Chair and CEO Community

HIGHLIGHTS

- **Completed first full six months of implementing turnaround strategies.**
- **Net Loss After Tax of ($0.19m) versus ($0.80m) for same period last year.**
- **Wireless channel strategy reset underway.**
- **Adjusted Operating costs down $1.96m (15.0%) on same period last year.**
- **FY23 guidance re-affirmed.**

OPERATIONAL RESET

Vital Limited ("VTL" or "Company") reported a net loss after tax of $0.19 million for the first half of FY23 versus a loss of $0.80 million in the prior corresponding six month period. The result includes an after-tax lease adjustment accounting loss of $0.38 million,
so the adjusted result for the interim period was a net profit of $0.19 million.

This performance reflects the first full six-month period following the introduction of an organisational-wide operational reset under CEO, Jason Bull, appointed in April 2022. VTL's Turnaround Metrics were outlined at the Company's FY22 annual result. These results are largely in line with those metrics, and there are early signs that VTL's strategy is beginning to gain traction.

Revenue stabilising, costs down

Revenues declined against the prior corresponding six-month period although this was mostly a result of the prior year having several items of one-off customer-driven projects. When measured against the preceding six months, the second half of FY22, revenues have started to stabilise (VTL typically has little seasonal variation in its recurring revenues).

Adjusted Operating costs reduced materially, down $1.96 million or 15.0% on the corresponding prior period. The new radio wholesale strategy has landed around 500 new connections, generating in excess of $0.2m of additional annualised radio revenue at very little incremental cost. With network build outs now largely complete, current capital expenditure is forecast to decline and is mainly for site relocations or additional customer network requirements. VTL leases around 350 sites across New Zealand and lease expiries or renewals mean a regular capex requirement related to either shifting locations or in some cases to upgrading hardware.

Leases represent VTL's second largest cost item. A new "3F" (Future Focussed Footprint) programme developed as part of the operational reset plans is focussed on optimising site locations and network efficiency. This is already delivering significant savings (lease and maintenance costs) and productivity gains. Further cost savings will be delivered over the remainder of FY23 and into FY24. Prior capital expenditure, along with the 3F programme, has resulted in the Company having largely modern networks with ample capacity and resilient solutions – a key factor when engaging with existing and prospective customers, and more important than ever as digital infrastructure becomes more critical.

Increased focus on customer and culture

The refocused sales activity is improving relationships and the sales pipeline has now significantly improved as has the level of customer and channel partner contact and engagement. Offsetting that, the macroeconomic environment is clearly challenging, with customers looking for cost savings, which will prolong the sales conversion cycle.

There has also been a renewed focus on improving organisational culture, resulting in engagement metrics showing significant improvement with eNPS (Employee Net Promoter Score) rising 33 points to 19 over the last twelve months. Staff turnover has been reducing since late in FY22 and that trend has continued, however the Company will continue to focus on retaining talent, reducing turnover and lifting staff engagement.

OPERATIONAL PERFORMANCE

Wired

VTL provides customers with access to wire (fibre optic) networks in Auckland and Wellington where there is fibre presence in both CBDs, although there is greater fibre concentration in Wellington.

Wired segment (all figures $000)	**H1 FY2023**	**H1 FY2022**	**Percentage Change**
Revenue	4,942	5,102	-3.1%
Lease/rent costs [1]	1,097	1,299	-15.6%
Other operating costs	1,721	1,951	-11.8%
EBITDA (Adjusted) [2]	**2,124**	**1,852**	**14.7%**
EBITDA Margin (Adjusted) [2]	43.0%	36.3%	18.4%
Capital expenditure	350	668	-47.6%
Total assets	33,972	46,748	-27.3%

1. Lease/rent costs including those otherwise included in depreciation and net interest charges
2. Post lease/rent costs that are otherwise treated as depreciation and interest.

The benefits of VTL's network optimisation efforts are producing a reduction in operating costs and are driving EBITDA (Adjusted) growth. The reduction in total assets almost wholly relates to the impairment charge at end FY22 that removed all goodwill intangible asset value from VTL's balance sheet.

Significant efforts are going into implementing a refreshed sales channel strategy utilising VTL's unique market positioning.

Wireless

VTL provides the only New Zealand-wide commercial mobile radio infrastructure. The network is supported by a 24/7 Network Operations Centre (NOC) located in New Zealand.

The mobile radio network leases over 350 sites, some in remote locations. Mobile radio provides wider geographic coverage than cellular and is more resilient and reliable than cellular in times of emergency or disaster (lower congestion risk than cellular as it is not used by the general public, plus it usually has better battery backup than cellular sites). Mobile radio is utilised by organisations that supply critical services (e.g. electricity network providers) that require "always available" reliability, or have remote work in areas outside cellular coverage as well as commercial operations.

The market/replacement value of VTL's mobile radio assets is likely higher than current book value, subject to the Company being able to generate an adequate rate of return on the assets.

Wireless segment (all figures $000)	**H1 FY2023**	**H1 FY2022**	**Percentage Change**
Revenue	9,206	11,399	-19.2%
Lease/rent costs [1]	2,248	2,899	-22.4%
Other operating costs	5,110	5,956	-14.2%
EBITDA (Adjusted) [2]	**1,847**	**2,544**	**-27.4%**
EBITDA Margin (Adjusted) [2]	22.1%	28.7%	-23.1%
Capital expenditure	1,349	1,404	-3.9%
Total assets	36,793	36,793	2.2%

1. Lease/rent costs including those otherwise included in depreciation and net Interest charges
2. Post lease/rent costs that are otherwise treated as depreciation and interest.

The decline in Wireless EBITDA is primarily the result of lower one-off installation and hardware revenues.

In FY2022, VTL started a strategy to move smaller customers to channel partners. Wholesale agreements in place with a number of regional mobile radio operators are now seeing progressive transfer of smaller customers for service and support. This is lowering VTL's "cost to serve" at minimal gross margin drop.

FINANCIAL PERFORMANCE

Revenue

Vital Revenue Breakdown (all figures $000)	H1 FY2023	H1 FY2022	Percentage Change
Wired (Fibre)	4,753	4,978	-4.5%
Wireless (Mobile Radio)	8,352	8,855	-5.7%
Installation	296	2,019	-85.3%
Hardware & Other	747	649	15.1%
Total Services Revenue	**14,148**	**16,501**	**-14.3%**

VTL's revenue declined 14.3% to $14.15 million. This was mostly the result of a reduction in one-off, customer-driven capex projects, but recurring revenue also dropped slightly. The decline in recurring revenue was largely in the Wireless segment from reduced capex projects and two one-off contracts concluding during the half. Recurring revenue also fell in the Wired (i.e. fibre) network where some ongoing rationalisation of customer circuits has been occurring, although the downward trend from the last several years is showing tentative signs of bottoming out. The more difficult macroeconomic environment is seeing customers increasingly focussed on costs and adopting a more cautious approach to growth spending.

VTL's first half loss was the result of lease accounting adjustment losses (after tax) of $0.38 million. Lease adjustments through the Income Statement are required when lease terms are changed; this is a non-cash accounting entry resulting from differences in balance sheet asset and liabilities created on the lease renewal or alteration.

VTL leases/rents around 350 sites for network infrastructure, typically on longer term leases and often with rights of renewal. The Company's results are complicated by IFRS 16 Accounting for Leases, which means that rent expense on the sites leased is predominantly shown under depreciation (and partly in net interest) in the Financial Statements. The following Summary Financial Performance restates the composition of the Income Statement to reflect what the Directors believe better represents the economic performance of the Company in the sense of EBITDA (Adjusted) in relation to free cash flow (noting that EBITDA is a non-GAAP accounting measure). The Summary Financial Performance table should be read in conjunction with VTL's Financial Statements.

This is also the basis for how internal performance is measured and the basis for forward estimates in the Turnaround Metrics Guidance section later in this report. The key adjustment relates to how lease/rent costs are reallocated from the depreciation and net interest categories into the lease/rent costs line prior to EBITDA (Adjusted). This is to reflect the fact that lease/rent costs are cash costs while depreciation is traditionally a non-cash charge against prior capital expenditure.

Summary Financial Performance (all figures $000)	H1 FY2023	H1 FY2022	Percentage Change
Total Revenue	14,148	16,501	-14.3%
Staff costs	4,058	4,802	-15.5%
Lease/rent costs [1]	3,346	4,198	-20.3%
Other Selling, General & Admin costs	3,700	4,064	-8.9%
EBITDA (Adjusted) [2]	**3,044**	**3,438**	**-11.5%**
EBITDA (Adjusted) margin (%)	21.5%	20.8%	
Depreciation [3]	2,183	3,808	-42.7%
EBIT (operating)	**861**	**-370**	**-332.0%**
Impairment charge	0	0	n.a.
EBIT (reported)	**861**	**-370**	**-332.0%**
Net Interest [4]	599	239	150.7%
Income Tax	-73	171	-143.0%
Net Profit after Tax (Adjusted)	**189**	**-438**	**-143.0%**
Lease accounting gain/(loss) (after tax) [5]	-379	-361	5.0%
Net Profit after Tax (Reported)	**-190**	**-799**	**-76.2%**

1. Lease/rent costs including those otherwise included in depreciation and net interest charges
2. Post lease costs that are otherwise treated as depreciation and interest
3. Excludes IFRS 16 adjustments resulting from changes to lease profiles
4. Excludes interest component of capitalised lease costs (this is in lease/rent costs)
5. Adjustments (non-cash) under IFRS 16 for changes to lease terms (net of tax at 28%)

The following table highlights the adjustments between pre- and post-NZ IFRS 16 results.

$000's NZD		H1 FY23	
	Excluding IFRS16	NZ IFS 16 Adjustments	NZ IFRS 16 Classification
Revenue	14,148	-	14,148
EBITDA	**3,044**	**2,607**	**5,650**
Depreciation and Amortisation	(2,183)	(2,298)	(4,481)
Finance Income	73	-	73
Finance Expenses	(672)	(843)	(1,514)
NPBT / (NLBT)	**262**	**(534)**	**(273)**
Tax	(73)	156	83
NPBT / (NLAT)	**189**	**(379)**	**(190)**

While the underlying result (net of the lease accounting loss) is a small profit of $0.19 million, this is not an acceptable level given the size and value of the network infrastructure VTL owns and operates. VTL's turnaround strategies are geared toward generating a fair and adequate rate of return on the Company's network asset base.

Balance sheet, liquidity and debt

VTL's bank debt facility, which consists of secured funding facilities with Bank of New Zealand with a combined limit of $17.5 million, has a maturity date of January 2024. Debt reduction is a key priority for VTL. The Company's existing interest rate hedges expires late in H1 FY23 so the impact of higher interest expense will be felt during H2 FY23.

Selected Balance Sheet and Cashflow Figures (all figures $000)	H1 FY2023	H1 FY2022	Change
Bank debt	14,000	14,850	-850
Cash	752	1,201	-449
Right of Use Assets [1]	22,093	16,305	5,788
Right of Use Liabilities	23,413	17,037	6,376
Wired network assets [1]	27,873	39,999	-12,126
Wireless network assets [1]	20,799	26,460	-5,661
Operating Activities cashflow (Adjusted) [2]	3,044	3,438	-394
Capital expenditure	1,699	2,072	-373
Operating cashflow (Adjusted) less Capex	**1,345**	**1,366**	**-21**

1. Note that Network assets (Wired and Wireless) include Right of use assets (mostly in Wireless)
2. Cashflow from Operating Activities in Financial Statements less Principal payment of Lease Liabilities

Capital expenditure for the H1 FY23 was $1.7 million versus $2.1 million in the prior period. As outlined in the Turnaround Metrics Guidance section, future (non-customer requested) capex is expected to decline.

TURNAROUND METRICS GUIDANCE

As noted at the Company's FY22 result, VTL's focus is aimed at ensuring it can achieve an appropriate rate of return on its infrastructure asset base. This may involve taking advantage of any network optionality or partnering or channel opportunities to improve network utilisation.

In FY22, VTL provided turnaround outlook guidance on several metrics.

Turnaround Metrics (all figures $m)	H1 FY2023 (Actual)	FY2023 (Outlook)	FY2024 (Outlook)
Revenue	14.15	27.5 – 28.5	28.0 – 29.0
Adjusted EBITDA [1]	3.04	5.8 – 6.5	6.6 – 7.1
Net Profit after Tax (adjusted) [2]	0.19	0.0 – 0.2	0.7 – 1.1
Adjusted free cash flow [3]	1.34	1.6 – 2.4	3.0 – 4.0

1. After lease costs that are otherwise treated as depreciation and interest
2. Excludes IFRS 16 adjustments resulting from changes to lease profiles
3. Adjusted EBITDA (as above) less capital expenditure

A range of scenarios was modelled in arriving at these metrics and typical risk caveats apply, including no material adverse or unforeseen events or circumstances. The Company notes that significant interest rate increases in New Zealand, and from central banks globally, may produce a greater than expected macroeconomic slowdown than previously envisaged.

The Company believes the turnaround metrics remain realistic and achievable. To date VTL is broadly tracking to its turnaround plan although some H2 FY23 pressure on Net Profit after Tax will result from higher interest charges. Capex is in line with forecast expectations, so free cash flow is currently tracking to plan.

LOOKING AHEAD

VTL notes that the first half result indicates modest recovery progress. The Company is committed to delivering its Turnaround Metrics, while preparing to mitigate the pending impact of any broad-based downturn in economic activity.

Despite rising near-term economic uncertainty, VTL owns and operates New Zealand's only nationwide commercial mobile radio network, which supports a diversified portfolio of customers with naturally defensive characteristics in many cases.

The current reset strategies represent a planned path to return VTL to positive free cash flow, with an initial focus on debt reduction. The Board remains acutely aware of the significant discount VTL shares are trading at relative to the book value of its net tangible assets and is committed to ensuring value is delivered to shareholders.