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Grafenia plc

Final Results

RNS Number : 3785H
Grafenia plc
07 June 2017

This announcement contains inside information for the purposes of Article 7 of EU Regulation 596/2014.

Grafenia plc
("Grafenia", "the Group" or "the Company")

Preliminary Results for the period ended 31 March 2017

Financial Highlights	**Continuing Activities***	
	2017	2016
Turnover	**£10.45m**	£10.77m
EBITDA**	**£0.76m**	£1.52m
EBITDA - Before impairment of receivables ***	**£1.02m**	£1.56m
Operating Loss	**£(0.98)m**	£(0.25)m
Loss before Tax	**£(0.99)m**	£(0.26)m
Tax Income	**£0.36m**	£0.27m
Total Comprehensive (Loss)/income	**£(0.63)m**	£0.06m
EPS Continuing Activities ****	**(1.37)p**	0.14p
Dividend per share	**-**	0.25p
Capital Expenditure	**£0.89m**	£1.82m
Net Cash	**£0.52m**	£0.69m
Net Funds*****	**£0.21m**	£0.36m

***Continuing activities for 2017 and 2016 exclude Grafenia BV which was sold on 6 October 2015.**
**** EBITDA is operating loss plus amortisation and depreciation**
***** Impairment of receivables was £0.26m *(2016:£0.04m)***
****** EPS - there are no dilutive factors**
******* Net funds is the net of cash and cash equivalents less other interest bearing loans and borrowings**

Operational highlights

- **Nettl UK Web Studio network doubles this year to over 110 locations**

- **Over 30 new printing.com locations opened in the year**
- **Licence Fee revenue grows to £1.49m**
- **First sign business acquired and successfully integrated**
- **Nettl 'founding' four partners signed in The Netherlands**

For further information:

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Chairman's Statement

Dear Shareholders,

Grafenia plc is in transition. I am taking this Chairman's Statement as an opportunity to update you on efforts in the past year and on what comes next. The format and style of this year's statement will differ from prior years, in that, I offer more detail and explain more about why we did what we did.

Any transformation creates uncertainty. I strongly believe that transparency and an open-door policy helps all shareholders apply better judgment about our course of action. After all, it is your business we are running and you deserve fair and objective reporting.

Operational performance

Grafenia makes money from different business sectors, which have delivered varying performance over the last few years. Most importantly, our print revenues have been declining for some years and much of the decline has been driven by continued pricing pressure in the market.

In the recent fiscal year, this drove a decrease in turnover by 2.3% to £10.44m *(2016: £10.77m)* and in EBITDA by 50.0% to £0.76m *(2016: £1.52m)*. Operating loss increased to £0.99m *(2016: loss of £0.25m)* while we achieved an effective tax income of £0.36m *(2016: income £0.27m)*. As in the prior year, the tax income was mainly due to the Group gaining Research & Development Relief. After spending capital investment of £0.89m *(2016: £1.82m)* plus £0.06m for the acquisition of ADD Signs Limited, we finished the year with a net cash position of £0.52m *(2016: £0.69m)*.

Whilst the aggregated financial figures are incredibly frustrating, a higher granularity regarding areas of performance is appropriate to consider. In contrast to the decreasing profit contribution from print products, we have enjoyed a strong increase in license revenues from our partners' subscriptions, especially from our new concept under the Nettl banner. Nettl has been very well received and we continue to expect increasing license fee contribution as we add new partners. To drive network growth, we have expanded our sales team to find more Nettl partners. This has had a negative impact on our profitability in the short term. However, we view this as an excellent investment as the cost of acquisition, relative to the customer lifetime value of signing new partners, have proven highly attractive. A similar logic applies to our continued spending on software development which is not all directed at maintaining the system, but rather considers adding new capabilities if our customers pay for them. We curtailed software investment significantly (as evidenced by a much lower current year capital expenditure in comparison to depreciation and amortization, which relates to past capital expenditures). We will continue to make our capital expenditure and sales investments according to the cash-on-cash return they create.

We find print revenues hard to predict and face challenges every day, although it remains an important part of the Group. Indeed, our team members are making incredible efforts to lower the current reliance on print. To that end, we are trying hard to enable our partners to offer a holistic suite of design and promotional services to their end clients, extending beyond print. These includes signage, ecommerce and expo display.

A main driver behind our weaker EBITDA and net loss figure is the impairment we applied to our receivables position. This year the Audit Committee insisted on management applying greater scrutiny to the age and profile of our receivables. These debts are old legacy balances from partners where we agreed payment schemes. For instance, partners would pay 20% on top of any invoice to reduce their outstanding balance with us. For that limited group of partners a more detailed estimation of collection time was carried out and our impairment provision increased to reflect a lower present value of collections. In plain English, we decided to value an estimated collection from a partner a year from now lower than a collection next week. I'd like to thank KPMG for their valuable input in assessing this exercise and the Audit Committee believes that the current balance sheet number is a prudent estimate of our receivables balance. In addition, this self-evaluation of collection practices has been used to refine systems to improve collection of receivables and we expect improvements in cash-conversion going forward.

Another important aspect of our financial reporting is the relatively high expense we incur as a public company. Most of our systems are designed to run a much larger operation and regulation requires us to retain a small army of advisers and compliance processes. While we are happy with them individually and value their advice, in aggregate they cause a perverse situation where most of our current operational profit is consumed by the cost of being a public company. This is clearly unacceptable and the core reason why I joined the board. The success of my tenure should be measured by whether we figure out a way to make better use of our public listing.

People at Grafenia, Board changes and priorities in the past year

As a non-executive director, there are only a few ways to influence the results of a business. I'll discuss below the measures we took during the last year and provide an update on future priorities.

The real work at Grafenia, however, gets done by our operational team members. I utterly believe that we have the right people at Grafenia to manage this transition. First and foremost, Peter is a terrific leader that inspires, motivates and creates what will be a transformed network of partners. We have a trusting relationship and he has impressed me with his willingness to learn and strive to achieve the best outcome for shareholders.

Any managerial effort is a team effort and, despite some less joyful moments every now and then, I believe the entire Grafenia family has worked incredibly hard in the last year. However, I'd like to specifically point out two individuals who drove many initiatives and achieved high performance in their roles.

Firstly, I'd like to thank our COO Gavin Cockerill for his relentless effort in driving sales performance. Gavin is a rare combination of a data-driven analytical mind and a great marketer. A large part of the scaling of Nettl can be ascribed to him. Make sure never to stand between him and a prospective Nettl partner!

Secondly, we can be lucky to have our Company Secretary Richard Lightfoot on the team. Richard has served Grafenia for many years as a central coordinator for everything legal and administration related. He is a thorough worker with a great eye for detail. Importantly, he has been leading various M&A efforts during the past year. You can rest assured that any sign business we might buy has been scrutinized by Richard.

So, what value did the Non-Executive Directors create?

I would like to group our efforts into three distinct fields:

1. Finding the right governance structure.

Over the course of the last year, we conducted a self-evaluation exercise to find out what type of board we need to drive Grafenia forward. More specifically, we took a hard look at how many non-executive board members we should have and what their competencies need to be.

Given that Pavel and I have a high overlap in skills, Pavel decided to step down from the board at the upcoming AGM. I would like to thank Pavel for his contribution over time and his great help during the last year.

Conrad and I complement each other well. Together we are looking at various options to make better use of our public listing. Quite frankly, the engagement of non-executives has been intense during the last few months and we are working hard with the executive team to evaluate the company's opportunities for capital deployment.

2. Setting incentives right.

We have started a long-overdue exercise to realign the compensation system for our CEO with shareholders'

interests. Peter's bonus scheme is now a direct function of accumulated free cash-flow over rolling three year periods. We view this as an appropriate incentive to drive sales performance and cash generation and align management actions with shareholder interests. If the scheme proves effective, we'll expand the roll-out to a broader group of management.

Moreover, we have offered all our employees the opportunity to set aside part of their salary to buy stock in a new Grafenia "save-as- you-earn" (SAYE) scheme. 49 employees (over 40%), chose to participate and save substantial sums of money to become part-owners in Grafenia. I find this a very healthy indicator and was proud to see such a high uptake.

Last, but not least, Conrad and I proposed a significant reduction in our non-executive remuneration. Specifically, we are reducing non-executive director annual pay by 25%, from £20k to £15k, whilst reducing the Chairperson pay by 50%, from £30k to £15k. Performance of Grafenia and the non-executives has not been sufficient for some years now and we feel it is appropriate to first show we are worth any money before thinking about raising our compensation!

3. Driving capital allocation.

As Directors of your company, we are your agents. It is our role to efficiently extract value from the capital we have a mandate to manage. Allocation of capital works best when it is based on an accepted, simple and rational framework. We have started to build such a framework to better allocate capital between the different options open to the company.

Our analysis started earlier in the year with Gavin creating a concise analysis, across our different channels, of customer acquisition cost versus customer lifetime value. Later, Richard led efforts to add a framework to evaluate acquisition opportunities in the sign space which was first applied to our acquisition of ADD Signs. Lastly, Alan improved our financial planning to provide better visibility in terms of valuation and when we should repurchase equity.

All of this structure is a good improvement and sets the standard for future board work.

A result of our capital allocation framework and analysis is that we have less desire to pay out dividends in the future. We find dividends to be a tax-inefficient way to reward shareholders and currently see numerous accretive opportunities for internal reinvestment. Furthermore, it does seem that Grafenia is better off scaling up rather than reducing size by returning money to shareholders.

Outlook & current priorities

The outlook for print products is uncertain and current trading has been tough. Nevertheless, our efforts in scaling up Nettl bode well and we are increasingly encountering potential partner opportunities to sell the concept in international markets.

One of our past mistakes has been in providing overly optimistic guidance to the market which was subsequently not met. Our quarter to quarter results are incredibly hard to predict and we have decided to provide less frequent, but more detailed, updates to the market as and when applicable. For example, in the past we updated on trading in Mid-October and would then publish our interim results in Mid-November. This seems like a lot of noise relative to the pace of change in our business. This year, we'll provide you with one informative Interim Update on November 6th, notwithstanding ad hoc events or changes in forecast trading.

A key focus area for the non-executive team is to continue improving our internal controls, forecasting function and reporting. All of the above are necessary to drive successful M&A as we strike out to acquire more sign businesses. In that context, we decided to tender our audit mandate and find an auditor that is the most effective business partner for our finance team. We have enjoyed working with KPMG, but after engaging them for 10 years we felt it is the time to obtain fresh eyes. They have been, quite literally, your eyes and ears into Grafenia and I'd like to thank KPMG for their valuable contribution over those 10 years. Moving ahead we are looking forward to working with the Manchester team of RSM, a large UK auditor with more than 3,000 professionals.

We are hosting our AGM on Friday, July 28th and invite all our shareholders to visit us. In addition to attending the formal meeting, you will get the opportunity to meet more of our team members and see our production operations and company owned Nettl store. We hope you come as a shareholder and leave as a proud Nettl website owner!

Jan-Hendrik Mohr
Chairman
7 June 2017

Strategic Report
Chief Executive's Statement

Things have changed

This year we've continued to execute our transformation plan. Not everything has gone the way we would have liked, but we have made progress.

I've altered the format of this year's CEO report. We've made a lot of changes since I permanently took over as CEO. One of those changes is the way we communicate with our teams and our partners. Our style is open and inclusive. We believe in keeping things to the point. We use clear and simple language. We present information in a format that's easy to understand.

We think it's important to extend this to the way we communicate with our shareholders.

In this report, I'd like to explain in more detail where we've come from and the challenges we face. Then, I'll share our vision of where we're trying to get to. You might know some of this stuff already, so apologies if you reach for the fast forward button.

Let's start from the top. We generate revenue from two main sources: licensing brands and software, and manufacturing product.

We license our brands, software and technology to partners in the UK and internationally. They pay us subscription fees in exchange. That bit is growing. We're putting our effort into scaling it more quickly. This is where we have the strongest competitive advantage. We think this is where our future lies. I'll talk about why in more detail a little later on.

We also directly manufacture a range of printing, signage, promotional items and expo displays in the UK. Overall, this bit declined this year. But it's a mixed story. Some bits are growing, some are flat and some are contracting.

The majority of our printing is sold via resellers. We split those into two types: Brand Partners and Trade Partners. With Brand Partners, our brands are exposed to the end client. With Trade Partners, the end client is unaware that we are manufacturing under 'white-label'. Both are important to us and I'll explain why in this report.

We also sell directly to some end clients in our own stores. We think that's *really* important. We do this to learn first-hand what clients want and what our partners need to deliver for their clients. We adapt and develop our offering, to ensure it fits those needs.

Our products are used by all sizes of business - from startups to large corporates. Our different channels tailor their message and service to address different parts of the market. More on that later.

A time to listen

Let's rewind. We grew up by franchising printing.com stores in the UK.

Over the past decade, as high street print began to decline, we tried many things to reshape our business. Our DNA is to innovate, try new things, move quickly and live test. Not everything we do works. Some things get killed before release. Some things fail fast. In some things, we see potential, we refine and iterate.

We've done things in the past which created conflict with our partners. That's an inevitable part of the change process and innovation cycle, but at times, our relationship with the then franchisees was more fractious than it should have been.

When I took over as CEO, we wanted to reset what it meant to be part of our network.

Our team immediately embarked on a listening exercise. We asked our partners what was grinding their gears. We encouraged them to be open and brutal. To tell us the things we did which added friction to their lives. To share stories of where we were unnecessarily difficult to do business with.

And they did. They shared. Lots. They made many suggestions. Their feedback was frank and honest.

As the notes came in, we assigned and prioritised the comments. We made some quick fixes and set to work on the larger problems. In particular one big, hulking elephant in the room.

The elephant in the printer

Time and time again, the same issue arose.

Straight in at number one. Pricing. Over and over, they complained about our product pricing. We were selling the same or similar products across our different channels at different prices. Some channels had everyday low pricing, others had deep, short-term vouchered discounts.

Some partners had the best of both worlds. Or so we thought. They could choose which price to sell at - everyday low, or list price with discount vouchers. Whilst this sounds fair in principle, the reality is different. It meant that partners were forced, every time, to make a comparison, before they could even give the client a price. That created noise and confusion.

There were also occasions where we were selling some products to end clients, below the price that partners could buy at.

We were doing this to respond to competitor discounting. As these competitors have sprung up, many from overseas, they've sought to grab market share by selling well below our historic pricing. Tempted by the lure of cheap print, partners were sometimes straying outside of our supply chain.

We had to fix this.

In April 2016, we embarked on Project OnePrice. This was a substantial and comprehensive exercise to simplify our pricing. We had two objectives. The first, to cut out the noise. Our Brand Partners should have a single, competitive price to buy at. Secondly, we should reward our Brand Partners' loyalty by ensuring they always had access to our best prices.

The macro effect of this is that we produced more orders overall than the previous year - over 120,000 individual jobs - but at a lower price.

The end of franchisees

As the suggestions piled in, something surprising happened. People started sharing positive comments. They told us the things that we did that they valued. They reminded us why they joined with us in the first place.

We wondered if there was a way to reboot printing.com. To refresh it and reinvent it. So we simplified the model. We kept the bits which people valued and discarded the constraints that were designed for a different time. And we packaged it at £299 per month.

We set fire to the hundred page franchise agreement. We replaced it with a simple one page software subscription and a brand licence.

And we changed the way we thought of printing.com owners. No longer would we call them franchisees. We would not behave as franchisor/franchisee. We didn't want them to think of us as suppliers and we didn't want to treat them as customers. We are in business together. To achieve the same aim. To help local businesses to promote themselves better.

Today, they are our partners. This may seem like a small change, but culturally, it is significant.

We tested the new model with a small presence at a private event. Imagine our delight when we signed a new partner. And then another.

By the end of the year over 30 new partners had signed and there are currently over 90 printing.com branded locations. We expect to add more new locations this year.

Existing printing.com's were invited to switch to the new subscription. So far over 80% have switched and we expect the remainder will make the transition in due course.

The journey from printer to trusted adviser

We opened the first printing.com studio in Edinburgh in 1998. The world was a very different place back then. In those days, the first thing a small business startup wanted was business cards. We'd design and print for local businesses, then we'd help them with marketing as they grew. Our efficient central production meant we had a better product at a lower price than local competitors.

Now, the first thing a small business wants is a website. The person who designs the website, often gets to keep the whole creative relationship. Clients want the same person to design their print, their signage, their exhibition displays as well as their digital marketing.

We've sold websites via printing.com stores for over 10 years, and many of our partners continue to offer them as part of their service. However, clients sometimes struggle to reconcile the thought of buying web design, or an ecommerce web shop, from their printer. They just print, don't they?

That's why we launched the Nettl formula back in September 2014. Nettl puts web and ecommerce first, because that's what clients are doing. Today, the majority of revenue in most Nettl studios still comes from the sale of print and display. However, to win new clients and retain existing ones, we've got to take care of all their creative and marketing needs. Those needs now start with web. So that's where we start.

I'll talk in a bit about the four studios we own. However, most Nettl locations are independent. We partner with print shops, design agencies, web designers and sign companies. They "bolt-on" Nettl to their business.

The Nettl solution is a suite of training, marketing and software which helps a graphics business to deliver higher value web projects, with their existing team's skillset. We show them how. We train them in sales and tech. The Nettl marketing collateral, updated monthly, gives them the tools to connect with existing clients and win new ones.

As we've developed the Nettl formula, we've designed nine distinct training courses. These cover sales, graphics, tech and operations at levels from beginner to expert. We've delivered over 2,000 individual classroom training seats to partners and our own team members since Nettl started. More than 1,250 training days in the last year alone.

Nettl partners pay a monthly subscription of typically £399. That gives them access to our systems and marketing. They also access our supply chain and can buy printing and display products from our hub, as well as third party suppliers.

Last year, the Nettl network doubled in size. The year ended with 108 locations (*2016: 53)* and we have continued to add partners since. Many Nettl partners were previously printing.com partners. We're grateful to have them add Nettl capability and we expect a few more to switch over this year.

If our talent pool was restricted to former printing.coms, you'd be forgiven for thinking the upside to Nettl was limited.

However, over one third of Nettl partners are either trade partners, or businesses we had no previous trading relationship with.

Over the last year, we redeployed people into Nettl partner acquisition and now have a scalable acquisition process. We expect the Nettl network to continue growing and aim to scale beyond 300 locations in the UK.

Since most Nettl locations also sell the printing.com product range and are listed on the website, we combine their sales. In the year product revenues produced by our brand partners were £3.76m *(2016: £3.89m)*. Our overall licence fee income grew to £1.49m *(2016: £1.40m)* of which Nettl and printing.com subscriptions grew to £0.80m *(2016: £0.61m)*.

Our Company Studios

Back in 2014, over a series of weekends, we rebranded the printing.com studios we own as Nettl. Whilst this was an essential step in our transformation, not all of our people had the right skills to be effective 'Nettlings'.

In a studio, revenues are made up from the sale of print and sale of web design, ecommerce and hosting. Project OnePrice means we're selling print at lower prices than before.

We've changed the dynamic in our company studios to have more focus on individual sales performance. That's meant that in each studio, we've changed team members and our performance management.

In the previous year, we closed an underperforming, company-owned studio. The lease was ending, so we thought it made sense to migrate the client base to another studio, less than 50 miles away. Despite regular contact, by the end of the following year, almost all of the revenue from the closed studio's client base was gone. Whilst this was a hard lesson to learn, we believe this demonstrates the necessity for a neighbourhood studio and that clients value a local creative relationship.

The overall effect is that this year, revenues from our Company Studios dropped to £1.15m (*2016: £1.42m*), although website sales increased to £0.15m *(2016: £0.14m)*.

Since our new teams have been assembled and structure has taken effect, early results are positive and we anticipate stronger performance this year.

We had to relocate our Birmingham studio last year. It's become our first Nettl Business Store and we're experimenting with meeting space rental and coffee sales to drive footfall. We are refining the experience and are encouraged by the team recently achieving their highest monthly sales and margin since 2006.

Spreading Nettl around the world

We license our systems and brands internationally. Master Licensees typically have print hubs and reseller networks and use our software and, in some instances, marketing in their country. Each agreement is structured slightly differently, however we are either paid a share of local licence fees, transaction fees, or both. Master licence fees increased slightly to £0.53m *(2016: £0.51m)*.

We are currently experimenting with ways of launching Nettl in other countries. In June 2017, we signed four 'founding' partners in The Netherlands. They'll help us to adapt the Nettl formula for the Dutch market. We'll talk about those in more detail when they move into roll-out. If you spot a Nettl abroad, pop in for a brew.

Building out our partner funnel

As volumes from our printing.com business reduced, we looked for other ways to utilise capacity at our Manchester production hub. We tried a few different channels before launching and scaling Marqetspace.com.

Marqetspace sells print and display to graphic professionals. To date, we've sold to 3,000 resellers. Our scalable marketing activity is attracting new trade partners each month. The sale of printing via Marqetspace.com and other online channels was £4.04m *(2016: £4.05m).*

More important than the volume, Marqetspace acts as our funnel for new brand partners. They try us. They buy stuff. We deliver on time. They like our quality. And we start a relationship. We ask them about their challenges. Then we try to help. It's easier to have that conversation once we've got to know each other. Our aim is to turn Marqetspace clients into brand partners. So far over 20 have made the leap.

As well as providing some printing on a white label basis, we also license specialist ecommerce and web design software on a white label basis too. Licence fees were £0.3m *(2016: £0.42m)*.

Whilst volumes in the traditional print market have been in steady decline, automation has increased overall capacity in the market. Add an influx of overseas capacity and the result is a market driven by price wars and over supply. We are forecasting further margin erosion on the sale of trade print and do not expect prices to increase in the short term. However, we're seeing a growing trend across Europe of "offline" print migrating online and our focus is on delivering a reliable service to capture our share.

Last year we diversified our product mix and invested in direct-to-textile printing kit. We call it ink-on-fabric. Because that's what it is. We now sell a range of expo display and custom furniture through Marqetspace and other channels. And that's growing well. Clients are choosing these next generation fabric displays because they're lighter and look better than the alternatives. Across all channels, May 2017's annualised monthly run rate ("AMRR") for ink-on-fabric was £0.86m. We expect this to grow and become a bigger share of our revenues.

Outlook

Our market is tough. We have many much larger competitors attacking us in different areas.

Except one.

Nettl.

Sure, there are independent web designers. Of course there are online web design tools. And yes, there are print shop chains who advertise websites in their windows. But there isn't a direct competitor to Nettl. Yet.

We believe we have a moment to grow Nettl into the world's largest network of web and design studios. A place where business can do business. A place where entrepreneurs can come for help with tricky things like e-commerce, online bookings and websites. Where they can see expo displays and signage in action. Merchandised to inspire them. Where they can talk about marketing. Print and digital. That's Nettl.

We'll work with partners to scale organically, in this country and others. But we want to grow faster.

In January 2017 we made our first small acquisition. ADD Signs in Liverpool. That started with a "100 day plan" for integration to bring our businesses together. We're pleased with ADD's performance so far. Now we're looking for a second business to roll together and exploit economies of scale.

We look at the signs sector and we think, well, we already sell some signage to our clients. Sign companies already sell some print. The market has converged. It's highly fragmented. We think there's an opportunity to roll up sign businesses and create value.

We're evaluating businesses for sale in other cities. These could be smaller or larger. Each is a different shape and size. Perhaps there could be a future national sign hub to support our brand partner network, in the same way we centrally supply print.

We figure that together, we can achieve more. By putting Nettl's marketing and systems together with an established client base and local manufacturing and installation teams.

This year, we aim to organically grow the Nettl network, both here and overseas. And we aim to make further acquisitions in the signs sector.

We're determined to make this happen.

Peter Gunning
Chief Executive
7 June 2017

Strategic Report
Financial Review

Revenue

Group Revenues decreased by 3.0% to £10.44m *(2016: £10.77m)*. Revenues from the Eurozone were 4.1% of the total *(2016: 5.02%)*, as disclosed in the Segmental Analysis note.

Gross Profit

The Group's definition of Gross Profit is revenue less direct materials (including the cost of distribution when made direct to customers). Gross Profit decreased as a percentage from 66.3% to 63.1%, reducing in monetary terms to £6.59m *(2016: £7.14m)* as margins on the sale of printing were eroded.

EBITDA / Operating Profit

The year showed a decrease in EBITDA, which is operating (loss)/profit before interest, tax, depreciation and amortisation, to £0.76m representing a margin of 7.3% *(2016: £1.52m, 14.1%)* to turnover. EBITDA represents

an indicator of the Group's potential to generate cash. There was an Operating Loss for the year of £983k *(2016: £249k*).

Pre-Tax Loss

The Group recorded a pre-tax loss of £0.99m *(2016: £0.26m)* being 9.5% *(2016: 2.3%)* of Group revenue. Staff costs reduced in the year to £3.72m *(2016: £3.78m)*, although rose as a percentage of revenue to 35.6% from 35.1%. Other operating charges included a receivables impairment of £0.21m. The depreciation and amortisation charge from continuing operations for the year was £1.75m *(2016: £1.46m)*. The amortisation of software development was 76.0% of the total *(2016: 69.2%)* as we increased the speed of write-off from 5 years to 3 years

Interest Received and Charged

Interest received and charged in the period were negligible.

Taxation

As in the prior year the Group gained Research & Development Relief and have accrued for the current year claim which contributed to a Tax income of £0.36m *(2016: £0.27m)*.

Earnings Per Share (EPS)

There is no dilution of continuing EPS in either year 1.37p *(2016: 0.14p)*, based on a weighted average number of shares in issue of 45,500,884 *(2016: 46,369,156)*.

Cash Flow

At the year end the Group had cash balances of £0.52m *(2016: £0.69m)*. Net Funds were £0.21m *(2016: £0.36m)*. Operational cash generated was £0.84m *(2016 outflow: £0.1m)*. Working Capital movement included a reduction in Trade Creditors of £0.36m.

Capital Expenditure

The total capital expenditure for the year was £0.89m *(2016: £1.82m)* plus £0.06m for the acquisition of ADD Signs Limited. Capital expenditure reflected investment in the development of the Group's systems the major item being Software Development for Nettl and the Group's SaaS platforms totalling £0.77m *(2016: £1.01m)*.

Manufacturing capacity at the Manchester Hub has capacity for growth however, expenditure will continue to be incurred on software development and enhancement to support our Partners and business streams.

Share-based Save as You Earn (SAYE) Scheme

The Company launched a SAYE Scheme commencing 1 March 2017. The Scheme offered all employees the opportunity to participate in the future growth of the Company through the granting of share options. The scheme requires employees to commit to making a monthly payment of between £5 and £500 for 36 months. These instalments are paid into a savings account, operated by Royal Bank of Scotland plc, held independently from the Company.

Employees were invited to subscribe for options over ordinary shares of 1 penny each in the Company ("Ordinary Shares") with an exercise price of 7.75 pence per share, representing the closing mid-market price of the Ordinary Shares on the day prior to the invitation to participate. The options are exercisable if all 36 payments have been made, between 1 March 2020 and 31 August 2020.

A total of 49 employees elected to participate in the SAYE Scheme and were granted options over 4,359,460 Ordinary Shares on 23 February 2017, equating to 9.6 per cent of the current total voting rights in the Company.

During the year the Company purchased 240,000 of its own shares at an average price of 9.99p.

Principal Risks and Uncertainties

The following are some of the principal risks relating to the Group's operations:

- uncertainty in the general economic environment may impact upon revenues and profitability;
- markets operated in are extremely competitive posing a threat to profitability;
- technological advances in manufacturing and or software may impact on operational effectiveness and earnings potential;
- a major catastrophe could impact the UK Production Hub. A disaster plan exists and losses are insured against but there could be a significant impact in the short and medium term;
- the Group and its clients depend on the W3P SaaS platform and all reasonable operational contingency is embedded for resilience in the event of a catastrophe;
- the ability to retain and recruit key people, across a multitude of disciplines, is essential in maintaining and growing the business;
- Group SaaS platforms are developed in-house but use third party components, the necessary rights exist but there is no certainty that these rights will be retained indefinitely.

Treasury Policies

Surplus funds are intended to support the Group's short term working capital requirements. These funds are invested through the use of short term deposits and the policy is to maximise returns as well as provide the flexibility required to fund ongoing operations. The Board anticipate cash balances will rise moving forward.

The Board has developed a model to establish a fair value for the Company's shares and will only purchase shares when the offer price is materially below that value and funds are available. It is not the Group's policy to enter into financial derivatives for speculative or trading purposes.

Alan Q. Roberts
Finance Director
7 June 2017

Consolidated Statement of Comprehensive Income

for the year ended 31 March 2017

Continuing Operations	*Note*	**2017 £000**	2016(1) £000
Revenue	*3*	**10,445**	10,766
Raw materials and consumables used		**(3,860)**	(3,631)
Gross profit		**6,585**	7,135
Staff costs		**(3,716)**	(3,776)
Other operating charges		**(2,049)**	(1,838)
Depreciation and amortisation		**(1,746)**	(1,462)
Restructuring costs		**(57)**	(308)
Total expenses		**(7,568)**	(7,384)
Operating loss		**(983)**	(249)
Operating (loss)/profit analysed as:			
Operating (loss)/profit before restructuring costs		**(926)**	59

Restructuring costs		**(57)**	(308)
Operating loss		**(983)**	(249)
Financial income		**17**	5
Financial expenses		**(21)**	(16)
Net financing expense		**(4)**	(11)
Loss before tax		**(987)**	(260)
Tax income	*4*	**362**	270
(Loss)/profit from continuing operations after tax		**(625)**	10
Profit from discontinued operations after tax		**-**	54
(Loss)/Profit for the year		**(625)**	64
Other comprehensive income		**-**	-
Total comprehensive income for the year		**(625)**	64
EPS - Continuing Operations	*5*	**(1.37)p**	0.02p
EPS - Discontinued Operations	*5*	**-**	0.12p
EPS - Total(2)	*5*	**(1.37)p**	0.14p

(1) Restated to reflect the disposal of Grafenia BV
(2) Earnings per share suffers no dilution

Consolidated Statement of Changes in Equity

Year ended 31 March 2016	**Share Capital £000**	**Share premium £000**	**Merger reserve £000**	**Treasury Shares £000**	**Retained Earnings £0000**	**Total £000**
Balance at 31 March 2015	475	-	838	(69)	4,708	5952
Profit and total comprehensive income for the year	-	-	-	-	64	64
Own shares acquired	-	-	-	(168)	-	(168)
Dividends paid	-	-	-	-	(586)	(586)
Total movement in equity	-	-	-	(168)	(522)	(690)
Balance at 31 March 2016	475	-	838	(237)	4,186	5,262
Year ended 31 March 2016						
Loss and total comprehensive income for the year	**-**	**-**	**-**	**-**	**(625)**	**(625)**
Own shares acquired	**-**	**-**	**-**	**(24)**	**-**	**(24)**

Total movement in equity	**-**	**-**	**-**	**(24)**	**(625)**	**(649)**
Balance at 31 March 2017	**475**	**-**	**838**	**(261)**	**3,561**	**4,613**

Consolidated Statement of Financial Position

At 31 March 2017

	2017	2016
	£000	£000
Non-current assets		
Property, plant and equipment	**1,333**	1,513
Investments in subsidiaries	**-**	-
Intangible assets	**2,305**	2,893
Other receivables	**50**	27
Total non-current assets	**3,688**	4,433
Current assets		
Inventories	**369**	316
Trade and other receivables	**2,386**	2,608
Current tax repayable	**138**	231
Cash and cash equivalents	**524**	686
Total current assets	**3,417**	3,841
Total assets	**7,105**	8,274
Current liabilities		
Other borrowings	**(83)**	(66)
Trade and other payables	**(1,370)**	(1,363)
Accruals and deferred income	**(389)**	(699)
Other liabilities	**(118)**	(108)
Total current liabilities	**(1,960)**	(2,236)
Non-current liabilities		
Other borrowings	**(216)**	(264)
Deferred tax liabilities	**(316)**	(512)
Total non-current liabilities	**(532)**	(776)
Total liabilities	**(2,492)**	(3,012)
Net assets	**4,613**	5,262
Equity attributable to equity holders of the parent		
Share capital	**475**	475
Merger reserve	**838**	838
Treasury shares	**(261)**	(237)
Retained earnings	**3,561**	4,186

Total equity	**4,613**	5,262

Consolidated Statement of Cash Flows

for year ended 31 March 2017

	2017	2016
	£000	£000
Cash flows from operating activities		
(Loss)/Profit for the year	**(658)**	64
Adjustments for:		
Depreciation, amortisation and impairment (continuing operations)	**1,746**	1,462
(Surplus)/Loss on sale of subsidiary	**-**	(279)
Net finance expense / (income)	**4**	11
Foreign exchange gains/(loss)	**14**	-
Tax income	**(329)**	(223)
Operating cash flow before changes in working capital and provisions	**777**	1,035
Change in trade and other receivables	**235**	(322)
Change in inventories	**(45)**	(114)
Change in trade and other payables	**(361)**	(632)
Cash generated/(used) from Operations	**606**	(33)
Interest paid	**(21)**	(16)
Income tax received /(paid)	**259**	(20)
Net cash inflow/(outflow) from operating activities	**844**	(69)
Cash flows from investing activities		
Proceeds from sale of subsidiary	**-**	1,728
Interest received	**3**	5
Acquisition of plant and equipment	**(119)**	(438)
Capitalised development expenditure	**(442)**	(513)
Acquisition of other intangible assets	**(327)**	(500)
Acquisition of Subsidiary net of cash	**(26)**	-
Dividends received	**-**	-
Net cash (used in)/generated by investing activities	**(911)**	282
Cash flows from financing activities		
Proceeds from the issue of share capital	**-**	-
Purchase of own shares	**(24)**	(168)
Payment of finance leases	**(69)**	(40)
Dividends paid	**-**	(586)
Net cash used in financing activities	**(93)**	(794)
Net decrease in cash and cash equivalents	**(160)**	(581)
Exchange loss on cash and cash equivalents	**(2)**	(10)
Cash and cash equivalents at start of year	**686**	1,277
Cash and cash equivalents at 31 March 2017	**524**	686

Notes

(forming part of the preliminary financial statements)

1 Basis of preparation

Grafenia is a company incorporated and domiciled in the UK.

These Financial Statements do not include all information required for full annual financial statements, and should be read in conjunction with the Financial Statements of the Group as at and for the year ended 31 March 2017.

The comparative figures for the year ended 31 March 2016 are not the Company's statutory accounts for that financial year. Those accounts have been reported on by the Company's auditors and delivered to the Registrar of Companies. The report of the auditors was (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006.

These condensed consolidated preliminary financial statements were approved by the Board of Directors on 7 June 2017.

2 Significant accounting policies

The accounting policies applied by the Group in these condensed consolidated interim financial statements are the same as those applied by the Group in its consolidated financial statements as at and for the year ended 31 March 2016.

3 Segmental information

As in the prior year the Group's operating and reporting segments are geographic being UK & Ireland, Europe and others. The segmental analysis by nature of service now states Licence Fees, Company owned Studio revenue, Brand Partner print and Online sales plus Trade print. This disclosure correlates with the information which is presented to the Chief Operating Decision Maker, the Chief Executive (CEO), who reviews revenue (which is considered to be the primary growth indicator) by segment. The Group's costs, finance income, tax charges, non-current liabilities, net assets and capital expenditure are only reviewed by the CEO at a consolidated level and therefore have not been allocated between segments in the analysis below.

Of the Group revenue of £10,444,000, £9,342,000 was generated in the UK *(2016: £9,551,000).* Revenue generated outside the UK is primarily attributable to France £385,000 *(2016: £427,000)* and Republic of Ireland £292,000 *(2016: £306,000).* No single customer provided the Group with over 10% of its revenue.

In Licence Fees BrandPartners, Nettl and printing.com, amounted to £0.80m *(2016: £0.61m).* White label fees reduced to £0.3m *(2016: £0.42m).* Master Licensees increased to £0.53m *(2016: £0.51m).* Company Studios achieved Website sales of £0.15m *(2016: £0.14m).*

Of the Group's non-current assets (excluding deferred tax) of £3,688,000, £3,626,000 are located in the UK. Non-current assets located outside the UK are in France £12,000 (*2016: 12,000*) and the Republic of Ireland £49,000 (*2016: £27,000*).

Analysis by location of sales

	UK & Ireland £000	Europe £000	Other £000	Total £000
Period ended 31 March 2017				
Segment revenues	**9,634**	**430**	**380**	**10,444**

Operating Expenses	**(11,427)**
EBITDA	**763**
Results from operating activities	**(983)**
Net finance expense	**(4)**
Loss before tax	**(987)**
Tax Income	**329**
Loss for the period	**(658)**
Assets - Unallocated net assets	**4,613**

Analysis by location of sales

	UK & Ireland £000	Europe £000	Other £000	Total £000
Period ended 31 March 2016				
Segment revenues	9,857	540	369	10,766
Operating Expenses				(10,707)
Results from operating activities				59
Exceptional restructuring costs				(308)
Net finance expense				(11)
Loss before tax				(260)
Tax Income				270
Profit from discontinued operations after tax				54
Profit for the period				64
Assets - Unallocated net assets				5,262

Analysis by type

	Licence Fees	**Company Studios**	**Brand Partner Print**	**Online & Trade**	**Total**
	£000	**£000**	**£000**	**£000**	**£000**
Period ended 31 March 2017					
Segment revenues	**1,489**	**1,151**	**3,762**	**4,042**	**10,444**
Operating Expenses					**(11,427)**
EBITDA					**763**
Results from operating activities					**(983)**
Net finance expense					**(4)**
Loss before tax					**(987)**
Tax Income					**329**
Loss for the period					**(658)**
Unallocated net assets					**4,613**

	Licence Fees £000	Company Studios £000	Brand Partner Print £000	Online & Trade £000	Total £000
Period ended 31 March 2016					
Segment revenues	1,403	1,425	3,893	4,045	10,766
Operating Expenses					(10,707)
EBITDA					1,213
Results from operating activities					59
Exceptional restructuring costs					(308)
Net finance income					(11)
Loss before tax					(260)
Tax Income					270

Profit for the period for continuing operations	10
Profit from discontinued operations	54
Profit for the period	64
Unallocated net assets	5,262

4 Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in profit and loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

The adjustment in the tax expense for prior years is primarily due to R&D tax reclaims. These amounts are recognised by the Group when the claims have been drafted. The amounts reclaimed differ from the development costs capitalised under IAS and therefore the difference is not recognised as part of the tax base of these assets.

Recognised in the income statement

	2017 £000	2016 £000
Current tax expense		
Current year	**(123)**	(219)
Foreign tax	**7**	54
Adjustments for prior years	**(50)**	(167)
	(166)	(332)
Deferred tax expense		
Origination and reversal of temporary differences (see note 8)	**(132)**	52
Movement due to change in rate of tax	**(26)**	(56)
Adjustment in respect of prior year	**(38)**	113
Total tax on continuing and discontinuing operations	**(362)**	(223)
The tax (credit)/expense in the income statement is disclosed as follows:		
Total tax in income statement on continuing operations	**(362)**	(270)
Total tax in income statement on discontinued operations	-	47
Total tax in income statement	**(362)**	(223)

Reconciliation of effective tax rate

Factors affecting the tax charge for the current period:

The current tax charge for the period is lower *(2016: lower)* than the standard rate of corporation tax in the UK of 20% *(2016: 20%).* The differences are explained below:

	2017 £000	2016 £000
Loss on continuing operations	**(987)**	(260)
Profit on discontinued operations	**-**	101
Loss for the period	**(987)**	(159)
Tax using the UK corporation tax rate of 20% (*2016: 21%*)	**(197)**	(32)
Effects of:		

Permanent differences	**13**	(87)
Overseas tax losses not recognised	**-**	-
Difference in overseas tax rate	**-**	10
Adjustments in respect of prior periods - current tax	**(50)**	(167)
Adjustments in respect of prior periods - deferred tax	**(38)**	113
Unrelieved losses carried into following year	**-**	75
Withholding tax	**9**	10
R&D losses surrendered	**46**	83
R&D super deduction	**(143)**	(171)
Movement due to the change in the tax rate	**(9)**	(57)
Total tax repayment	**(362)**	(223)

The Group Tax Debtor amounts to £138,000 *(2016 Debtor: £231,000)*. The deferred tax liabilities as at 31 March 2017 have been calculated using the tax rate of 17% which was substantively enacted at the balance sheet date.

The UK corporation tax rate has been progressively reduced over the last 4 years. The October 2015 statement announced that the rate will further reduce to 19% from 1 April 2017 and 18% from 1 April 2020

5 Earnings per share

The calculations of earnings per share are based on the following profits and numbers of shares:

	2017	2016
	£000	£000
(Loss)/Profit after taxation for the financial year from continuing operations	**(625)**	10
Profit after taxation on discontinued operations	**-**	54

Weighted average number of shares		
	Number of Shares	Number of Shares
For basic earnings per ordinary share	**45,500,884**	46,639,156
Exercise of share options	**-**	-
For diluted earnings per ordinary share	**45,500,884**	46,639,156

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

The holders of deferred shares shall not be entitled to any participation in the profits or the assets of the Company and the deferred shares do not carry any voting rights.

6 Dividends

	2017 £000	2016 £000
Final dividends paid in respect of prior year but not recognised as liabilities in that year	**-**	471
Interim dividends paid in respect of the current year	**-**	115
Total dividend paid in the year	**-**	586

After the balance sheet date the Board proposed no final dividend would be made (*2016: £nil)*.

7 Acquisitions of subsidiaries

Acquisitions in the current period

On 16 January 2017, the Company acquired all of the ordinary shares in Arthur Diamond Design Limited (ADD) for £63,000, satisfied in cash. The company designs, manufactures and installs building signage and vehicle graphics. This signage service is a logical extension of Grafenia's Brand Partners offering. In the three months to the period end the subsidiary contributed a loss of £327 to the consolidated result for the year. If the acquisition had occurred on 1st April 2016 Group revenue would have been £307,000 higher and an estimated net profit of £5,000 would have been added to Group results. In determining these amounts, management has assumed that the fair value adjustments that arose on the date of acquisition would have been the same if the acquisition occurred on the first day of accounting period.

Effect of acquisition

The acquisition had the following effect on the Group's assets and liabilities.

	Book and Fair values on acquisition £000
Acquiree's net assets at the acquisition date:	
Property, plant and equipment	**36**
Intangible assets	
Inventories	**8**
Trade and other receivables	**37**
Cash and cash equivalents	**37**
Interest-bearing loans and borrowings	**(38)**
Trade and other payables	**(68)**
Net identifiable assets and liabilities	**12**
Consideration paid:	
Initial cash price paid	**63**
Equity instruments issued	**Nil**
Contingent consideration at fair value	**-**
Deferred consideration at fair value	**-**
Total consideration	**63**

Goodwill of £51,000 arose on the acquisition and recognises the value placed upon acquired customer revenues.

No equity instruments were used in the transaction.

The Company has agreed to pay the vendor an additional consideration if EBIT for the 12 months ended 31 December 2017 exceeds £30,000, capped at EBIT £200,000 this would potentially earn the vendor an additional £90,000. As any additional consideration is contingent on the vendor continuing to be employed by the Group it will be treated as remuneration when earned.

8 Annual Report

The Annual Report will be sent to shareholders on or around 30 June 2016 and will be available on the Company's website www.grafenia.com from that date.

Copies of this announcement are available on the Company's website www.grafenia.com.

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