SLI Systems

H1 results

Quality over quantity

Software & comp services

SLI's financial performance in H1 reflected its current transitional phase with ARR remaining flat as the business is realigned to focus on value over volume through a number of initiatives. The key customer retention rate is reverting to historical levels and with an operationally geared model, we believe that only a modest recovery in new business momentum should support robust upside. Net cash stands at NZ$6m.

Year end	Revenue (NZ$m)	EBITDA (NZ$m)	PBT* (NZ$m)	EPS* (c)	P/E (x)	EV/sales (x)
06/15	28.6	(6.7)	(7.0)	(11.1)	N/A	0.3
06/16	35.7	1.1	0.7	1.1	29.1	0.8
06/17e	32.3	(0.5)	(0.8)	(1.3)	N/A	0.5
06/18e	34.7	0.9	0.5	1.0	32.0	0.5

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

A period of transition

The six months to December were a period of transition for SLI, as management realigned the business to improve competitiveness, particularly with higher-value enterprise customers. Key initiatives included realigning and training the sales team, launching a new website and implementation of new CRM systems. Planned launches in H2 such as HTTP/2 and SSL should enhance sales efforts with larger enterprise customers.

Relatively solid through transitional period

Annualised Recurring Revenue (ARR), SLI's key momentum indicator, was flat over the six-month period at NZ$31.1m with customer retention improving to 87% vs 84% for FY16. Revenues dropped to $15.5m from $17.4m (H116) due to currency (strong NZ$) and unavoidable customer losses in Q416. This led to a NZ$0.6m EBITDA loss over the period, vs a NZ$1m profit in H216, although the balance sheet remains solid with net cash of NZ$6m.

Ingredients for a recovery in momentum

With good execution, we believe the ingredients for a robust turnaround are in place. SLI is the market leader in a large and growing market, with plenty of scope to add new customers and upsell/cross-sell other services. Data points are still limited, but on the basis of revised sales initiatives bearing fruit and new product enhancements being brought to market, we forecast a return to growth in ARR in H2, returning to a low double-digit growth trajectory and EBITDA profitability in FY18. Two substantial US Enterprise client wins further bear this out.

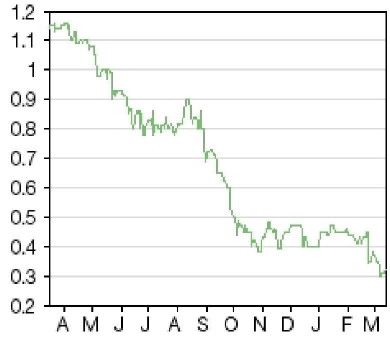
Valuation: Modest uptick should drive upside

At 0.5x EV/Sales, SLI is trading at an acute recovery rating and a substantial discount to search/SaaS peers (typically 2x+). However, any recovery momentum should drive operationally geared growth in profitability and a re-rating upwards. Our DCF scenario analysis suggests that sustaining 5% growth in the mid-term should generate upside, while 7.5% mid-term growth and 20% EBITDA margins result in a DCF valuation of NZ$0.77, twice the current share price.

14 March 2017

Price	**NZ$0.32**
Market cap	**NZ$20m**
	US$/NZ$1.399
Net cash (NZ$m) at 31 December 2016	6.0
Shares in issue	62.3m
Free float	40%
Code	SLI
Primary exchange	NZX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(25.6)	(28.9)	(71.9)
Rel (local)	(25.8)	(31.9)	(73.6)
52-week high/low		NZ$1.2	NZ$0.3

Business description

SLI Systems' core products are e-commerce site search and navigation tools that learn from customer behaviours to improve the relevance of search results and therefore increase sales conversion. Customers pay a monthly subscription based on the number of queries per month.

Next events

Full year results	July 2017

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Edison profile page

SLI Systems is a research client of Edison Investment Research Limited

Investment summary

Company description: e-commerce optimisation

SLI Systems provides a suite of premium e-commerce optimisation products designed to increase online sales for its clients. This is achieved by search engine enhancement tools to maximise click-through rates (CTRs) to its clients' websites from search engines, in addition to search and merchandising functionality on the clients' websites to improve the conversion rate of site visitors to customers. SLI continuously adds to and develops its series of complementary products that enhance its core search functionality.

Financials: Investing in growth

One of SLI's key differentiators is that is has very low implementation costs for its clients, as it uses its own staff for installation and set-up at minimal additional cost to the client. While this helps to win business, it also results in a net cash outflow for each new client acquisition, with a typical payback period of two years. Despite this trade-off between growth and profitability, cash at 31 December 2016 remains high at NZ$6m, so we do not foresee the need to raise additional operational capital. Operating revenues fell by NZ$1.9m y-o-y, attributable to FX fluctuations and the three largely unavoidable client losses in Q416 (as a result of insolvencies and change of ownership). Net losses for the period grew to NZ$1.3m (H116: NZ$446,000).

We forecast a continuation of historic client retention levels of 87%, with a corresponding CAGR increase in ARR of 7.8% in FY16-19. We expect the company to exit FY17 at a cash flow-neutral run rate, with a return EBITDA profitability (NZ$928,000) in FY18 and EPS profitability the following year (NZ$0.26/share).

Sensitivities: Acquiring and keeping clients is key

The retention rate is the key sensitivity for mid- to long-term profitability. SLI attempts to mitigate the risk of client churn by investing heavily in customer support and having automatic renewal with a 90-day notice period for most of its customers.. However, the industry is very competitive and therefore it is likely that SLI (and its peers) will need to invest continually in R&D just to keep up with the crowd. This makes a close customer relationship even more important since it provides SLI with insight that its more standardised peers will miss. The success and growth of the e-commerce platforms may also have a substantial effect on the company.

Valuation: Significant discount to peers

Assuming mid-term CAGR revenues of 7.3% and matured EBITDA margins of 20%, our core DCF scenario using a WACC of 12% and a terminal growth rate of 1.5% yields a valuation of NZ$0.77/share. At EV/Sales of 0.5x, SLI is trading at an acute recovery rating and a substantial discount to search/SaaS peers (typically 2x+). While the current price is a reflection of the company's loss-making status and the reduction in ARR y-o-y, any recovery momentum should drive operationally geared growth in profitability and a re-rating upwards. We believe that early signs of such a recovery are already apparent, as demonstrated by the recent uptick in client retention rates, in addition to the H117 recovery of ARR.

Operational review

Operational update

H116 was a transitional period for SLI, with CEO Chris Brennan implementing a number of changes aimed at reinvigorating growth and cementing a scalable business model. Changes are being implemented at a number of different levels. Investment in R&D has been increased to accelerate the rate of product innovation with a particular view to enhancing competitiveness for larger enterprise accounts. The sales structure and incentives have been changed to focus on lifetime value rather than volume and the company has invested in CRM systems to enable better targeting and tracking of these higher-value accounts.

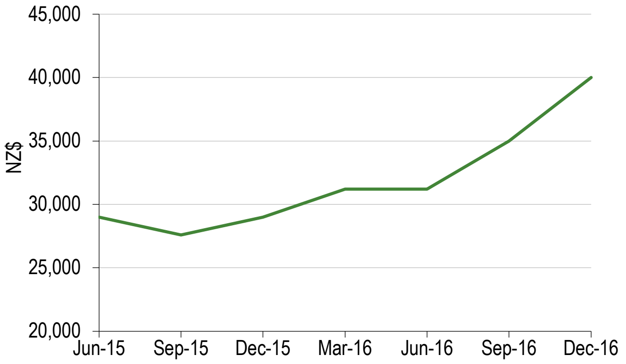
It is early days yet, but we believe there were enough encouraging signs in SLI's H1 performance (such as recent high-profile US client wins) to suggest that a recovery in momentum may be due.

Improving customer mix offsetting low end-churn

Management is seeking to improve its sales mix through improving its offering and sales approach to higher-value enterprise customers while moving out of bidding for smaller, less profitable accounts. Success should benefit the business in a number of ways including improving the scalability and margins of the business as larger accounts typically incur proportionately lower set-up costs and supporting the ability to drive sustainable growth as larger established customers tend to be less volatile and offer more scope for cross/up-selling.

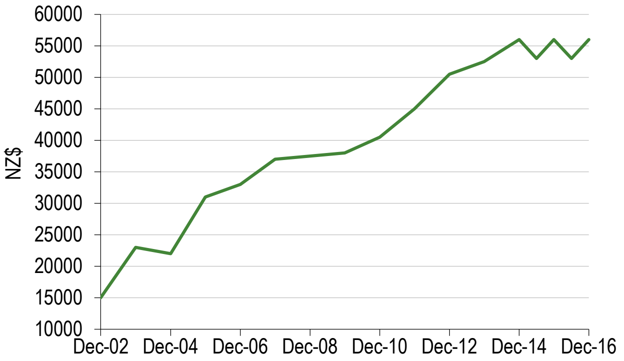
There were signs of this strategy coming through in H1. While the company lost 69 customers and won 39 over the period, ARR remained flat, with the new customer average contract value (ACV) of NZ$40,000 (Exhibit 1) substantially higher than the ACV of NZ$31,000 for lost clients.

Exhibit 1: Six-month rolling initial average contract value



Source: SLI Systems, Edison Investment Research

Exhibit 2: Average annual recurring revenue per customer (constant currency)



Source: SLI Systems, Edison Investment Research

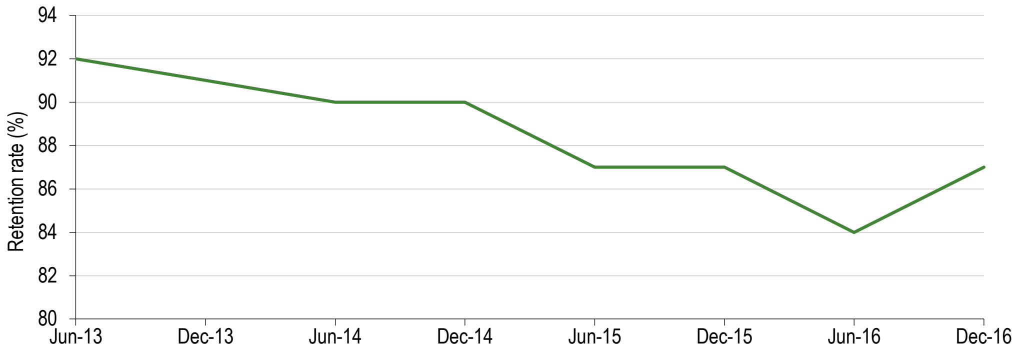
Enterprise wins offer encouragement

This growth in new client ACV was helped by winning two important US enterprise accounts over the period: Crate & Barrel, a housewares retailer with NZ$800m online sales and 8.8m monthly visits (Internet Retailer rated number 71) and Rocky Mountain ATV, the online auto parts retailer ranked in the top 50,000 global Alexa ranking. The Crate & Barrel client win is particularly encouraging in terms of demonstrating the company's ability to compete in the enterprise space, given that it was won following a beauty parade against competitors including Endeca (owned by Oracle), which was the incumbent supplier. Both of these accounts will rank within SLI's top 15% of contracts by ACV.

Customer retention recovers from trough

Customer retention over the H1 period was 87% on an annualised basis, compared to 84% for the 12-month period (Exhibit 3), which was affected by the largely unavoidable loss of three large customers late in FY16 (due to insolvencies or change of control). It is difficult to gauge how much this figure can be improved in the future. Whereas historically the company enjoyed higher retention rates (90%+ in 2013 and 2014), this churn was coming out of a substantially lower historic customer base. As churn typically happens when customers migrate to a new e-commerce or web platform, the customers decision to reassess their search provider is not necessarily a result of dissatisfaction, although a competitive offering is clearly key to retaining the business when these decisions are made.

Exhibit 3: Historical retention rate (by ARR)



Source: Company accounts, Edison Investment Research

Investment in R&D to boost competitiveness

The company has continued to invest in product innovation with R&D headcount increased by 25% over the period, despite costs reducing by c NZ$1m from H216 to H117 (reduction in sales expenditure and currency were the offsetting factors).

Key enhancements in H1 were the launch of SLI ESP (Enhanced Search Personalization), which improves real-time individualisation of the results returned on search and navigation pages using the SLI product, and a new tracking technology for JavaScript, which enables the provision of more comprehensive data for personalising the shopping experience.

Enhancements to speed and security should support enterprise drive

Management aims to further the capabilities in H2 with the roll-out of support for HTTP/2 (faster page loads through improved data compression) and the addition of the SSL certification (cryptographic web server protection), which will deliver speed and performance improvements for retailers and improve security levels, respectively. These measures should improve SLI's competitiveness, particularly when pitching for larger clients, as both these aspects are increasingly being seen as necessary requirements for mid- to large-cap companies.

Expanding the envelope through corporate development

Licensing, partnerships and acquisitions all considered

Whereas SLI has to date followed a purely organic path, the announcement of a new corporate development function signals that the company is now looking at more expansive opportunities for growth. A range of opportunities will be considered here, including licensing or resale agreements (to strengthen the proposition and create cross-selling opportunities), partnerships or M&A. Should any substantial acquisitions take place, it is likely that management would need to raise additional capital. We see this scenario as unlikely, so do not build it into our forecasts.

Company description: e-commerce optimisation

Founded in 2001, SLI Systems provides a suite of premium e-commerce optimisation products designed to increase online sales for its clients. This is achieved by search engine enhancement tools to maximise CTRs to its clients' websites from search engines, in addition to search and merchandising functionality on the clients' websites to improve the conversion rate of site visitors to customers. Small increases to CTRs and conversion rates can have a significant accretive earnings impact for clients. SLI prioritises client services, which in our view is equally important to the technology solution due to the fragmentation of the market and the corresponding difficulty for companies operating in this space to be gauged against their peers.

SLI continuously adds to and develops its series of complementary products, which enhance its core search functionality. A complete list of SLI's products and descriptions is shown in Exhibit 4.

Exhibit 4: Product list

Product name	Description
Learning Search	Learning Search is SLI's core product and uses a number of techniques such as autocomplete and spell check to increase the sales conversion rates for its customers. Autocomplete attempts to guess what the customer is looking for as soon as they start typing and suggests a list of items and searches immediately as the customer types.
Learning Recommendations	When a user has searched for an item, SLI's Learning Recommendations suggests similar products in which the user may be interested. This means the customer does not have to return to the search screen and alternative products are suggested on the same page.
Learning Navigation	Learning Navigation filters products by category to make it easier for users to find the product they are looking for. It automatically updates the ranking of products based on user behaviour.
Site Champion	Site Champion is SLI's search engine optimisation (SEO) product. It works by automatically generating search engine-friendly pages based on customer behaviour. It helps to improve the ranking of customers' websites on search engines such as Google, Bing and Yahoo!. There is no monthly fee for the use of Site Champion; instead, SLI charges per referral from internet search engines.
Merchandising	Merchandising (ie controlling how a product is presented to a potential customer) is key to increasing average spend and conversion rate. It has many different aspects, but can include adjusting which products are displayed alongside others and which products are placed on sale. SLI can use its search data and statistics across multiple companies to learn how best to merchandise products and its multivariate testing can provide an unbiased judge of which merchandising tools work best.
Dynamic product banners	Dynamic product banners help to suggest alternative products when people come to a website from an external search engine rather than through the site's internal search. External search engine data may be out of date and therefore it is an important to suggest alternative products when linked to from an external website. For many websites less than 20% of site visitors use internal product search and therefore it is important to have alternative product suggestion tools.
SLI Mobile	Mobile is increasingly becoming the dominant form of internet access. It accounts for 50% of traffic to websites and 37% of UK online retail (source: IMRG), yet Paul Smith* reports that cart abandonment rates for mobile-based shopping are 60-80%, which is much higher than for desktop. There is a 2% conversion rate for desktop compared to 1.75% for apps and 0.5% for mobile websites. The smaller screen on mobiles makes merchandising and effective search and navigation even more important and therefore it plays well to SLI's competitive advantage. Paul Smith implemented SLI and experienced a 39% increase in conversion rate, 45% increase in customers using site search and an 11% increase in site search revenue.
Multivariate testing	Multivariate testing is a method for assessing the performance of different website designs and tools. SLI and its customers can use it to assess the performance of its products against its peers and different website designs against each other. It is useful to demonstrate the value of its products to customers and the return on investment they might expect from implementing a certain design.
Landing Page Creator	The Landing Page Creator was launched by SLI Systems in 2015. It allows non-technical staff to easily and quickly create landing pages to optimise marketing messages and search engine ranking through a drag-and-drop interface.
Enhanced Search Personalization (ESP)	Real-time personalisation of the results shown on the search and navigation pages. Product launched in H117.

Source: SLI Systems. Note: *Paul Smith UK retailer.

Business model

SLI Systems typically charges customers monthly or quarterly in advance, with fees depending on their usage and the number of products they use. SLI differentiates itself by absorbing on-boarding costs for new clients by using its own staff to implement its systems on clients' websites. This results in a net cash outflow for each new client acquisition, with a typical payback period of two years. However, the revenues are high margin, and are highly recurring due to both the efficacy of the technology offering and the company's emphasis on customer service. A high retention rate is therefore critical to long-term profitability. The company generally pays its expenses in arrears (mostly salaries), thereby giving it a working capital-neutral model, with light capex requirements.

Market opportunity and competition

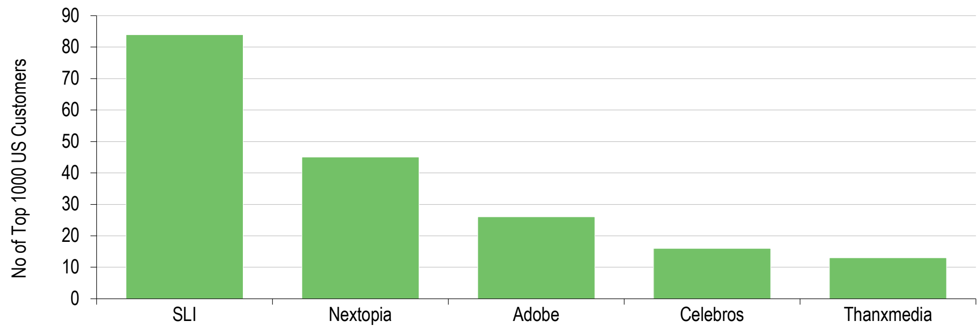
Structural growth market

The addressable market for SLI's solutions is unquestionably very large and growing fast. eMarketer estimates worldwide retail e-commerce sales will rise to US$3.6tn by 2019 from US$1.7tn in 2015 (16% CAGR), while it further projects that retail e-commerce will still only represent a mere 12.8% of all retail purchases. These statistics indicate the growth opportunity available to SLI as its technology will continue to aid its customers to maximise their online revenues.

Competition

Competition for site search comes from three main sources. Alternative providers of dedicated site search solutions include Cetona, Nextopia, Adobe with Target and a number of others. In addition, there are suppliers of e-commerce platforms that include search functionality. This category includes companies such as Magento, WooCommerce, Shopify and PrestaShop. Finally, in-house platforms – often built on open-source building blocks – are still used by (typically larger) e-commerce sites (Exhibit 5).

Exhibit 5: US market share of top 1,000 US internet retailers



Source: SLI Systems

We believe that a crucial factor in the company's success will be to sell into customers who currently that third-party e-commerce platforms. At present, many retailers use third-party platforms, which include all the web-based functionality retailers need to operate an online store, including product search. In our opinion, online search and merchandising will become more of a speciality because of its importance to revenue and we therefore believe SLI's main competition in the long term will be direct independent search providers.

Financials

Review of H117 results

SLI Systems achieved a return to growth in its annual recurring revenue of 0.3% for the six months ending 31 December 2016 compared to the previous six-month period on a constant currency basis, as seen in Exhibit 6. Operating revenues fell by NZ$1.9m y-o-y, although approximately half of this fall was related to currency fluctuations, particularly in the recent weakness of sterling. Net losses for the period grew to NZ$1.3m (H116: NZ$446,000). Gross margins fell slightly to 74.4% for the six-month period, although this remains in line with the long term average.

Exhibit 6: Review of H117 results

NZ$000s	H116	H216	H117	H117 y-o-y chg	H117 h-o-h chg
Annual Recurring Revenue (ARR)	35,597	31,191	31,147	(12.5%)	(0.1%)
ARR on a constant currency basis	33,706	31,057	31,147	(7.6%)	0.3%
Operating revenue	17,367	17,639	15,482	(10.9%)	(12.2%)
Other income	75	571	273	264.0%	(52.2%)
Delivery costs	(4,094)	(3,864)	(3,965)	(3.2%)	2.6%
Growth costs	(8,631)	(9,000)	(7,850)	(9.0%)	(12.8%)
Other costs	(5,163)	(4,812)	(5,190)	0.5%	7.9%
Total costs	(17,888)	(17,965)	(17,005)	(4.9%)	(5.3%)
Loss before tax	(446)	284	(1,250)	180.3%	(540.1%)
Gross Margin %	76.4	78.1	74.4	(2.6%)	(4.7%)

Source: SLI Systems accounts, Edison Investment Research

Exhibit 7 shows net cash outflows of NZ$753,000 for the period, primarily driven by the reduction in operating revenues attributable to currency fluctuations, in addition to continued investment for growth. Net cash at the end of the period remains strong at NZ$6m, and management remains committed to continued operations without a further capital raise, as significant cost reductions could be made, if required, by the reduction of investment for growth. SLI's model allows for a relatively smooth cash flow as inflows are generally billed in advance while outflows are paid in arrears.

Exhibit 7: Interim cash flows

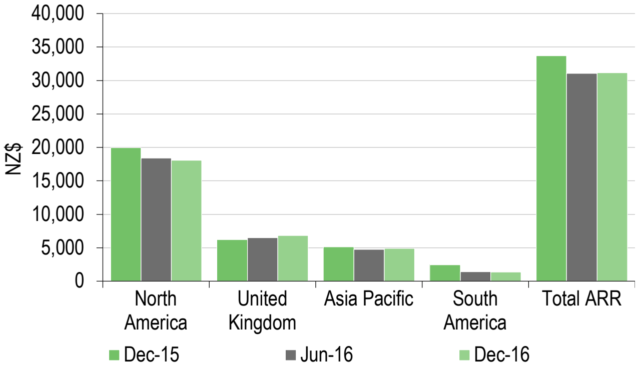
	H116	H216	H117
Net cash (outflow) from operating activities	(154)	962	(569)
Net investing cash flow (outflow)	(60)	223	(184)
Cash from financing activities	238	300	0
Cash increase/(decrease)	24	1,159	(753)
Cash at end of period	5,606	6,765	6,012

Source: Edison Investment Research

Geographical breakdown

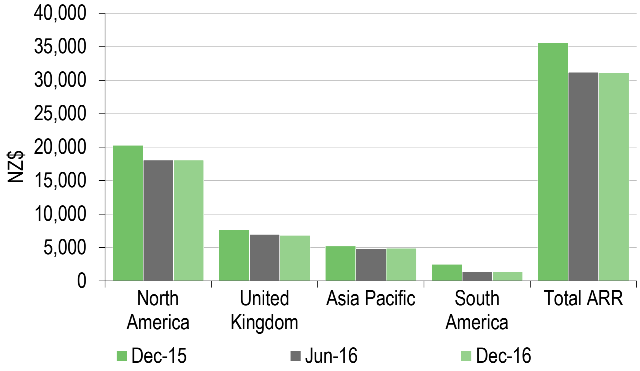
Exhibits 8 and 9 show how North America remains the critical market for SLI. On both constant currency and reported currency bases, the North American market represents just under 60% of total annual recurring revenues. The degree of sales success and client retention rates in this market will hence go a long way to deciding the long term growth profile of SLI. The recent high profile client acquisitions of Crate & Barrel and Rocky Mountain ATV provide assurance that management is prioritising this highly important market. UK growth was strong, with ARR on a constant currency basis up 10% y-o-y, much of which was offset by currency. The effects of the loss of three major clients in South America in Q416 can also be seen, with a reduction in ARR of 45% on a constant currency basis y-o-y.

Exhibit 8: Annual recurring revenue by region (constant currency basis)



Source: SLI Systems accounts, Edison Investment Research

Exhibit 9: Annual recurring revenue by region (reported currency basis)



Source: SLI Systems accounts, Edison Investment Research

Forecasts

We reinitiate our forecasts, having suspended them in August. Data points are still limited, but on the basis of an improving contract base and new product enhancements being brought to market there are grounds to support a return to growth in ARR in H2 and continuing into FY18 and FY19. Our estimates assume that the client retention rate remains steady at the 87% H217 level, while the level of new business won steadily recovers (Exhibit 10). While we expect some increased investment to support growth, we forecast that operational gearing returns the business to EBITDA profitability in FY18 and EPS profitability in FY19.

Exhibit 10: Forecast summary

NZ$000s	2015	2016	2017e	2018e	2019e
Currency headwind (tailwind)	4,798	(3,489)	(134)	0	0
Retention rate	87%	84%	87%	87%	87%
ARR lost	(3,243)	(4,978)	(4,072)	(4,339)	(4,773)
ARR won	8,096	5,058	6,122	7,676	10,279
ARR	34,600	31,191	33,374	36,712	42,219
ARR Growth rate	39%	-10%	7%	10%	15%
Revenue	28,126	35,006	31,802	34,209	38,088
Other income (government grants)	466	646	500	500	500
Total revenue and other income	28,592	35,652	32,302	34,709	38,588
Cash opex	(35,276)	(34,516)	(32,784)	(33,781)	(35,094)
EBITDA	(6,684)	1,136	(482)	928	3,494
EBITDA Margin	N/A	3%	N/A	3%	9%
Reported profit/(loss) before tax	(7,550)	(162)	(1,683)	(359)	2,212
IFRS EPS (c)	(11.94)	(0.39)	(2.78)	(0.42)	2.58
Cash and cash equivalents	5,582	6,765	5,670	4,959	5,939

Source: Edison Investment Research

The company has a broadly neutral working capital model and we do not expect the business to pay tax in our forecast period, so the P&L profile should be broadly mirrored in the company's cash performance. On the basis of our forecasts, cash should trough at c NZ$5m at end FY18.

Valuation

Recovery rating and significant discount to peers

At EV/Sales of 0.5x, SLI is trading at an acute recovery rating and a substantial discount to search/SaaS peers (typically 2x+). Revenues are highly recurring and we do not believe that this aspect is currently priced in by the market. This is understandable given the company's recent flat

ARR and loss-making status. However, any recovery momentum should drive operationally geared growth in profitability and a re-rating upwards. We believe that early signs of such a recovery are already apparent, as demonstrated by the recent uptick in client retention rates, in addition to the H117 recovery of ARR.

Exhibit 11: Peer comparison using forward consensus estimates

Company	Quoted currency	Price	Market cap (m)	EV in reporting currency (m)	EV/Sales FY1 (x)	EV/Sales FY2 (x)	EV/EBITDA FY1 (x)	P/E FY1 (x)	EBITDA Margin FY1 (%)
SLI Systems	**NZ$**	**0.32**	**20.0**	**16.3**	**0.5**	**0.5**	**N/A**	**N/A**	**N/A**
Alphabet Inc-CL A	US$	856.75	584,402.4	496,126.4	5.6	4.9	11.4	20.6	32.6
BazaarVoice	US$	4.20	351.3	302.2	1.5	1.5	18.4	N/A	N/A
International Business Machines Corp	US$	181.95	171,617.5	205,404.5	2.6	2.6	10.6	13.2	23.1
Oracle Corp	US$	42.92	176,073.0	172,577.0	4.6	4.4	10.4	16.7	43.8
Web.com Group	US$	19.80	997.0	1,640.7	2.2	2.1	8.7	6.8	21.7
Attraqt Group	p	0.49	13.1	12.0	2.3	1.8	N/A	N/A	N/A
Dotdigital Group	p	0.65	192.4	173.5	5.4	4.4	17.5	29.7	32.0
Intershop Communications	€	1.14	36.1	29.0	0.8	0.7	58.0	N/A	N/A
E-commerce companies			**Median**	**302**	**2.3**	**2.1**	**10.6**	**6.8**	**21.7**

Source: Bloomberg, Edison Investment Research.

NZ$0.77/share DCF valuation

Our core DCF analysis uses a WACC of 12% and a terminal growth rate of 1.5%, resulting in a DCF valuation of NZ$0.77. It further assumes a CAGR of revenues of 7.3% from 2017-23, and a matured EBITDA margin of 20% (Exhibit 12).

Exhibit 12: DCF valuation

WACC	12%
Terminal growth rate	1.5%
CAGR in revenues 2017-23	7.3%
Terminal value (NZ$m)	20,897
Enterprise value (NZ$m)	41,864
Plus cash (NZ$m) at 31 December 2015	6,012
Equity value (NZ$m)	47,876
Equity value per share	NZ$0.77

Source: Edison Investment Research

Our DCF scenario analysis (Exhibit 13) suggests that achieving and sustaining 5% growth in the mid-term should generate upside, while a DCF valuation equal to a doubling of the current share price is very achievable (7.5% mid-term growth and 20% EBITDA margins). This compares favourably with historical CAGR of revenues of 17.7% in 2012-16.

Exhibit 13: DCF scenario analysis at WACC of 12%

		Mid-term growth				
	0.77	5%	7.5%	10.0%	12.5%	15.0%
Matured EBITDA margin	5%	0.22	0.29	0.35	0.42	0.49
	10%	0.38	0.46	0.55	0.64	0.73
	15%	0.52	0.64	0.74	0.86	0.98
	20%	0.54	0.80	0.94	1.08	1.22
	25%	0.54	0.86	1.13	1.29	1.47

Source: Edison Investment Research

Sensitivities

- **Retention rate:** a high retention rate is critical to the success of the business. There is a typical payback period of 24 months before a client becomes profitable and retaining clients for at least as long as that is therefore critical to reaching profitability. Having reviewed case studies and spoken to some of SLI's clients, we are confident that customers receive a very high quality of service and display an impressive level of praise for the quality of service they receive.
- **Currency movements:** SLI has suffered from a weakening US dollar/NZ dollar exchange rate since the end of 2015. This headwind would reduce should the currencies stabilise, and may return to a beneficial impact in the medium to long term if the NZ$ returns to historic levels relative to the US$.
- **Competition:** there are a number of platforms and technologies that provide embedded site search and other companies that provide customised search. Sales and marketing, as well as continual R&D, will be important in ensuring that existing and potential customers are informed about SLI's products and that those products live up to the client's expectations.
- **Funding:** there is a short-term trade-off between growth and profitability and therefore, while we currently forecast that SLI will reach profitability without having to raise further funding, it may mean that investment in growth needs to be cut back in the short term to conserve cash. We currently forecast profitability in 2019, although it could occur sooner if management chooses to cut back on growth costs. Should management see an opportunity to acquire a complementary product offering as part of its new corporate development programme, it is possible that additional capital would need to be raised to fund this purchase.
- **Return on investment on growth costs:** SLI is currently investing heavily in growth. So far it appears this investment is generating substantial returns, but this may change over time. It may become more costly to win and retain clients, or that the return on each client may fall as a result of lower retention rate or subscription fees.

Exhibit 14: Financial summary

NZ$'000s	2014	2015	2016	2017e	2018e	2019e
30-June	NZ GAAP	NZ GAAP	NZ GAAP	NZ GAAP	NZ GAAP	NZ GAAP
PROFIT & LOSS						
Revenue	22,396	28,592	35,652	32,302	34,709	38,588
Delivery costs	(5,618)	(7,211)	(7,958)	(7,633)	(8,145)	(8,924)
Gross Profit	16,778	21,381	27,694	24,670	26,564	29,665
EBITDA	(5,412)	(6,684)	1,136	(482)	928	3,494
Operating Profit (before amort. and except.)	(5,860)	(7,198)	687	(820)	522	3,072
Intangible Amortisation	0	0	0	0	0	0
Exceptionals	0	0	0	0	0	0
Other	(525)	(526)	(888)	(888)	(888)	(888)
Operating Profit	(6,385)	(7,724)	(201)	(1,708)	(366)	2,184
Net Interest	472	174	39	25	8	28
Profit Before Tax (norm)	(5,388)	(7,024)	726	(795)	529	3,100
Profit Before Tax (FRS 3)	(5,913)	(7,550)	(162)	(1,683)	(359)	2,212
Tax	191	190	(77)	(33)	100	(619)
Profit After Tax (norm)	(5,197)	(6,834)	649	(828)	630	2,481
Profit After Tax (FRS 3)	(5,722)	(7,360)	(239)	(1,716)	(258)	1,593
Average Number of Shares Outstanding (m)	61.0	61.6	61.6	61.6	61.6	61.6
EPS - normalised (c)	(8.5)	(11.1)	1.1	(1.3)	1.0	4.0
EPS - (IFRS) (c)	(9.4)	(11.9)	(0.4)	(2.8)	(0.4)	2.6
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	74.9	74.8	77.7	76.4	76.5	76.9
EBITDA Margin (%)	N/A	N/A	3.2	N/A	2.7	9.1
Operating Margin (before GW and except.) (%)	N/A	N/A	1.9	N/A	1.5	8.0
BALANCE SHEET						
Fixed Assets	2,159	2,369	2,056	2,648	2,766	2,868
Intangible Assets	115	99	65	83	80	78
Tangible Assets	1,589	1,582	1,316	1,890	2,011	2,115
Deferred Tax assets	455	688	675	675	675	675
Current Assets	16,391	12,213	12,641	11,413	10,661	12,287
Stocks	0	0	0	0	0	0
Debtors	5,002	6,631	5,876	5,742	5,701	6,348
Cash	11,389	5,582	6,765	5,670	4,959	5,939
Other	0	0	0	0	0	0
Current Liabilities	(7,278)	(9,641)	(8,870)	(9,543)	(9,206)	(9,400)
Creditors	(7,278)	(9,641)	(8,870)	(9,543)	(9,206)	(9,400)
Short term borrowings	0	0	0	0	0	0
Long Term Liabilities	(57)	(17)	(29)	(29)	(29)	(29)
Long term borrowings	0	0	0	0	0	0
Other long term liabilities	(57)	(17)	(29)	(29)	(29)	(29)
Net Assets	11,215	4,924	5,798	4,489	4,191	5,725
CASH FLOW						
Operating Cash Flow	(4,550)	(5,892)	747	(563)	(256)	2,153
Net Interest	445	246	111	25	8	28
Tax	(91)	8	(50)	(33)	100	(619)
Capex	(699)	(472)	(163)	(524)	(563)	(583)
Acquisitions/disposals	0	0	0	0	0	0
Financing	902	303	538	0	0	0
Dividends	0	0	0	0	0	0
Net Cash Flow	(3,993)	(5,807)	1,183	(1,095)	(711)	980
Opening net debt/(cash)	(15,382)	(11,389)	(5,582)	(6,765)	(5,670)	(4,959)
HP finance leases initiated	0	0	0	0	0	0
Other	0	0	0	0	(0)	0
Closing net debt/(cash)	(11,389)	(5,582)	(6,765)	(5,670)	(4,959)	(5,939)

Source: Company accounts, Edison Investment Research

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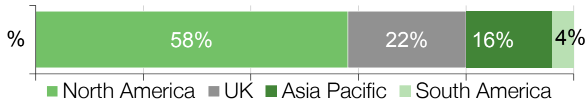
Revenue by geography



Management team

Chairman: Greg Cross	CEO: Chris Brennan
Greg is executive chairman of PowerbyProxi, a wireless power company he co-founded in 2007. He joined SLI's board in July 2003 and has been chairman since 2005. He has previously been MD of Microsoft New Zealand and CEO of Advantage Group (an NZX-listed company).	Chris brings 30 years' experience in technology management, from running pre-IPO start-ups to multinationals. He is former founder, CEO and chairman of SaaS security vendor Net Authority and presently sits on the board of MarketLive, an e-commerce merchandising solutions provider.
VP Corporate Development: Dr Shaun Ryan	**CFO: Rod Garrett**
Shaun was one of the original founders of Global Brain, which developed the search technology used at SLI. It was then sold to NBC in 2000, before being bought back by Shaun and the other SLI founders in 2001 after the dot-com crash. Before Global Brain, Shaun worked as a software developer. He has a PhD in artificial intelligence from the University of Canterbury.	Rod worked for PwC in New Zealand and London in insolvency and corporate recovery. He joined SLI in 2006, before which time he was CFO of Eaton Power Quality. He has an honours degree in accounting and finance from the University of Otago.

Principal shareholders	(%)
Shaun Ryan	10.83
Pioneer Capital Management	9.77
ANZ New Zealand Investments	9.43
Marder Media Group	6.91
Grant James Ryan	6.29
Lynnwood Holdings	4.28
First NZ Capital Group	3.29

Companies named in this report

Oracle (ORCL:NYQ), Adobe (ADBE:NSQ), Alphabet (GOOGL:NSQ), Yahoo (YHOO:NSQ), BazaarVoice (BV:NSQ), Web.com (WWWW:NSQ), Attraqt (ATQT:AIM), Dotdigital (DOTD:AIM), Intershop Communications (ISH2:ETR), International Business Machines (IBM:NYSE), Shopify (SHOP:NYSE).

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