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DIRECTORS' AND MANAGEMENT COMMENTARY

FY2023 Result Overview

Solution Dynamics Limited ("SDL" or "Company") recorded a net profit after tax of $3.42 million for FY2023, a 33.6% gain on the profit of $2.56 million the prior financial year. FY2023 earnings per share was 23.3 cents, up 33.6% from 17.5 cents the prior year. This is another record profit result for the Company.

The Company's revenue was broadly flat at $40.4 million (up 0.6% from $40.2 million). SDL's New Zealand operations made significant progress, gaining share in a declining local print and mail market. International operations generated only modest new business, but suffered from more difficult economic conditions, especially from customers in the US mortgage market where volumes were down around 75%. This international weakness drove a 4.6% reduction SDL's Software & Technology platform revenue, to $28.4 million.

Earnings before interest, tax, depreciation and amortisation ("EBITDA") increased 26.4% to $5.71 million (FY2022 $4.52 million), on the back of improved Gross Profit from growth in higher margin accounts, pricing actions and new business.

Cash flow from operations was $4.84 million (FY2022 $2.98 million) and the net cash position at year end was $6.63 million (FY2022 $5.01 million).

The directors have declared a final cash dividend of 1.5 cent per share (FY2022 4.0 cents), bringing total cash dividends for FY2023 of 11.5 cents per share (FY2022 13.0 cents). All dividends are fully imputed. During the second half of FY2023 (backdated to late in the first half), SDL received a three-year, co-funding International Growth Fund development grant from NZ Trade & Enterprise ("NZTE"). One of NZTE's conditions is that SDL's dividend payout ratio is capped at 50% for the duration of the grant and the final 1.5 cent dividend brings the full year payout ratio to 49.4%.

FY2023 Business Performance

The New Zealand business produced solid gains following a refreshed focus on new business activity that commenced in late FY2022, following staff changes and restructuring the sales team. Further gains were also achieved from changes amongst local competitors that occurred in FY2022.

SDL achieved broad-based price increases in New Zealand during the year, something that has not occurred for an extended time, although this is mainly offset inflation pressures that were particularly noticeable in certain areas of staffing.

The Company was pleased to implement a “living wage” policy during the year. This was not a significant cost but it was meaningful for the recipients.

International operations continued to expand business with higher margin clients that have global customer communications requirements, enabling significant growth in margins and profit despite relatively flat revenue growth. Postal organisations globally are continuing to implement significant hikes in postage rates, aimed at offsetting the revenue erosion they are suffering from falling volumes. SDL expects this trend to continue and expects ongoing sizeable increases in postage rates in the markets the Company operates in, including New Zealand Post. SDL is well positioned through its global customer communications cloud and distributed print network and expertise to capture postage savings while accelerating digital transformation. This was confirmed during FY2023 with the addition of a “big four” global Business Process Outsourcer based in New York choosing SDL for a leading global credit card provider’s international communications programme.

The Company refurbished its Auckland office space during the first half of the year. This has contributed to improved staff morale and engagement, along with assisting the process of staff returning to the office. The fitout was completed cost effectively.

SDL’s website has recently been updated to better reflect the Company’s unique advantages around digitally transforming global customer communications.

Given difficult macroeconomic conditions, and sales underperformance in International markets, the Company was pleased to generate a record profit in FY2023.

Business Description

SDL operates in the global Customer Communications market, providing a comprehensive suite of software technology, professional services, and managed services to facilitate the digital transformation of global customer communications. SDL operates primarily in New Zealand, North America and the UK, increasingly supporting global organisations with customer communications needs. The Company’s products and services are represented by two revenue streams:

- Services (split into Digital Print & Document Handling, and Outsourced Services); and
- Software & Technology.

Services reflects the New Zealand business where SDL owns and operates mail house activities. Within Services, Digital Print & Document Handling revenues are generated from digital printing and mail house processing for two categories of mail items: transactional mail, such as invoices and statements; and direct marketing and promotional mail. Outsourced Services such as envelope printing and postage are typically bundled as part of the total solution albeit generally at much lower margins.

Software & Technology, reflecting the International business principally in North America and the UK, provides a comprehensive suite of global customer communications cloud solutions. This cloud service provides a complete global solution while the DMC (Digital Mail Centre) leverages and extends the capabilities of the SDL cloud to the desktop through a simple yet powerful user experience. Primary components of the SDL technology stack include:

- complete, workflow and integration;
- complete digital and print multi-channel distribution;
- global distributed print integration in over 50 countries;
- digital asset management;
- digital and print campaign optimisation and management;
- document scanning, workflow and archiving;
- artificial intelligence applied to document enhancement;
- document composition and hyper-personalisation;
- desktop digital mail centre User Interface (UX digital document managemenl);
- data quality and enhancement; and,
- dashboards and analytics.

SDL has several different business models for international clients. For some, the Company provides only software and related consulting services, but for others it also integrates with third party printing and logistics providers, on which it will typically earn a modest margin. For these latter clients, the software charge and print/logistics margins are typically aggregated into an overall charge to the customer. This means Software & Technology revenues are a mix of pure software and software consulting revenues for some clients, while others also include third party printing and logistics revenues that are generated from SDL's software. The third-party printing and logistics revenues are the larger proportion of total Software & Technology revenue.

The primary focus for most clients is digital transformation of customer communications, while improving the efficiency and effectiveness of printed communications remains vital. While the majority of SDL's revenue in FY2023 are from printed communications, increasingly our growth and differentiation globally is in our software and in digital transformation.

Total Software & Technology revenue (some of which is revenue billed from New Zealand) as a proportion of total revenue was around 70% in FY2023.

Description and Review of Revenue Streams

Services

Services is the Company's New Zealand operation that provides mail house operations to high-volume postal mail users in the business-to-consumer sector. Services operates leased, high-speed digital colour and monochrome printers. In addition to digital printing, Services also provides the ancillary document handling operations such as automated envelope inserting and flow-wrap.

Services now bases its sales approach around digital transformation; some of the largest SDL clients in New Zealand rely on SDL for digital services from data quality and enhancement, to digital channel distribution and closed loop reporting.

Services revenue also includes Outsourced Services, which encompasses a variety of outsourced functions or components such as postage, third party offset printing, freight, paper and envelopes, and digital channel delivery.

The Company has an access agreement with NZ Post and an alternative carrier which provides wholesale rates and bulk mail discounts off retail rates. The gross profit margins on many of these outsourced components, especially postage, are low but an important component of the total solution.

SDL is part way through implementing several updated systems to improve efficiency and productivity across various parts of the business. These include an end-to-end estimating, ordering, invoicing and production management information system that is expected to provide improved flexibility and control of the Company's print operations. A more modern ERP/accounting package is expected to be installed and largely operational by year end, and a new sales CRM (customer relationship management) system is currently under testing for rollout.

In a declining mail market, SDL's mail volumes managed a 2% rise on the prior year (FY2022 mail volumes fell by 8%). This resulted from market share gains, especially new wins amongst New Zealand Councils. However, the headwinds to physical transactional mail are exacerbating as rapidly increasing postage rates accelerate customers' switch to digital. From 1 July 2023, NZ Post increased its standard medium-sized letter retail pricing by $0.30 to $2.00 a rise of 17.6%. SDL remains confident it holds a strongly competitive cost position in the market and has recently implemented a further broad-based price increase.

On the digital communications side, SDL's volume of customer emails rose about 5%.

SDL Services Revenue Breakdown (all figures $000)	FY2023	FY2022 Restated[1]	Percentage Change
Digital Printing and Document Handling	4,430	4,271	3.7%
Outsourced Services	7,528	6,053	24.4%
Total Services Revenue	11,958	10,324	15.8%

1. Total Services revenue is unchanged, this is a reallocation between the two revenue categories and is restated for classification purposes. Prior FY2022 revenue for Digital Print and Document Handling was $3,812. Prior FY2022 revenue for Outsourced Services was $6,512.

The successful refocus of New Zealand sales to lead with SDL's digital transformation produced solid FY2023 results with revenue up a strong 15.8% and the pipeline for FY2024 is robust. While the overall domestic postal market decline provides an ongoing headwind that makes sustained growth difficult to achieve, the full year benefit from FY2023 gains, a recent round of price increases, plus pipeline opportunities, should underpin further solid growth in FY2024.

SDL Software & Technology

Software & Technology generated revenue of $28.4 million in FY2023, a decline of 4.6% on the prior year's revenue of $29.8 million. There was some relative improvement in H2 which saw revenue rise 1.3% versus the H1 year-on-year decline of 8.2%.

SDL saw growth in the UK market as post-COVID recovery in volumes continued, although UK and European revenue still remains around 30% below FY2020 levels. The Company's largest customer, based in North America, increased revenue by around 7%. Despite growth in the two largest clients, revenue overall was well down in North America as a result of the collapse of the US mortgage market and several large, one-time low margin deals in FY2022. The strategy going forward is to focus on global clients with global opportunities and avoid single country applications that are lower margin and where SDL's technology services provide less value add. During the second half of FY2023, SDL won a large software and managed services contract for one of the "Big Four" Business Process Outsourcers based in New York servicing a major global credit card brand. This contributed to improved revenue and margin performance in H2.

Despite the lower revenue, Software and Technology achieved a mix of higher margin revenue that enabled North American gross profit to grow by 14% in FY2023.

Software & Technology revenue is partly platform based, typically under SaaS (software as a service) arrangements, which can be priced as a monthly subscription tiered base on volume or on a per document basis. It also includes revenue where SDL manages the total communications solution including document printing and distribution for the customer. The printing and distribution component forms the larger part of Software & Technology's revenue and is generally lower margin.

SDL has "productised" its global customer communications platform, DMC, and made it easier for customers to access and "self serve". DMC simplifies onboarding of customers and sending and tracking of documents through physical and digital channels. DMC integrates with other SDL products including the document composition platform, Composer, and the automation tool, Autoprod, to enable creation of highly personalised communications at scale. DMC integrates with SDL's print partner network through the Company's distributed print platform, Jupiter, to manage and provide real time status updates on job completion and mailing. SDL's expertise in global postage management delivers significant cost savings by leveraging DMC to optimise production and delivery logistics. The Company's objective is to grow SaaS platform revenue at a faster rate than print services by focusing on digital transformation.

Communication channels are no longer "one size fits all"; customers now receive increasingly personalised messaging through multi-media channels. SDL's software platforms enable one to one personalisation of each form of communication – whether a customer email, an invoice or account statement, or a piece of marketing collateral – as a means to enrich and deepen the relationships that our customers have with their customers.

SDL excels at enabling organisations to drive down cost of customer communications while improving client engagement. Leading global brands rely on the Company's software to simplify sending of complex global customer communications through print and digital channels. SDL's global network of mail service providers delivers significant savings in print and postage costs as well as assurance against pandemic/supply chain driven business interruptions. As the secular decline in mail continues, SDL's software platforms provide an omni-channel bridge to digital transformation.

For a more detailed view of SDL's software solutions, refer to the Company's website at: https://solutiondynamics.com/customer-solutions/

In H2 FY2023, SDL applied for and received an International Growth Fund ("IGF") co-funding grant from NZ Trade and Enterprise ("NZTE") to support a range of market development activities in North America. The IGF provides 50:50 co-funding for eligible project costs up to a maximum of $0.6 million from NZTE over a three-year period from November 2022. A condition of the co-funding is that SDL cannot make distributions that exceed 50% of net profit after tax for the duration of the co-funding agreement.

Financial Performance

SDL's growth in earnings over FY2023 resulted from a combination of successful new business growth in New Zealand and improved margins on $25.7 million of international revenue. Additionally, price increases in the local market helped offset inflationary cost pressures.

The improved revenue mix along with better sourcing to mitigate rising input costs, saw Gross Profit improve 14.7% on largely unchanged total revenue. SG&A costs suffered from inflationary pressures in some parts of the business, along with additional incentive payments for above-budget performance, rising 9.0% on the prior year. EBITDA grew 26.4% to $5.71 million.

Summary Financial Performance (all figures $000)	FY2023	FY2022	Percentage Change
Total Revenue	**40,385**	**40,127**	**0.6%**
Less: Cost of Goods Sold	24,399	26,186	-6.8%
Gross Profit	**15,986**	**13,941**	**14.7%**
Gross Margin (%)	39.6%	34.7%	
Less: Selling, General & Admin (SG&A)	10,274	9,422	9.0%
EBITDA	**5,712**	**4,519**	**26.4%**
EBITDA margin (%)	14.1%	11.3%	
Depreciation	965	885	9.0%
Amortisation	85	168	-49.4%
EBIT	**4,662**	**3,466**	**34.5%**
Net Interest paid	18	59	-69.5%
Income Tax	1,219	844	44.4%
Net Profit after Tax	**3,425**	**2,563**	**33.6%**
Tax rate	26.2%	24.8%	

SDL's earnings in FY2023 benefitted from NZTE's market development co-funding assistance, which totaled $0.1 million pre-tax.

The following table highlights first and second half performance for the last two financial years. The timing of a small number of particularly large customer jobs during the year can materially alter the split of first and second half earnings.

SDL Half Financial Years (all figures $000)	2H FY2023	2H FY2022	Percentage Change	1H FY2023	1H FY2022	Percentage Change
Total Revenue	17,041	16,409	3.9%	23,344	23,718	-1.6%
EBITDA	1,601	898	78.3%	4,111	3,621	13.5%
EBITDA margin	9.4%	5.5%		17.6%	15.3%	
Net Profit after Tax	**968**	**531**	**82.3%**	**2,457**	**2,032**	**20.9%**

Balance Sheet, Liquidity and Debt

SDL closed the year with net cash (i.e. cash less interest-bearing debt) on hand on $6.63 million (FY2022 $5.01 million). This net cash figure excludes debt liabilities relating to Right to Use Liabilities arising from the Lease Accounting standard; these liabilities are approximately offset by Right to Use Assets.

The Directors intend to maintain a prudent approach to balance sheet management and are conscious that a period of more difficult economic times may provide acquisition opportunities.

The Company maintains an overdraft arrangement from ANZ Bank with a $200,000 limit. This was unused during FY2023.

Selected Balance Sheet and Cashflow Figures (all figures $000)	FY2023	Restated FY2022	Change
Net Cash/(Debt & Borrowings)	6,628	5,009	1,619
Non-Current Assets	1,663	1,541	122
Right of Use Assets	2,188	3,017	-829
Net Other Assets/(Liabilities)	-878	-602*	-276
Right of Use Liabilities	-2,250	-3,051	801
Net Assets	**7,351**	**5,914***	**1,437**
Cashflow from Trading	4,740	3,902	838
Movement in Working Capital	103	-923	1,026
Cash Inflow from Operations	**4,843**	**2,979**	**1,864**

**Restatement only for Right of Use asset and Right of Use liability around the timing of SDL's building lease renewal for IFRS 16 purposes, the FY2022 Right of Use asset and Right of Use liability amounts are both increased by $0.4 million. There is no other impact from this change and the FY2022 Income Statement is unaffected."*

Capital expenditure for the year was $0.3 million. The Company does not capitalise any software development. The largest item of capex was the refurbishment to the fitout of SDL's Albany office, followed by a number of items of computer and print equipment, including a new server.

Net assets includes intangible assets of around $1.1 million, which is all goodwill and subject to an annual impairment test.

SDL operates with a largely neutral working capital balance, meaning growth typically does not require additional investment of capital, although international expansion and larger "lumpier" contracts means month-to-month and intra-month cash flow movements can fluctuate significantly.

Taxation and Dividends

SDL pays full New Zealand tax on locally generated earnings. In both FY2022 and FY2023, the Company obtained some benefit from New Zealand's Research and Development Tax Incentive (RDTI) which provides a tax credit equal to 15% of eligible R&D expenditure. The RDTI tax credit benefit is the primary reason why the overall tax rate of 26.2% is below statutory tax rates in the jurisdictions in which SDL operates.

SDL intends to pay dividends only to the extent that it can fully impute them and also subject to the Company not experiencing any one-off requirements for abnormal capital expenditure or any significant acquisition or investment activity. Additionally, NZTE's IGF co-funding caps SDL's dividend payout ratio at 50% for the duration of the grant agreement. This limited the full year FY2023 final dividend to 1.5 cents per share.

Earnings and Dividends per Share	FY2023	FY2022	Percentage Change
Closing Shares on Issue ('000)	14,720	14,720	0.0%
Reported Earnings per Share (cents)	**23.23**	**17.41**	**33.4%**
Dividend per Share (cents)	**11.5**	**13.0**	**-11.5%**
Dividend Proportion Imputed	100.0%	100.0%	
Dividend Payout ratio	49.5%	74.7%	

The final dividend of 1.5 cents per share will be fully imputed and paid on 22 September 2023.

The number of shares on issue was unchanged year-on-year. At financial year end, the Company had outstanding ESOP rights to four key staff members in the plan (including the CEO) who collectively held rights to 0.6 million shares.

Risk Factors

Physical mail volumes in New Zealand are continuing to show structural decline, especially for transactional mail. As previously noted, NZ Post standard-mail retail postage rates have increased 17.6% for FY2024. The Company has several key domestic contracts that, if lost, could place material pressure on local profitability although much of this is under medium-term contract. SDL expects that consolidation in the New Zealand print market is inevitable, but the Company will not participate unless there is clear value enhancement for shareholders.

SDL's largest five customers accounted for 59% of revenue. Loss of one or more of those, particularly the Company's largest customer, would cause financial results to change very materially.

The Company's software provides critical document management, distributed print, and storage functions for its clients. SDL needs to ensure it continues to maintain appropriate levels of software development quality control and sufficient, along with well-trained staff for software delivery and support. Cyber and data security is a known high-risk area. The Company regularly reviews its IT and data security arrangements including through the use of external consultants.

The Company operates a single site facility for its New Zealand print and mail house production, with an offsite for data and server backup. The Directors are conscious of the operational risk a single site implies for digital imaging and mail house operations. SDL has a reciprocal disaster recovery ("DR") plan with another printer, as well as a degree of backup capability with a division of its major print equipment supplier.

The Company mainly relies on distribution channel partners to market its software products into the UK, Europe and the US. This means SDL has little or no contact with many of the end user customers of its products. While these channel partner arrangements are currently stable there is no guarantee these arrangements will continue. SDL aims to ensure its software meets channel partner requirements.

At present, the Company expects ongoing growth from existing customers and new contract wins as sufficient to support growth expectations. However, the global environment, especially macroeconomic conditions, remains extremely uncertain and this could materially affect the Company's results.

While the risks noted represent ongoing challenges and headwinds, the market opportunities to help organisations with their global customer communications digital transformation can be significant. SDL holds a leadership position in global postage management and distributed print, capturing significant savings as the first step in the digital transformation journey. Leading brands rely on SDL's digital document management platform and the Company's sales and marketing efforts should enable growth in key vertical global markets and offer longer term paybacks. Nevertheless, the shorter-term headwinds in the global environment, especially relating to macroeconomic conditions, are producing significant uncertainty and this could materially affect the Company's results.

FY2024 Outlook

In SDL's domestic New Zealand market, there are two offsetting factors. First is SDL's ongoing success in winning new business, which is currently more than offsetting the rate of overall decline in the print and mail house market. Second is the continued rate hikes by postal operators globally, including NZ Post, in postage rates. This will inevitably hasten the move from physical to digital communications although the effect is more pronounced for transactional mail (severely affected) than for promotional mail (very modestly affected).

Internationally, renewed focus and staffing changes have occurred to the sales function. SDL has narrowed its focus to key vertical markets, such as sectors with cross-border mail, or where the Company has competitive advantage based on sector domain knowledge and the ability to utilise distributed print capability. Difficult macroeconomic conditions as higher interest rates effect economic growth are making sales cycles longer and more difficult, however, the changed focus has resulted in a developing pipeline of prospects.

SDL has previously announced that its largest customer has indicated it intends to review its communications contracts by issuing a Request for Proposal ("RFP") tender for the work the Company has undertaken for around five years. The customer has stated it is very satisfied with SDL's service quality and operational flexibility and that the RFP is part of the customer's periodic review of its large contracts. The current expectation is that the RFP is likely to be issued early in 2024, although timing remains uncertain and subject to change. This customer is very material to SDL and every effort will be undertaken to ensure the business is retained, although an RFP process will inevitably carry significant risk for the Company.

The timing of the RFP, and its outcome, make providing guidance for the financial year ahead unusually difficult. The directors have decided to defer providing FY2024 earnings guidance until the result of the RFP is known. At this stage, the first half result for FY2024 will not be affected.

In addition to the large-customer-specific risk, the Company cautions that significant volatility in results is possible and a number of factors, especially macroeconomic headwinds, are outside the Company's control.

Patrick Brand
Chief Executive Officer

John McMahon
Director (Chairman)

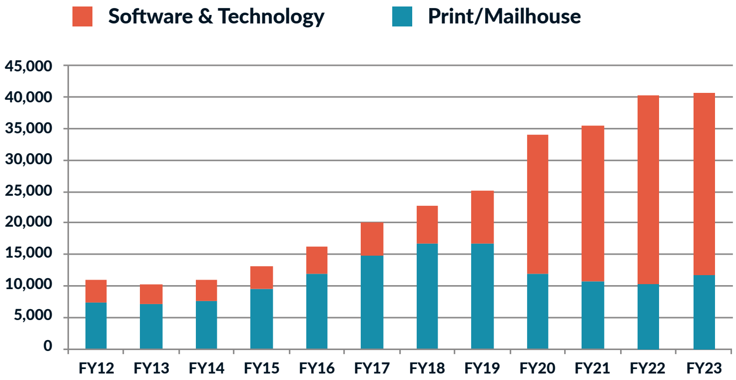
Key Financial Trend Metrics

Revenue ($000)

Revenue CAGR (10 yr) 14.6%

Software CAGR (10 yr) 25.1%

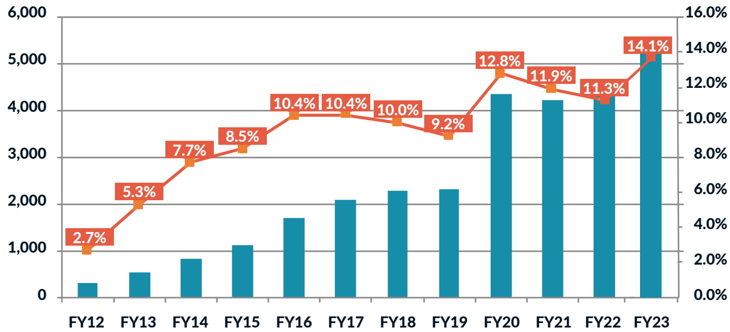
Print/Mail CAGR (10 yr) 5.1%



EBITDA ($000)

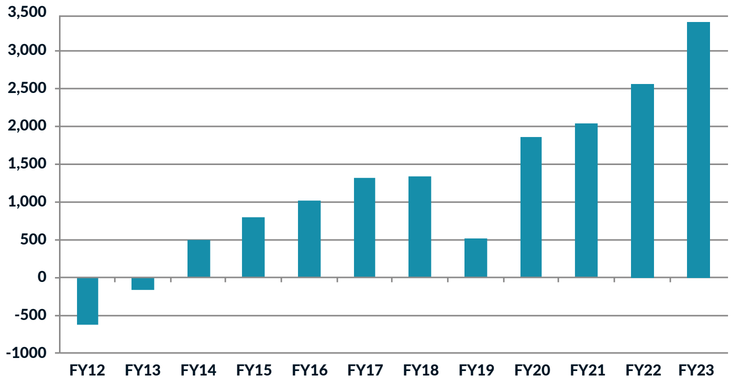
CAGR (10 year) 26.5%

EBITDA is as reported in financial statements, noting this is affected by the change of accounting standard to NZ IFRS 16 (accounting for leases) in FY2020 (increases reported EBITDA) so FY2020 onwards is not comparable with prior years.



Net Profit ($000)

Reported net profit. Note that SDL paid no tax from FY2012 to FY2014.



Dividends

Cents per share
(excludes imputation credits).

All dividends are fully imputed.