24 February 2022

Chairman's and Chief Executive's Report

Result Overview

Solution Dynamics Limited ("SDL" or "Company") produced an unaudited net profit after tax of $2.03 million for the half year (1H FY2021 $1.45 million), a year-on-year increase of 40.2%. This is a record half year profit for the Company and equals the entire year's profit in FY2021.

However, the extent of year-on-year first half growth in FY2022 reflects a high concentration of customer jobs that are usually spread more evenly across the year. This is partly the result of COVID-related delays and disruptions in 2021. International activity and revenue continued to increase through a combination of new customers and generally growing volume levels, although some markets and customers remain affected by COVID. NZ print and mail services continues to see pressure, particularly on pricing and gross margins, although volumes held up well and recent sales efforts have begun to gain traction with some new business success which is expected to partly contribute later in the second half.

Cash flow from operations was $3.34 million (1H FY2021 $2.54million). The closing net cash position at 31 December was $7.00 million (1H FY2021 $6.06 million), noting that approximately $1.2 million of this cash represents pre-payments of postage by customers. The Directors have declared a fully-imputed interim dividend of 9.0 cents per share (1H FY2021 7.0 cents).

Nelson Siva and Governance Update

The biggest change – and a loss that cannot be understated – in SDL's first half was the November passing of long-term CEO, Nelson Siva, after an illness since early 2020. The significant growth in earnings over the last ten years, along with the Company's international expansion are Nelson's legacy to SDL. More importantly, is the legacy of SDL's culture; a "can do", strong customer service-oriented focus, that drives the ability to tackle complex customer communication problems. Development of the Company's communications platforms and capability to sustain growth are testament to Nelson's strategic and tactical capabilities and the development of internal management capability is testament to Nelson's positive approach and people skills.

In November, SDL appointed Mr Patrick Brand, who previously headed SDL's US and international operations, as the Company's new CEO. Patrick has significant depth of global experience in customer communications, including as a member of the executive leadership team at Pitney Bowes. The Company has subsequently made a number of internal responsibility changes aimed at enhancing operational and sales effectiveness, as well as providing structure to cover COVID travel restrictions that are likely to prevent Patrick from being in New Zealand for some time. The Directors are conscious of ensuring both business momentum and the Company culture are maintained during COVID headwinds and the handover to Patrick.

Operational Commentary

Operating revenue grew 28.1% to $23.72 million with strong international gains offset by declines in New Zealand operations. Software & Technology revenue increased 42.3%. As noted above, this growth rate was assisted by the timing of customer activity, although revenue growth continues to be held back by volume weakness in the UK (COVID-affected customers). The overall New Zealand market remains in structural decline and SDL is now seeing this place pressure on pricing and margins.

SG&A costs rose 20.9% year-on-year (on top of a 6.2% increase in the prior year first half). Part of this is the annualised effect of prior increase in staff numbers 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. The Company is also seeing a broad range of cost pressures across much of its operating structure, with technology costs particularly affected.

SDL's traditional digital print and document handling services market revenue in New Zealand grew 3.6% year-on-year to $2.14 million (1H FY2021 $2.07 million), although this was cycling a 23.9% drop in the prior comparable period when COVID affected volumes. Digital imaging processing volumes for the first half were almost flat year-on-year and this along with a sales mix change, drove the revenue growth. Pricing pressure is expected to continue and the Company has restructured its sales efforts to look to gain market share. Email volumes in New Zealand were largely flat year-on-year.

SDL continued with its COVID-related work practices around health monitoring, segregated teams and controlled facility access, which has helped ensure no staff member has been infected to date. Post the half year end, the Omicron variant has begun circulating in New Zealand. Overseas experience around the high level of Omicron transmissibility suggests it will likely become endemic in New Zealand during the second half of FY2022. The Company has reiterated its commitment to having effective health protocols in place. Nevertheless, a key risk is that operations – both SDL's and our customers – may see disruption affecting FY2022 earnings.

The Company continues to generate new sales for its post-on-demand (POD) and distributed print solutions. Functionality is being updated, combining some existing products into a Digital Mail Centre (DMC) and this includes enhancing the platform for improved scalability and more cost-effective customer onboarding. Sales activity internationally remains mainly focussed on the enterprise market; particular success has been achieved in the mortgage origination and data breach notice sectors. In the SMB (small-to-medium business) segment, SDL's present sales efforts are largely through one very large channel partner and mainly focussed in Europe. Further development of DMC as noted above, along with sales rollout into the US, UK and New Zealand markets, is a key priority for 2022 and beyond.

Financial Performance

Earnings before interest, tax, depreciation and amortisation (EBITDA) increased 27.4% to $3.62 million (1H HY2021 $2.85 million) on sales revenue that rose 28.1%.

Summary Financial Performance (all figures $000)	1H FY22	1H FY21	Yr-on-Yr $ change	Yr-on-Yr % change
Total Revenue	**23,718**	**18,522**	**5,196**	**28.1%**
Cost of Goods Sold	14,700	11,214	3,486	31.1%
Gross Margin	**9,018**	**7,308**	**1,710**	**23.4%**
Gross Margin (%)	**38.0%**	**39.5%**		
Selling, General & Admin Costs	5,397	4,463	934	20.9%
EBITDA	**3,621**	**2,845**	**776**	**27.3%**
EBITDA Margin (%)	**15.3%**	**15.4%**		
Depreciation	476	612	-136	-22.2%
Amortisation	97	150	-53	-35.2%
EBIT	**3,048**	**2,083**	**965**	**46.3%**
Net Interest	**60**	27	33	122.2%
Net Profit before Tax	**2,988**	**2,056**	**932**	**45.3%**
Taxation	**956**	607	349	57.5%
Net Profit after Tax	**2,032**	**1,449**	**583**	**40.2%**

The EBITDA gain is largely based on the abnormally high concentration of customer activity in the first half of FY2022. Note that 1H FY2022 includes no support from NZ Trade & Enterprise for market development as the grant was fully utilised in FY2021. The interim result in the prior period also included a net gain from foreign exchange currency hedges that were not repeated in this half year result. These two items totalled around $0.8 million (pre-tax) in the prior comparable period.

SDL's taxation rate in 1H FY2022 was 32.0% versus 29.5% in the prior period.

Revenue Analysis (all figures $000)	1H FY22	1H FY21	Yr-on-Yr $ change	Yr-on-Yr % change
Software & Technology	18,645	13,099	5,546	42.3%
Digital Print & Document Handling	2,140	2,065	75	3.6%
Outsourced Services	2,933	3,358	-425	-12.7%
Total Revenue	**23,718**	**18,522**	**5,196**	**28.1%**

SDL's pipeline of opportunities and sales efforts in the UK, European and US markets points to Software & Technology continuing to grow revenue, although COVID remains a risk to sales activity and the Company has several large customers where operational issues, changes to contracts or changes to those customers' plans could materially alter the revenue outlook.

Balance Sheet, Liquidity and Debt

SDL closed the half year with net cash on hand of $7.0 million, up 15.4% on 1H FY2021 ($6.06 million), although around $1.2 million of this represents customer balances the Company is holding as prepayment for postage (the customers can ask for this to be returned). A bank overdraft facility of $0.2 million remains in place but is unused. Capital expenditure remains low at $0.04 million in the half, largely for minor items of print and computer equipment.

Selected Balance Sheet and Cashflow (all figures $000)	1H FY22	1H FY21	Yr-on-Yr $ change	Yr-on-Yr % change
Net Cash on Hand (net of debt)	6,998	6,063	935	15.4%
Non-current Assets (excl Right of Use)	1,665	2,048	-383	-18.7%
Right of Use Assets	826	900	-74	-8.2%
Net Other Liabilities (excl Right of Use)	-2,065	-2,606	541	-20.8%
Right of Use Liabilities	-974	-1,036	62	-6.0%
Net Assets	**6,450**	**5,369**	**1,081**	**20.1%**
Cashflow from Trading	2,705	1,887	818	43.3%
Movement in Working Capital	636	651	-15	-2.3%
Cash Inflow from Operations	**3,341**	**2,538**	**803**	**31.6%**

Book value (net assets) increased 20.1% to $6.45 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 although some payment times have stretched.

Dividend

SDL has declared an interim dividend of 9.0 cents per share, a 28.6% increase on the prior year.

Earnings and Dividend per Share	1H FY22	1H FY21	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)	13.88	9.90	3.98	40.2%
Earnings per share (cents) on NPATA [(a)]	**14.54**	**10.92**	**3.62**	**33.2%**
Dividend per share (cents)	**9.00**	**7.00**	**2.00**	**28.6%**
Dividend proportion Imputed	100.0%	100.0%	n.a.	n.a.
Payout ratio (on NPATA)	61.9%	64.1%	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 64.9% of earnings per share (61.9% of NPATA). While the Company maintains a comparatively high net cash position (excluding the customer balances for pre-payments of postage), the Directors maintain a preference for financial flexibility given the ongoing elevated level of global uncertainty. Furthermore, the extent of volatility in global markets and economies may provide SDL with the opportunity for step-out or bolt-on acquisitions to broaden the Company's product offering or channels to market internationally.

FY 2022 Outlook

SDL has previously provided FY2022 earnings guidance of around $2.5 million.

A number of factors are likely to affect the second half, including price and margin pressure in the New Zealand print and mail market, greater than expected cost pressures and COVID (Omicron) disruption to revenue in the UK which we had previously expected would begin to recover during 2H FY2022. While SDL is gaining new business and continues to have a solid pipeline of opportunity (in both New Zealand and the US), the timing of customer onboarding is unlikely to fully offset these drags on earnings.

Based on the above factors, SDL is amending its FY2022 guidance to around $2.3 million. Significant volatility is possible around this guidance range.