



2020 Annual Meeting Address

22 October 2020

FY2020 Overview

FY2020 was a year of significant progress for Solution Dynamics (“SDL” or “Company”). After a difficult FY2019, mainly in the domestic NZ market which further suffered from the COVID-induced downturn in late FY2020, the Company’s offshore expansion gained traction with new business gains and US expansion.

SDL’s software platforms continue to gain traction across the UK and Europe and increasingly now in the US. The DéjarMail post-on-demand (POD) solution allows customers to route mail correspondence, traditionally handled by companies on an in-house basis, to printers such as SDL and the Company’s print partners. Along with efficiency, this provides costs savings for small and medium sized businesses, especially for ad hoc or low volume mailings. The Jupiter solution is a technology platform that links a range of customer communication origin points with a global network of print production and fulfilment services. There is clear customer demand for these solutions and limited competition at the scale and with the integration functionality SDL provides.

Customer wins from the last couple of years progressively onboarded and ramped up business during FY2020 and further growth from finalisation of these onboardings is expected to continue into FY2021.

Historically, SDL has been a New Zealand business with some international software and technology-related revenue. An important milestone for the Company saw that position change in FY2020. SDL noted earlier this year that international Software & Technology revenue as a proportion of total revenue had moved from around 26% in 1H FY2019 to around 49% in 1H FY2020. This trend is continuing and for FY2020 international Software & Technology revenues as a proportion of total revenue was around 65%.

Looking ahead into FY2021, and assuming the software contracts underway deliver as expected, then SDL’s international activities will further dominate the sales mix. Note that international Software & Technology revenue includes two different business models: in one, SDL is a pure software SaaS provider and earns revenue solely from the customer utilising the software. In the other, SDL still provides software on a SaaS basis but also earns revenue directly related to the software platform by acting as the customer’s provider of a total communications solution service (including third party print, logistics, postage and digital).

The requirement to provide high levels of international customer service for software delivery and support capability means SDL’s New Zealand technology staff are regularly called upon after hours to support overseas customers and the Company’s international staff. SDL recognises the stress that international expansion and time zone differences have placed on staff, both in New Zealand and globally, and is actively increasing the number of support-related staff in the northern hemisphere. Growth in employee numbers is needed to increase for both global customer support and the sales infrastructure necessary to address the scale of sales prospects. Additionally, the need for in-market offshore staff has heightened to counter the travel restrictions imposed by COVID on New Zealand-based staff. Additional employees have been added in the UK, France and the USA.

Physical Address

18-24 Canaveral Drive, Rosedale
Auckland 0632, New Zealand

Postal Address

PO Box 301248, Albany
Auckland 0752, New Zealand

Contact

Phone: +64 9 970 7700
Email: info@solutiondynamics.com

New Zealand • United Kingdom • United States of America

www.solutiondynamics.com

SDL continues to maintain a conservative approach to debt and balance sheet management. The Company only has lease-related debt, which is now recognised on balance sheet as a result of changes to accounting standards in FY2020 (SDL's leases are predominantly for premises and print equipment).

FY2020 Financial Metrics

As the financial metrics table notes, revenue growth for the year was strong at 35%, despite some impact late in the year from COVID on New Zealand and UK volumes. The Company achieved milestones of new highs in revenue and net profit and has achieved a five-year compound annual growth rate (CAGR) of 21%.

As previously noted, SDL is investing in staff, particularly in northern hemisphere markets, to address sales opportunities and provide a range of customer support activities. International expansion has been the key factor in the rise of Selling, General and Administration (SG&A) expenses over the past few years, along with significantly improving the breadth and depth of the management team reporting to the CEO.

Financial Metrics (all figures \$'000)	FY2020	FY2019	Growth Y/Y (%)	Five-Yr CAGR (%)
Total Revenue	34,030	25,176	35.2%	21.0%
- Digital Print & Outsourced (a)	12,018	16,831	-28.6%	4.6%
- Software & Technology	22,012	8,345	163.8%	44.4%
Gross Profit	13,459	8,494	58.5%	18.4%
Gross Margin	39.6%	33.7%		
SG&A expenses (c)	9,105	6,174	47.5%	n.a.
EBITDA (b) (c)	4,354	2,320	87.7%	n.a.
EBITDA Margin	12.8%	9.2%		
Net Profit after Tax	1,866	526	254.8%	18.3%
Earnings per share (cents)	12.75	3.59	254.8%	17.3%
Dividends per share (cents)	9.00	4.00	125.0%	43.1%

(a) Around half the decline in Digital Print & Outsourced is the result of reallocation of certain UK services (including postage) to Software & Technology as that revenue is derived from the customer's usage of SDL's software platforms.

(b) EBITDA (i.e. Earnings before Interest, Taxation, Depreciation, Amortisation and Impairment) is a non-GAAP earnings figure that equity analysts tend to focus on for comparable company performance analysis. The Company considers that it is a useful financial indicator because it avoids the distortions caused by the differences in amortisation and impairment policies.

(c) An accounting standard change to the way in which leases are treated for expense allocation purposes means the FY2015 and FY2020 figures for Gross Profit and EBITDA are not comparable.

SDL's reported profit in FY2020 included two items of a one-off nature. The first was a requirement under accounting rules to mark-to-market unrealised gains on foreign exchange contracts that relate to activity in FY2021. The second was incentive expenses relating to previous international contract

wins. The net gain (after tax) from these two items totals \$0.23 million, meaning a more normalised picture of SDL's underlying earnings for FY2020 is \$1.63 million (note this is a non-GAAP measure).

The Company's FY2020 dividends totalled 9.0 cents per share (fully imputed), up from 4.0 cents the prior year. Directors reiterate SDL's policy of 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. A market development grant for North America was obtained from NZ Trade and Enterprise. The Company acknowledges and appreciates NZTE's support and note the grant limits SDL to a maximum dividend payout ratio of 75% of net profit after tax plus amortisation while it is in effect. Given the expansion of the US cost base recently, this grant is expected to be fully utilised during FY2021.

Effects of COVID

SDL is pleased with its success to date in ensuring its staff remained safe. Strict health monitoring and effective work practices were put in place early and rigorously adhered to. The use of segregated teams, health monitoring, and controlled facility access helped ensure no SDL staff member has been infected by COVID-19. These measures are expected to remain in place for an extended period or at least until a vaccine is available.

A range of SDL's clients were deemed essential services businesses and consequently the Company continued partial onsite production operations throughout the New Zealand lockdown. The Company's non-production employees were able to work successfully from home, including SDL's international staff.

Revenue during the New Zealand lockdown period only declined by around 15%, a better result than had initially been anticipated, but nevertheless causing a drag on New Zealand profitability over a three-month period. UK volumes were materially affected as large parts of that economy slowed significantly during lockdown, including one large client whose activity declined around 80%. The UK economy has been slow to recover and, at the time of this report has seen a slight uplift in activity as the government there is attempting to slowly normalise conditions. The UK lockdown and economic slowdown tipped SDL's UK business into loss for the half and this has distorted the Company's overall tax rate upwards as that loss is ring fenced for tax purposes so is not able to offset profits in other jurisdictions.

Some costs savings were achieved around travel and temporary rent relief, however, these were insufficient to offset the decline in gross profit from lower revenues and the Company estimates COVID caused a modest drag to FY2020 earnings.

A longer term question is whether COVID causes the ongoing decline in transactional mail volumes to accelerate. While this would have little to no effect on SDL's international expansion, it could cause increased competition with higher risk of client loss and margin erosion in the domestic print and mail business.

Global contract: World Vision

SDL noted in June 2019 that it had signed a Master Services Agreement with a major multinational organisation that would progressively ramp up over 2020. That organisation is World Vision (WV), a

Christian, humanitarian not-for-profit (with headquarters in the US and UK). WV is a global leader in improving and transforming the lives of children, their families, and their communities, with over 37,000 employees in more than 100 countries covering six continents (for further information see <https://www.wvi.org/about-us/our-structure>).

WV has complex requirements for the several global communications it undertakes each year. These involve challenging data processing and production and logistics requirements, with logistics into over 50 countries and mail into over 175 countries. SDL's solution has initially involved utilising the Jupiter platform to centralise printing and distribution, resulting in significant cost savings. A later phase may see a move to utilise Jupiter's platform of global distributed print partners, which should provide further efficiencies and cost savings.

COVID-19 has affected WV's operations during 2020, and SDL is endeavouring to assist WV in ensuring that communications flows can be maintained in an efficient and timely manner.

US contract: Pitney Bowes

SDL noted in April 2020 that the Company had successfully concluded and signed a multiyear contract with a major US-based company that provides commerce solutions including technology for physical and digital communications. That company is NYSE-listed Pitney Bowes which has over 11,000 employees globally and supports over 750,000 business customers (for further information see www.pitneybowes.com/us/our-company.html)

SDL's solution is being delivered through its proven Jupiter and POD platforms which will enable Pitney Bowes' customers to access that company's cloud-based print and digital services. A range of Pitney Bowes' US customers have been successfully onboarded and SDL's solution is now commencing rollout for Pitney Bowes France, Australia and New Zealand.

SDL's solution provides a technology platform which links together customer communication origin points such as ERP, transactional and marketing output with production and fulfilment on a globally distributed basis. Closely integrated with over 300 service providers globally, customers can use a highly flexible web service API to achieve simultaneous concurrent fulfilment across five continents, all while retaining visibility and control of the process via an intuitive and mobile friendly web portal.

The roll out of this contract commenced earlier this year. Implementation will occur progressively over a number of phases and is expected to be fully complete across Pitney Bowes globally by late 2021.

US Customer Communications Management (CCM)

The small to medium business (SMB) CCM market in the US is significant. There are around 15,000 medium-sized businesses of 500 to 5,000 employees. Existing service providers typically have CCM software aimed at enterprise customers; this software is very fully featured and complex. While this is effective for enterprise customers where individual client volumes are significant, it means the complexity, cost and time to onboard medium and small-sized businesses generally makes that market uneconomic to serve. Consequently, much of the SMB market utilises in-house communications operations (both digital and print) which is less efficient and higher unit cost than external service provider solutions.

SDL's solution (Jupiter and POD) was designed to be effective for a key pain point for service providers: the time and cost to onboard clients along with ease of integration with the customer communication output of most SMBs. The Company has an opportunity to gain share in the largely unaddressed US SMB market for customer communications.

Strategy and FY2021 Outlook

SDL's key focus is on continuing and accelerating international expansion based around the Company's key software platforms, particularly Jupiter and POD. For most of FY2021 the critical delivery factor is to successfully execute the onboarding of key client wins. This will deliver growth in FY2021 that should also continue into FY2022.

While SDL has traditionally used channel partners for its go-to-market strategy, a trial of direct selling has recently commenced in a US state. This is targeting the smaller to medium-sized business market that the channel partner strategy is unlikely to reach, but which is, in aggregate, a significant and under-served market for software platforms such as POD and Jupiter. The results of the trial will be evaluated in early 2021.

The Directors reiterate previous guidance for FY2021 of earnings in a range of \$2.0 to \$2.5 million. This outlook assumes little recovery in lower offshore volumes and that new client projects and onboarding activities proceed as currently planned.

Risks from COVID mean the outlook for the short to medium term remains volatile. The possibility of macroeconomic shocks or delays to customer plans and projects could cause significant variation in earnings outcomes for FY2021. The need to bring on new staff internationally, coupled with an inability of NZ staff to travel offshore, increases execution risk.

The Directors advise that profit in FY2021 is expected to be biased towards the first half, which is likely to be around two-thirds of full year guidance (prior year 1H FY2020 earnings of \$0.47 million).