Stock Data

Share Price:	19.30p
Market Cap:	£62.23m
Shares in issue:	322.45m
52-week high/low:	72.60p/16.79p

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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Nanoco Group plc

Nanoco has announced the posting of a Circular setting out details of a Proposed Capital Reduction to create distributable reserves in order to facilitate future returns to Shareholders. This Circular will also contain the Notice of General Meeting to be held on 7 July 2023. This action is in accordance with the Board's declared intention to deliver a "material return of capital to shareholders" following 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. Utilising the second tranche of the proceeds it is expecting to receive in February 2024, the Board intends to initiate a return of between £33 million and £40 million (or approximately 10 pence to 12 pence per share), although no final decision has yet been taken as to the precise method of this distribution. Beyond this, it has declared its intention to retain approximately £20 million of cash to invest in R&D and commercial activities, funding for an IP licensing programme, and paying off debt with a view to providing the Group with working capital through to the self-financing position that it expects to be achieved during 2025.

Highlights of the Circular

- The Group is proposing to undertake a Capital Reduction in order to facilitate the return of capital to Shareholders. The Group is currently restricted from returning capital to its Shareholders as it does not have distributable reserves.
- The Board intends to initiate a return of between £33 million and £40 million (or approximately 10 pence to 12 pence per share) using the second tranche of the proceeds of the Samsung litigation (US$75 million pre-tax) which is expected to be received during February 2024. No final decision has yet been taken as to the method of any such return of capital.
- Nanoco intends to retain approximately £20 million of cash (following the return to shareholders) to invest in R&D and commercial activities, a proactive IP licensing programme, payment of debt obligations (approximately £5m), and to provide working capital (including modest buffer to mitigate risk of unforeseen events) through to the self-financing position that is expected to be achieved during 2025.
- The Board is confident that the near-term opportunities for commercial production of sensing materials, together with the current interest in the Group's display materials following the successful IP litigation and the growing display market for CFQD® cadmium free quantum dots, fully merit the allocation of funds noted above.

Now positioned to exploit significant growth opportunities

Nanoco now finds itself 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 was left with a balance of c.£4.5m from the first tranche payment (received during the first week of March 2023) which, together with end-January 2023 net cash of £6.0m on its balance sheet, left the Group with sufficient 'firepower' 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, broadly in line with expectations the Board intends to initiate a return of between £33m and £40m (which is likely to be delivered in the form of special dividends, a tender offer and/or a share buy-back) to shareholders. Resolutions contained in the Circular and to be proposed at the General Meeting enable the cancelation of the Group's share premium account (which presently stands to the credit of c.£121.1 million) and capital redemption reserve (c.£4.4 million) in order to permit such actions to be taken.

A copy of the Circular will be published on Nanoco's website later today at www.nanocotechnologies.com

Precise payment terms and use of proceeds from sale of IP and license agreement by tranche are believed to be as follows:

- **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 – Steady organic progress continues

- 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.

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) and 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 initiated the capital reduction proposed in the Circular to create distributable reserves that will facilitate a return of funds to shareholders, for which it is currently examining the most tax efficient route.

Capital return plus prudent retained cash reflects Board's confidence in delivering value

Nanoco's declaration of its intent to distribute up to approximately two-thirds of the net proceeds from the Samsung litigation will now permit its share price to refocus on the value of its core commercial business and validated IP portfolio. Management intends to remain highly 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 did not in any respect encumber the Group's operational freedoms, which remain open in all of its markets, territories, products and material types.

Given the highly uncertain outcome of the Samsung litigation and the potentially extended timeframe required to deliver a successful outcome, 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, to conserve cash 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. Savings from the Manchester exit have been offset by recent inflationary rises in salaries and raw material costs in particular, in addition to investment in new staff in preparation for potential commercial production. Today's announcement references new investment in accelerating development of next generation materials and an IP licensing programme suggesting that the installed cost base will increase in FY 2023/24. 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 is clearly going to be 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 to be left on its balance sheet 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.

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 HEATWAVE® nanoparticles represent a new class of material that have potential to be applied in a range of applications. 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.

Nothing priced in for the Board's confidence it will become self-financing during 2025

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 decision with respect to how it will direct available funding in coming years, however, shareholders remain uncertain as to the exact 'shape' of the proposed distribution, although it would be a surprise if it were not to be received 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, a reasonable proportion of the available cash is 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, having put aside a reasonable cash reserve to ensure rapid follow-up of all/any further IP infringements, without recourse to investors or assuming further leverage. Given the Board's success in rigorously defending Nanoco's technologies while continuing to develop their global opportunities and market position, it is rather surprising the equity still prices in absolutely nothing for its unshakable confidence in the potential for commercial production of sensing materials, along with the continuing interest in its display materials and the growing display market for CFQD® cadmium free quantum dots.

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