax in the range of $2.0 to $2.5 million. This outlook assumes little recovery in lower international volumes in the UK and that new client projects and onboarding activities proceed as currently planned. Significant volatility is possible around the guidance range and the predominant likely causes of volatility (including world health and macroeconomic outlooks) are in many cases beyond the Company's control.