Nanoco Group plc

Nanoco has released its unaudited Interim Results for the half year ended 31 January 2023 ('the Period' or 'H1 FY2022/23'). While H1 FY2022/23 numbers were very much in line with expectations, February's transformative securing of final definitive agreements (collectively the 'Settlement') with Samsung amounting to US$150m (c.£124.3m) in settlement of ongoing litigation, now places the Group on a firm footing from which to exploit significant growth opportunities presented through its organic business. Continuing to make strong progress in terms of customer delivery and scaling, the Board anticipates receipt of potential 'milestone' commercial production orders by the end of CY2023. After servicing the various 'high ticket' costs directly and indirectly related to the litigation, Nanoco has been left with a balance of c.£4.5m from the first tranche payment which, together with end-January 2023 net cash of £6.0m on its balance sheet, leaves it with 'firepower' sufficient to comprehensively address all immediate end market and licensing opportunities, while also actively chasing other potentially infringing parties. The second tranche payment due in February 2024 will by contrast be received largely unencumbered. Recognising this along with the protection offered through existing carried forward tax losses (in excess of £40m), weighing the Board's likely wish to continue investing substantially in its technologies for creation of a self-sustaining organic business, TPI nevertheless considers it may be in a position to recommend distributing a good proportion of the available surplus, possibly up to £45m (presumably in the form of special dividends and/or a share buy-back).

Financial Summary – Nanoco's enhanced financial position

- Revenue increased 45% to £1.6m (H1 FY2021/22: £1.1m) in line with the Board's expectations;
- Adjusted LBITDA £1.1m (H1 FY2021/22: loss £1.1m) in line with the Board's expectations, includes strategic investment in additional capability and impact of recent inflationary cost increases;
- Results in H2 reflect the significant benefit of the IP sale and the license agreement;
- Payment and use of proceeds from sale of IP and license agreement:
  - First tranche of £62.1m received in March 2023 used to pay funder and advisers (£50.2m), contingent interest on loan notes (£4.7m), and Korean withholding tax (£2.7m) on the first payment tranche of the license agreement.
  - Second tranche due in February 2024 (c.£62.1m) will be wholly for Nanoco (less withholding tax (c.£2.7m)).

Operational Summary – good organic progress

- Nearing full production validation of two nano-materials for European Electronics Customer;
- Facility and staffing levels being prepared for potential production orders;
- Delivered development milestones for Asian Chemical company, new agreements being discussed;
- Other early-stage engagements with customers in display with materials on test.

Stock Data

Share Price:	20.00p
Market Cap:	£64.49m
Shares in issue:	322.45m
52-week high/low:	72.60p/19.69p

Company Profile

Sector:	Technology
Ticker:	NANO
Exchange:	LSE

Activities

Nanoco Group plc ('Nanoco', 'NANO', 'the Group') harnesses the power of nano-materials. These are materials with dimensions typically in the range 1 - 100 nm. Nano-materials have a range of useful properties, including optical and electronic. Nanoco is listed on the Main Market of the London Stock Exchange.

www.nanocotechnologies.com/

5-year share price performance

Source: LSE

Past performance is not an indication of future performance.

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Half-year financial performance very much in line with expectations

H1 FY2022/23 revenue, comprising product sales, rendering of services and royalties/licence payments across four main geographic areas, totalled £1.56m (H1 FY2021/22: £1.10m) of which a material customer accounted for £1.22m (H1 2022/23: £0.90m), remained very much in line with the Board's expectations. Active cost management also successfully reduced monthly net cash burn, falling to just c.£0.1m/month by period end. Continued successful delivery of technical milestones throughout for the Group's European Electronics and Asian Chemical customers, together with the FX tailwinds that were enjoyed during the Period, mean that its Adjusted EBITDA loss for the full year is expected to be narrower than (and therefore ahead of) the Board's expectations at the start of FY2022/23. Net cash consumption for the six months was £0.8m, leaving a cash balance of £6.0m at end-January 2023, prior to receipt of proceeds from the sale of IP and license agreement post Period end.

Expected accounting impact of the settlement

The sale of IP is expected to be accounted for as a profit on disposal of intangible assets in accordance with the requirements of IAS 38 Intangible Assets. This is expected to generate a net amount of c.£70m to Nanoco based on the proceeds noted above less the net book value of the patents at the point of sale. This profit on disposal will be recognised in the Group's FY2022/23 financial statements.

Income from the IP Licence agreement will instead be accounted for in accordance with the requirements of IFRS 15 Revenue from Contracts with Customers. It is expected that the revenue from the IP contract will be recognised over the average estimated remaining life of the existing entire IP portfolio after the sale of IP noted above, even though the cash will be received in the two tranches noted earlier (implying, a revenue recognition period of approximately nine years). The patents that would have been presented if the trial had gone ahead had remaining lives of two and a half years and five years respectively. The cash and receivable due for the IP licence will give rise to a significant deferred income balance of approximately £54.0m in the Group's Financial Statements that will be recognised as revenue in line with the nine-year period noted above. Revenue from the IP licence in H2 FY2022/23 is expected to be approximately £3.0m and then £6.0m each year thereafter until the deferred income has been recognised in full.

The first tranche instalment of £62.1m is being used to satisfy the contractual payments to the funder & advisers (£50.2m) plus Korean withholding tax (£2.7m) will be expensed in full in FY2022/23 as standalone costs reflecting the fact that the litigation itself has now ceased. There is also a one-off interest charge of c.£4.7m linked to the Group's loan notes that were executed in July 2021, based on a successful conclusion to the Samsung litigation.

Nanoco's accumulated tax losses will be available to offset any tax impacts from the above subject to final computations, normal UK rules restricting the utilisation of losses in any one year, and any overseas withholding tax. Depending on forecasts of the possible utilisation of tax losses in future financial years, a deferred tax asset may be recognised in the Group's Financial Statements. It is expected that net cash tax payable in respect of FY2022/23 will be modest. The final tax position will also depend on any losses in the organic business in the year (excluding the Samsung agreements) as well as any beneficial impact of both the UK's R&D tax credit and Patent Box regimes. The Group expects to have net negative distributable reserves in a number of subsidiary companies and in the parent company itself after the impact of the transactions noted above. The Board has therefore decided to review options for its future capital structure prior to the receipt of the second tranche of proceeds in February 2024 in order to facilitate a possible return of funds to shareholders.

Settlement validates Nanoco's core-IP and refocuses it on the growing organic business

Nanoco's successful settlement of its long-running Samsung litigation will now permit its share price to refocus on the value of its core IP (against which it will remain vigilant to other potential infringement activity, as well as opportunities to pro-actively deliver new licence agreements) and the growing success of its organic business.

Importantly in this respect, the Settlement does not encumber the Group's operational freedoms, which remain open in all of its markets, territories, products and material types.

Given the highly uncertain timing of any final settlement with Samsung, past years have seen the Group reducing its installed cash cost base from over £12.0 million in FY2018/19 to c.£5.0 million for FY2022/23, while retaining its core capabilities and building its revenue generating potential. Amongst other things, it achieved this through closure of the Group's Manchester facilities and relocation to Runcorn, which was delivered on budget and slightly ahead of time by focusing on its 'dot only' strategy. The centralising of its operations plays to Nanoco's technological expertise and creates a number of operational and team benefits, which are now being supported through recruitment of additional production and associated personnel. Following the recently completed decommissioning and dilapidations, the Group's annualised installed cost base is expected to reduce to around £0.4 million (net) although savings are being partly offset by raw material price increases, wage inflation plus new staff hires. Management's focus now remains on delivering a production-ready facility and validated materials in anticipation of commercial production orders in CY2023.

Settlement's transformational outcome positions Nanoco to seize true opportunity of its IP

The Settlement should be considered transformative for Nanoco, in that despite recognising the inherent value and long-term potential of its IP, it has been forced to considerably limit potential outgoings in recent years. Although prudence is likely to remain the Board's watchword going forward, the extent of new cash now in-hand makes it realistic to expect otherwise deferred expenditure on a number of projects in both Display (CFQD® quantum dots) and Sensing Electronics (where it sees potential to deliver significant value once in commercial production) to be ramped up and business development opportunities approached with increased confidence. Shareholders now await such details from Nanoco's Board in anticipation of it creating significant new revenue generating opportunities, while potentially also rewarding them through distribution of any financial surplus.

Market forecasts for infra-red sensors and quantum dot based technologies show strong positive growth for the next five years. That is expected to create an environment where Nanoco's unique cadmium free quantum dots and other novel nano-materials can leverage their strong performance characteristics into large mass-produced commercial applications:

- **Display (CFQD® quantum dots)** – By investing in the scaling-up of existing commercial production of material at the Runcorn facility/client R&D services, while also budgeting its internal research to extend the Group's patent library/technical understanding, Nanoco is positioning itself to take advantage of any broadening in the adoption of non-toxic quantum dots by global display manufacturers as the opportunity arises. Having already demonstrated QD can also be tuned for use in a variety of different media with adjustment of the surface ligands, opening them up to several different form factors and applications (including OLED/µLED colour conversion, the incorporation of CFQD® quantum dots directly within the OLED emitting device and even a proposition for optical security tagging), internal research is being focussed in leading-edge development.

  The current market for flat panel televisions is estimated to be c.250 million units per annum. Displays containing quantum dots are estimated to have accounted for around 6% of this market in 2022 (or 15 million units). Some 90% of the QD televisions sold today are cadmium free, which is a clear reflection of Samsung's market dominance. Within the QD TV market, the number of cadmium-based units is expected to fall significantly, primarily due to guidance from the Restriction of Hazardous Substances Directive ('RoHS') regarding toxicity and environmental concerns.

  Information contained in a variety of independent market research reports lead Nanoco's management to estimate the QD share of the total television market will rise to around 35% by 2030 (in excess of 100 million units), with Samsung's share expected to gradually decline over the same period. This is expected to create an opportunity for Nanoco as both a manufacturer of cadmium free quantum dots and as the owner of a validated IP portfolio fundamental to the manufacture of cadmium free quantum dots at an industrial scale.

With the need for access to Nanoco's IP portfolio seen expanding in line with the number of cadmium free display products being sold in the open market, the Group will explore opportunities to encourage participants to take a license over its IP as an alternative to future potentially costly litigation. Nanoco has already retained a Special Adviser with regard to taking the next steps in its IP licensing strategy and is reviewing potential IP licensing partners, alongside its internal business team who are evaluating potential value opportunities.

- **Sensing Electronics** – Operational expansion could target reinforcement of Nanoco's dominance in the crafting of quantum dot and nanoparticle solutions. The Group's CMOS® Image Sensors and VIVODOTS® nanoparticles represent a new class of material that have potential to be applied in a range of techniques. Having moved from a single customer/single product in early 2018 to being engaged with five customers presently while working with twelve distinct materials/wavelength combinations today, it already finds itself strongly positioned. A number of materials are progressing from development towards final validation, which is the last step before commercial production orders are placed. The Group's European and Asian customers participate in very large global markets wherein final customer adoption of QD sensing technology would lead to significant revenue opportunity. This will build significantly upon the Group's global reputation, while new investment could deliver capacity necessary to secure and support customer relationships.

Firm intention to deliver a "material return of capital to shareholders"

Retaining in excess of £40m in carried forward losses, the Board is confident that its remaining tax liability from the Settlement will be modest, leaving it with cash plus promised cash in excess of the Group's current market capitalisation. In the absence of a formal Board decision with respect to how it will direct available funding in coming years, however, shareholders remain uncertain as to the extent of any potential distribution, either in the form of special dividends and/or the initiation of a share buyback programme. Recognising the management's confidence in its technological capabilities/validated IP and its ability to exploit the longer-term opportunity these present, it would be realistic to expect a substantial proportion of the total secured cash to be reserved and then directed toward, amongst other things, enhancing and automating production capacity, while expanding marketing to what is a relatively limited number of very large existing and potential customers in anticipation of delivering a self-sustaining business model, possibly also putting aside a reasonable cash reserve to ensure rapid follow-up of all/any further IP infringements, without recourse to investors or assuming further leverage. At this point, TPI estimates that an available cash surplus in the range of £45m could be made available for distribution to shareholders during FY2023/24.

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